Competitiveness and Private Sector Development

# Competitiveness in South East Europe 2021

## A POLICY OUTLOOK



OECD

Competitiveness and Private Sector Development

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## A POLICY OUTLOOK

OECD
BETTER POLICIES FOR BETTER LIVES

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# Preface

Advancing an ambitious reform agenda, the six Western Balkan (WB6) economies have emerged over the last two decades as a group of small but growing open economies that are improving business conditions and attracting investment. Since 2000, reforms have contributed to a doubling of the region's GDP and a six-fold increase in export volumes.

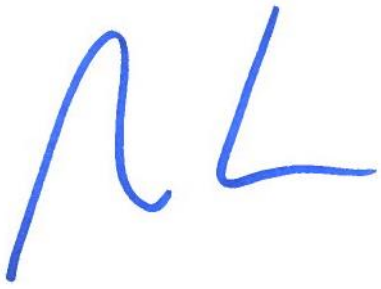
Yet more needs to be done: the average gross domestic product per capita is still only one-third of the European Union's and unemployment levels remain too high, especially among young people. Many industries in the WB6 economies remain fragile, their technology largely outdated and their products not sufficiently competitive outside their region. Furthermore, wage increases in the export sector are outpacing productivity growth, thus blunting the region's competitive edge.

The persisting structural weaknesses of the Western Balkan region have been amplified by the COVID-19 pandemic crisis. Lockdown measures to protect citizens' lives have resulted in a sharp drop in economic activity, a collapse of exports and a rise in unemployment in most WB6 economies.

Innovative growth strategies are needed more than ever to support a post-pandemic recovery that is robust, inclusive and sustainable. Further reforms are necessary to ensure the region can avoid the middle-income trap and help unleash growth and investment in knowledge-based sectors with higher potential for value-added and quality jobs. Ultimately, a people-centred policy approach is needed to improve opportunities and living conditions by fostering human capital and well-being, areas where the WB6 economies can benefit from the experience of EU members and OECD countries. In this context, an important driver for balanced reform efforts is the prospect of accession to the European Union (EU).

This third edition of *Competitiveness in South East Europe: A Policy Outlook* provides a wide-ranging representation of economic performance, governance and regulation in the Western Balkan economies. It offers extensive guidance to steer structural reforms, supporting the Economic Reform Programmes and the EU's Economic and Investment Plan for the WB6, and – through its regional collaboration approach – regional economic integration of the Western Balkans. It draws on qualitative and quantitative information across 16 key policy dimensions, and is broken down into over 350 individual indicators that allow WB6 policy makers to directly compare economic performance across countries and benchmark themselves against OECD and EU averages. It also enables policy makers to track performance over time, by comparing outcomes against those reported in previous editions, published in 2016 and 2018. This 2021 edition clearly highlights that while uneven, progress is being made across all areas, together with increasing intergovernmental co-operation. For example, the WB6 economies are engaged in important initiatives to align their tax systems with recent international tax trends and have laid the foundations for a competitive energy market.

Importantly, this report illustrates the benefits of a strategic approach to driving economic reform, which is guided by in-depth evidence-based analysis. This publication was drafted in close collaboration with hundreds of WB6 government representatives as well as local and regional stakeholders and co-funded by the European Union. The WB6 governments provided rigorous qualitative self-assessments and statistical data. We would like to thank all those who have contributed to this collaboration. We very much hope that this C*ompetitiveness in South East Europe: A Policy Outlook* is used to strengthen the competitiveness of the WB6 countries to build more inclusive, prosperous and resilient economies for the citizens in this increasingly relevant region.



**Mathias Cormann**

OECD Secretary-General



**Olivér Várhelyi**

EU Commissioner for Neighbourhood and Enlargement

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# Table of contents

Preface 3

Acknowledgements 5

Abbreviations and acronyms 25

Executive summary 29
- Key achievements 29
- Key priorities 30

1 Economic context 31
- Key economic features 32
- References 44
- Notes 47

2 Assessment methodology and process 48
- Introduction 49
- Scope 49
- Methodology 50
- The assessment process 53
- The strengths and limitations of the Competitiveness Outlook 2021 56
- References 57

3 Overview of key findings 58
- Key findings by dimension 59
- Notes 74

Part I Assessment findings by policy dimension 75

4 Investment policy and promotion (Dimension 1) 76
- Comparison with the 2018 assessment 77
- Implementation of the Competitiveness Outlook 2018 recommendations 78
- Introduction 79
- Assessment framework 80
- Investment policy and promotion performance and context in the WB6 83
- Investment policy (Sub-dimension 1.1) 86
- Investment promotion and facilitation (Sub-dimension 1.2) 95
- Investment for green growth (Sub-dimension 1.3) 107

Conclusion 111
References 112
Notes 115

5 Trade policy (Dimension 2) 117
Comparison with the 2018 assessment 119
Implementation of the Competitiveness Outlook 2018 recommendations 119
Introduction 121
Assessment framework 123
Trade policy dimension performance and context in the WB6 126
Trade policy framework (Sub-dimension 2.1) 128
Services trade restrictiveness (Sub-dimension 2.2) 139
E-commerce and digitally enabled services (Sub-dimension 2.3) 156
Conclusion 160
References 162
Notes 167

6 Access to finance (Dimension 3) 171
Comparison with the 2018 assessment 172
Introduction 173
Assessment framework 174
Access to finance performance and context in the WB6 176
Access to bank finance (Sub-dimension 3.1) 178
Access to alternative financing sources (Sub-dimension 3.2) 183
Mobilisation of long-term financing (Sub-dimension 3.3) 188
Conclusion 195
References 196
Notes 198

7 Tax policy (Dimension 4) 200
Comparison with the 2018 assessment 202
Implementation of the Competitiveness Outlook 2018 recommendations 202
Introduction 204
Assessment framework 204
Tax policy performance and context in the WB6 206
Tax policy framework (Sub-dimension 4.1) 208
Tax administration (Sub-dimension 4.2) 215
International co-operation (Sub-dimension 4.3) 218
Conclusion 221
References 222
Notes 223

8 Competition policy (Dimension 5) 224
Comparison with the 2018 assessment 225
Implementation of the Competitiveness Outlook 2018 recommendations 226
Introduction 226
Assessment framework 228
Competition policy performance and context in the WB6 230
Scope of action (Policy area 5.1) 231
Anti-competitive behaviour and implementation (Policy areas 5.2 and 5.5) 236

Probity of investigation (Policy area 5.3) 241
Advocacy (Policy area 5.4) 242
Conclusion 246
References 247
Annex 8.A. Competition Questionnaire 252

9 State-owned enterprises (Dimension 6) 255
Comparison with the 2018 assessment 257
Implementation of the Competitiveness Outlook 2018 recommendations 257
Introduction 258
Assessment framework 259
State-owned enterprise performance and context in the WB6 261
Efficiency and performance through improved governance (Sub-dimension 6.1) 265
Transparency and accountability practices (Sub-dimension 6.2) 270
Ensuring a level playing field (Sub-dimension 6.3) 276
Reforming and privatising state-owned enterprises (Sub-dimension 6.4) 278
Conclusion 280
References 281
Notes 282

10 Education policy (Dimension 7) 284
Comparison with the 2018 assessment 286
Implementation of the Competitiveness Outlook 2018 recommendations 286
Introduction 287
Assessment framework 288
Education performance and context in the WB6 290
Early childhood and school education (Sub-dimension 7.1) 293
Teachers (Sub-dimension 7.2) 300
Vocational education and training (Sub-dimension 7.3) 305
Tertiary education (Sub-dimension 7.4) 308
System governance (cross-cutting sub-dimension) 312
Conclusion 313
References 314
Notes 316

11 Employment policy (Dimension 8) 318
Comparison with the 2018 assessment 320
Implementation of the Competitiveness Outlook 2018 recommendations 320
Introduction 321
Assessment framework 322
Employment performance and context in the WB6 325
Labour market governance (Sub-dimension 8.1) 328
Skills (Sub-dimension 8.2) 336
Job quality (Sub-dimension 8.3) 344
Activation policies (Sub-dimension 8.4) 348
Conclusion 352
References 354
Notes 361

12 Science, technology and innovation (Dimension 9) 363
Comparison with the 2018 assessment 364
Implementation of the Competitiveness Outlook 2018 recommendations 365
Introduction 366
Assessment framework 367
Science, technology and innovation performance and context in the WB6 369
STI system (Sub-dimension 9.1) 372
Public research system (Sub-dimension 9.2) 377
Business-academia collaboration (Sub-dimension 9.3) 381
Conclusion 385
References 386
Notes 387

13 Digital society (Dimension 10) 389
Comparison with the 2018 assessment 391
Implementation of the Competitiveness Outlook 2018 recommendations 391
Introduction 392
Assessment framework 394
Digital society performance and context in the WB6 396
Access (Sub-dimension 10.1) 398
Use (Sub-dimension 10.2) 404
Jobs (Sub-dimension 10.3) 410
Society (Sub-dimension 10.4) 416
Trust (Sub-dimension 10.5) 419
Conclusion 425
References 426
Notes 429

14 Transport policy (Dimension 11) 431
Comparison with the 2018 assessment 433
Implementation of the Competitiveness Outlook 2018 recommendations 433
Introduction 434
Assessment framework 435
Transport policy performance and context in the WB6 437
Planning (Sub-dimension 11.1) 439
Governance and regulation (Sub-dimension 11.2) 445
Sustainability (Sub-dimension 11.3) 450
Conclusion 455
References 456
Notes 458

15 Energy policy (Dimension 12) 460
Comparison with the 2018 assessment 462
Implementation of the Competitiveness Outlook 2018 recommendations 462
Introduction 463
Assessment framework 464
Energy performance and context in the WB6 465
Governance and regulation (Sub-dimension 12.1) 467
Security of energy supply (Sub-dimension 12.2) 472
Energy markets (Sub-dimension 12.3) 478

Energy incentives and subsidies (cross-cutting sub-dimension) 480
Conclusion 482
References 483
Notes 485

16 Environment policy (Dimension 13) 487
Comparison with the 2018 assessment 489
Implementation of the Competitiveness Outlook 2018 recommendations 489
Introduction 491
Assessment framework 491
Environment policy performance and context in the WB6 494
Resource productivity (Sub-dimension 13.1) 495
Natural asset base (Sub-dimension 13.2) 502
Environmental quality of life (Sub-dimension 13.3) 509
Conclusion 515
References 516
Notes 519

17 Agriculture policy (Dimension 14) 521
Comparison with the 2018 assessment 522
Implementation of the Competitiveness Outlook 2018 recommendations 523
Introduction 524
Assessment framework 525
Agricultural policy performance and context in the WB6 526
Agro-food system capacity (Sub-dimension 14.1) 527
Agro-food system regulation (Sub-dimension 14.2) 531
Agricultural support system (Sub-dimension 14.3) 533
Agricultural innovation system (Sub-dimension 14.4) 536
Conclusion 537
References 538
Notes 542

18 Tourism policy (Dimension 15) 543
Comparison with the 2018 assessment 545
Implementation of the Competitiveness Outlook 2018 recommendations 545
Introduction 546
Assessment framework 548
Tourism policy performance and context in the WB6 550
Governance and co-operation (Sub-dimension 15.1) 553
Destination accessibility and tourism infrastructure (Sub-dimension 15.2) 559
Availability of a qualified workforce (Sub-dimension 15.3) 564
Sustainable and competitive tourism (Sub-dimension 15.4) 567
Tourism branding and marketing (Sub-dimension 15.5) 572
Conclusion 575
References 577
Notes 579

19 Anti-corruption policy (Dimension 16) 582
Comparison with the 2018 assessment 584
Implementation of the Competitiveness Outlook 2018 recommendations 584

Introduction 585
Assessment framework 586
Anti-corruption policy performance and context in the WB6 588
Anti-corruption policy framework (Sub-dimension 16.1) 591
Prevention of corruption (Sub-dimension 16.2) 594
Independence of the judiciary (Sub-dimension 16.3) 600
Business integrity and corporate liability (Sub-dimension 16.4) 602
Investigation and prosecution (Sub-dimension 16.5) 604
Conclusion 608
References 609

Part II Competitiveness Outlook assessment: Western Balkan profiles 615

20 Albania profile 616
Economic context 620
Scope and methods 630
Investment policy and promotion (Dimension 1) 632
Trade policy (Dimension 2) 640
Access to finance (Dimension 3) 661
Tax policy (Dimension 4) 666
Competition policy (Dimension 5) 672
State-owned enterprises (Dimension 6) 680
Education policy (Dimension 7) 689
Employment policy (Dimension 8) 697
Science, technology and innovation (Dimension 9) 709
Digital society (Dimension 10) 714
Transport policy (Dimension 11) 723
Energy policy (Dimension 12) 733
Environment policy (Dimension 13) 743
Agriculture policy (Dimension 14) 752
Tourism policy (Dimension 15) 760
Anti-corruption policy (Dimension 16) 768
References 778
Notes 807

1 Bosnia and Herzegovina profile 824
Economic context 828
Scope and methods 837
Investment policy and promotion (Dimension 1) 839
Trade policy (Dimension 2) 849
Access to finance (Dimension 3) 870
Tax policy (Dimension 4) 876
Competition policy (Dimension 5) 883
State-owned enterprises (Dimension 6) 889
Education policy (Dimension 7) 899
Employment policy (Dimension 8) 905
Science, technology and innovation (Dimension 9) 920
Digital society (Dimension 10) 925
Transport policy (Dimension 11) 934
Energy policy (Dimension 12) 944

Environment policy (Dimension 13) 954
Agriculture policy (Dimension 14) 964
Tourism policy (Dimension 15) 973
Anti-corruption policy (Dimension 16) 980
References 991
Notes 1017

22 Kosovo profile 1042
Economic context 1046
Scope and methods 1055
Investment policy and promotion (Dimension 1) 1058
Trade policy (Dimension 2) 1063
Access to finance (Dimension 3) 1082
Tax policy (Dimension 4) 1087
Competition policy (Dimension 5) 1094
State-owned enterprises (Dimension 6) 1100
Education policy (Dimension 7) 1108
Employment policy (Dimension 8) 1115
Science, technology and innovation (Dimension 9) 1128
Digital society (Dimension 10) 1133
Transport policy (Dimension 11) 1142
Energy policy (Dimension 12) 1152
Environment policy (Dimension 13) 1161
Agriculture policy (Dimension 14) 1169
Tourism policy (Dimension 15) 1177
Anti-corruption policy (Dimension 16) 1184
References 1193
Notes 1221

23 Montenegro profile 1236
Economic context 1239
Scope and methods 1249
Investment policy and promotion (Dimension 1) 1252
Trade policy (Dimension 2) 1258
Access to finance (Dimension 3) 1278
Tax policy (Dimension 4) 1285
Competition policy (Dimension 5) 1291
State-owned enterprises (Dimension 6) 1298
Education policy (Dimension 7) 1308
Employment policy (Dimension 8) 1316
Science, technology and innovation (Dimension 9) 1330
Digital society (Dimension 10) 1335
Transport policy (Dimension 11) 1344
Energy policy (Dimension 12) 1354
Environment policy (Dimension 13) 1363
Agriculture policy (Dimension 14) 1371
Tourism policy (Dimension 15) 1381
Anti-corruption policy (Dimension 16) 1392
References 1402
Notes 1426

24 North Macedonia profile 1447
Economic context 1451
Scope and methods 1462
Investment policy and promotion (Dimension 1) 1464
Trade policy (Dimension 2) 1472
Access to finance (Dimension 3) 1491
Tax policy (Dimension 4) 1498
Competition policy (Dimension 5) 1504
State-owned enterprises (Dimension 6) 1511
Education policy (Dimension 7) 1519
Employment policy (Dimension 8) 1527
Science, technology and innovation (Dimension 9) 1542
Digital society (Dimension 10) 1548
Transport policy (Dimension 11) 1556
Energy policy (Dimension 12) 1566
Environment policy (Dimension 13) 1577
Agriculture policy (Dimension 14) 1584
Tourism policy (Dimension 15) 1593
Anti-corruption policy (Dimension 16) 1600
References 1611
Notes 1635

25 Serbia profile 1652
Economic context 1656
Scope and methods 1666
Investment policy and promotion (Dimension 1) 1668
Trade policy (Dimension 2) 1675
Access to finance (Dimension 3) 1695
Tax policy (Dimension 4) 1705
Competition policy (Dimension 5) 1711
State-owned enterprises (Dimension 6) 1718
Education policy (Dimension 7) 1726
Employment policy (Dimension 8) 1734
Science, technology and innovation (Dimension 9) 1747
Digital society (Dimension 10) 1752
Transport policy (Dimension 11) 1761
Energy policy (Dimension 12) 1771
Environment policy (Dimension 13) 1780
Agriculture policy (Dimension 14) 1788
Tourism policy (Dimension 15) 1798
Anti-corruption policy (Dimension 16) 1806
References 1817
Notes 1848

Annex A. The Competitiveness Outlook 2021 scoring model for Bosnia and Herzegovina 1866

## Tables

Table 1.1. WB6: Main regional macroeconomic indicators (2020) 33

Table 1.2. Progress towards achieving the SDGs 35
Table 2.1. Policy dimensions assessed in the Competitiveness Outlook 2021 50
Table 2.2. Climate change mitigation and adaptation scoring levels 52
Table 2.3. Competitiveness Outlook assessment: stakeholders and meetings 55
Table 2.4. Strengths and limitations of the Competitiveness Outlook 2021 56
Table 3.1. Scores and indicators for investment policy and promotion 59
Table 3.2. Scores and indicators for trade policy 60
Table 3.3. Scores and indicators for access to finance 61
Table 3.4. Scores and indicators for tax policy 62
Table 3.5. Scores and indicators for state-owned enterprises 63
Table 3.6. Scores and indicators for education policy 64
Table 3.7. Scores and indicators for employment policy 65
Table 3.8. Scores and indicators for science, technology and innovation 66
Table 3.9. Scores and indicators for digital society 67
Table 3.10. Scores and indicators for transport policy 68
Table 3.11. Scores and indicators for energy policy 69
Table 3.12. Scores and indicators for environment policy 70
Table 3.13. Scores and indicators for agriculture policy 71
Table 3.14. Scores and indicators for tourism policy 72
Table 3.15. Scores and indicators for anti-corruption policy 73
Table 4.1. Implementation of the CO 2018 policy recommendations: investment policy and promotion 78
Table 4.2. Top five investing economies in WB6 economies (2018) 85
Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework 86
Table 4.4. Key sectoral restrictions to foreign service ownership in the WB6 89
Table 4.5. Scores for Sub-dimension 1.2: Investment promotion and facilitation 96
Table 4.6. IPA mandates in the WB6 economies (2020) 98
Table 4.7. Investment promotion agencies: Number of employees and mandates (2019) 100
Table 4.8. Scores for Sub-dimension 1.3: Investment for green growth 107
Table 5.1. Implementation of the CO 2018 policy recommendations: Trade policy 120
Table 5.2. Scores for Sub-dimension 2.1: Trade policy framework 129
Table 5.3. WB6 economies' bilateral and multilateral free trade agreements 133
Table 5.4. Scores for Sub-dimension 2.3: E-commerce and digitally enabled services 157
Table 6.1. Implementation of the Competitiveness Outlook 2018 policy recommendations: Access to finance dimension 173
Table 6.2. Scores for Sub-dimension 3.1: Access to bank finance 179
Table 6.3. Coverage of public and private credit bureaus in WB6 economies (2019) 180
Table 6.4. WB6 credit guarantee schemes established in response to COVID-19 182
Table 6.5. Scores for Sub-dimension 2: Access to alternative financing sources 184
Table 6.6. Business angel activity in the Western Balkans 186
Table 6.7. Scores for Sub-dimension 3.3: Mobilisation of long-term financing 189
Table 6.8. Infrastructure development in the WB6: Performance of public-private partnerships 190
Table 6.9. Accounts and savings held with WB6 financial institutions (2017) 191
Table 6.10. Number and value of bonds listed in WB economies with active stock markets (2018) 194
Table 7.1. Implementation of the CO 2018 policy recommendations: Tax policy 203
Table 7.2. Scores for Sub-dimension 4.1: Tax policy framework 208
Table 7.3. Scores for Sub-dimension 4.2: Tax administration 215
Table 8.1. Implementation of the CO 2018 policy recommendations: Competition policy 226
Table 8.2. Competition policy qualitative dimension assessment framework 229
Table 9.1. Implementation of the Competitiveness Outlook 2018 policy recommendations: State-owned enterprises dimension 258
Table 9.2. Scores for Sub-dimension 6.1: Efficiency and performance through improved governance 266
Table 9.3. Rationales for economy ownership, as reported by WB6 authorities 266
Table 9.4. Scores for Sub-dimension 6.2: Transparency and accountability practices 271
Table 9.5. Scores for Sub-Dimension 6.3: Ensuring a level playing field 276
Table 9.6. Companies with state minority shareholdings in WB6 economies (2019) 279
Table 10.1. Implementation of the CO 2018 policy recommendations: Education policy 286
Table 10.2. Scores for Sub-dimension 7.1: Early childhood and school education 293
Table 10.3. Early school leavers by degree of urbanisation (2019) 297
Table 10.4. Scores for Sub-dimension 7.2: Teachers 301
Table 10.5. Scores for Sub-dimension 7.3: Vocational education and training 306

Table 10.6. Scores for Sub-dimension 7.4: Tertiary education 309
Table 10.7. Scores for cross-cutting sub-dimension: System governance 312
Table 11.1. Implementation of the CO 2018 policy recommendations: Employment policy 321
Table 11.2. Scores for Sub-dimension 8.1: Labour market governance 328
Table 11.3. Scores for Sub-dimension 8.2 337
Table 11.4. Average regional employment and unemployment rate by educational level (2015 and 2019 Q2) 337
Table 11.5. Scores for Sub-dimension 8.3 344
Table 11.6. Minimum and gross average wages in the Western Balkans, Bulgaria and Croatia (2018) 345
Table 11.7. Scores for Sub-dimension 8.4 349
Table 11.8. Caseloads for PES counsellors (2019) 349
Table 11.9. Incidence of long-term unemployment (2015 and 2019) 349
Table 12.1. Implementation of the CO 2018 policy recommendations: Science, technology and innovation dimension 365
Table 12.2. Patents granted, WB region and CEEC averages (2019) 370
Table 12.3. Scores for Sub-dimension 9.1: STI system 372
Table 12.4. Scores for Sub-dimension 9.2: Public research system 378
Table 12.5. WB6 participation in the Marie Skłodowska-Curie Actions (2014-2020) 380
Table 12.6. Scores for Sub-dimension 9.3: Business-academia collaboration 382
Table 13.1. Implementation of the CO 2018 policy recommendations: Digital society 392
Table 13.2. Scores for Sub-dimension 10.1: Access 398
Table 13.3. Scores for Sub-dimension 10.2: Use 404
Table 13.4. Scores for Sub-dimension 10.3: Jobs 411
Table 13.5. Scores for Sub-dimension 10.4: Society 416
Table 13.6. Scores for Sub-dimension 10.5: Trust 420
Table 14.1. Implementation of the CO 2018 policy recommendations: Transport policy 434
Table 14.2. Scores for Sub-dimension 11.1: Planning 439
Table 14.3. WB6 economies' transport strategies 440
Table 14.4. Scores for Sub-dimension 11.2: Governance and regulation 446
Table 14.5. Scores for Sub-dimension 11.3: Sustainability 450
Table 15.1. Implementation of the CO 2018 policy recommendations: Energy policy 463
Table 15.2. Scores for sub-dimension 12.1: Governance and regulation 468
Table 15.3. Scores for sub-dimension 12.2: Security of energy supply 472
Table 15.4. Scores for sub-dimension 12.3: Energy markets 478
Table 16.1. Implementation of the CO 2018 policy recommendations: Environment policy 490
Table 16.2. Scores for Sub-dimension 13.1: Resource productivity 495
Table 16.3. Scores for Sub-dimension 13.2: Natural asset base 502
Table 16.4. Scores for Sub-dimension 13.3: Environmental quality of life 509
Table 17.1. Implementation of the CO 2018 policy recommendations: Agriculture policy 523
Table 17.2. Scores for Sub-dimension 14.1: Agro-food system capacity 528
Table 17.3. Scores for Sub-dimension 14.2: Agro-food system regulation 531
Table 17.4. Scores for Sub-dimension 14.3: Agricultural support system 533
Table 17.5. Scores for Sub-dimension 14.4: Agricultural innovation system 536
Table 18.1. Implementation of CO 2018 policy recommendations: Tourism policy 546
Table 18.2. Scores for Sub-dimension 15.1: Governance and co-operation 554
Table 18.3. Tourism strategies and tourism-related strategic documents in WB6 economies 555
Table 18.4. Formal bodies for co-operation and dialogue with non-government tourism stakeholders in WB6 556
Table 18.5. Scores for Sub-dimension 15.2: Destination accessibility and tourist infrastructure 560
Table 18.6. Scores for Sub-dimension 15.3: Availability of a qualified workforce 565
Table 18.7. Scores for Sub-dimension 15.4: Sustainable and competitive tourism 567
Table 18.8. Scores for Sub-dimension 15.5: Tourism branding and marketing 572
Table 18.9. WB6 economies in the WEF Travel and Tourism Competitiveness Index (2017 and 2019) 573
Table 19.1. Implementation of the CO 2018 policy recommendations: Anti-corruption policy 584
Table 19.2. Scores for Sub-dimension 16.1: Anti-corruption policy framework 591
Table 19.3. Scores for Sub-dimension 16.2: Prevention of corruption 594
Table 19.4. Sanctions for violations related to conflicts of interest (2017-19) 597
Table 19.5. Numbers of whistle-blower reports and requests for protection (2016-20) 598
Table 19.6. Scores for Sub-dimension 16.5: Investigation and prosecution 605
Table 19.7. Number of final convictions for high-level corruption (2014-19) 607

Table 20.1. Albania: Main macroeconomic indicators (2015-20) 621
Table 20.2. Albania's progress towards achieving the SDGs 622
Table 20.3. Competitiveness Outlook scoring system 631
Table 20.4. Albania's scores for investment policy and promotion 632
Table 20.5. Albania's scores for trade policy 640
Table 20.6. Albania's scores for access to finance 661
Table 20.7. Albania's scores for tax policy 666
Table 20.8. Albania's tax revenues as a percentage of GDP 666
Table 20.9. Selected tax rates in Albania 667
Table 20.10. Albania's scores for state-owned enterprises 680
Table 20.11. Albania's scores for education policy 689
Table 20.12. Albania's scores for employment policy 697
Table 20.13. Key labour market indicators for Albania (2015 and 2019) 697
Table 20.14. Albania's scores for science, technology and innovation 709
Table 20.15. Albania's scores for digital society 714
Table 20.16. Albania's scores for transport policy 723
Table 20.17. Trends in rail transport in Albania (2017-19) 728
Table 20.18. Road safety trends in Albania (2010-20) 730
Table 20.19. Albania's scores for energy policy 733
Table 20.20. Key infrastructure investment projects 736
Table 20.21. Albania's scores for environment policy 743
Table 20.22. Albania's scores for agriculture policy 752
Table 20.23. Agricultural vocational training institutions in Albania 754
Table 20.24. Albania's scores for tourism policy 760
Table 20.25. Albania's cross-cutting tourism strategies 762
Table 20.26. Albania's scores for anti-corruption policy 768
Table 21.1. Bosnia and Herzegovina: Main macroeconomic indicators (2015-2020) 829
Table 21.2. Bosnia and Herzegovina's progress towards achieving the SDGs 830
Table 21.3. Competitiveness Outlook scoring system 838
Table 21.4. Bosnia and Herzegovina's scores for investment policy and promotion 839
Table 21.5. Bosnia and Herzegovina's scores for trade policy 849
Table 21.6. Bosnia and Herzegovina's scores for access to finance 870
Table 21.7. Listing rules in Bosnia and Herzegovina 873
Table 21.8. Bosnia and Herzegovina's scores for tax policy 876
Table 21.9. Bosnia and Herzegovina's tax revenue as a percentage of GDP 877
Table 21.10. Selected tax rates in Bosnia and Herzegovina 877
Table 21.11. Bosnia and Herzegovina's scores for state-owned enterprises 889
Table 21.12. Bosnia and Herzegovina's scores for education policy 899
Table 21.13. Bosnia and Herzegovina's scores for employment policy 906
Table 21.14. Key labour market indicators for Bosnia and Herzegovina (2015 and 2019) 906
Table 21.15. Bosnia and Herzegovina's scores for science, technology and innovation 920
Table 21.16. Bosnia and Herzegovina's scores for digital society 925
Table 21.17. Bosnia and Herzegovina's scores for transport policy 934
Table 21.18. Trends in rail transport in Bosnia and Herzegovina (2017-19) 938
Table 21.19. Trends in road transport in Bosnia and Herzegovina (2017-19) 939
Table 21.20. Road safety trends in Bosnia and Herzegovina (2010-19) 940
Table 21.21. Bosnia and Herzegovina's scores for energy policy 944
Table 21.22. Distribution losses as a share of final electricity consumption 947
Table 21.23. List of strategic natural gas infrastructure projects 948
Table 21.24. Bosnia and Herzegovina's scores for environment policy 955
Table 21.25. Bosnia and Herzegovina's scores for agriculture policy 964
Table 21.26. Value of exports and imports of the agriculture, forestry and fisheries sector (2016-19) 965
Table 21.27. Bosnia and Herzegovina's scores for tourism policy 973
Table 21.28. Bosnia and Herzegovina's scores for anti-corruption policy 980
Table 22.1. Kosovo: Main macroeconomic indicators (2015-20) 1047
Table 22.2. Competitiveness Outlook scoring system 1056
Table 22.3. Kosovo's scores for investment policy and promotion 1058
Table 22.4. Kosovo's scores for trade policy 1063
Table 22.5. Kosovo's scores for access to finance 1082
Table 22.6. Kosovo's scores for tax policy 1087

Table 22.7. Kosovo's tax revenues as a share of GDP 1087
Table 22.8. Selected tax rates in Kosovo 1088
Table 22.9. Kosovo's scores for state-owned enterprises 1100
Table 22.10. Kosovo's main state-owned enterprises 1100
Table 22.11. Kosovo's scores for education policy 1108
Table 22.12. Kosovo's scores for employment policy 1115
Table 22.13. Key labour market indicators for Kosovo (2015 and 2019) 1115
Table 22.14. Kosovo's scores for science, technology and innovation 1128
Table 22.15. Kosovo's scores for digital society 1133
Table 22.16. Kosovo's scores for transport policy 1142
Table 22.17. Trends in rail transport in Kosovo (2017-19) 1147
Table 22.18. Road safety trends in Kosovo (2010-20) 1148
Table 22.19. Kosovo's scores for energy policy 1152
Table 22.20. Kosovo's institutional framework for energy policy 1154
Table 22.21. Kosovo's scores for environment policy 1161
Table 22.22. Kosovo's scores for agriculture policy 1169
Table 22.23. Area covered by most important crops (2014-19) 1169
Table 22.24. Kosovo's scores for tourism policy 1177
Table 22.25. Kosovo's scores for anti-corruption policy 1184
Table 23.1. Montenegro: Main macroeconomic indicators (2015-20) 1241
Table 23.2. Montenegro's progress towards achieving the SDGs 1242
Table 23.3. Competitiveness Outlook scoring system 1250
Table 23.4. Montenegro's scores for investment policy and promotion 1252
Table 23.5. Montenegro's scores for trade policy 1258
Table 23.6. Montenegro's scores for access to finance 1278
Table 23.7. Montenegro's scores for tax policy 1285
Table 23.8. Montenegro's tax revenues as a percentage of GDP 1286
Table 23.9. Selected tax rates in Montenegro 1287
Table 23.10. Montenegro's scores for state-owned enterprises 1298
Table 23.11. The five largest employers in Montenegro's SOE sector, 2019 1300
Table 23.12. Montenegrin SOEs privatised between 2010 and 2014 1305
Table 23.13. Privatisation revenues (EUR) in Montenegro (2010-2019) 1305
Table 23.14. Montenegro's scores for education policy 1308
Table 23.15. Montenegro's scores for employment policy 1316
Table 23.16. Key labour market indicators for Montenegro (2015 and 2019) 1316
Table 23.17. Montenegro's scores for science, technology and innovation 1330
Table 23.18. Montenegro's scores for digital society 1335
Table 23.19. Montenegro's scores for transport 1344
Table 23.20. Trends in transport infrastructure investments and maintenance, Montenegro (2017-19) 1346
Table 23.21. Trends in transport of passengers and goods in Montenegro 1348
Table 23.22. Trends in road transport in Montenegro 1349
Table 23.23. Road safety trends in Montenegro 1351
Table 23.24. Montenegro's scores for energy policy 1354
Table 23.25. Montenegro's scores for environment policy 1363
Table 23.26. Montenegro's scores for agriculture policy 1371
Table 23.27. Employment by sector and sex, Montenegro (2019) 1371
Table 23.28. Livestock and poultry numbers in Montenegro (2016-19) 1372
Table 23.29. Agriculture enrolments in first year of high school (2016-20) 1375
Table 23.30. Montenegro's scores for tourism policy 1381
Table 23.31. Montenegro's tourism-related strategic documents 1383
Table 23.32. Montenegro's scores for anti-corruption policy 1392
Table 24.1. North Macedonia: Main macroeconomic indicators (2015-20) 1452
Table 24.2. North Macedonia's progress towards achieving the SDGs 1454
Table 24.3. Competitiveness Outlook scoring system 1463
Table 24.4. North Macedonia's scores for investment policy and promotion 1464
Table 24.5. North Macedonia's scores for trade policy 1472
Table 24.6. North Macedonia's scores for access to finance 1491
Table 24.7. Listing rules in North Macedonia 1495
Table 24.8. North Macedonia's scores for the tax policy 1498
Table 24.9. North Macedonia's tax revenues as a percentage of GDP 1498

Table 24.10. Selected tax rates in North Macedonia 1499
Table 24.11. North Macedonia's scores for state-owned enterprises 1511
Table 24.12. North Macedonia's scores for education policy 1519
Table 24.13. North Macedonia's scores for employment policy 1527
Table 24.14. Key labour market indicators for North Macedonia (2015 and 2019) 1527
Table 24.15. North Macedonia's scores for science, technology and innovation 1542
Table 24.16. North Macedonia's scores for digital society 1548
Table 24.17. North Macedonia's scores for transport policy 1556
Table 24.18. Trends in transport infrastructure investments and maintenance in North Macedonia (2017-19) 1558
Table 24.19. Trends in rail transport of passengers and goods in North Macedonia (2017 and 2019) 1560
Table 24.20. Trends in road transport of passengers and goods in North Macedonia (2017 and 2019) 1561
Table 24.21. Road safety trends in North Macedonia (2010-19) 1562
Table 24.22. North Macedonia's scores for energy policy 1566
Table 24.23. North Macedonia's energy balance (2018) 1568
Table 24.24. Energy consumption (2018) 1571
Table 24.25. North Macedonia's scores for environment policy 1577
Table 24.26. North Macedonia's scores for agriculture policy 1584
Table 24.27. National budget support for agriculture (2016-18) in million EUR 1588
Table 24.28. North Macedonia's scores for tourism policy 1593
Table 24.29. North Macedonia's scores for anti-corruption policy 1600
Table 25.1. Serbia: Main macroeconomic indicators (2015-2020) 1657
Table 25.2. SDG Trends 1658
Table 25.3. Competitiveness Outlook scoring system 1667
Table 25.4. Serbia's scores for investment policy and promotion 1668
Table 25.5. Serbia's scores for trade policy 1675
Table 25.6. Serbia' scores for access to finance 1695
Table 25.7. Listing segments of the regulated market in the Belgrade Stock Exchange 1700
Table 25.8. Serbia's scores for tax policy 1705
Table 25.9. Serbia's tax revenues as a percentage of GDP 1705
Table 25.10. Selected tax rates in Serbia 1706
Table 25.11. Serbia's scores for state-owned enterprises 1718
Table 25.12. Serbia's scores for education policy 1726
Table 25.13. Objectives and indicators 1733
Table 25.14. Serbia's scores for employment policy 1734
Table 25.15. Key labour market indicators for Serbia (2015 and 2019) 1734
Table 25.16. Serbia's scores for science, technology and innovation 1747
Table 25.17. Serbia's scores for digital society 1752
Table 25.18. Serbia's scores for transport policy 1761
Table 25.19. Trends in rail transport of passengers and goods in Serbia (2017 and 2019) 1765
Table 25.20. Trends in road transport of passengers and goods in Serbia (2017 and 2019) 1766
Table 25.21. Road safety trends in Serbia (2010-19) 1768
Table 25.22. Serbia's scores for energy policy 1771
Table 25.23. Serbia's distribution losses as % of final electricity consumption (2014-18) 1774
Table 25.24. Serbia's renewable energy generation as a share of gross inland consumption (2014-19) 1774
Table 25.25. Serbia's scores for environment policy 1780
Table 25.26. Serbia's scores for agriculture policy 1788
Table 25.27. Serbia's scores for tourism policy 1798
Table 25.28. Serbia's scores for anti-corruption policy 1806

## Figures

Figure 2.1. The Competitiveness Outlook 2021 overall assessment approach 51
Figure 2.2. Qualitative indicators: what does the scoring mean? 52
Figure 4.1. Overall scores for the investment policy and promotion dimension (2018 and 2021) 78
Figure 4.2. Investment dimension assessment framework 82
Figure 4.3. FDI flows into WB6 economies (2009-19) 84
Figure 4.4. FDI inflows as a percentage of GDP (2009-19) 84

Figure 4.5. FDI stock as a percentage of GDP (2019) 85
Figure 4.6. Regulatory quality in the WB6: the Worldwide Governance Indicators (2015-19) 87
Figure 4.7. OECD FDI Regulatory Restrictiveness Index (2020) 88
Figure 4.8. Economies' ability to enforce contracts (2015 and 2019) 90
Figure 4.9. Efficiency of legal framework in settling disputes (2019) 91
Figure 4.10. Ease and time to start a business in the WB6 (2020) 101
Figure 5.1. Overall scores for the trade policy dimension (2018 and 2021) 119
Figure 5.2. Trade policy dimension assessment framework 124
Figure 5.3. Key trends in external trade in goods and services (2015-19) 126
Figure 5.4. Main trading partners of the WB6 127
Figure 5.5. Impact of COVID-19 on import and export volumes (2019-20) 127
Figure 5.6. OECD trade facilitation indicators: WB6 evolution (2017-19) 134
Figure 5.7. WB6 average TFI performance compared with the OECD and CEEC-11 (2019) 134
Figure 5.8. OECD trade facilitation indicators for the six WB economies (2019) 136
Figure 5.9. Contribution of services to GDP in WB6 economies (2008-17) 139
Figure 5.10. Policy-induced average costs for cross-border services trade 140
Figure 5.11. WB6 economies' evolution on the services trade restrictiveness index (2014-2020) 141
Figure 5.12. Services trade restrictiveness index – WB6 economies (2020) 142
Figure 5.13. How harmonised are services regulations in WB6 and CEEC economies (2020)? 143
Figure 5.14. Services trade restrictiveness in road and rail freight transport (2020) 145
Figure 5.15. Services trade restrictiveness in air transport and courier services (2020) 147
Figure 5.16. Services trade restrictiveness in legal services (2020) 149
Figure 5.17. Services trade restrictiveness in commercial banking and insurance services (2020) 150
Figure 5.18. Services trade restrictiveness in construction services (2020) 152
Figure 5.19. Services trade restrictiveness in architecture and engineering services (2020) 153
Figure 5.20. Services trade restrictiveness in computer services and telecommunications (2020) 154
Figure 5.21. Digital services trade restrictiveness index: WB6 and CEEC economies 158
Figure 6.1. Overall scores for the access to finance dimension (2018 and 2021) 173
Figure 6.2. Access to finance dimension assessment framework 175
Figure 6.3. Domestic credit to the private sector in WB6 economies (2011-2019) 177
Figure 6.4. Gross domestic savings in WB6 economies (2011-2019) 177
Figure 6.5. Non-performing loans in the WB6 economies (2008-2020) 178
Figure 6.6. Loans requiring collateral in WB6 economies, and the value of collateral (2019) 181
Figure 7.1. Overall scores for the tax policy dimension (2018 and 2021) 202
Figure 7.2. Tax policy dimension assessment framework 205
Figure 7.3. Tax revenues by tax type (2019) 206
Figure 7.4. Selected taxes as a share of total tax revenues (2019) 207
Figure 8.1. Overall scores for the qualitative competition policy dimension (2018 and 2021) 226
Figure 8.2. Competition policy scores (2021) 231
Figure 8.3. Degree of alignment for scope of action (Policy area 5.1) 232
Figure 8.4. Number of staff working on competition in WB6 competition authorities (2019) 233
Figure 8.5. Budget of WB6 competition authorities (2019) 234
Figure 8.6. Scores for anti-competitive behaviour (Policy area 5.2) 236
Figure 8.7. Scores for implementation (Policy area 5.5) 237
Figure 8.8. Cartel decisions involving an immunity application (2019) 238
Figure 8.9. Example of co-operation between competition and procurement authorities 240
Figure 8.10. Scores for probity of investigation (Policy area 5.3) 241
Figure 8.11. Scores for advocacy (Policy area 5.4) 243
Figure 9.1. Overall scores for the state-owned enterprises dimension (2018 and 2021) 257
Figure 9.2. State-owned enterprise dimension assessment framework 260
Figure 9.3. Number of central government SOEs in WB6 economies 263
Figure 9.4. SOEs' share of total employment in WB6 economies (2019) 264
Figure 9.5. Sectoral distribution of SOEs across the Western Balkans 265
Figure 9.6. Estimated number of SOEs with private shareholders in WB6 economies (2019) 272
Figure 9.7. Extent of shareholder rights for stock-exchange listed companies in the WB6 (2019) 273
Figure 9.8. Minority investor protections for stock-exchange listed companies in the WB6 273
Figure 10.1. Overall scores for the education policy dimension (2018 and 2021) 286
Figure 10.2. Education policy dimension assessment framework 289
Figure 10.3. GDP per person employed (2015-19) 290
Figure 10.4. Highest educational attainment by gender (2019) 291

Figure 10.5. PISA 2018 performance in science, reading and mathematics by gender 292
Figure 10.6. PISA 2018 low achievers in science, reading and mathematics by gender 292
Figure 10.7. Gross enrolment ratio, pre-primary (ISCED 02), both sexes (2018) 294
Figure 10.8. Percentage of early school leavers (2013 and 2018) 297
Figure 10.9. Teacher qualifications (PISA 2018) 302
Figure 10.10. Teachers with a bachelor's or master's or higher degree (2019) 302
Figure 10.11. Participation of teaching staff in professional development (PISA 2018) 303
Figure 10.12. PISA 2018 low achieving students and education programmes 307
Figure 10.13. Employment rates of recent graduates in the EU and WB6 economies (2008 and 2019) 310
Figure 11.1. Overall scores for the employment policy dimension (2018 and 2021) 320
Figure 11.2. Employment policy dimension assessment framework 324
Figure 11.3. Employment and unemployment rates among 15-64 year-olds (2019) 326
Figure 11.4. Evolution of employment (2019 Q3 to 2020 Q3) 326
Figure 11.5. Youth unemployment rates in the WB6 (2015 and 2019) 340
Figure 11.6. Young people not in employment, education or training (2015 and 2019) 341
Figure 11.7. Annual change in labour productivity (2015-19) 345
Figure 11.8. Gender employment gaps in the WB6 (2015 and 2019) 346
Figure 12.1. Overall scores for the science, technology and innovation dimension (2018 and 2021) 365
Figure 12.2. Science, technology and innovation dimension assessment framework 367
Figure 12.3. Gross domestic expenditure on R&D (GERD) (2013 and 2018) 369
Figure 12.4. Funding sources for research and development (2017) 370
Figure 12.5. Charges for the use of intellectual property, receipts and payments (2015 and 2019) 371
Figure 12.6. Knowledge-intensive service exports, European Innovation Scoreboard (2020) 371
Figure 12.7. International co-publications originating from the WB6 (2013-2019) 375
Figure 12.8. Number of researchers per million population (2013-18) 379
Figure 13.1. Overall scores for digital society dimension (2018 and 2021) 391
Figure 13.2. Digital society dimension assessment framework 395
Figure 13.3. Fixed broadband penetration (2017-19) 397
Figure 13.4. Percentage of individuals with basic or above basic overall digital skills (2016-19) 398
Figure 13.5. Internet access in WB6 households (2017-20) 399
Figure 13.6. Internet access by individuals via mobile/smart phones (2017-2019) 400
Figure 13.7. Rate of Internet use when interacting with public authorities (2017-20) 406
Figure 13.8. Share of enterprises offering online sales (2018-20) 408
Figure 13.9. Share of enterprises training their staff in ICT skills (2018-20) 413
Figure 13.10. Households without access to the Internet at home because of lack of skills (2016-19) 418
Figure 13.11. Households without access to the Internet at home because of high access costs (2016-19) 418
Figure 13.12. Enterprises that have defined or reviewed their ICT security policy in the last 24 months (2015 and 2019) 423
Figure 14.1. Overall scores for the transport policy dimension (2018 and 2021) 433
Figure 14.2. Transport policy dimension assessment framework 436
Figure 14.3. WB6 Logistic Performance Index scores (2016-2018) 437
Figure 14.4. WB6 Global Competitiveness Index scores (2019) 438
Figure 14.5. WB6 DHL Global Connectedness Index scores (2019) 438
Figure 14.6. Evolution of road freight transport volumes 440
Figure 14.7. Rail network utilisation in the Western Balkans (2017-19) 447
Figure 14.8. Air traffic trends in the WB6 region (2017-19) 448
Figure 14.9. Road safety trends (2010-2020) 451
Figure 14.10. $CO_2$ emission from transport 452
Figure 15.1. Overall scores for the energy policy dimension (2018 and 2021) 462
Figure 15.2. Energy policy dimension assessment framework 465
Figure 15.3. WB6 progress on transposing the EU’s Third Energy Package (2018-20) 466
Figure 15.4. Share of WB6 firms experiencing electrical outages (2013 and 2019) 467
Figure 15.5. Share of firms identifying electricity as a major constraint (2013 and 2019) 467
Figure 15.6. Distribution losses as a share of injected electricity (2018) 471
Figure 15.7. The WB6 energy mix compared with the EU and CEEC-11 (2018) 473
Figure 15.8. The WB6 energy mix (2018) 473
Figure 15.9. Gross electricity generation mix in the WB6 (2018) 474
Figure 16.1. Overall scores for the environment policy dimension (2018 and 2021) 489
Figure 16.2. Environment policy dimension assessment framework 493

Figure 16.3. Composition of value added by economic sector (2019) 494
Figure 16.4. $CO_2$ emissions by sector (transport, electricity and heat production) 496
Figure 16.5. Municipal waste generation per capita (2018) 498
Figure 16.6. Municipal waste recycling rates (2018) 498
Figure 16.7. Renewable internal freshwater resources per capita (2017) 503
Figure 16.8. Freshwater abstractions by sector (2017) 503
Figure 16.9. Forest area in the Western Balkans (2018) 505
Figure 16.10. Terrestrial protected areas (2014 and 2020) 506
Figure 16.11. Agricultural land (2012 and 2016) 506
Figure 16.12. Annual mean population exposure to $PM_{2.5}$ air pollution (2014-19) 510
Figure 16.13. Population connected to wastewater treatment facilities (2018) 512
Figure 17.1. Overall scores for the agriculture policy dimension (2018 and 2021) 523
Figure 17.2. Agriculture policy dimension assessment framework 525
Figure 17.3. Share of agriculture value added (2016-19) 526
Figure 17.4. Share of employment in agriculture (2016-20) 527
Figure 17.5. Productivity index for the Western Balkans economies (2016-19) 527
Figure 18.1. Overall scores for the tourism policy dimension (2018 and 2021) 545
Figure 18.2. Tourism policy dimension assessment framework 549
Figure 18.3. Growth of international tourist arrivals (2015-19) 551
Figure 18.4. Tourist arrivals and overnight stays in the Western Balkans (2019-2020) 551
Figure 18.5. Travel and tourism and GDP growth in the Western Balkans (2018-19) 552
Figure 18.6. Contribution of travel and tourism to employment and exports (2019) 553
Figure 18.7. Growth of the number of tourist beds in the WB6 (2016-19) 562
Figure 18.8. Budget for tourism marketing in WB6 economies (2016-19) 573
Figure 19.1. Overall scores for the anti-corruption policy dimension (2018 and 2021) 584
Figure 19.2. Anti-corruption policy dimension assessment framework 587
Figure 19.3. Control of Corruption Indicator (2009-19) 589
Figure 19.4. Corruption Perceptions Index (2012-20) 589
Figure 19.5. Experience of corruption pressure (2001-19) 590
Figure 19.6. Perceptions of the effectiveness of government anti-corruption efforts (2001-19) 591
Figure 19.7. Independence of the judiciary (2013-20) 600
Figure 20.1. Scores for Albania (2018 and 2021) 617
Figure 20.2. Net FDI inflows to Albania (2015-19) 632
Figure 20.3. FDI Regulatory Restrictiveness Index (2019) 634
Figure 20.4. Impact of COVID-19 on trade, Albania versus the OECD (2019-20) 641
Figure 20.5. Services, value added (% of GDP) - Albania (2007-17) 644
Figure 20.6. Services Trade Restrictiveness Index for Albania (2020) 646
Figure 20.7. Evolution of STRI scores by sector in Albania (2014-20) 646
Figure 20.8. Digital services trade restrictiveness index: WB6 and CEEC economies 657
Figure 20.9. Albania's legal and institutional competition framework 672
Figure 20.10. Competition decisions in Albania (2015-19) 674
Figure 20.11. How co-operation between competition and procurement authorities could work 678
Figure 20.12. Sectoral distribution of SOEs by number of enterprises 681
Figure 20.13. Sectoral distribution of SOEs by employment 681
Figure 20.14. Performance in reading, mathematics and science in Western Balkan education systems 690
Figure 20.15. Agriculture's contribution to GDP in Albania (2016-19) 753
Figure 20.16. Enrolments in the first year of agriculture degrees (2017-19) 755
Figure 20.17. Seasonality of Albanian tourism (2019-20) 761
Figure 21.1. Scores for Bosnia and Herzegovina (2018 and 2021) 825
Figure 21.2. Net FDI inflows to Bosnia and Herzegovina (2015-19) 839
Figure 21.3. FDI Regulatory Restrictiveness Index (2019) 841
Figure 21.4. Impact of COVID-19 on trade, Bosnia and Herzegovina versus the OECD (2019-20) 850
Figure 21.5. Contribution of services to Bosnia and Herzegovina's GDP (2007-17) 853
Figure 21.6. Services Trade Restrictiveness Index for Bosnia and Herzegovina (2020) 854
Figure 21.7. Evolution of STRI scores by sector in Bosnia and Herzegovina (2014-20) 855
Figure 21.8. STRI courier services – comparison between Bosnia and Herzegovina and Slovenia 859
Figure 21.9. Digital services trade restrictiveness index: WB6 and CEEC economies 866
Figure 21.10. Bosnia and Herzegovina's legal and institutional competition framework 883
Figure 21.11. Competition decisions in Bosnia and Herzegovina (2015-19) 885
Figure 21.12. Example of co-operation between competition and procurement authorities 888

Figure 21.13. Sectoral distribution of SOEs by number of enterprises (2017) 890
Figure 21.14. Sectoral distribution of SOEs by employment (2017) 890
Figure 21.15. Performance in reading, mathematics and science in Western Balkan education systems, 2018 900
Figure 21.16. Contribution of agriculture, services and industry to GDP in Bosnia and Herzegovina 965
Figure 21.17. Tourist arrivals and overnight stays Bosnia and Herzegovina (2018-20) 974
Figure 22.1. Scores for Kosovo (2018 and 2021) 1043
Figure 22.2. Net FDI inflows to Kosovo (2015-19) 1058
Figure 22.3. FDI Restrictiveness Index (2019) 1059
Figure 22.4. Impact of COVID-19 on trade, Kosovo versus the OECD (2019-20) 1064
Figure 22.5. Services Trade Restrictiveness Index for Kosovo (2020) 1068
Figure 22.6. Evolution of STRI scores by sector in Kosovo (2014-20) 1069
Figure 22.7. Digital services trade restrictiveness index: WB6 and CEEC economies 1079
Figure 22.8. Kosovo's legal and institutional competition framework 1094
Figure 22.9. Competition decisions in Kosovo (2015-19) 1096
Figure 22.10. How co-operation between competition and procurement authorities could work 1099
Figure 22.11. Sectoral distribution of SOEs by employment 1101
Figure 22.12. Performance in reading, mathematics and science in Western Balkan education systems (2018) 1109
Figure 22.13. Kosovo's energy consumption (2000-19) 1158
Figure 22.14. Number of students enrolling in the first year of the agriculture university programme 1172
Figure 22.15. Tourist arrivals and overnight stays in Kosovo (2011-20) 1178
Figure 23.1. Scores for Montenegro (2018 and 2021) 1237
Figure 23.2. Net FDI inflows to Montenegro (2015-19) 1252
Figure 23.3. FDI Regulatory Restrictiveness Index (2019) 1254
Figure 23.4. Impact of COVID-19 on trade, Montenegro versus the OECD (2019-20) 1259
Figure 23.5. Services, value added (% of GDP) - Montenegro (2007-17) 1261
Figure 23.6. Services trade restrictiveness index for Montenegro (2020) 1263
Figure 23.7. Evolution of STRI scores by sector in Montenegro (2014-2020) 1263
Figure 23.8. Comparing courier services restrictiveness in Montenegro and Slovenia 1267
Figure 23.9. Digital services trade restrictiveness index: WB6 and CEEC economies 1274
Figure 23.10. Montenegro's legal and institutional competition framework 1291
Figure 23.11. Competition decisions in Montenegro 1293
Figure 23.12. Example of co-operation between competition and procurement authorities 1296
Figure 23.13. Sectoral distribution of Montenegro's SOEs 1299
Figure 23.14. Sectoral contribution of fully corporatised SOEs to SOE employment 1300
Figure 23.15. Performance in reading, mathematics and science in Western Balkan six education systems, 2018 1309
Figure 23.16. Montenegro's non-hydro renewable energy generation (1990-2019) 1357
Figure 23.17. International and domestic tourist arrivals in Montenegro (2017-19) 1382
Figure 23.18. Budget dedicated to tourism in Montenegro (2014-19) 1384
Figure 23.19. Top market shares of tourist arrivals by economy of origin (2015 & 2019) 1390
Figure 24.1. Scores for North Macedonia (2018 and 2021) 1448
Figure 24.2. Net FDI inflows to North Macedonia (2015-19) 1464
Figure 24.3. FDI Regulatory Restrictiveness Index (2019) 1466
Figure 24.4. Impact of COVID-19 on trade, North Macedonia versus the OECD (2019-20) 1473
Figure 24.5. Services, value added (% of GDP) - North Macedonia (2007-17) 1476
Figure 24.6. Services trade restrictiveness index for North Macedonia (2020) 1478
Figure 24.7. Evolution of STRI scores by sector in North Macedonia (2014-20) 1478
Figure 24.8. Digital services trade restrictiveness index: WB6 and CEEC economies 1487
Figure 24.9. North Macedonia's legal and institutional competition framework 1504
Figure 24.10. Competition decisions in North Macedonia (2015-19) 1506
Figure 24.11. Example of co-operation between competition and procurement authorities 1510
Figure 24.12. Sectoral distribution of SOEs by number and contribution to employment 1512
Figure 24.13. Performance in reading, mathematics and science in Western Balkan education systems (2018) 1520
Figure 24.14. Gross renewable electricity generated by sources in North Macedonia (2017 and 2018) 1569
Figure 24.15. Planned natural gas infrastructure projects in North Macedonia 1571
Figure 24.16. Renewable energy as a share of gross inland consumption (1990-2018) 1573
Figure 24.17. Employment by economic sector (2019) 1584

Figure 24.18. Tourist arrivals and overnight stays (2019-2020) 1594
Figure 25.1. Scores for Serbia (2018 and 2021) 1653
Figure 25.2. Net FDI inflows to Serbia (2015-19) 1668
Figure 25.3. FDI Regulatory Restrictiveness Index (2019) 1669
Figure 25.4. Impact of COVID-19 on trade, Serbia versus the OECD (2019-20) 1677
Figure 25.5. Contribution of services to Serbia's GDP (2007-17) 1679
Figure 25.6. Services trade restrictiveness index for Serbia (2020) 1681
Figure 25.7. Serbia's Services Trade Restrictiveness Index by sector (2014-20) 1682
Figure 25.8. Digital services trade restrictiveness index: WB6 and CEEC economies 1692
Figure 25.9. Serbia's legal and institutional competition framework 1711
Figure 25.10. Distribution of the budget of competition agencies participating in OECD CompStats 2020 1712
Figure 25.11. Competition decisions in Serbia (2015-19) 1714
Figure 25.12. Example of co-operation between competition and procurement authorities 1717
Figure 25.13. Sectoral distribution of SOEs by number of enterprises 1719
Figure 25.14. Sectoral distribution of SOEs by employment 1719
Figure 25.15. Sectoral distribution of state minority-owned companies by employment 1720
Figure 25.16. Performance in reading, mathematics and science in Western Balkan education systems, 2018 1727
Figure 25.17. Serbia's gross electricity generation mix (2016 and 2019) 1774
Figure 25.18. Number of students enrolling in the first year of university agriculture programmes 1791
Figure 25.19. Seasonality and growth of tourism in Serbia (2017-20) 1799

# Abbreviations and acronyms

| | |
|---|---|
| **ADR** | Alternative dispute resolution |
| **AIDA** | Albanian Investment Development Agency |
| **ALB** | Albania |
| **ALMP** | Active labour market programme |
| **BCP** | Border crossing point |
| **BEEPS** | Business Environment and Enterprise Performance Survey |
| **BEPS** | Base erosion and profit shifting |
| **BIH** | Bosnia and Herzegovina |
| **BIT** | Bilateral investment treaty |
| **CAP** | Common Agricultural Policy |
| **CBA** | Cost-benefit analysis |
| **CEEC** | Central and Eastern European countries |
| **CERT** | Computer emergency response team |
| **CEFTA** | Central European Free Trade Agreement |
| **CIT** | Corporate income tax |
| **CO** | Competitiveness Outlook |
| **$CO_2$** | Carbon dioxide |
| **CRM** | Common Regional Market |
| **CSO** | Civil society organisation |
| **DHLGCI** | DHL Global Connectedness Index |
| **DSO** | Distribution system operator |
| **DTIDZ** | Directorate for Technological Industrial Development Zones |
| **EBRD** | European Bank for Reconstruction and Development |
| **ECE** | Early childhood education |
| **EEA** | European Economic Area |
| **EFTA** | European Free Trade Association |
| **EIB** | European Investment Bank |

| | |
|---|---|
| **EMIS** | Education management information system |
| **ERP** | Economic Reform Programme |
| **ETF** | European Training Foundation |
| **EU** | European Union |
| **EUR** | Euro |
| **FAO** | Food and Agriculture Organization |
| **FBiH** | Federation of Bosnia and Herzegovina |
| **FDI** | Foreign direct investment |
| **FIP** | Feed-in premium |
| **FIT** | Feed-in tariff |
| **GCI** | Global Competitiveness Index |
| **GDP** | Gross domestic product |
| **GDPR** | EU General Data Protection Regulation |
| **GERD** | Gross expenditure on research and development |
| **GHG** | Greenhouse gas |
| **GST** | Goods and services tax |
| **GVC** | Global value chain |
| **HEI** | Higher education institution |
| **HR** | Human resources |
| **ICT** | Information and communication technology |
| **IFI** | International financial institution |
| **ILO** | International Labour Organization |
| **IMF** | International Monetary Fund |
| **IP** | Intellectual property |
| **IPA** | Instrument for Pre-Accession Assistance |
| **IPA** | Investment promotion agency |
| **IPARD** | Instrument for Pre-Accession Assistance for Rural Development |
| **IPP** | Intellectual property protection |
| **ISIC** | International Standard Industrial Classification |
| **ITE** | Initial teacher education |
| **IWW** | Inland waterways |
| **KIESA** | Kosovo Investment and Enterprise Support Agency |
| **KOS** | Kosovo |
| **LFS** | Labour Force Survey |
| **LPI** | Logistics Performance Index |

| | |
|---|---|
| **LPIS** | Land parcel identification systems |
| **MKD** | North Macedonia |
| **MIA** | Montenegro Investment Agency |
| **MNE** | Montenegro |
| **MNE** | Multinational enterprise |
| **MSME** | Micro, small and medium-sized enterprise |
| **NEET** | Not in education, employment or training |
| **NGO** | Non-government organisation |
| **$NO_2$** | Nitrogen dioxide |
| **NPL** | Non-performing loans |
| **OECD** | Organisation for Economic Co-operation and Development |
| **OHS** | Occupational health and safety |
| **OSS** | One-stop shop |
| **PARS** | Public Administration Reform Strategies |
| **PDP** | Personal data protection |
| **PES** | Public employment services |
| **PISA** | Programme for International Student Assessment |
| **PIT** | Personal income tax |
| **PM** | Particulate matter |
| **PPI** | Private participation in infrastructure |
| **PPP** | Public-private partnership |
| **PPP** | Purchasing power parity |
| **Q** | Quarter |
| **R&D** | Research and development |
| **RAS** | Development Agency of Serbia |
| **RCC** | Regional Cooperation Council |
| **RDI** | Research and development institutes |
| **RIA** | Regulatory impact assessment |
| **RS** | Republika Srpska |
| **SDG** | Sustainable Development Goal |
| **SME** | Small and medium-sized enterprise |
| **SOE** | State-owned enterprise |
| **SPP** | Single project pipeline |
| **SPS** | Sanitary and phytosanitary measures |
| **SSC** | Social security contribution |

| | |
|---|---|
| **SRB** | Serbia |
| **STI** | Science, technology and innovation |
| **STP** | Science and technology parks |
| **STRI** | OECD Services Trade Restrictiveness Index |
| **TCPS** | Transport Community Permanent Secretariat |
| **TCT** | Transport Community Treaty |
| **TEN-T** | Trans-European Transport Network |
| **TFI** | OECD Trade Facilitation Indicators |
| **TSA** | Tourism Satellite Account |
| **TSO** | Transmission system operator |
| **UNDP** | United Nations Development Programme |
| **UNFCCC** | United Nations Framework Convention on Climate Change |
| **USD** | United States dollar |
| **VAT** | Value-added tax |
| **VET** | Vocational education and training |
| **WB6** | Six Western Balkan economies |
| **WBIF** | Western Balkan Investment Framework |
| **WB EDIF** | Western Balkans Enterprise Development and Innovation Facility |
| **WBL** | Work-based learning |
| **WHO** | World Health Organization |
| **WIPO** | World Intellectual Property Organization |
| **WTO** | World Trade Organization |
| **WWTP** | Wastewater treatment plants |
| **y-o-y** | Year on year |

# Executive summary

Over the past two decades, the six Western Balkan (WB6) economies have implemented a number of economic reforms that have strengthened their competitiveness; however, 2020 has confronted them with unprecedented challenges. The COVID-19 pandemic has taken a heavy toll on the region, with gross domestic product contracting by 3.3%, exacerbating existing structural challenges and bringing new ones to the fore. The pandemic has revealed the need to reorient the region's reform priorities towards a stronger focus on sustainability, inclusiveness and citizen well-being. Against this backdrop, a holistic, evidence-based structural reform agenda that outlines a path to sustainable, inclusive growth and rising living standards is of utmost importance for all WB6 economies.

This publication seeks to contribute to this endeavour. It provides policy makers in the WB6 economies – Albania, Bosnia and Herzegovina, Kosovo, the Republic of North Macedonia, Montenegro and Serbia – with an evidence-based assessment of 16 policy areas key to their competitiveness, as well as tailored policy recommendations built on OECD and European Union (EU) good practice. Unlike the previous editions, this third edition of *Competitiveness in South East Europe: A Policy Outlook* (Competitiveness Outlook) complements a regional analysis of the 16 policy areas with extensive economy-specific profiles for each WB6 economy. It is the result of a participatory assessment process that included more than 700 WB6 government and statistical office representatives, as well as non-government stakeholders.

## Key achievements

On average, the WB6 economies have improved their performance since the publication of the Competitiveness Outlook 2018 report in two-thirds of the policy dimensions analysed. Although this clearly indicates progress in the setting up of polices to enhance their competitiveness, effective and continuous implementation, monitoring, and upgrading these policies should remain a key priority if they are to have a lasting impact. For this assessment cycle, the strongest performance among WB6 economies was in the following areas:

- **Tax policy**. Since the last assessment, all WB6 economies except Kosovo have joined the Inclusive Framework on base erosion and profit shifting (BEPS) and have implemented the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. They all also carry out some form of regional co-operation and co-ordination on tax matters.
- **Trade policy**. All WB6 economies have made significant improvements to strengthen regional co-operation in trade and open up trade in services within the Central European Free Trade Agreement (CEFTA) framework. This has been achieved through the conclusion of CEFTA Additional Protocol 6 in December 2019 and its ratification by Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. These and subsequent efforts will reduce the costs of trade in services in the region.
- **Energy policy**. The WB6 economies have made advances towards aligning their energy policies with EU and Energy Community standards. They have an advanced legislative framework that

transposes a significant share of the EU's Third Energy Package. There has also been progress in deploying EU-style organised markets in energy.

- **Investment policy and promotion**. The WB6 economies continue to be among the most open economies to foreign direct investment (FDI) thanks to their open markets and comprehensive regulatory environments for investment activities. All WB6 economies have established an investment promotion agency mandated to promote and facilitate inward FDI, exports and innovation. By giving the same rights and remedies to foreign and domestic investors in their court systems, the economies are facilitating foreign investment.

## Key priorities

By contrast, challenges remain for all WB6 economies in several policy areas. In particular there is room for improvement in environment policy; digital society; science, technology and innovation policy; and transport policy – dimensions for which the economies score the lowest in this 2021 Competitiveness Outlook assessment. The key areas for improvement are:

- **Improve environmental quality of life.** With levels of fine particulate matter ($PM_{2.5}$) two to three times above the maximum limits recommended by the World Health Organization, the WB6 economies should decrease their dependence on fossil fuels in the energy mix, upgrade household heating systems, reduce transport emissions and decrease emissions from industry. Waste management should also be improved by enforcing measures to separate and reduce waste and increase recycling and recovery in line with circular economy principles. The WB6 should also increase the number of wastewater treatment plants and reassess the fee structure so that fees cover the service costs.
- **Provide stronger support to citizens and businesses to harness the benefits of the digital transformation.** Low digital literacy remains prevalent in the region and threatens to deepen a digital divide despite significant efforts to increase broadband access. Greater co-operation with the information and communication technology (ICT) industry is needed to address digital skills gaps through education and training, while business digitalisation and ICT sector growth should be supported and promoted further.
- **Increase investment in public research and innovation**. Public research remains systemically underfunded, while the allocation of funding does not always encourage optimal research outputs. Human capital for research and innovation is below potential due to limited development opportunities, lack of funding and few incentives to commercialise research. With increased funding for public sector research and by promoting scientific research as an attractive profession to develop human capital and counteract brain drain, innovation systems could be a key driver of economic growth in the region.
- **Improve transport project and asset management and strengthen combined transport.** Most WB6 economies would benefit from improving their systems for transport project identification, prioritisation and selection to make the allocation of funds and investment in transport infrastructure projects more efficient. The WB6 should accelerate the development of an asset management system for all transport infrastructure and ensure that it is in line with the domestic inventory system. They should also develop or prioritise combined transport strategies, which are needed to boost cost efficiency, reduce environmental pollution, and increase co-modality and co-operation among freight forwarding network companies.

# 1 Economic context

## Key economic features

The Western Balkan region consists of six small open economies: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia. In the post-transition period, the economies of this region have become predominantly service-oriented, though some manufacturing sectors have been expanding in recent years. Services account for the largest share of the regional gross domestic product (GDP) at 52.2%, dominated by wholesale and retail trade (World Bank, 2021[1]). In Montenegro and Albania, tourism also contributes a significant share to the services sector (32.1% and 21.2% of GDP respectively) (World Travel and Tourism Council, 2020[2]). Industry contributes 23.4% to GDP, with the highest contribution coming from the manufacturing and construction sectors. However, the share of the manufacturing sector varies across the six economies – from 4% of GDP in Montenegro and 6% of GDP in Albania to between 12% and 14% in the remaining four economies (World Bank, 2021[1]). The agriculture sector has declined significantly over the past two decades, its contribution to GDP having fallen from 15.3% in 2000 to 8.6% in 2020 (World Bank, 2021[1]). However, this sector's contribution to employment remains much more significant, at 18.6% in 2019 (World Bank, 2021[1]). Its contribution to informal employment is also likely to be significant (ILO, 2021[3]).

The growth of the Western Balkan economies has slowed down significantly in the aftermath of the global financial crisis, but it has become more balanced (World Bank, 2021[1]). Their annual average growth rate has been 2.3% since 2010, compared to 5.8% in 2001-08. Prior to the crisis, GDP growth was driven predominantly by consumption and investment, fuelled by high capital inflows channelled through the newly privatised financial institutions. In the context of weak export growth and high reliance on imports, this led to the build-up of significant imbalances, including high trade and current account deficits and high levels of (external) debt, both public and private. In the post-crisis period, weaker credit growth has moderated the growth in consumption and investment, including foreign direct investment (FDI). Furthermore, productivity growth has been undermined by weaker labour reallocation from less productive sectors (mainly agriculture) to more productive service and manufacturing sectors, as well as by the decline in within-sector productivity growth. On the other hand, the growth in exports (from 28.8% to 44.6% of GDP between 2008 and 2019), fuelled in some economies (North Macedonia and Serbia) by the influx of export processing FDI, has resulted in more balanced growth and a more stable macroeconomic environment (World Bank, 2021[1]).

The moderate economic growth of the past decade reflects numerous underlying structural challenges that undermine productivity and capital accumulation. Despite significant progress, the business environment remains challenging due to corruption, weak and uncertain contract enforcement, lengthy and costly procedures for obtaining licences and permits, and unfair competition from the informal sector, among others. Micro and small enterprises, especially start-ups, face considerable hurdles in obtaining financing from bank and non-bank financial institutions. Infrastructure gaps (including hard and soft transport infrastructure and, in economies such as Albania and Kosovo, energy infrastructure) further undermine competitiveness, investment – particularly export-oriented FDI – and integration into global value chains.

These challenges are also reflected in weak labour market and well-being outcomes. Unemployment remains an important problem for all economies in the region, with rates ranging from 9% in Serbia to 25.7% in Kosovo (Table 1.1). Youth unemployment is particularly high: almost 50% in Kosovo and between 27% and 35.5 in all other economies. A high share of the unemployed are long-term unemployed. Meanwhile, most employed people work in low-wage, low-productivity jobs, which is reflected in the still relatively large gap in per capita income vis-à-vis the European Union (EU) – less than 40% of the EU and OECD average GDP per capita (PPP adjusted) – and the relatively higher poverty rates (World Bank, 2021[1]). High inequality also significantly affects well-being in the Western Balkan economies across gender, ethnicity and regions, with well-being also undermined by high pollution levels and environmental degradation.

## Table 1.1. WB6: Main regional macroeconomic indicators (2020)

| Indicator | Unit of measurement | Albania | Bosnia and Herzegovina | Kosovo | Montenegro | North Macedonia | Serbia | WB6 average |
|---|---|---|---|---|---|---|---|---|
| **GDP growth**[1] | % year-on-year | -3.3 | -4.5 | -3.9 | -15.2 | -4.5 | -1.0 | -3.3 |
| **GDP per capita**[2] | Current international $ | 13 818 | 15 612 | 11 368 | 20 567 | 16 927 | 19 231 | 17 093 |
| **Agriculture, forestry, and fishing, value added**[2] | % of GDP | 19.3 | 6.2 | 7.6 | 6.4 | 9.1 | 6.5 | 8.6 |
| **Industry (including construction), value added**[2] | % of GDP | 19.7 | 23.9 | 25.8 | 16.1 | 22.6 | 24.8 | 23.4 |
| **Services, value added**[2] | % of GDP | 48.4 | 55.7 | 44.2 | 58.7 | 57.0 | 51.5 | 52.2 |
| **Net FDI**[1] | % of GDP | 7.3 | 1.8 | 4.2 | 11.2 | 1.9 | 6.2 | 5.1 |
| **Exports of goods and services**[1] | % of GDP | 23.3 | 32.1 | 21.6 | 25.8 | 58.1 | 47.7 | 40.2 |
| **Imports of goods and services**[1] | % of GDP | 38.1 | 45.9 | 53.7 | 60.6 | 70.9 | 56.6 | 53.9 |
| **Current account balance**[1] | % of GDP | -8.9 | -3.1 | -7.1 | -26.0 | -3.5 | -4.3 | -5.7 |
| **Unemployment**[1] | % | 12.2 | 18.0 | 25.7* | 18.4 | 16.4 | 9.0 | 14.1 |
| **Youth unemployment***[2] | % of total labour force ages 15-24 | 27.0 | 34.0 | 49.5** | 25.3 | 35.5 | 27.1 | 31.6 |
| **Inflation**[1] | Consumer price index, annual % change) | 1.6 | -1.1 | 0.2 | -0.8 | 1.2 | 1.6 | 0.5*** |
| **Public and publicly guaranteed debt**[3] | (% GDP, estimate for 2020) | 77.4 | 39.6 | 22.8 | 109.2 | 60.0 | 58.2 | 57.5 |
| **External debt***[4] | % of GDP | 60.1 | 64.3 | 30.8 | 170.2 | 72.2 | 66.1 | 65.8 |
| **Exchange rate (if applicable local currency/euro)**[1] | Value | 123.77 | 1.96 | .. | .. | 61.67 | 117.58 | .. |
| **Remittance inflows**[2] | % of GDP | 9.9 | 9.2 | 18.9 | 12.6 | 3.4 | 7.3 | 8.5 |
| **Mean population exposure to PM2.5***[5] | Micrograms per cubic metre | 18.5 | 30.3 | .. | 22.3 | 32.7 | 25.5 | .. |

Note: Unless specified otherwise, all WB6 averages are weighted averages.
* 2019 data due to unavailability of 2020 data; ** For Kosovo this is an economy-wide estimate as opposed to ILO modelled estimate for all remaining economies. *** Simple average.
Source: 1) (European Commission, 2021[4]) *EU Candidate Countries' and Potential Candidates' Economic Quarterly (CEEQ) Q1 2021* https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf; 2) (World Bank, 2021[1]), *World Development Indicators* https://databank.worldbank.org/source/world-development-indicators; 3) (World Bank, 2021[5]), *Western Balkans Regular Economic Report, Spring 2021* https://openknowledge.worldbank.org/bitstream/handle/10986/35509/Subdued-Recovery.pdf?sequence=1&isAllowed=y; 4) (EBRD, 2020[6]), *Transition Report 2020-21*, https://2020.tr-ebrd.com/countries; 5) (OECD, 2021[7]), *Statistics*, https://stats.oecd.org/Index.aspx?DataSetCode=EXP_PM2_5.

### *Sustainable development*

All of the Western Balkan economies have committed to implementing the 2030 Agenda for Sustainable Development; however, progress in improving well-being outcomes has been relatively modest over the past decade. Achieving the 2030 targets will require considerable effort across most of the 17 Sustainable Development Goals (SDGs).

Since the start of the economic transition, the WB economies have made significant progress in improving economic and social outcomes. Strong economic growth, particularly in the period leading up to the global financial crisis, led to significant job creation, rising productivity and incomes, and declining poverty. These trends have continued over the past decade, though progress has been slow, and significant gaps with the 2030 targets remain (Table 1.2):

- Health and well-being outcomes are strongly affected by high rates of non-communicable diseases (cardiovascular disease, diabetes, cancer, etc.) and obesity; lack of access to high-quality healthcare; high out-of-pocket expenditures for healthcare etc. Air and water pollution also negatively affect health and well-being.
- High and rising inequality is an important challenge in the Western Balkan economies, as well as globally. Inequality is manifested not only in terms of income (as measured by the Gini coefficient), but also in all kinds of well-being outcomes – from access to quality education and healthcare, to municipal infrastructure, etc. Inequality is visible across various dimensions including gender, ethnicity, regions, and urban vs. rural areas.
- Economic outcomes are undermined by weaknesses in competitiveness, infrastructure and innovation, manifested in low job creation and high unemployment. Weaknesses in the quality and relevance of education also damage productivity and long-term growth prospects.
- Environmental outcomes are poor across all relevant SDGs. Air pollution is high, and is a major problem especially in the region's largest cities. Significant progress can be made in improving energy efficiency. Environmental degradation on land and below water represents a major challenge in most economies, as does the building of a circular economy.

## Table 1.2. Progress towards achieving the SDGs

| SDG | Albania | Bosnia and Herzegovina | North Macedonia | Montenegro | Serbia |
|---|---|---|---|---|---|
| **1 – No Poverty** | Challenges remain | SDG achieved | Challenges remain | Challenges remain | SDG achieved |
| **2 – Zero Hunger** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Major challenges remain | Significant challenges remain |
| **3 – Good Health and Well-Being** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **4 – Quality Education** | SDG achieved | Information unavailable | Challenges remain | Challenges remain | SDG achieved |
| **5 – Gender Equality** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **6 - Clean Water and Sanitation** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **7 - Affordable and Clean Energy** | Challenges remain | Significant challenges remain | Significant challenges remain | Challenges remain | Challenges remain |
| **8- Decent Work and Economic Growth** | Major challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **9 - Industry, Innovation and Infrastructure** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **10 - Reduced Inequalities** | Significant challenges remain | Significant challenges remain | Major challenges remain | Major challenges remain | Significant challenges remain |
| **11 - Sustainable Cities and Communities** | Significant challenges remain | Major challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **12 - Responsible Consumption and Production** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Major challenges remain | Significant challenges remain |
| **13 - Climate Action** | SDG achieved | Significant challenges remain | Significant challenges remain | Significant challenges remain | Challenges remain |
| **14 - Life Below Water** | Major challenges remain | Challenges remain | Information unavailable | Major challenges remain | Information unavailable |
| **15 - Life on Land** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Major challenges remain | Major challenges remain |
| **16 - Peace, Justice and Strong Institutions** | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain | Significant challenges remain |
| **17 - Partnerships for the Goals** | Significant challenges remain | Challenges remain | Challenges remain | Challenges remain | Challenges remain |

Note: An assessment is not yet available for Kosovo. The order of progress (from greatest to least) is as follows: SDG achieved; challenges remain; significant challenges remain; major challenges remain.
Source: (Sachs et al, 2021[8]), *Sustainable Development Report 2021: the Decade of Action for the Sustainable Development Goals*, https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

### *Structural economic challenges*

Significant outstanding structural challenges undermine the Western Balkan economies' competitiveness, investment environment and integration into global value chains (GVCs):

*Weak knowledge and skills hinder economic diversification and upgrading*

- **Improving the quality of education** is a major challenge for the six economies of the Western Balkan region (WB6). Student performance in international assessments, such as the Programme for International Student Assessment (PISA), is significantly behind OECD countries, as well as Central and Eastern European peers. For example, around 50% of students in the WB6 fail to achieve the baseline level of proficiency (level 2) in each of the three subjects tested by PISA

(mathematics, science and reading). By comparison, about 80% of OECD students achieve baseline proficiency across each of the three tested subjects (OECD, 2018[9]).

- There are many reasons for the poor quality of education at all levels, including low and inefficient spending on education. The relatively low spending on education is reflected in inadequate teaching facilities, limited access to technology and other teaching tools (OECD, 2020[10]). The quality of spending is also a challenge in many economies. For example, low student-teacher ratios result in high spending on teacher salaries, which does not translate into superior student performance (OECD, 2020[10]).
- **Skills gaps** are another important challenge for education in the Western Balkan economies. Skills gaps undermine investment and growth in existing sectors of an economy, and also limit the scope for economic upgrading through investment (including FDI) in more knowledge-based sectors. The employer Skills Measurement Program (STEP) survey conducted by the World Bank in a number of regional economies has pointed to skills gaps as a major cause of hiring difficulties (World Bank, 2021[11]). Meanwhile, a significant share of respondents to the Balkan Barometer survey do not feel that the skills they obtained during their education meet the needs of their jobs. The skills most lacking include technical skills, as well as more cognitive and behavioural skills such as communication, the ability to learn on the job, creativity, innovation and risk taking (Regional Cooperation Council, 2019[12]).

### *A challenging business climate undermines investment and private sector development*

Over the past decade, most Western Balkan economies have made progress in simplifying and streamlining administrative procedures to make it easier to start and operate businesses. This has helped boost their rankings in the Doing Business report. However, many challenges still persist, including high corruption, weak and costly contract enforcement, lengthy and costly licensing and permitting procedures, and high levels of informality (World Bank, 2020[13]).

- **Corruption** remains an important obstacle to doing business in the Western Balkan region. In recent enterprise surveys, firms from the WB6 economies noted a higher prevalence of corruption than did aspirational peers. Likewise, a large share of WB6 firms identified corruption as a major obstacle to doing business in the region. The challenge is particularly large in Kosovo, Albania and Bosnia and Herzegovina, according to the Business Environment and Enterprise Performance Survey (BEEPS). In Kosovo, for example, over 50% of surveyed firms identified corruption as a major constraint, compared to the Europe and Central Asia (ECA) average of 17.9%. The equivalent figure for Albania was over 43.4%, and 29.5% for Bosnia and Herzegovina. In Albania, 36.1% of firms stated that they had experienced at least one bribe payment request, which is considerably higher than the ECA average of 8.3% (World Bank, 2019[14]). The most recent Transparency International Corruption Perception Index ranks most economies in the Western Balkan region at over 100th place out of the 180 participating economies (Transparency International, 2020[15]).
- **Contract enforcement** is slow, costly and unreliable in the WB6 economies. It takes on average 542 days, which is somewhat faster than the OECD average (590 days), but considerably longer than the global leaders on the Doing Business index (164 days in Singapore) (World Bank, 2020[13]). In many economies, the process is slowed down by an overburdened court system which has a significant backlog of cases. At 34.5% of the claim value, contract enforcement is also costly compared to the OECD average of 21.5% (World Bank, 2020[13]). Finally, and perhaps most importantly, confidence is lacking in the judicial system's fair and impartial decision making, which elevates the uncertainty in contract enforcement. In the latest Regional Cooperation Council barometer survey, 58% of respondents in the WB6 stated that they do not trust the court system, while 64% stated that they do not believe that the judiciary is independent of political influence.

Likewise, 70% of WB respondents do not believe that the law is applied equally to everyone (Regional Cooperation Council, 2019[12]).

- **Obtaining licenses and permits** is also a relatively long and costly process in most WB6 economies. According to the latest Doing Business report, obtaining a construction permit in Albania, Bosnia Herzegovina and Kosovo takes on average 247 days (compared to a 152-day average for the OECD) and requires 18 procedures (compared to the OECD average of 13). The cost of obtaining these permits ranges from 5.2% of the warehouse value in Kosovo, to 20.3% in BIH (compared to 1.5% for the OECD) (World Bank, 2020[13]).
- **Unfair competition**, particularly from the informal sector, represents an important constraint for businesses in most WB6 economies. In the BEEPS enterprise survey, 44.5% of Western Balkan firms stated that they compete against informal firms, while 35.5% of firms stated that informal competition is a major obstacle for their business (World Bank, 2019[14]). The share of informal employment in the region is estimated at 17-40% (The Vienna Institute for International Economic Studies, 2019[16]).

### *Infrastructure deficiencies undermine investment, trade and GVC integration*

The infrastructure gap varies across economies. All economies face important challenges with respect to the size and quality of transport infrastructure, particularly in the railway sector, while some economies also experience important challenges in the reliability of electricity supply.

- **Deficiencies in transport infrastructure connectivity**: Road and railway density is low compared to CEEC[1] peers and the EU, and the quality of infrastructure in both transport modes is relatively weak due to underinvestment and inadequate maintenance (Eurostat, 2020[17]). The underdeveloped selection and implementation processes for transport infrastructure projects in the WB6 are also an obstacle to the efficient development of the transport network, although some WB6 economies (Albania and Serbia) have recently made progress in implementing more transparent and efficient project prioritisation processes.
- **The unreliable electricity supply** is an important obstacle to doing business in the region. According to the latest World Bank Enterprise Survey, around 30% of surveyed firms stated that they considered electricity supply to be a major constraint in 2019 (an increase of 10% since 2013) (World Bank, 2019[14]). High distribution losses are another important challenge, as all the WB6 economies experience higher levels of distribution losses (around 18.5% on average) than the EU (6.7%) and CEEC (5.2%) averages. This is particularly true for Albania and Kosovo, where electricity distribution loss levels are around 34% and 28% respectively (CEER, 2020[18]). The WB6 economies are all reliant on coal-fuelled electricity generation (around 50% in 2018), and have limited non-hydro renewable capacity, which limits their domestic generation potential and greenhouse gas emissions reduction capabilities (Eurostat, 2021[19]).

### *Poor access to finance hinders SME investment, innovation and technology adoption*

- **Access to finance** remains an important challenge across all Western Balkan economies, particularly for micro and small enterprises. These enterprises cannot meet the relatively stringent requirements for bank lending, including high collateral, turnover, credit history and other requirements. Furthermore, they have limited alternatives to bank financing. Progress has been made in many WB6 economies to boost financing for small and medium-sized enterprises (SMEs) through credit guarantee schemes, financing through national development banks, innovation funds and other public entities. Nevertheless, the financing gap still remains relatively wide; closing it will be an important challenge over the coming decade – especially if the region's governments wish to develop more competitive and innovative knowledge-based economies.

*Cross-cutting and sector-specific constraints undermine the growth of key sectors*

- **Agriculture** in the region is mainly characterised by smallholder and subsistence farming, high land fragmentation, low access to and take-up of new technologies, limited compliance with quality standards, limited access to finance, and, in some cases, high input costs. The result is low productivity and low value added per worker (the latter is roughly one-quarter of the EU average or less in most economies) (World Bank, 2021[1]).
- **Manufacturing** development, export growth and GVC integration are all constrained by weaknesses in infrastructure, customs and logistics and the business environment; by skills gaps and firms' limited capacities for technology adoption; and limitations in access to finance, among others. However, analyses of the WB6 economies' product spaces reveal considerable long-term potential for growth in the automotive industry (vehicle and engine parts), electronics, machinery and metal processing (OECD, 2019[20]).
- **Tourism** in the region is highly seasonal and mainly concentrated in those economies with coastlines – leading to over-crowded and congested coastal areas. Given their relatively small size, most economies have scope to benefit from more high-end tourism offers, but development of this theme is still limited. The development and upgrading of the tourism sector across the Western Balkan region are hampered by poor infrastructure, lack of quality standards, high pollution levels and environmental degradation, weak protection of cultural heritage, and weak branding and marketing.
- **Information and communication technology (ICT)** is a fast-growing sector in most Western Balkan economies and has considerable potential to boost the value added and exports of services across the region. However, the sector is constrained by infrastructure gaps, the low supply of skilled workers, weak collaboration between the sector and the relevant educational institutions, and lack of access to finance (particularly for start-ups) and high-risk venture capital.

*Weak management of public finances holds back long-term development*

- **Fiscal policy challenges** are considerable in many economies in the region. Revenue performance is weak due to a relatively narrow tax base, tax evasion and the large informal sector. Low tax rates and lack of tax progressivity in many economies further limit the scope for boosting revenues. On the other hand, a high and growing share of public expenditures go to public sector wages, as well as subsidies and transfers. This has not only limited the level of discretionary spending, as exemplified in the response to the COVID-19 pandemic – it has also had an impact on capital spending in many economies. In some economies, such as Albania and Montenegro, this has also had a strong impact on the levels of public debt and the sustainability of public finances. The economies' long-term development prospects will depend significantly on governments' efforts to widen the tax base, improve compliance and boost the efficiency and effectiveness of public spending and its targeting to areas with strong productivity enhancing potential (e.g. green infrastructure, health, education, etc.)

*Environmental degradation threatens long-term development and well-being*

- **Air pollution** has become an acute challenge in all the major cities of the WB6. For example, the exposure of the Western Balkan economies' populations to fine particulate matter ($PM_{2.5}$) is two to three times higher than the World Health Organization's (WHO) recommended highest levels of 10 $\mu g/m^3$ (OECD, 2021[7]). Air pollution levels are particularly high in the winter months, when pollution from ageing vehicles (the average age is considerably higher than in developed countries) and other sources is compounded by pollution from residential heating, often sourced from burning wood or coal.

- **All of the Western Balkan economies are highly prone to natural disasters** (e.g. floods, earthquakes and landslides) and have suffered significant economic and physical damage as a result. With the frequency and severity of some of these hazards likely to increase with climate change, the importance of addressing underlying man-made environmental degradation and strengthening adaptation to climate change will be critical over the coming decades (European Commission, 2020[21]).
- **Natural resource conservation** is critical for the well-being of people and wildlife, and has important economic benefits as well. For example, reducing land and water pollution and increasing biodiversity conservation would have a strong positive impact on the region's attractiveness for tourists and the potential for upgrading the tourism offer across all economies.

### *Inequality remains an important challenge*

- Over the past two decades, **incomes per capita and living standards have improved** across all the WB6 economies. Nevertheless, the gap between the WB6 and the average EU and OECD economies remains relatively large. The WB6 average GDP per capita (PPP adjusted) is less than 40% of the EU and OECD averages – and inequality remains a considerable challenge. The level of income inequality, as measured by the Gini coefficient, is relatively high. And there are also considerable regional and ethnic inequalities in access to education, and other public services, employment, etc. (Sachs et al, 2021[8]). For example, these inequalities disproportionally affect ethnic minorities such as the Roma, while regional disparities are also significant, with citizens living in large cities benefitting from higher incomes, better employment opportunities, better infrastructure and services than their rural counterparts. Fostering more inclusive growth is thus a critical challenge for the WB6 economies going forward.

### *Covid-19 has exacerbated structural challenges*

The COVID-19 pandemic has had a significant impact on the Western Balkan economies in 2020, with the regional GDP estimated to have declined by 3.3% on the back of falling domestic demand and exports (European Commission, 2021[4]). The biggest impact was felt in the second quarter (Q2) of 2020, when lockdown measures, disruptions to global value chains and travel restrictions strongly affected critical service and manufacturing sectors, including retail and wholesale trade, transport as well as tourism and hospitality. Despite some recovery in Q3 and Q4 as travel restrictions and lockdowns were lifted, it was relatively subdued due to high uncertainty in the midst of recurrent waves of the pandemic. As a result, in most regional economies GDP growth remained negative on a year-on-year basis in the second half of 2020.

The degree to which each economy has been affected by the crisis has depended on key economic fundamentals, the strength of the fiscal response as well as the relative strength of the pandemic wave. Montenegro was by far the most badly affected WB6 economy due to its high dependence on tourism, as well as its limited scope for a proportional fiscal response in light of the already high level of public debt. As a result, Montenegro's annual GDP declined by 15.2% in 2020. In Albania, meanwhile, the strong impact on the tourism sector and on domestic demand was mitigated by the recovery from the 2019 earthquake, resulting in a year-on-year GDP decline of 3.3% in 2020. Serbia's economy declined by just 1% in 2020 thanks to its more diversified economic base and the strong fiscal stimulus implemented to combat the economic fallout of the crisis. Meanwhile, the economies of Bosnia and Herzegovina and North Macedonia were more strongly affected by the second wave of the pandemic; this impact could not be lessened despite the additional stimulus measures implemented in the second half of 2020 (World Bank, 2021[22]).

The impact on the labour market was mitigated by government measures aimed at supporting employment and the liquidity of companies in the most critically affected sectors of the economy. Montenegro and

Bosnia and Herzegovina saw the highest increase in unemployment: in Montenegro by 3% (from 15.4% in 2019 to 18.4% in 2020) and in Bosnia and Herzegovina by 2.3% (from 15.7% in 2019 to 18% in 2020). In Albania, unemployment remained relatively unchanged (12% in 2019 to 12.2% in 2020), while in the other three economies the decline in unemployment continued despite the pandemic (European Commission, 2021[4]).

Many of the structural challenges described above have played a role in either amplifying the impact of the COVID-19 epidemic or limiting the scope of the policy responses to lessen its impact. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** As noted above, all WB6 governments introduced fiscal policy measures to stave off the economic and social impact of the crisis. The packages ranged in size and composition, but most included measures to stimulate employment retention (wage and socials security subsidies) and firm liquidity (deferred tax payments, reduced VAT rates for specific goods and services, SME credit guarantee schemes, etc.) and boost support for the poorest and most vulnerable households (cash transfers).
- The fiscal response has been critical for avoiding significant economic fallout from COVID-19, especially on labour market outcomes. However, it has resulted in a significant narrowing of the fiscal space. In Montenegro, for example, the fiscal deficit plunged to 11% in 2020 and public and publicly guaranteed debt rose to 109.2% of GDP. In Albania, a deficit of 6.7% resulted in a further increase in public and publicly guaranteed debt to 77.4% of GDP. In North Macedonia, public and publicly guaranteed debt increased by more than 10% in 2020, from 49.4% to 60% of GDP (World Bank, 2021[22]).
- In the context of weaker prospective revenues in the wake of the crisis, particularly if the recovery is slow, improving the efficiency of public spending will be critical over the coming months. Expenditures that can support the recovery and promote productivity growth and structural transformation must be prioritised to ensure stronger and more resilient long-term growth. This includes increasing public investment, which has suffered significantly due to high and rising current expenditures. The crisis has also highlighted the importance of rebuilding fiscal buffers in the post-crisis period. In addition to managing expenditures better, achieving this will also require tackling some of the structural constraints that undermine revenue performance.
- **Innovation and technology adoption:** The COVID-19 crisis has starkly demonstrated the importance of firm adaptability in meeting new challenges and changing circumstances. It has also revealed the advantages that firms which have embraced digitalisation and modern practices have over others. The resilience of the post-COVID recovery will therefore depend on addressing structural issues limiting firm innovation and technology (see Structural economic challenges section) and mainstreaming digitalisation and digital skills.
- **Access to finance:** The crisis highlights the significance of having a well-developed and diversified financial sector that can respond to the financing needs of enterprises – not only in times of crisis, but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis were government support for subsidised lending or lending guarantees. But a robust financial sector made up of diversified financial institutions that can provide financing for riskier and innovative ventures, and not just established enterprises, will be very important in the recovery phase and beyond.
- **Informality:** The large size of the informal sector, and the significant share of informal employment even within the formal sector, have limited the scope of the measures to protect the income and employment of people in the worst-affected sectors. Informality is widespread in the sectors most affected by the crisis, including retail trade and tourism. For example, a study in North Macedonia found that there were 33 000 informal jobs in the nine most vulnerable sectors to the COVID-19 pandemic, accounting for around 26% of total informal employment in the economy (ILO, 2020[23]).

This segment has not been able to benefit from government subsidies, favourable loan terms and loan guarantees or other support measures. Developing a more resilient economy will also depend on improving the incentives for formalisation of businesses and improving the oversight and sanctioning of non-compliance.

- **Health sector:** The pandemic has exposed some of the critical challenges that the WB6 health sectors were already facing. Some of these include lower government spending on health care than in EU and OECD countries, resulting in lower quality and poor access. Citizens' high out-of-pocket expenditures are another important challenge for the health systems in the region, with important implications for equality of access as well as quality of care (World Bank, 2021[1]). For example, during the pandemic the high cost of testing for the virus resulted in low propensity for testing, underestimation of the number of cases and more rapid contagion (EURACTIV, 2020[24]).

### *EU accession process*

All of the WB6 economies are committed to pursuing EU accession, and the approximation process has been an important anchor for reforms in the region over the past two decades. Of the WB6 economies, four (Albania, Montenegro, North Macedonia and Serbia) are candidates for EU accession and two (Bosnia and Herzegovina and Kosovo) are potential candidates. Since 2010, citizens of all the WB economies except for Kosovo have been able to travel visa-free to all EU Member States that are part of the Schengen area.

The importance of advancing on the socio-economic reform agenda remains a critical priority on the Western Balkan economies' journey to EU membership. The findings of this Competitiveness Outlook (CO) 2021 offer monitoring relevant to a number of critical chapters of the *acquis*, while its recommendations provide the guidance needed to meet the accession requirements. The Competitiveness Outlook also provides a good basis for assessing the critical challenges that the economies face as a starting point for developing their Economic Reform Programmes (Box 1.1)

#### Box 1.1. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services

10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[25]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[26]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

### *EU financial and development support*

The EU is the largest provider of external financial assistance to the Western Balkan economies. Since 2007, the EU has provided over EUR 12 billion in pre-accession funds aimed at strengthening democracy and the rule of law, strengthening competitiveness, boosting innovation in agriculture and rural development, reforming the public administration, improving energy and transport infrastructure and policies and fostering climate action. A further EUR 10.2 billion of financing has been provided through the European Investment Bank (EIB) since 1999, while financing of EUR 1.14 billion through the Western Balkans Investment Framework (WBIF) has leveraged additional investment worth an estimated EUR 16.4 billion. Finally, the EU has provided significant grant financing to support disaster relief and reconstruction in the aftermath of the floods that have affected many regional economies, as well as the disastrous earthquake that struck Albania in 2019 (European Commission, 2021[27]).

In addition to the grant funding and lending, the EU also provides important support through guarantees for public and private investment to reduce the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade (European Commission, 2020[28]).

The Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the WBIF, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment to support better connectivity in the WB region. It also represents the first step in implanting the flagship projects under the Economic and Investment Plan for the region (European Commission, 2021[29]).

The EU has also been instrumental in supporting the Western Balkan economies in their response to the COVID pandemic. This included more than EUR 500 million in repurposed IPA 2014-2020 financing to cover the urgent needs of the health sector, support economic and social recovery in the aftermath of the crisis, and to help WB countries gain access to COVID-19 vaccines through a EUR 70 million package adopted in December 2020. In addition, in February 2021, a joint EU/WHO project provided assistance of EUR 7 million to support vaccination readiness and health sector resilience in the region (European Commission, 2021[29]). The WB economies have also been recipients of the EU's regional economic reactivation package of EUR 385 million. A further EUR 500 million was provided in macro-financial assistance to support the economic recovery in Albania, Kosovo, Montenegro and North Macedonia, while the European Investment Bank mobilised EUR 1.7 billion, bringing the EU financial response to COVID-19 in the Western Balkans to more than EUR 3.3 billion in total.

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## Notes

[1] The 11 Central and Eastern European countries (CEECs) joining the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

# 2 Assessment methodology and process

## Introduction

The publication series, Competitiveness in South East Europe: A Policy Outlook (Competitiveness Outlook), provides a comprehensive assessment of competitiveness reforms in the six Western Balkan (WB6) economies: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia. The publication uses international and OECD good practice to design sustainable economic reform agendas that enable policy makers to achieve greater competitiveness for their economies.

As the third edition of the Competitiveness Outlook series, the Competitiveness Outlook 2021 provides an important benchmarking tool that monitors the development, implementation and performance of policies affecting a broad range of policy areas. Its methodology has been only marginally refined in comparison to the 2018 edition, thus making it possible to track progress on policy design and implementation over time. This integral feature supports the domestic policy cycle by equipping policy makers with a tool to measure progress, ensure stronger co-ordination and consistency between policies and identify policy priorities. Likewise, the Competitiveness Outlook's collaborative assessment process is itself a vital exercise that fosters government capacity by integrating the perspectives of government and non-government stakeholders in order to identify the primary economic challenges in an economy and develop tailored policy reforms to address them. This collaborative approach seeks to provide policy makers with a robust source of evidence-based guidance on how to achieve greater economic competitiveness and prosperity.

For the first time in the Competitiveness Outlook series, economy-specific profiles for each of the six WB6 economies offer an in-depth analysis of the key policy areas for strengthening competitiveness post-COVID-19. The inclusion of economy-specific profiles enables this edition of the Competitiveness Outlook to provide individualised structural reform recommendations tailored to the specific challenges of each of the Western Balkan economies.

This assessment cycle of the Competitiveness Outlook took place during the COVID-19 pandemic that began in early 2020. The COVID-19 related developments in France and the Western Balkans had a significant impact on the project activities. Multiple lockdowns in Europe and the Western Balkan economies over the course of 2020 created new challenges associated with remote working and other atypical working conditions. The extraordinary challenges presented by the pandemic necessitated major modifications to the planned project activities. Accordingly, this assessment process used a flexible and innovative approach to successfully conduct data collection and analysis, as well as to engage in the extensive policy dialogue that this assessment requires (Box 2.2).

## Scope

Although the term "competitiveness" is frequently used by academics, policy makers and the general public, it lacks a common definition and can have different meanings in different contexts, such as a firm, industry, regional, national or supranational context. Academics have attempted to find general definitions that recognise the multi-dimensional character of competitiveness and that can be more practical when applied at the macro level.

The Competitiveness Outlook uses the following three definitions of competitiveness, which all include the concept of sustainability and go beyond an exclusive focus on cost competitiveness and GDP:

- "The ability of companies, industries, regions, nations or supranational regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a sustainable basis" (Hatzichronoglou, 1996[1]).
- "A measure of an economy's ability to provide its population with high and rising standards of living and high rates of employment on a sustainable basis" (EC, 2012[2]).

- "The ability of a country (region, location) to deliver the beyond-GDP goals for its citizens, today and tomorrow" (Aiginger, Bärenthaler-Sieber and Vogel, 2013[3]).

These holistic definitions imply that to increase an economy's competitiveness, policy reforms should not be pursued in isolation. Instead, they should seek a comprehensive approach with co-ordinated actions across a variety of policy areas, enabling them to build on one other. In order to achieve this holistic policy-making process, the Competitiveness Outlook 2021 used a collaborative assessment approach encompassing 16 policy dimensions. These dimensions are grouped under four key pillars that are crucial for strengthening competitiveness (Table 2.1).

### Table 2.1. Policy dimensions assessed in the Competitiveness Outlook 2021

| Pillar | Policy dimension |
|---|---|
| **I. Business environment** | 1. Investment policy and promotion |
| | 2. Trade policy |
| | 3. Access to finance |
| | 4. Tax policy |
| | 5. Competition policy |
| | 6. State-owned enterprises |
| **II. Skills and capacity** | 7. Education policy |
| | 8. Employment policy |
| | 9. Science, technology and innovation |
| | 10. Digital society |
| **III. Economic structure** | 11. Transport policy |
| | 12. Energy policy |
| | 13. Environment policy |
| | 14. Agriculture policy |
| | 15. Tourism policy |
| **IV. Governance** | 16. Anti-corruption policy |

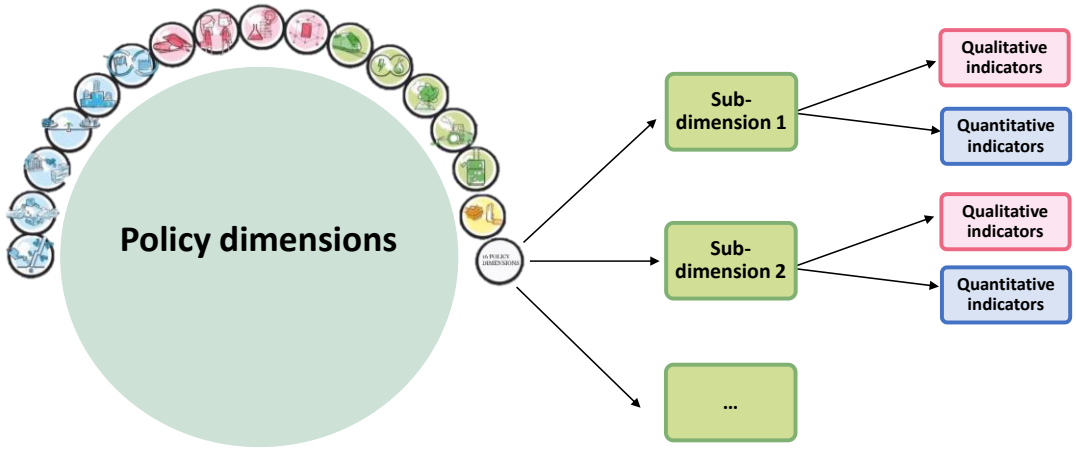
## Methodology

The Competitiveness Outlook's methodology is designed to provide an evidence-based assessment of progress in the design and implementation of policies related to overall economic competitiveness. The assessment is based on a set of indicators that have been tailored to each of the 16 policy dimensions and evaluated using a highly participatory process that involves more than 700 local stakeholders.

### *The overall assessment approach*

Each policy dimension is divided into several sub-dimensions that highlight the key elements of that policy area. The sub-dimensions in turn are composed of qualitative and quantitative indicators (Figure 2.1), which capture the design, implementation and performance of policies, processes and institutions. To reflect the latest trends in OECD economic policy research and good practice developed since the previous Competitiveness Outlook (2018) (OECD, 2018[4]), new qualitative and quantitative indicators have been included across the 16 assessment frameworks. Moreover, the assessment has been designed to inform economies on their progress towards achieving the UN Sustainable Development Goals.

### Figure 2.1. The Competitiveness Outlook 2021 overall assessment approach




The indicators in the Competitiveness Outlook's 2018 edition were taken as a basis for this publication and further refined in order to increase the focus on critical areas and to integrate additional OECD tools and instruments (Box 2.1). The set of indicators used for each of the 16 policy dimensions can be found in the "assessment framework" included at the beginning of each chapter.

#### Box 2.1. Refinements to the Competitiveness Outlook 2021

The Competitiveness Outlook 2021 has introduced new features that build on the assessment framework used during the 2018 edition to strengthen the analysis and increase its salience and impact. These include:

- refined assessment materials to increase the focus on certain critical areas identified by updated OECD methodologies and best practice
- collaborative, cloud-based assessment materials to encourage stronger participation across governments
- more extensive collaboration with OECD directorates and bodies, including an increased application of OECD instruments to Western Balkan economies and more detailed questionnaires to capture more nuanced qualitative information
- six economy-specific profiles containing:
  - an overview of the economy's key economic features and structural challenges
  - an overview of the economy's progress towards achieving the UN Sustainable Development Goals
  - a comprehensive, economy-level analysis and targeted policy advice for each of the 16 policy dimensions

### *Qualitative indicators*

Qualitative indicators assess whether competitiveness-enhancing policy settings, strategies, processes or institutions exist and, if so, the extent to which they have been adopted, implemented, monitored and updated. Each qualitative indicator is assigned a numerical score that reflects the level of policy development and implementation in order to facilitate the comparison of performance among the Western Balkan economies (Figure 2.2).

## Figure 2.2. Qualitative indicators: what does the scoring mean?




Table 2.2 illustrates how the general structure of the scoring scale used to measure qualitative information has been translated into level descriptors, using the environment policy dimension's climate change mitigation and adaptation indicator as an example.

## Table 2.2. Climate change mitigation and adaptation scoring levels

| Level | Level descriptor |
|---|---|
| Level 5 | Impact assessments on climate change mitigation and adaptation policy, legal and institutional outcomes are regularly conducted with clear accountability mechanisms for government bodies in place. |
| Level 4 | Advanced implementation of approved climate change adaptation and mitigation policy framework, with the policy framework aligned with related policy areas including waste management and sectoral policies such as trade, innovation, industry and agriculture. The implementation is regularly monitored and adjusted if needed. |
| Level 3 | Evidence of policy implementation as measured by programme outputs and inputs of the approved climate change adaptation and mitigation policy. Government bodies' human and financial resources are adequate for executing relevant responsibilities. |
| Level 2 | A policy framework addressing climate change adaptation and mitigation is in place and has clear strategic vision linked with national economic and social objectives, clear and measureable objectives, defined actions and measures. |
| Level 1 | A policy framework addressing climate change mitigation and adaptation is under development – government activity in framework drafting, conducting stakeholder consultations, and/or progressing through the adoption process. |
| Level 0 | A policy framework addressing climate change adaptation and mitigation does not exist or is obsolete. |

Policy dimension and sub-dimension average scores are generated by calculating a simple average across the relevant qualitative indicator scores. Indicators are not weighted because the relative importance of each indicator may be different to different stakeholders. Average scores should therefore be interpreted with caution and taken only as a rough estimate of overall policy development.

Unlike the other 15 policy dimensions assessed in this edition, where indicators are allocated a score from one to five, the assessment of the four qualitative policy areas and one quantitative policy area in the Competition policy dimension is based on yes/no (coded as 1/0) answers to 71 questions in a questionnaire (listed in the Annex to the Competition policy chapter). Where a response to a question is yes (coded as 1), this is referred to as an adopted criterion. Each of the five policy areas has a different number of possible

criteria that can be stated as having been adopted. For more information, please see the Competition policy chapter.

### *Quantitative indicators*

The quantitative indicators are input and output factors pertinent to the assessment of policies, policy making, institutional conditions and policy results – e.g. public or private spending in the policy field in question; the share of actors engaging in a certain activity; or the volume of a certain output resulting from a policy or economic activity. They complement qualitative indicators by supplying quantifiable information on the performance of policy settings, processes and institutions.

The Assessment framework part in each of the 16 policy dimension chapters provides an overview of the qualitative and quantitative indicators used to assess this policy dimension.

## The assessment process

The Competitiveness Outlook 2021's assessment process consisted of four main phases, conducted between October 2019 and June 2021: 1) the design phase; 2) the evaluation phase; 3) the consolidation phase; and 4) the review and publication phase:

1. **Design phase (October 2019 – March 2020)**

In this phase, the OECD developed the qualitative and quantitative questionnaires to assess each of the 16 policy dimensions. This process constituted extensive research to ensure that the latest international and OECD good practice were incorporated into the assessment frameworks for each policy dimension. For each qualitative indicator assessed, the OECD compiles a table, which lists the necessary elements that need to be met to attain a certain score level. Respondents have to complete a set of yes/no, multiple-choice and open-ended questions. The answers to these questions and the listed criteria for each score level enable the respondents to self-evaluate the score for this indicator. For every answer, the OECD asks respondents to provide supporting evidence (e.g. adopted strategies, legislation, monitoring reports, etc.), which is subsequently verified and the score level either confirmed or revised. The quantitative questionnaires are tailored to each economy depending on the extent to which statistical data are already available to the OECD. Only quantitative indicators for which data are not available publicly are included in the quantitative questionnaire. The qualitative and quantitative questionnaires had to be digitalised and complemented with additional guidance documents following the impact of the COVID-19 pandemic (Box 2.2).

2. **Evaluation phase (April – November 2020)**

This phase consisted of the government self-assessment. It was led by a designated Government Co-ordinator (see Acknowledgements for a list of names), and co-ordinated with the help of policy dimension and statistical office contact points in each economy. Since the qualitative and quantitative questionnaires for each policy dimension always cover several sub-dimensions (Figure 2.1), their completion called for an inclusive approach which led to extensive collaboration among different ministries, public agencies and statistical offices in each WB6 economy, often underpinned by dedicated working groups. Completing the OECD questionnaires thus enabled WB6 policy makers of different institutions working in the same policy field to reflect together on the most pressing challenges, priorities and most suitable way forward for their policy field. This phase also enabled WB6 policy makers to reflect on the roles of their respective services in the policy dimension in question, forge closer ties across different institutions, and to improve future inter-ministerial collaboration for holistic policy making beyond this assessment. Remaining information and data gaps were filled through virtual fact-finding meetings with relevant government stakeholders as well as local non-government stakeholders.

### 3. Consolidation phase (December 2020 – March 2021)

The results of the government self-assessments were consolidated into draft economy profiles and draft regional policy chapters whose key findings and initial policy recommendations were presented at seven stakeholder meetings (one for each WB6 economy and one regional meeting). While these meetings were held in the six Western Balkan capitals in previous assessment cycles, COVID-19 restrictions meant that the roundtables had to be held virtually. The meetings brought together Western Balkan government officials as well as international donor representatives and ambassadors from a number of interested EU and OECD countries. The consolidated assessment and first policy recommendations for each policy area were discussed with the meeting participants and formed the basis for completing the draft economy profiles and regional chapters of the Competitiveness Outlook 2021 publication.

### 4. Review and publication phase (January – June 2021)

The 6 draft economy profiles and 16 regional chapters were shared with Western Balkan government officials and experts across the OECD, the European Commission, and regional expert organisations for comprehensive review. Their helpful feedback and comments helped to maximise the accuracy of the publication's analysis as well as its salience for local policy makers. Subsequently, the OECD prepared the report for publication. The publication was released at the Berlin Process Summit on 5 July 2021.

#### Box 2.2. The impact of COVID-19 on the project

The COVID-19 pandemic triggered lockdowns around the world, requiring a novel approach to this assessment cycle of the Competitiveness Outlook. In light of these extraordinary developments, the OECD team adopted the following measures:

- All assessment materials (qualitative and quantitative questionnaires) were transformed into digital formats designed to be accessible and easy to use for all who contributed to the assessment. This approach made it possible for multiple persons to remotely access and work on the assessment materials simultaneously, which was an essential feature during the multiple lockdowns and confinements implemented across the Western Balkans.
- Since the assessment materials could not be explained to WB6 policy makers during dedicated assessment launch meetings, the OECD team prepared extensive explanatory documents for the completion of each policy dimension's assessment materials, including dimension-specific tutorials explaining the assessment framework and the specific elements that merit further clarification, as well as two guidance notes with step-by-step explanations for the completion of the qualitative and quantitative questionnaires.
- In lieu of the planned assessment launch events in each WB6 economy, the OECD team organised individual dimension-specific virtual launch meetings, requiring 77 virtual kick-off meetings to be organised with government dimension co-ordinators, statistical office representatives and their teams.
- In order to retain the vital policy dialogue that underpins each phase of the assessment cycle, the preliminary key findings of each economy profile and the regional policy chapter were presented virtually during 7 virtual stakeholder meetings attended by a total of about 750 stakeholders. This enabled policy makers in the Western Balkans to further contribute to the OECD's findings and incorporate policy developments that occurred after the initial data collection phase was finalised.

Despite these measures, the challenges created by the COVID-19 pandemic caused some delays in the input collection process. A number of dimension co-ordinators of the Competitiveness Outlook 2021 became ill with COVID-19 and needed to be temporarily replaced, necessitating multiple additional kick-off meetings and calls with individuals newly included in the assessment process. Moreover, mandatory lockdowns and teleworking in the Western Balkans negatively affected the co-ordination across various administrative units, which also slowed down the government self-assessment data-collection process.

### The participatory nature of the Competitiveness Outlook 2021 assessment process

The Competitiveness Outlook's methodology is complemented by a participatory assessment process which has been designed to foster peer learning, to create consensus on reform priorities and to facilitate stakeholder co-ordination. The participatory basis of the publication is reflected in the high number and diversity of stakeholders included in the assessment and the Competitiveness Outlook meetings and roundtables (Table 2.3).

**Table 2.3. Competitiveness Outlook assessment: stakeholders and meetings**

| | |
|---|---|
| **Involved stakeholders:** | 8 Western Balkan Government Co-ordinators<br>128 Western Balkan Policy Dimension Contact Points<br>95 Western Balkan Statistical Office Contact Points<br>More than 550 Western Balkan Government Officials<br>6 local expert consultant agencies<br>Representatives from the private sector, academia, civil society and international donor organisations |
| **Meetings and roundtables:** | 77 assessment kick-off meetings<br>27 fact-finding meetings<br>6 economy-specific stakeholder meetings<br>1 regional stakeholder meeting |

The involvement of these stakeholders strengthened the analysis in terms of data collection. In turn, the stakeholders engaged in gainful exchanges among themselves and with the OECD on concrete policy issues. This participatory approach is a particular strength of the Competitiveness Outlook, enabling the assessment process to:

- catalyse positive organisational change through government self-assessment and roundtables which ask stakeholders to judge the success of current policies and resource allocations, while identifying possible directions for improvement
- strengthen inter-ministerial consultation by asking Western Balkan government officials across various ministries and agencies to exchange and co-ordinate with one another as they assess the policy dimensions, as well as by bringing them together during economy-specific stakeholder meetings to reflect on the roles of their respective services in the policy dimension in question
- encourage Western Balkan statistics offices and government bodies to produce new or more frequent statistics through the process's demand for key indicators for assessing competitiveness
- support regional integration and a regional perspective on policy issues by virtue of the regional virtual stakeholder meeting.

## The strengths and limitations of the Competitiveness Outlook 2021

The Competitiveness Outlook 2021 possesses a number of strengths which make it a uniquely valuable tool for Western Balkan policy makers, citizens, researchers, as well as investors and international donor organisations. Table 2.4 lists the Competitiveness Outlook's main strengths, as well as its limitations.

### Table 2.4. Strengths and limitations of the Competitiveness Outlook 2021

| Strengths | Limitations |
|---|---|
| Six economy profiles provide accurate and salient analysis and recommendations tailored to the specific context and needs of each economy | While the Competitiveness Outlook 2021 focuses on areas crucial for strengthening competitiveness in the Western Balkans, it does not cover all areas of competitiveness exhaustively |
| Independent and rigorous assessment enables performance to be benchmarked against peer economies and OECD good practice | Statistical coverage of many issues is limited in the region and the economy-specific context of the quantitative data cannot always be acknowledged |
| The government self-evaluation acts as a change management tool and creates a process that enhances the quality of pro-competitiveness policy development | As the same set of indicators is applied to all economies in the region, certain economy-specific characteristics may not be fully reflected in the scoring |
| Good practice examples and policy recommendations offer guidance to policy makers in designing or redefining a sustainable economic reform agenda to foster competitiveness | The benchmarking potential of certain policy areas is limited as some qualitative indicator score levels were refined for the 2021 edition of the Competitiveness Outlook |
| The analysis draws on both original data collected by the OECD and existing data collected by other organisations | |
| The participatory assessment process enables stakeholder dialogue on policy, joint learning, and agreement on identified strengths and shortcomings to help build consensus for future reform | |
| Scoring levels by policy dimension helps public officials communicate more effectively on policy progress and areas where future reform is necessary | |
| Economy-specific contexts and other wide-ranging factors that affect competitiveness and policy development underpin the analysis and supplement the scores | |

## References


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# 3 Overview of key findings

This chapter provides an overview of the key findings of the Competitiveness Outlook 2021 for each of the 16 policy dimensions covered in the assessment, as well as the complete scores for each dimension, sub-dimension and qualitative indicator. Full details of the methodology and the background to this assessment are contained in the Assessment methodology and process chapter.

## Key findings by dimension

### *Dimension 1: Investment policy and promotion*

Overall, the markets in all WB6 economies are open to FDI, and exceptions to national treatments are limited. All the economies have established regulatory environments for investment and foreign investors have the same rights and remedies before their court systems as domestic investors. However, commercial disputes are costly and lengthy in WB6 most economies, and public awareness, familiarity and use of dispute resolution tools remain low in general. All six economies have established investment promotion agency (IPA) structures and strategies to promote and facilitate investment efficiently. Most IPAs are autonomous public agencies similar to those in OECD countries. The IPA boards in the region have varying compositions, and their roles range from supervisory to advisory. However, all mandates include the promotion and facilitation of inward FDI. In addition, export and innovation promotion are the most recent additions to the investment promotion mandate of the region's agencies. However, financial constraints are an important common challenge for the region's IPAs. All WB6 economies are generally in the early development stages of green investment policy and promotion initiatives. Every economy has shown commitment to establishing and revising environmentally conscious legislation and long-term strategies for the environment. Yet only half of the economies have a clear strategy or programme for attracting and incentivising green investment, or clearly outlining green growth priorities.

**Table 3.1. Scores and indicators for investment policy and promotion**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **1. Investment policy and promotion dimension average** | **3.1** | **2.7** | **2.0** | **3.0** | **3.2** | **3.9** | **3.0** |
| **1.1. Investment policy framework** | **2.9** | **2.9** | **2.4** | **3.5** | **3.6** | **4.1** | **3.2** |
| Legal frameworks for investment | 3.5 | 2.0 | 2.5 | 3.0 | 3.5 | 4.0 | 3.1 |
| Exceptions to national treatment | 3.5 | 3.5 | 4.0 | 3.5 | 4.0 | 4.0 | 3.8 |
| Investor protection against expropriation | 3.0 | 4.0 | 2.0 | 4.0 | 3.0 | 4.5 | 3.4 |
| Alternative dispute resolution | 2.0 | 2.5 | 2.0 | 3.5 | 3.5 | 4.0 | 2.9 |
| Intellectual property rights legal framework | 3.0 | 3.0 | 2.0 | 4.0 | 4.0 | 4.0 | 3.3 |
| Intellectual property rights enforcement | 2.0 | 2.5 | 2.0 | 3.5 | 3.0 | 4.0 | 2.8 |
| Intellectual property rights awareness raising and access to information | 3.5 | 2.5 | 2.0 | 3.0 | 4.0 | 4.0 | 3.2 |
| **1.2. Investment promotion and facilitation** | **3.4** | **2.7** | **2.4** | **2.8** | **2.8** | **3.9** | **3.0** |
| Investment promotion agency structure and strategy | 4.0 | 2.0 | 2.0 | 3.0 | 2.0 | 4.0 | 2.8 |
| Investment facilitation services and activities | 3.5 | 2.0 | 3.0 | 2.0 | 2.5 | 3.5 | 2.8 |
| Investor targeting | 3.5 | 3.5 | 2.0 | 3.0 | 3.5 | 4.0 | 3.3 |
| Investor incentives | 2.5 | 2.5 | 1.0 | 4.0 | 2.5 | 4.0 | 2.8 |
| Aftercare activities | 3.5 | 3.5 | 4.0 | 2.0 | 3.5 | 4.0 | 3.4 |
| **1.3. Investment for green growth** | **2.8** | **2.0** | **0.0** | **1.5** | **3.0** | **3.0** | **2.0** |
| Green investment policy and promotion | 3.0 | 2.5 | 0.0 | 1.0 | 3.0 | 3.0 | 2.1 |
| Choosing public and private provisions for green growth | 2.5 | 1.5 | 0.0 | 2.0 | 3.0 | 3.0 | 2.0 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Investment policy and promotion chapter for more information about the scoring in this particular policy dimension.

### *Dimension 2: Trade policy*

Policy frameworks for trade have been strengthened in all WB6 economies. Inter-institutional co-ordination is also strong in most economies, and there are formal instruments for consultation with the private sector. However, implementation and evaluation vary across economies. The WB6 economies are well integrated commercially with their main trading partners – i.e. the EU and each other – within the Central European Free Trade Agreement (CEFTA). However, integration with other economies is still rather limited. While the WB6 continue to develop their networks of bilateral and multilateral trade agreements, they do so at varying rates, and treaties with non-EU states are still relatively rare. Global integration is still an issue, with Bosnia and Herzegovina and Serbia's accession process to the World Trade Organization (WTO) still ongoing. This may limit the benefits of favourable regulatory regimes for FDI. Notable improvements have been made in the sphere of trade in services through the adoption of Additional Protocol 6 to CEFTA in December 2019. This has given impetus in the region to reform the regulatory regimes for services. Nevertheless, the extent of liberalisation depends on the economy and the sector under analysis. A number of regulatory restrictions remain, limiting the attractiveness of certain sectors to foreign providers even though the region is relatively open to trade. In e-commerce, all economies have taken steps to strengthen their legal frameworks. They have continued to align their sectoral laws with the EU E-Commerce Directive and have made efforts to remove non-tariff barriers to e-commerce. The emergence of the global pandemic and the growing importance of digital trade have driven government responses in this area. However, with regulatory frameworks evolving heterogeneously across the WB6, the economies respond differently to the challenges of global e-commerce.

#### Table 3.2. Scores and indicators for trade policy

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **2. Trade policy dimension average** | **3.3** | **2.5** | **3.5** | **3.8** | **3.2** | **3.8** | **3.4** |
| **2.1. Trade policy framework** | **3.5** | **2.8** | **3.8** | **3.8** | **3.5** | **3.8** | **3.5** |
| Institutional co-ordination on trade policy formulation | 3.5 | 2.5 | 3.5 | 4.0 | 3.5 | 4.0 | 3.5 |
| Public-private consultation | 3.5 | 3.0 | 4.0 | 3.5 | 3.5 | 3.5 | 3.5 |
| Network of free-trade agreements | n.a. | | | | | | |
| OECD Trade Facilitation Indicators | | | | | | | |
| **2.2. Trade in services restrictiveness** | **n.a.** | | | | | | |
| Transport and distribution supply chain | n.a. | | | | | | |
| Market bridging and supporting services | | | | | | | |
| Physical infrastructure services | | | | | | | |
| Digital network services | | | | | | | |
| **2.3 E-commerce and digitally enabled services** | **3.0** | **2.0** | **3.0** | **4.0** | **2.5** | **4.0** | **3.1** |
| E-commerce policy framework | 3.0 | 2.0 | 3.0 | 4.0 | 2.5 | 4.0 | 3.1 |
| Trade in digitally enabled services restrictiveness | n.a. | | | | | | |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Trade policy chapter for more information about the scoring in this particular policy dimension. N.a. = indicator has a different scoring system so results are presented in the text, not in the table.

### *Dimension 3: Access to finance*

The legal and regulatory frameworks for the banking industries are generally well developed in all WB6 economies, being aligned with Basel II and III requirements. The private sector relies heavily on bank financing in the region. However, collateral requirements remain high, hindering small and growing businesses from accessing credit and securing loans. The six economies have all improved their alternative financing sources, although in practice the use of alternative financing tools is limited in the region. The most progress has been made on regulations for factoring and leasing policies: all WB6 economies have legal frameworks to regulate factoring options and leasing services benefit from dedicated legislation. Private equity and venture capital are generally in the early stages of development in the region, as is crowdfunding. With the exception of Montenegro, none of the WB6 economies have dedicated laws for crowdfunding. Business angel networks are increasingly being used despite the lack of legal frameworks for defining and regulating them. When it comes to the mobilisation of long-term financing, each WB6 economy has adopted a dedicated legal framework for public-private partnerships (PPP) that enables private participation in infrastructure projects. They also have a specialised government entity that facilitates PPP programmes. According to an external assessment, the region performs best on procurement of PPPs, though there is room for improvement in the preparatory activities that take place prior to launching the procurement process for a PPP project. Access to equity capital through the stock market is limited. The low level of activity and liquidity in the stock market is a barrier for companies using it to raise new capital.

**Table 3.3. Scores and indicators for access to finance**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **3. Access to finance dimension average** | **2.5** | **2.3** | **2.1** | **2.4** | **2.7** | **3.3** | **2.6** |
| **3.1. Access to bank finance** | **3.5** | **3.1** | **3.4** | **3.0** | **3.1** | **4.4** | **3.4** |
| Banking industry | 3.5 | 3.3 | 3.0 | 3.0 | 3.5 | 4.5 | 3.5 |
| Register | 4.0 | 3.0 | 4.0 | 3.0 | 4.0 | 4.5 | 3.8 |
| Collateral requirements | 2.5 | 2.5 | 2.5 | 2.0 | 2.5 | 3.5 | 2.6 |
| Credit information services | 4.0 | 3.5 | 4.0 | 4.0 | 2.5 | 5.0 | 3.8 |
| **3.2. Access to alternative financing sources** | **2.0** | **1.6** | **1.8** | **1.6** | **2.1** | **2.5** | **1.9** |
| Factoring | 3.5 | 3.5 | 3.5 | 2.5 | 4.0 | 4.0 | 3.5 |
| Leasing | 3.5 | 4.0 | 4.0 | 3.5 | 3.5 | 4.0 | 3.8 |
| Private equity, venture capital | 1.0 | 1.0 | 1.5 | 1.5 | 2.0 | 2.0 | 1.5 |
| Business angel networks | 0.0 | 0.0 | 1.0 | 1.0 | 1.0 | 1.0 | 0.7 |
| Crowdfunding | 0.0 | 0.0 | 0.0 | 0.5 | 1.0 | 0.0 | 0.3 |
| Blockchain | 4.0 | 1.0 | 1.0 | 0.5 | 1.0 | 4.0 | 1.9 |
| **3.3. Mobilisation of long-term financing** | **2.3** | **3.0** | **0.5** | **3.5** | **3.5** | **3.8** | **2.8** |
| Access to stock markets | 2.5 | 3.0 | 0.0 | 3.5 | 3.5 | 3.5 | 2.7 |
| Access to bond markets | 2.0 | 3.0 | 1.0 | 3.5 | 3.5 | 4.0 | 2.8 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Access to finance chapter for more information about the scoring in this particular policy dimension.

### *Dimension 4: Tax policy*

In general, the WB6 economies have made significant efforts to strengthen their tax administrations. They all have a unified tax administration body (except for Bosnia and Herzegovina due to its specific institutional setup), reflecting OECD best practice. All the tax administrations mix a taxpayer with a functional approach. This means that their internal organisation mostly reflects the various tax administration functions (audit, tax collection, taxpayer services, etc.), but there are also divisions targeted at specific taxpayer groups, such as large taxpayers or small and medium-sized enterprises (SMEs). The WB6 economies rely significantly on revenues from social security contributions (SSC) and taxes on goods and services to fund their health system and public spending programmes. Consequently, other taxes play a smaller role. Revenues from personal income tax (PIT) are low in the region, partly explained by low PIT rates and high basic allowances. The WB6 economies could consider rebalancing revenue from SSCs to PIT, perhaps with those economies with flat rates introducing a progressive PIT rate schedule. The region's involvement with international tax initiatives and alignment with international tax trends are increasing. Notably, since the last assessment all the economies with the exception of Kosovo, have joined the Inclusive Framework on base erosion and profit shifting (BEPS), and have also implemented the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. In addition, the WB6 economies all carry out some form of regional co-operation and co-ordination. However, the region would benefit from greater regional tax co-ordination and tax co-operation to tackle tax avoidance and evasion coherently.

**Table 3.4. Scores and indicators for tax policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **4. Tax policy dimension average** | **2.8** | **2.6** | **3.4** | **3.3** | **2.8** | **3.1** | **3.0** |
| **4.1. Tax policy framework** | **3.0** | **2.9** | **2.8** | **3.0** | **2.0** | **2.0** | **2.6** |
| Investment incentives | 3.0 | 3.0 | 2.0 | 3.0 | 2.0 | 2.5 | 2.6 |
| Tax revenues | 3.0 | 2.8 | 3.0 | 3.1 | 2.0 | 3.0 | 2.8 |
| Modelling and forecasting | 3.0 | 3.3 | 3.0 | 5.0 | 3.0 | 2.5 | 3.3 |
| Tax expenditure reporting | 3.0 | 2.5 | 3.0 | 1.0 | 1.0 | 0.0 | 1.8 |
| **4.2. Tax administration** | **2.7** | **2.4** | **4.0** | **3.5** | **3.4** | **3.9** | **3.3** |
| Functions and organisation | 3.0 | 1.5 | 4.0 | 3.0 | 3.0 | 5.0 | 3.3 |
| Compliance assessment and risk management | 3.0 | 3.5 | 4.0 | 3.9 | 3.0 | 3.5 | 3.5 |
| Independence and transparency | 0.5 | 0.0 | 4.0 | 3.0 | 3.0 | 2.5 | 2.2 |
| Tax filing and payment procedures | 3.0 | 3.3 | 4.0 | 3.3 | 4.0 | 3.5 | 3.5 |
| Taxpayer services | 4.0 | 3.8 | 4.0 | 4.5 | 4.0 | 5.0 | 4.2 |
| **4.3. International co-operation** | | | | **n.a.** | | | |
| International taxation framework | | | | n.a. | | | |
| Digital taxation | | | | | | | |
| Regional co-operation | | | | | | | |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Tax policy chapter for more information about the scoring in this particular policy dimension. N.a. = indicator has a different scoring system so results are presented in the text, not in the table.

### *Dimension 5: Competition policy*[1]

Overall, the WB6 economies' legal and institutional competition frameworks are largely aligned with best international practice, including EU competition rules. Although the WB6 competition authorities are committed to enforcing competition rules and advocating against competitive restrictions in laws and regulations, they are limited by a lack of financial and professional resources. In general, implementation of competition decisions is still insufficient, especially for cartels. Above all, sanctions for infringers are not high enough to deter firms from engaging in anti-competitive conduct. Moreover, the fight against cartels

requires the WB6 competition authorities to make full use of their investigative powers, yet some of the WB6 competition authorities have not yet carried out inspections, and others have only started very recently. All WB6 competition authorities have engaged in competition advocacy, which is a necessary element of competition enforcement to avoid legal constraints and promote a culture of competition.

### *Dimension 6: State-owned enterprises*

Most of the WB6 economies lack ownership policies outlining why the state owns companies and what it expects them to achieve. As a result, performance objectives are ad hoc and there is limited accountability among state actors for SOEs' performance. Small steps have been taken to improve SOE board appointments in some of the WB6 economies, for instance by introducing basic qualifications criteria or requirements for independent directors on boards. Although SOEs are mostly subject to sound basic requirements for financial reporting, compliance with these financial requirements is not consistent. There is also significant scope to strengthen disclosure by the state as shareholder, notably through aggregate reports analysing the performance of all SOEs. The legal and regulatory treatment of SOEs is broadly aligned with that of private companies across the WB6 region. However, the existence of the separate legal form of "public enterprise" for some SOEs in several economies may unwittingly distort the playing field with private companies. Many SOEs do not earn economically significant rates of return – this inefficient allocation of resources should be addressed through structural reforms of individual enterprises.

**Table 3.5. Scores and indicators for state-owned enterprises**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **6. State-owned enterprises dimension average** | **2.3** | **2.0** | **3.1** | **2.3** | **2.7** | **3.1** | **2.6** |
| **6.1. Efficiency and performance through improved governance** | **1.6** | **1.6** | **3.1** | **1.8** | **2.3** | **2.8** | **2.2** |
| Clarification of ownership policy and rationales | 1.5 | 1.0 | 3.0 | 1.5 | 2.0 | 3.0 | 2.0 |
| Professionalising state ownership | 2.0 | 1.3 | 3.5 | 1.5 | 2.0 | 3.0 | 2.2 |
| Robust board nomination framework | 2.0 | 1.5 | 3.5 | 2.0 | 2.5 | 2.5 | 2.3 |
| Promoting independent and professional boards | 1.0 | 2.5 | 2.5 | 2.0 | 2.5 | 2.5 | 2.2 |
| **6.2. Transparency and accountability practices** | **2.8** | **2.5** | **3.2** | **2.8** | **3.0** | **3.5** | **3.0** |
| Financial and non-financial reporting | 2.5 | 2.0 | 3.5 | 2.5 | 3.0 | 3.5 | 2.8 |
| Auditing practices | 3.0 | 2.5 | 3.0 | 2.5 | 3.0 | 4.0 | 3.0 |
| Protection of minority shareholders | 3.0 | 3.0 | 3.0 | 3.5 | 3.0 | 3.0 | 3.1 |
| **6.3. Ensuring a level playing field** | **2.8** | **2.0** | **3.0** | **2.5** | **3.0** | **3.3** | **2.8** |
| Legal and regulatory treatment | 3.5 | 2.0 | 4.0 | 3.0 | 3.5 | 3.5 | 3.3 |
| Access to finance | 2.0 | 2.0 | 2.0 | 2.0 | 2.5 | 3.0 | 2.3 |
| **6.4. Reforming and privatising state-owned enterprises** | **n.a.** | | | | | | |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the State-owned enterprises chapter for more information about the scoring in this particular policy dimension. N.a. = indicator has a different scoring system so results are presented in the text, not in the table.

### *Dimension 7: Education policy*

Secondary school students in the WB6 economies performed below their peers in CEEC-11[2] and OECD countries on the 2018 Programme for International Student Assessment (PISA). Around half of the WB6 students who participated in PISA did not achieve baseline proficiency in reading, mathematics or science, compared to one-fifth of students in OECD countries. The WB6 economies have made progress in the design and implementation of education policies, which aim to improve the quality, equity and inclusiveness of their education systems. Most of the WB6 economies have also adopted new strategies to improve the quality of their pre-university education, although they vary in their comprehensiveness, implementation progress and monitoring. Furthermore, all the WB6 economies have developed or are developing competency-based curricula and learning standards. The WB6 economies have also achieved a significant reduction in the level of early school leavers and made progress in increasing the coverage of early childhood education. However, enrolment rates in pre-primary education are still below the EU and OECD average. Teachers' participation in professional development activities is also below the OECD and EU averages. While the WB6 economies have made progress in strengthening the governance of vocational education and training (VET), gaps in core literacy and numeracy skills between VET and general students remain high, according to the 2018 PISA assessment. The low employment rates of recent graduates are a challenge, indicating that there is significant room to improve the labour market relevance of higher education. Data collection remains a cross-cutting challenge across various sectors, particularly in VET and tertiary education. While most WB6 economies have developed education information management systems (EMIS), they do not systematically exploit and analyse the data collected or comprehensively report on overall progress to inform policy.

#### Table 3.6. Scores and indicators for education policy

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **7. Education policy dimension average** | **3.3** | **2.1** | **3.2** | **2.9** | **3.2** | **3.2** | **3.0** |
| **7.1. Early childhood and school education** | **3.3** | **2.2** | **3.5** | **2.3** | **3.2** | **3.5** | **3.0** |
| Early childhood education | 3.0 | 2.0 | 3.5 | 2.5 | 3.5 | 2.5 | 2.8 |
| Instructional system | 4.0 | 2.5 | 2.5 | 2.5 | 2.0 | 4.0 | 2.9 |
| Prevention of early school leaving | 3.0 | 2.0 | 4.5 | 2.0 | 4.0 | 4.0 | 3.3 |
| **7.2. Teachers** | **3.5** | **1.5** | **2.3** | **2.5** | **3.3** | **3.3** | **2.7** |
| Initial teacher education | 3.5 | 1.5 | 2.0 | 2.5 | 3.0 | 2.5 | 2.5 |
| Professional development of teachers | 3.5 | 1.5 | 2.5 | 2.5 | 3.5 | 4.0 | 2.9 |
| **7.3. VET** | **3.3** | **2.0** | **3.3** | **3.5** | **3.5** | **3.3** | **3.1** |
| VET governance | 3.5 | 2.0 | 3.0 | 4.0 | 4.0 | 3.5 | 3.3 |
| Work based learning | 3.0 | 2.0 | 3.5 | 3.0 | 3.0 | 3.0 | 2.9 |
| **7.4. Tertiary education** | **3.0** | **2.8** | **2.8** | **3.0** | **2.8** | **2.5** | **2.8** |
| Equity in access to higher education | 2.5 | 2.5 | 2.5 | 2.5 | 2.0 | 2.5 | 2.4 |
| Labour market relevance and outcomes | 3.5 | 3.0 | 3.0 | 3.5 | 3.5 | 2.5 | 3.2 |
| **7.5. Cross-cutting sub-dimension: System governance** | **3.5** | **1.5** | **4.0** | **4.0** | **3.5** | **3.5** | **3.3** |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Education policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 8: Employment policy*

The WB6 economies have made some progress on their employment regulatory frameworks and policies, improving the functioning and flexibility of their labour markets. Some economies have improved the regulatory framework for non-standard forms of work and occupational health and safety. However, implementation of the regulatory framework remains a challenge. Labour inspectorates continue to lack capacity and tackling informal employment poses a key challenge. Although the role of tripartism in regulating employment issues is stronger, workplace representation and collective bargaining remain weak. Most economies have made significant progress in analysing skills mismatches and have started to set up strategies to reduce them. Although improvements have been made to help young people gain work experience, the education system is largely failing to produce the skills employers need. Moreover, school-to-work transition mechanisms are not very effective, participation in upskilling and skills adaptation activities among both the employed and unemployed is low, and emigration exacerbates skills shortages and skills gaps. Participation in adult learning is only about one-quarter of the EU average; relevant initiatives consist mainly of systems to recognise and validate prior learning and some small-scale measures for the low-skilled and unemployed. Most economies have been successful in their efforts to increase female employment rates; however, they remain 20 percentage points below OECD and EU averages. The WB6 economies have improved the capacities of their public employment services by introducing tools to better profile the unemployed and creating individual job seekers' action plans. Active labour market programmes have become better targeted, although vulnerable groups and minority groups continue to be less well covered. Unemployment benefits and means-tested minimum income schemes are not very generous and job-search requirements are not sufficiently implemented.

**Table 3.7. Scores and indicators for employment policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **8. Employment policy dimension average** | **2.8** | **2.0** | **1.6** | **3.3** | **3.0** | **2.8** | **2.6** |
| **8.1. Labour market governance** | **2.8** | **2.1** | **1.8** | **3.3** | **3.0** | **2.9** | **2.6** |
| Regulatory framework | 3.0 | 2.0 | 1.5 | 3.0 | 3.0 | 2.5 | 2.5 |
| Labour inspectorates | 3.0 | 2.0 | 2.0 | 3.0 | 3.5 | 3.0 | 2.8 |
| Employment policy framework | 2.5 | 1.8 | 2.0 | 3.5 | 3.0 | 3.5 | 2.7 |
| Tripartism and social dialogue | 2.5 | 2.5 | 1.5 | 3.5 | 2.5 | 2.5 | 2.5 |
| **8.2. Skills** | **2.8** | **1.1** | **1.0** | **2.8** | **3.0** | **2.8** | **2.2** |
| Skills mismatch | 3.0 | 1.3 | 1.0 | 3.0 | 3.5 | 3.5 | 2.6 |
| Adult learning | 2.5 | 0.8 | 1.0 | 2.5 | 2.5 | 2.0 | 1.9 |
| **8.3. Job quality** | **2.8** | **1.9** | **1.5** | **3.5** | **2.5** | **2.3** | **2.4** |
| Quality earnings | 2.0 | 1.0 | 1.0 | 3.0 | 2.0 | 2.0 | 1.8 |
| Policies to promote female employment | 3.5 | 2.8 | 2.0 | 4.0 | 3.0 | 2.5 | 3.0 |
| **8.4. Activation policies** | **3.0** | **2.4** | **2.0** | **3.5** | **3.3** | **3.0** | **2.9** |
| Public employment services | 3.5 | 2.5 | 2.5 | 3.5 | 3.5 | 3.5 | 3.2 |
| Mutual obligations framework | 2.0 | 2.5 | 1.5 | 3.5 | 3.0 | 2.5 | 2.5 |
| Active labour market programmes | 3.5 | 2.3 | 2.0 | 3.5 | 3.5 | 3.0 | 3.0 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Employment policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 9: Science, technology and innovation*

Most WB6 economies have a comprehensive strategic framework for science, technology and innovation (STI) in place, or are in the process of reviewing an existing one. However, effective implementation is sometimes hindered by limited co-ordination, as well as a lack of policy prioritisation and impact evaluation. Some economies have or are establishing an innovation fund – a key vehicle for implementing STI policy. However, overall expenditure on research and development remains low, and well below the EU level. Public research remains systemically underfunded, while the allocation of funding does not always encourage optimal research outputs. Human capital for research and innovation is below potential, due to limited development opportunities, lack of funding and few incentives to commercialise research. However, some economies are increasingly supporting young researchers and promoting linkages with their diaspora to address falling numbers of researchers and brain drain. All economies are connected to European and international research networks and international research collaboration is growing, but its results vary across economies. There are few linkages between academic research and industry, and no strategic policy to promote them. While all economies have experimented with financial incentives for business-academia collaboration, non-financial incentives remain almost non-existent. The institutional support for such collaboration has expanded, but often lacks a systemic approach, and efforts collide with broader policy measures to create an innovation ecosystem focusing on start-ups.

**Table 3.8. Scores and indicators for science, technology and innovation**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **9. Science, technology and innovation dimension average** | **1.8** | **1.3** | **1.3** | **2.4** | **2.4** | **3.1** | **2.1** |
| **9.1. STI system** | **2.2** | **1.7** | **1.8** | **2.6** | **2.9** | **3.4** | **2.4** |
| STI strategy | 2.8 | 1.3 | 1.3 | 2.5 | 3.5 | 3.5 | 2.5 |
| Institutional framework | 1.8 | 1.2 | 1.5 | 2.8 | 2.5 | 4.0 | 2.3 |
| Regulatory framework | 2.0 | 1.3 | 2.0 | 2.0 | 2.0 | 3.0 | 2.1 |
| International collaboration | 1.8 | 2.0 | 2.0 | 2.5 | 2.8 | 3.0 | 2.4 |
| Alignment with EU STI policies | 2.5 | 2.5 | 2.0 | 3.3 | 3.5 | 3.5 | 2.9 |
| **9.2. Public research system** | **1.9** | **1.2** | **1.3** | **2.5** | **2.3** | **2.9** | **2.0** |
| Institutional structure of the public research system | 1.5 | 1.3 | 1.5 | 2.3 | 2.5 | 2.5 | 1.9 |
| Public research funding | 2.0 | 1.3 | 1.5 | 1.8 | 1.8 | 3.3 | 2.0 |
| Human resources for research and innovation | 2.3 | 1.0 | 1.0 | 3.3 | 2.5 | 3.0 | 2.2 |
| **9.3. Business-academia collaboration** | **1.1** | **0.9** | **0.7** | **2.1** | **2.0** | **3.0** | **1.6** |
| Collaboration promotion framework | 1.3 | 0.8 | 0.0 | 2.8 | 3.0 | 3.0 | 1.8 |
| Financial incentives for business-academia collaboration | 1.0 | 1.0 | 1.0 | 2.8 | 2.0 | 3.3 | 1.9 |
| Non-financial incentives for business-academia collaboration | 0.5 | 0.0 | 0.5 | 1.0 | 1.0 | 2.0 | 0.8 |
| Institutional support for business-academia collaboration | 1.5 | 1.8 | 1.3 | 1.8 | 2.0 | 3.5 | 2.0 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Science, technology and innovation chapter for more information about the scoring in this particular policy dimension.

### *Dimension 10: Digital society*

Most of the WB6 economies are increasing efforts to expand broadband access by preparing economy-wide broadband plans and securing significant donor financing to develop rural broadband infrastructure. All economies are transforming their public administrations into user-centric public services using digital technologies, although the pace varies, and are making progress on the accessibility and transparency of public sector data. However, low digital literacy in many Western Balkan economies increases the risk of widening the digital divide as public services move online. All economies recognise digital skills as a key competency in their education policies and have incorporated information technology (IT) subjects in education and training systems, but more efforts and increased co-operation with the IT industry are needed to close the digital skills gap. Shortcomings in schools' information and communication (ICT) equipment, distance-learning platforms, and IT training for teachers are key obstacles to digital skill development. Most economies offer insufficient support for business digitalisation and ICT sector growth, and although legal frameworks for e-commerce and e-business have improved in some economies, implementation of effective support and promotion programmes is lacking. While legal frameworks for privacy and data protection are in place, their enforcement is weak as the competent authorities lack the required resources and executive power. Measures for consumer protection in e-commerce are now included in legislation in all WB6 economies, but they could be more developed and opportunities for consumer education are limited. All economies are also gradually aligning with the EU cybersecurity framework and most have a cybersecurity strategy in place, but insufficient budgetary allocations continue to slow down progress.

#### Table 3.9. Scores and indicators for digital society

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **10. Digital society dimension average** | **2.5** | **1.7** | **2.3** | **2.4** | **2.7** | **3.0** | **2.4** |
| **10.1. Access** | **3.2** | **1.8** | **2.8** | **3.3** | **3.2** | **3.0** | **2.9** |
| Broadband infrastructure | 3.5 | 2.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.3 |
| ICT Regulatory policy framework | 3.5 | 2.0 | 2.5 | 3.5 | 3.5 | 2.5 | 2.9 |
| Data accessibility | 2.5 | 1.5 | 2.5 | 3.0 | 2.5 | 3.0 | 2.5 |
| **10.2. Use** | **2.5** | **1.8** | **1.8** | **2.0** | **3.0** | **3.5** | **2.4** |
| Digital government | 3.5 | 2.0 | 2.0 | 2.5 | 3.5 | 3.5 | 2.8 |
| Private sector ICT adoption | 1.5 | 1.5 | 1.5 | 1.5 | 2.5 | 3.5 | 2.0 |
| **10.3. Jobs** | **2.0** | **1.7** | **2.3** | **2.2** | **2.5** | **3.0** | **2.3** |
| Digital skills for students | 2.0 | 2.0 | 2.0 | 2.5 | 3.0 | 3.0 | 2.4 |
| Digital skills for adults | 2.0 | 1.5 | 2.5 | 2.0 | 2.5 | 2.5 | 2.2 |
| ICT sector promotion | 2.0 | 1.5 | 2.5 | 2.0 | 2.0 | 3.5 | 2.3 |
| **10.4. Society** | **2.5** | **1.5** | **1.5** | **1.5** | **2.0** | **3.5** | **2.1** |
| Digital inclusion | 2.5 | 1.5 | 1.5 | 1.5 | 2.0 | 3.5 | 2.1 |
| **10.5. Trust** | **2.2** | **1.7** | **2.2** | **2.2** | **2.3** | **2.7** | **2.2** |
| Privacy protections | 2.5 | 2.0 | 2.0 | 2.5 | 2.0 | 2.5 | 2.3 |
| Consumer protection in e-commerce | 2.0 | 1.5 | 2.5 | 2.0 | 2.0 | 2.5 | 2.1 |
| Digital security risk management | 2.0 | 1.5 | 2.0 | 2.0 | 3.0 | 3.0 | 2.3 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Digital society chapter for more information about the scoring in this particular policy dimension.

### *Dimension 11: Transport policy*

Most of the WB6 economies have long-term transport strategies to guide the development of their transport sectors and align them further with EU *acquis* and the Transport Community Treaty (TCT). However, most of these strategies lack proper monitoring and implementation plans. The Ministerial Council of the Transport Community Permanent Secretariat (TCPS) endorsed regional action plans for roads, railways, road safety and transport facilitation in October 2020. While reforms in the railway sector have advanced, railway markets in the WB6 economies are not yet fully open, and further efforts are needed to align regulations with the EU *acquis* and TCT. In July 2019, Serbia and North Macedonia opened a one-stop-shop at their road border crossing point on Corridor X. This form of transport facilitation should help to reduce queueing times and promote regional traffic flows. Another significant achievement is the improvement to road safety, with the WB6 economies seeing a more significant fall in road fatalities in the period 2017-19 than the CEEC-11, EU and OECD countries. Most of the WB6 economies would benefit from improving their systems for project identification, prioritisation and selection, to make the allocation of funds and investment in transport infrastructure projects more efficient. Systems for managing transport assets are still in the early stages in most WB6 economies, and mainly in the road sector. The integration of environmental sustainability objectives into transport policies is another area for improvement. Most WB6 economies include these goals in a range of documents, and therefore lack a holistic approach to sustainable transport. Combined transport is also underdeveloped in the region; however, there have been positive developments such as the participation of most WB6 economies in the Integrating Multimodal Connections in the Adriatic-Ionian Region project and ongoing efforts to deploy combined transport infrastructure in North Macedonia and Serbia.

#### Table 3.10. Scores and indicators for transport policy

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **11. Transport policy dimension average** | **2.5** | **1.3** | **1.4** | **1.8** | **2.1** | **3.0** | **2.0** |
| **11.1. Planning** | **3.3** | **1.5** | **1.5** | **2.3** | **1.9** | **3.3** | **2.3** |
| Transport vision | 4.0 | 2.0 | 2.0 | 2.5 | 2.5 | 3.5 | 2.8 |
| Transport project selection | 4.5 | 0.8 | 1.0 | 2.5 | 2.5 | 4.0 | 2.6 |
| Implementation and procurement | 3.0 | 2.0 | 2.0 | 2.5 | 2.5 | 4.0 | 2.7 |
| Asset management | 1.5 | 1.0 | 1.0 | 1.5 | 0 | 1.5 | 1.1 |
| **11.2. Governance and regulation** | **2.5** | **1.9** | **1.5** | **2.5** | **3.3** | **3.8** | **2.6** |
| Rail regulation | 1.5 | 1.3 | 1.5 | 1.5 | 3.5 | 3.5 | 2.1 |
| Aviation regulation | 3.5 | 2.5 | 1.5 | 3.5 | 3.0 | 4.0 | 3.0 |
| Road market regulation | n.a. | | | | | | |
| International Water Waste and maritime market regulation | | | | | | | |
| **11.3. Sustainability** | **1.5** | **0.8** | **1.2** | **0.8** | **1.5** | **2.2** | **1.3** |
| Road safety strategy | 1.5 | 1.3 | 1.5 | 1.5 | 2.5 | 2.5 | 1.8 |
| Environmental sustainability strategy | 1.5 | 0.5 | 1.5 | 0.5 | 1.5 | 1.5 | 1.2 |
| Combined transport strategy | 1.5 | 0.5 | 0.5 | 0.5 | 0.5 | 2.5 | 1.0 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Transport policy chapter for more information about the scoring in this particular policy dimension. N.a. = indicator has a different scoring system so results are presented in the text, not in the table.

### *Dimension 12: Energy policy*

The WB6 economies all have advanced legislative and policy frameworks that transpose significant parts of the EU's Third Energy Package. However, implementation can be improved and key policy documents need to be updated. The latter issue is being tackled for the most part as all WB6 economies are drafting their new National Energy and Climate Plans. There has been progress in deploying EU-style organised markets, with Albania, Kosovo and Montenegro recently establishing power exchanges. However, unbundling of natural monopolies and ensuring third-party access to infrastructure have yet to be finalised in some WB6 economies. These elements are key to the competitiveness of energy markets. The development of energy efficiency measures and non-hydro renewables is still in the early stages across the WB6 region. The economies use outdated subsidy schemes for renewable energy, and energy efficiency suffers from a lack of technical capacity in relevant public bodies and an overall scarcity of funding. The WB6 regional electricity generation mix is still overwhelmingly coal-reliant. The continued subsidisation of coal and other fossil fuels distorts the market and runs counter to the WB6 economies' commitments to reducing greenhouse gas emissions.

**Table 3.11. Scores and indicators for energy policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **12. Energy policy dimension average** | **3.2** | **2.1** | **3.0** | **3.7** | **3.0** | **3.0** | **3.0** |
| **12.1. Governance and regulation** | **3.5** | **1.7** | **3.3** | **3.7** | **3.2** | **3.3** | **3.1** |
| Energy policy, legal and institutional framework | 3.0 | 2.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.2 |
| Energy regulator | 4.0 | 1.5 | 3.0 | 4.0 | 4.0 | 3.5 | 3.3 |
| Management of energy infrastructure | 3.5 | 1.5 | 3.5 | 3.5 | 2.0 | 3.0 | 2.8 |
| **12.2. Security of energy supply** | **2.9** | **2.6** | **2.8** | **3.6** | **2.6** | **2.9** | **2.9** |
| Natural gas supply framework | 2.0 | 3.0 | 1.5 | 3.5 | 2.0 | 2.0 | 2.3 |
| Electricity supply framework | 4.0 | 3.0 | 3.5 | 3.5 | 3.0 | 3.0 | 3.3 |
| Renewable energy policy | 3.5 | 2.5 | 3.5 | 4.0 | 3.0 | 3.5 | 3.3 |
| Energy efficiency policy | 2.0 | 2.0 | 2.5 | 3.5 | 2.5 | 3.0 | 2.6 |
| **13.3. Energy markets** | **3.3** | **1.8** | **3.0** | **3.7** | **3.2** | **2.8** | **3.0** |
| Market operation | 3.0 | 1.5 | 2.5 | 4.0 | 3.5 | 3.5 | 3.0 |
| Unbundling and third-party access | 3.5 | 1.5 | 4.5 | 3.5 | 4.0 | 2.5 | 3.3 |
| Regional market integration | 3.5 | 2.5 | 2.0 | 3.5 | 2.0 | 2.5 | 2.7 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Energy policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 13: Environment policy*

Legal and policy frameworks for the environment and climate change are gradually being introduced and major climate-related risks are being identified across the WB6. Nevertheless, common challenges remain. Air pollution is one of the main environmental challenges, with levels of fine particulate matter ($PM_{2.5}$) two to three times above the maximum limits recommended by the World Health Organization. Moreover, recycling rates of municipal waste remain extremely low across the region – significantly lower than in the EU. Some actions have been taken on waste management and to develop a circular economy, but specific policy frameworks are largely lacking. Industrial waste management frameworks have not advanced and the policy and legislative bases for soil protection are almost non-existent. Unregulated burning and illegal dumping of waste is still prevalent in the region, posing problems to the environment and public health through groundwater, soil and air pollution. The groundwork for the freshwater management legislative framework has been done in most assessed economies, though little has been done to improve international co-ordination of transboundary river basis. Water supply and sanitation systems also remain inadequate. Although investments are ongoing, water service fees are too low to cover or complement the infrastructure investment costs and water supply services. Moreover, insufficient institutional capacities and poor co-ordination among the responsible local authorities impede implementation of water management measures. Finally, all WB6 economies have adopted policy frameworks for biodiversity conservation, and most have plans for endangered species and protected areas. Nevertheless, biodiversity and forestry monitoring systems and public inventories are rarely in place, which impedes proper implementation.

**Table 3.12. Scores and indicators for environment policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **13. Environment policy dimension average** | **1.9** | **1.7** | **2.1** | **2.3** | **2.4** | **2.2** | **2.1** |
| **13.1. Resource productivity** | **1.8** | **1.7** | **1.8** | **2.0** | **2.3** | **2.2** | **2.0** |
| Climate change mitigation and adaptation | 2.0 | 2.0 | 2.0 | 2.5 | 3.5 | 2.0 | 2.3 |
| Circular economy framework | 1.0 | 1.5 | 1.0 | 1.0 | 1.0 | 2 | 1.3 |
| Municipal waste management | 2.5 | 1.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.3 |
| **13.2. Natural asset base** | **2.2** | **1.7** | **2.2** | **2.5** | **2.0** | **1.8** | **2.1** |
| Freshwater management | 2.5 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.1 |
| Biodiversity and forest management | 2.5 | 1.5 | 2.5 | 3.0 | 3.0 | 2.0 | 2.4 |
| Land-use management framework | 1.5 | 1.5 | 2.0 | 2.5 | 1.0 | 1.5 | 1.7 |
| **13.3. Environmental quality of life** | **1.8** | **1.8** | **2.2** | **2.3** | **2.8** | **2.5** | **2.3** |
| Air quality framework | 2.0 | 2.0 | 2.5 | 3.5 | 3.5 | 2.5 | 2.7 |
| Water supply and sanitation system | 2.0 | 2.0 | 2.5 | 1.5 | 2.5 | 3.0 | 2.3 |
| Industrial waste management framework | 1.5 | 1.5 | 1.5 | 2.0 | 2.5 | 2.0 | 1.8 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Environment policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 14: Agriculture policy*

All WB6 economies have undertaken significant investment in agriculture. Implementation of the Instrument for Pre-Accession Assistance for Rural Development (IPARD) programme continues to improve among the accredited economies (Albania, Montenegro, North Macedonia and Serbia), and IPARD disbursing authorities are increasing their administrative capacity. However, harmonisation of the criteria for IPARD funding and national budget subsidies remain an issue. The WB6 economies continue to invest in rural infrastructure. In particular, they support projects related to sewage systems, electricity and gas supply and broadband internet, which are among the essential preconditions for competitive agriculture. Investment in other key areas, such as irrigation systems, is increasing, but their efficiency, sustainability and monitoring (such as of erosion, drainage and soil moisture) are still inadequate. Despite those improvements, some aspects of agriculture are still under-funded. For example, investment in agricultural research projects remains low and agricultural extension services are uneven in scope and quality. Similarly, education and training have been neglected throughout the last decade in the WB6; as a result, the number of students in agriculture continues to decline. Economy-wide agricultural strategies are being implemented, but they often do not address agricultural education or, if they do, the measures are not realised. The sector's performance is also hampered by other weaknesses, such as generally poor cross-sectoral co-operation between agriculture and other relevant public institutions (such as environment and education), which not only limits the sector's productivity but also slows down reforms. And while all six economies have made efforts to improve and create an evidence-based policy system, monitoring and evaluation capacity is still limited.

**Table 3.13. Scores and indicators for agriculture policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **14. Agriculture policy dimension average** | **2.8** | **2.0** | **2.4** | **2.8** | **3.4** | **3.1** | **2.7** |
| **14.1. Agro-food system capacity** | **3.2** | **1.5** | **2.9** | **3.1** | **3.3** | **2.5** | **2.8** |
| Rural infrastructure policy | 3.5 | 1.0 | 3.5 | 4.0 | 3.5 | 2.0 | 2.9 |
| Irrigation policy framework | 3.0 | 2.0 | 2.0 | 2.8 | 3.5 | 3.0 | 2.7 |
| Agricultural education system | 3.0 | 1.5 | 3.3 | 2.5 | 3.0 | 2.5 | 2.6 |
| **14.2. Agro-food system regulation** | **3.0** | **2.3** | **2.3** | **3.3** | **3.5** | **3.3** | **2.9** |
| Regulations on natural resources | 3.5 | 2.5 | 2.0 | 3.0 | 3.5 | 3.6 | 3.0 |
| Regulations on products | 2.5 | 2.0 | 2.6 | 3.5 | 3.5 | 3.0 | 2.9 |
| **14.3. Agricultural support system** | **2.8** | **2.1** | **2.1** | **2.2** | **3.5** | **3.3** | **2.7** |
| Agricultural policy framework | 3.0 | 3.0 | 2.5 | 3.1 | 3.5 | 3.5 | 3.1 |
| Domestic producer support instruments | 3.0 | 2.0 | 2.0 | 3.2 | 3.5 | 3.0 | 2.8 |
| Agricultural trade policy | 2.5 | 2.0 | 2.0 | 3.0 | 4.0 | 3.0 | 2.8 |
| Agricultural tax regime | 2.5 | 1.5 | 2.0 | 1.4 | 3.5 | 3.0 | 2.3 |
| Sanitary and phytosanitary (SPS) measures | 3.0 | 2.0 | 2.0 | 1.4 | 3.0 | 4.0 | 2.6 |
| **14.4. Agricultural innovation system** | **2.0** | **2.0** | **2.5** | **3.2** | **3.0** | **3.0** | **2.6** |
| Agricultural research and development framework | 2.0 | 2.0 | 2.5 | 3.1 | 2.5 | 3.0 | 2.5 |
| Agricultural extension services framework | 2.0 | 2.0 | 2.5 | 3.2 | 3.5 | 3.0 | 2.7 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Agriculture policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 15: Tourism policy*

All the WB6 economies have recognised tourism as an opportunity for economic development. Most economies have developed tourism strategies and have committed to developing an efficient governance structure involving inter-ministerial co-ordination, vertical co-operation, and dialogue with private and other tourism stakeholders. Albania and Montenegro, where tourism is a much more important sector, have the most developed frameworks overall. Progress has been achieved in all economies on collecting tourism data and registering accommodation facilities. Although some progress has been achieved in some economies on developing a tourism VET framework, a qualified workforce is still lacking throughout the region, mainly due to the poor skills supply framework and lack of higher education courses in tourism. Moreover, tourism innovation, marketing and branding, as well as comprehensive natural and cultural heritage enhancement frameworks, are largely lacking in the WB6. Overall, the absence of a common regional tourism brand lessens the visibility of the Western Balkans as an attractive tourist destination offering a diversity of unique tourist experiences.

**Table 3.14. Scores and indicators for tourism policy**

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **15. Tourism policy dimension average** | **2.1** | **1.2** | **1.5** | **1.5** | **3.1** | **2.3** | **2.0** |
| **15.1. Governance and co-operation** | **2.4** | **1.3** | **1.9** | **1.8** | **3.8** | **3.0** | **2.3** |
| Tourism governance and institutional set up | 2.0 | 1.0 | 1.0 | 1.0 | 4 | 3.0 | 2.0 |
| Partnerships with stakeholders | 3.5 | 1.0 | 2.0 | 1.0 | 4.0 | 3.0 | 2.4 |
| Vertical co-operation | 2.0 | 1.0 | 1.0 | 1.5 | 3.0 | 3.0 | 1.9 |
| Data collection and interpretation | 2.0 | 2.0 | 3.5 | 3.5 | 4.0 | 3.0 | 3.0 |
| **15.2. Destination accessibility and tourism infrastructure** | **2.5** | **1.5** | **1.5** | **1.7** | **3.5** | **2.7** | **2.2** |
| Connectivity framework | 2.0 | 0.5 | 0.5 | 1.0 | 3.0 | 2.0 | 1.5 |
| Accommodation capacity and quality of tourism offer | 3.0 | 2.0 | 1.0 | 2.0 | 3.5 | 3.0 | 2.4 |
| Information availability | 2.5 | 2.0 | 3.0 | 2.0 | 4.0 | 3.0 | 2.8 |
| **15.3. Availability of a qualified workforce** | **1.8** | **1.3** | **1.8** | **1.7** | **2.3** | **2.0** | **1.8** |
| Skills supply framework | 2.0 | 0.5 | 1.5 | 1.5 | 2.0 | 1.0 | 1.4 |
| VET framework for tourism | 2.0 | 2.0 | 2.5 | 1.5 | 2.5 | 3.0 | 2.3 |
| Higher education framework for tourism | 1.5 | 1.5 | 1.5 | 2.0 | 2.5 | 2.0 | 1.8 |
| **15.4. Sustainable and competitive tourism** | **1.3** | **1.3** | **1.2** | **0.8** | **3.0** | **1.7** | **1.6** |
| Natural and cultural heritage enhancement framework | 1.5 | 1.5 | 2.0 | 1.0 | 3.0 | 1.0 | 1.7 |
| Promotion of sustainable development and operations within the tourism sector | 1.0 | 1.0 | 1.0 | 0.5 | 3.0 | 2.0 | 1.4 |
| Tourism investment and innovation policy framework | 1.5 | 1.5 | 0.5 | 1.0 | 3.0 | 2.0 | 1.6 |
| **15.5. Tourism branding and marketing** | **2.8** | **0.5** | **0.5** | **1.3** | **2.8** | **1.8** | **1.6** |
| Tourism branding and marketing strategy | 2.5 | 0.5 | 0.5 | 1.5 | 4.0 | 2.0 | 1.8 |
| Digital tourism marketing framework | 3.0 | 0.5 | 0.5 | 1.0 | 1.5 | 1.5 | 1.3 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Tourism policy chapter for more information about the scoring in this particular policy dimension.

### *Dimension 16: Anti-corruption policy*

All WB6 economies have anti-corruption strategies and/or plans and mechanisms for monitoring their implementation. However, their analytical frameworks vary. Several of the economies have replaced outdated strategies but not yet adopted them. While the authorities involve civil society in preparing anti-corruption strategies and plans, some NGOs are concerned about the lack of response to their proposals. Most WB6 economies have multi-functional corruption prevention bodies, whose independence is mostly safeguarded and who observe due public accountability. However, some struggle to implement their mandate due to limited resources. Most of the WB6 economies fund awareness-raising and education activities from their national budgets, which is positive a sign that this area is prioritised. None of the WB6 economies have yet achieved a sound and sustainable independent judiciary, however. Several of the economies have implemented reforms, including setting up judiciary councils, introducing competitive procedures for the selection and promotion for judicial positions, and strengthening disciplinary liability mechanisms. Most WB6 economies have recent laws for the registration and provision of public access to data on beneficial owners of legal entities. All WB6 economies envisage the liability of legal persons for all criminal offences. Most WB6 economies have also had at least some convictions in prominent corruption cases.

#### Table 3.15. Scores and indicators for anti-corruption policy

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 |
|---|---|---|---|---|---|---|---|
| **16. Anti-corruption policy dimension average** | **2.1** | **2.0** | **1.8** | **2.9** | **3.6** | **2.9** | **2.5** |
| **16.1. Anti-corruption policy framework** | **1.0** | **1.5** | **1.0** | **2.8** | **3.5** | **2.8** | **2.1** |
| Corruption risk assessment | 1.0 | 2.0 | 1.0 | 3.0 | 4.5 | 3.0 | 2.4 |
| Corruption proofing of legislation | 1.0 | 1.0 | 1.0 | 2.5 | 2.5 | 2.5 | 1.8 |
| **16.2. Prevention of corruption** | **4.0** | **3.0** | **2.5** | **3.0** | **4.0** | **3.0** | **3.3** |
| Anti-corruption public awareness and education | 4.0 | 3.0 | 2.5 | 3.0 | 4.0 | 3.0 | 3.3 |
| **16.3. Independence of the judiciary** | **n.a.** | | | | | | |
| **16.4. Business integrity and corporate liability** | **n.a.** | | | | | | |
| **16.5. Investigation and prosecution** | **2.5** | **2.0** | **2.5** | **3.0** | **3.5** | **3.0** | **2.8** |
| Anti-corruption law enforcement bodies | 2.5 | 2.0 | 2.5 | 3.0 | 3.5 | 3.0 | 2.8 |

Note: Please see the Assessment methodology and process chapter for more information about the score levels in general and the Anti-corruption policy chapter for more information about the scoring in this particular policy dimension. N.a. = indicator has a different scoring system so results are presented in the text, not in the table.

## Notes

[1] This dimension is scored using a different methodology to the other dimensions. You can find more details on the competition scoring methodology in the Competition policy chapter.

[2] The 11 Central and Eastern European countries (CEECs) who have joined the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

# Part I Assessment findings by policy dimension

# 4 Investment policy and promotion (Dimension 1)

Providing investors with a sound regulatory environment, clear non-discriminatory policies, strong implementing institutions and more opportunities for public procurement projects can have a beneficial impact on the volume and quality of foreign investment, in turn creating more employment opportunities, boosting growth, and encouraging technology transfers. This chapter, divided into three sub-dimensions, analyses the extent to which Western Balkan governments have established favourable investment climates that support steady economic growth and sustainable development. The first sub-dimension, the investment policy framework, assesses the breadth and depth of investment policies, notably the regulatory environment of host economies and the protection that it provides to investors – including intellectual property protection – as well as its consistent treatment of both domestic and foreign investors. The second sub-dimension, investment promotion and facilitation, examines the strategies, services, and institutions in place to promote and facilitate investment before, during and after establishment. The third, new, sub-dimension, investment for green growth, reviews strategies to promote investment in renewable energy and energy efficiency projects, and their facilitation through public and private partnerships.

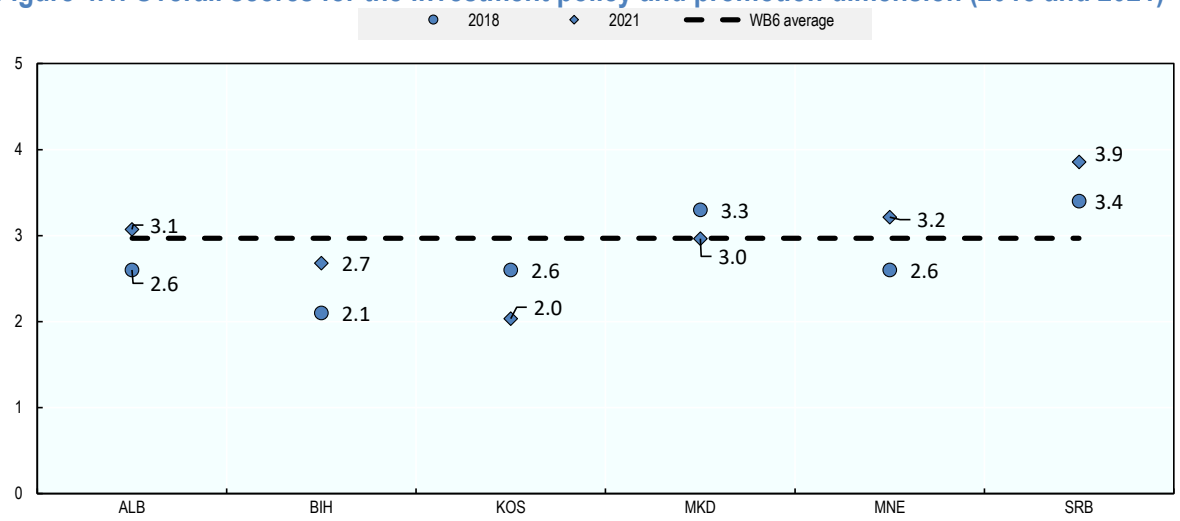
## Key findings

- **The markets in all WB6 economies are open to FDI and regulatory environments for investment are sound.** While there are few sectors closed to foreign investors, most frameworks remain complex and problematic for investors to navigate due to overlapping laws and institutional mandates.
- **Foreign investors in all WB6 economies have the same rights and remedies before national court systems as domestic investors**. All the economies, except Albania, Kosovo and North Macedonia, have dedicated commercial courts that have first instance jurisdiction over commercial matters. However, commercial disputes are costly and lengthy in most economies and enforcing contracts is problematic, except in Montenegro and North Macedonia.
- **Alternative dispute mechanisms are offered in all economies and some have updated their mediation legislation.** However, public awareness, familiarity with and use of dispute resolution tools remain low in all economies except Montenegro.
- **All economies have sound intellectual property (IP) rights laws and regulations**. Albania, Montenegro, North Macedonia and Serbia have made progress in reinforcing the capacities and resources of their authorities in charge of IP rights. However, the relevant authorities in Bosnia and Herzegovina and Kosovo continue to lack resources and inter-institutional co-operation.
- **Each of the six economies has a well-established investment promotion agency (IPA), a clearly defined institutional framework and a strategy in place for investment promotion and facilitation**, though Bosnia and Herzegovina lack the latter two elements. However, the resources and capacities of all IPAs, with the exception of Albania and Serbia, remain insufficient, making it challenging to fulfil their mandates efficiently.
- **Albania, Montenegro, North Macedonia and Serbia have put in place complex and multi-layered investment incentive schemes.** Those in Bosnia and Herzegovina are implemented at the entity level with little state oversight. The mandates of all IPAs include aftercare services with dedicated aftercare units or strategies, including Montenegro's IPA which is currently being established.
- **Almost all economies (except Kosovo) have adopted various policies and mechanisms to encourage green investment and private sector participation in green infrastructure**. Some economies, like Albania and Montenegro, have developed concrete programmes to encourage and facilitate green investment initiatives.

### Comparison with the 2018 assessment

Since the last assessment, almost all economies have increased their scores in both the investment policy and investment promotion and facilitation sub-dimensions. However, the WB6 average remains almost unchanged due to differences in the assessment framework: the scores of the new sub-dimension on green investment lower the average by 0.3 points compared to the scores for the first and second sub-dimensions.

## Figure 4.1. Overall scores for the investment policy and promotion dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

### Table 4.1. Implementation of the CO 2018 policy recommendations: investment policy and promotion

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 Policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Further improve the clarity, transparency, and predictability of the regulatory framework for investment** | Most economies have continued to update investment legislation since the last assessment, aiming to improve the predictability of their regulatory framework. However, implementation has been slow to materialise in some economies. | Moderate |
| **Systematically ensure prompt legal procedures and consistent interpretation of the law, especially when it comes to enforcing commercial contracts** | While some economies remain without dedicated commercial courts, Albania, Montenegro, North Macedonia and Republika Srpska[1] have all significantly improved the efficiency of their commercial procedures and substantially reduced backlogs. | Limited |
| **Strengthen co-ordination among IP-related institutions and make further efforts to sensitise businesses and the public and provide them with better access to information on IP rights** | Several economies have established strategies and guidelines to develop and improve the legislative and institutional framework for IP enforcement and establish inter-institutional co-operation; however, implementation is weak. Most economies still have very limited co-operation and co-ordination of IP-related institutions, with the exception of Albania, Serbia, and Republika Srpska, which have strong frameworks for inter-institutional co-operation. | Limited |
| **Give IPAs adequate resources and capacity to conduct key investment promotion and facilitation functions, such as investor targeting and aftercare.** | Some economies, like Kosovo and Serbia, have substantially increased funding for IPAs, while Montenegro has completely overhauled its structure by establishing a new IPA with significantly improved staffing and funding.<br>However, many IPAs in the WB6 still lack the resources and capacity to carry out their mandates effectively, including suitable investment promotion and aftercare services. | Limited |
| **Take steps to enhance the impact of FDI by creating linkages between foreign investors and domestic firms.** | The large majority of WB6 economies have made significant progress in establishing and implementing strategies and support programmes to reinforce linkages between local firms and multinational companies through financial support, facilitating contacts between local suppliers and multinational enterprises, training and information exchanges. | Moderate |

## Introduction

Foreign direct investment (FDI) is a crucial component for promoting international economic integration. It can provide economies with financial stability, encourage economic development and enhance the well-being of societies. With the right policy framework, FDI can not only help increase economic competitiveness and create jobs, but also bring further benefits, such as technology and skills transfers, increased innovation and exports, and support the transition towards green growth. Non-discriminatory principles, limited barriers to investment, property rights protection and strong mechanisms for settling investment disputes underpin a quality investment environment. Meanwhile, continuous efforts to promote and facilitate investment can enable investors to establish or expand their activities with ease and thus contribute to a hospitable investment environment. While the WB6 economies have seen a surge in FDI over the last decade, the COVID-19 pandemic has limited the region's steady progress towards becoming a strong investment destination. The pandemic has had detrimental consequences for the region, including deep contractions in economic activity, steep increases in unemployment, and severe repercussions for small and medium-sized enterprises (SMEs). Although public investment has increased in some economies due to policy support packages to stimulate the economy, private investment has plummeted, putting an end to the region's upturn. In the months following the pandemic, the six Western Balkan economies will need to turn their attention to policies to mobilise support for existing foreign investors, promote strategic sectors catering to economic and technological development, and leverage investor networks and investment promotion agencies to protect global value chains (OECD, 2020[1]).

Creating sound legislation and strategies to promote the attractiveness of the WB6 economies as investment destinations can stimulate the region's overall economic growth and development, encourage further market integration efforts, and support a sustainable and resilient recovery from the COVID-19 crisis. To this end, WB6 governments need to establish a fair, transparent, and predictable regulatory framework for investment. The Competitiveness Outlook's investment policy and promotion dimension assesses the quality and predictability of the WB6 investment climates, including their legal frameworks, judicial systems, investor rights and protection, as well as activities to make them more conducive for strategic and targeted investment projects.

Building a favourable climate for investment requires a whole-of-government approach. Although almost all policy areas analysed in the Competitiveness Outlook play a role in contributing to a hospitable investment landscape for foreign investors, the following dimensions are particularly important to the investment policy and promotion dimension:

- **Chapter 5. Trade** and investment relationships are at the core of globalisation and are vital for facilitating the cross-border transfer of goods, services and capital. Enterprises combine trade with investment to ensure global value chain (GVC) performance and to organise the supply of inputs, expand to new markets, access knowledge, and provide services to consumers.
- **Chapter 6. Access to finance** in the long term is crucial for infrastructure investments; public-private partnerships play an important role in facilitating foreign investment projects where public investment cannot meet the needs of the economy.
- **Chapter 7. Tax policy** is often used as an incentivising tool for investors through which host governments can create a competitive advantage for their economies. However, tax policies must balance the need for foreign investment with collecting appropriate tax revenue from multinational enterprises (MNEs).
- **Chapter 8. Competition policy** can improve the fairness and efficiency of markets, thus contributing to a more attractive environment for investors. It also plays a role in minimising exceptions to national treatment and in ensuring equal treatment between domestic and foreign investors.

- **Chapter 9. State-owned enterprises** and their corporate governance play a large part in investor confidence, as does treatment of private investors in relation to public enterprises, where fair dispute settlement and upheld legal frameworks can encourage investment.
- **Chapter 10. Education policy** helps provide investors with access to a highly qualified workforce and adequate skills and abilities, especially for MNEs operating in science, finance or R&D, as well as for staff training in the production and manufacturing sectors.
- **Chapter 12. Science, technology and innovation** relies on a dependable intellectual property legal framework which can protect individuals and businesses and enable technology transfers for investors interested in innovative SMEs and entrepreneurs.
- **Chapter 15 and 16. Energy and environment policies** play a key role in creating a hospitable environment for green investment. Strong environmentally conscious legislation and strategies to cut carbon emissions and focus on renewable energy and energy efficiency solutions can create profitable green project opportunities for investors.
- **Chapter 19. Anti-corruption policy** plays a key role in investor confidence by ensuring a sound, reliable and fair justice system that investors can depend on when it comes to commercial matters and enforcing contractual rights.

## Assessment framework

### *Structure*

This chapter assesses policies to improve the investment policy and promotion in the WB6 through the three main sub-dimensions and one cross-cutting sub-dimension:

1. **Sub-dimension 1.1: Investment policy framework.** To what extent have the economies designed and implemented sound legal frameworks for investors; are the economies open to FDI; and how does the legal framework for investment protect investors, including their intellectual property rights regime?
2. **Sub-dimension 1.2: Investment promotion and facilitation**. What is the institutional framework to attract and facilitate inward investment, including strategies and investment promotion activities, measures to facilitate investments and expansions, and the promotion of business linkages?
3. **Sub-dimension 1.3: Investment for green growth**. Are the WB6 developing favourable and specific frameworks that encourage green investment, and are they encouraging private procurement partnerships for green investment projects, including in infrastructure?

Figure 4.2 shows how the sub-dimensions and their constituent indicators make up the investment policy and promotion assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information which the OECD collected with the support of the WB6 governments and their statistical offices. Qualitative indicators are based on the OECD's Policy Framework for Investment (OECD, 2015[2]). They have been scored in ascending order on a scale of 0 to 5. The statutory restrictions assessed for the foreign direct investment indicator are based on the OECD FDI Regulatory Restrictiveness Index (Box 4.1).

### Box 4.1. The OECD FDI Regulatory Restrictiveness Index

The OECD FDI Regulatory Restrictiveness Index seeks to gauge the restrictiveness of an economy's FDI rules. The FDI Index is currently available for more than 60 economies, including all OECD and G20 members, allowing FDI policies to be compared and potential areas for reform identified. It is commonly used on a stand-alone basis to assess the restrictiveness of FDI policies when reviewing candidates for OECD accession and in OECD Investment Policy Reviews, including reviews of new adherent economies to the OECD Declaration on International Investment and Multinational Enterprises. The index does not provide a full measure of an economy's investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of an economy's attractiveness to foreign investors; and the index, used in combination with other indicators measuring the various aspects of the FDI climate, may help to explain variations among economies in attracting FDI.

The FDI Index covers 22 sectors, including agriculture, mining, electricity, manufacturing, and the main services (transport, construction, distribution, communications, real estate, financial and professional services). For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted
- the screening and approval procedures applied to inward foreign direct investment
- restrictions on key foreign personnel
- other restrictions such as on land ownership, corporate organisation (e.g. branching).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is the average of the 22 individual sectoral scores. The discriminatory nature of measures, i.e. when they only apply to foreign investors, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. For OECD and non-OECD member adherents to the OECD Declaration on International Investment and Multinational Enterprises, the measures taken into account by the index are limited to statutory regulatory restrictions on FDI, as reflected in their list of exceptions to national treatment and measures notified for transparency under OECD instruments, without assessing their actual enforcement. For non-OECD economies, information is collected through Investment Policy Reviews or, when not in the review process, through a dedicated questionnaire. Regulatory information is updated on a yearly basis following the monitoring of investment measures carried in the context of OECD Freedom of Investment Forum for participating economies, and on the basis of ad-hoc monitoring for the remaining ones.

Source: (Kalinova, 2010[3]), *OECD's FDI Restrictiveness Index: 2010 Update*, www.oecd.org/daf/inv/investment-policy/WP-2010_3.pdf. For the latest scores, see: www.oecd.org/investment/index.

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more details on the methodology underpinning this assessment please refer to the Methodology and assessment process chapter.

## Figure 4.2. Investment dimension assessment framework

**Investment policy and promotion dimension**

**Outcome indicators**
1. Overall annual FDI inflow (% of GDP)
2. Annual inward FDI by sector
3. Annual investment flows into greenfield investments (% of GDP) - new

| Sub-dimension 1.1<br>Investment policy framework | Sub-dimension 1.2<br>Investment promotion and facilitation | Sub-dimension 1.3<br>Investment for green growth |
|---|---|---|
| **Qualitative indicators**<br>1. The legal framework for investment<br>2. Exceptions to national treatment<br>3. Investor protection against expropriation<br>4. Dispute settlement<br>5. Intellectual property rights legal framework<br>6. Intellectual property rights enforcement<br>7. Intellectual property rights awareness raising and access to information | **Qualitative indicators**<br>8. Investment promotion agency structure and strategy<br>9. Investment facilitation services and activities<br>10. Investor targeting<br>11. Investor incentives<br>12. Aftercare services | **Qualitative indicators**<br>13. Green investment policy and promotion<br>14. Choosing public and private partnerships for green growth |

**Cross-cutting indicator: FDI restrictiveness Index**

| | | |
|---|---|---|
| **Quantitative indicators**<br>1. Number of industrial land transactions with foreign investors<br>2. Intellectual property rights: number of cases of law enforcements<br>3. No. of procedures to start a foreign-owned business<br>4. No. of days to start a foreign-owned business<br>5. No. of days to lease private land<br>6. No. of days to lease public land | **Quantitative indicators**<br>7. Number of investment promotion matchmaking events organised<br>8. Number of staff at IPA<br>9. Budget of IPA as share of total GDP | **Quantitative indicators**<br>n.a |
| **OECD instruments**<br>Policy Framework for Investment<br>• Chapter on investment policy<br>FDI Regulatory Restrictiveness Index<br>• Covering 22 economic sectors | **OECD instruments**<br>Policy Framework for Investment<br>• Chapter on investment promotion and facilitation | **OECD instruments**<br>Policy Framework for Investment<br>• Chapter on Investment Policy and promotion for Green Investment |

The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan (AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The action plan is made up of targeted actions in four key areas: 1) regional trade; 2) regional investment; 3) regional digital; and 4) regional industrial and innovation (Regional Cooperation Council, 2021[4]).

In the regional investment area, the WB6 economies commit to greater regional alignment of investment policies and better co-ordinated investment promotion by removing existing barriers to regional investment, conducting regional investment promotion campaigns, developing regional guidance criteria for screening mechanisms, attracting investment in sustainable regional value chains, and concluding economy-specific international investment agreements (IIAs) with the EU.

The regional investment area section of the CRM 2021-24 AP includes the following three components: 1) regional investment promotion; 2) regional investment policy reforms; and 3) regional investment retention

and expansion. The findings of the investment promotion and facilitation sub-dimension can inform the implementation of actions under this component (Box 4.4).

### *Key methodological changes to the assessment framework*

Since the 2018 edition of the Competitiveness Outlook, Investment for green growth (Sub-dimension 1.3) has been added. In addition, the court system analysis under Investment policy (Sub-dimension 1.1) has been broken down into investor protection against expropriation and alternative dispute resolution. Under Investment promotion and facilitation (Sub-dimension 1.2), the strategy and institutional framework for investment promotion and facilitation has been split into investment promotion agency structure and strategy as well as investment facilitation services and strategy, to better map the investment promotion agencies in the WB6 region and benchmark them against OECD economies. Furthermore, the starting a business and FDI-SME linkages indicators have been absorbed into existing indicators under Investment promotion and facilitation (Sub-dimension 1.2).

## Investment policy and promotion performance and context in the WB6

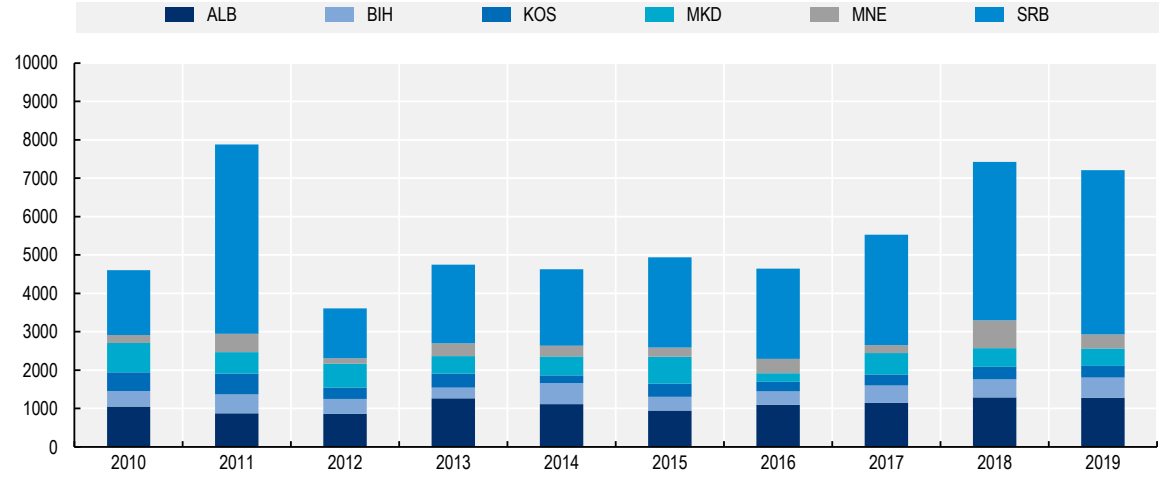
After a steady decrease in global FDI flows over the last decade, COVID-19 shrunk investment circulation to 1% of world GDP in 2020, the lowest levels since 1999 (OECD, 2021[5]). The pandemic hit the WB6 in the midst of an economic upturn after several years of sizable investments that provided economic growth, lowered unemployment, and boosted innovation and technological development. COVID-19 caused a deceleration of both public and private investment as the region's high concentration and composition of FDI created vulnerability.

FDI fell globally by 38% in 2020, from USD 1.37 trillion in 2019 to an estimated USD 846 billion, according to the OECD FDI in Figures Report (OECD, 2021[5]). While the global economic outlook is positive, with the OECD expecting an estimated 5.8% growth, according to UNCTAD, as of January 2021, FDI flows are expected to fall further, by 5-10%, in 2021 (UNCTAD, 2020[6]). The Western Balkans have seen a less severe drop of FDI inflows during the first half of 2020 than at the global level. FDI relative to GDP remained stable in Albania and Bosnia and Herzegovina, and increased in Montenegro (European Commission, 2020[7]).

Prior to the COVID-19 pandemic, WB6 economies attracted USD 6 billion of foreign investment annually over 2015-19. This was up from the USD 5.1 billion attracted over 2010-14, with FDI in the region increasing by 4.6% a year over 2010-19 (Figure 4.3). Serbia continues to account for more than half of the region's FDI each year, given its relatively large economy, reaching 59% of the region's FDI inflows in 2019. In relative terms, Albania and Montenegro have been the leading economies for FDI inflows measured as a percentage of GDP, whereas the lowest ratios in 2019 (and in 2017) remain in Bosnia and Herzegovina (2.7%) and North Macedonia (2.9%) (Figure 4.4).

## Figure 4.3. FDI flows into WB6 economies (2009-19)

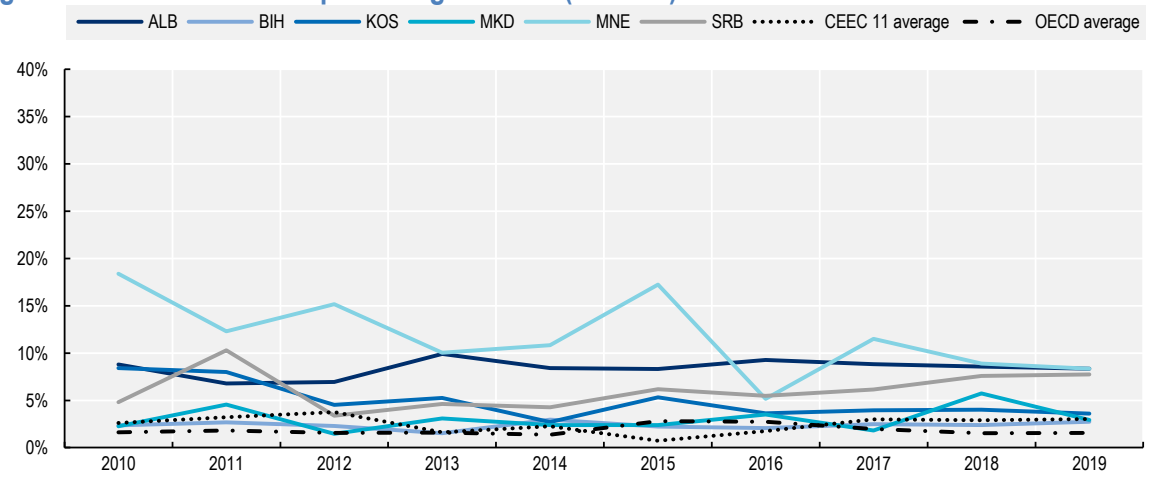
USD millions




Source: (UNCTAD, 2020[6]). *UNCTAD, World Investment Report 2020: International Production Beyond the Pandemic*, https://unctad.org/system/files/official-document/wir2020_en.pdf.

StatLink https://doi.org/10.1787/888934253328

## Figure 4.4. FDI inflows as a percentage of GDP (2009-19)



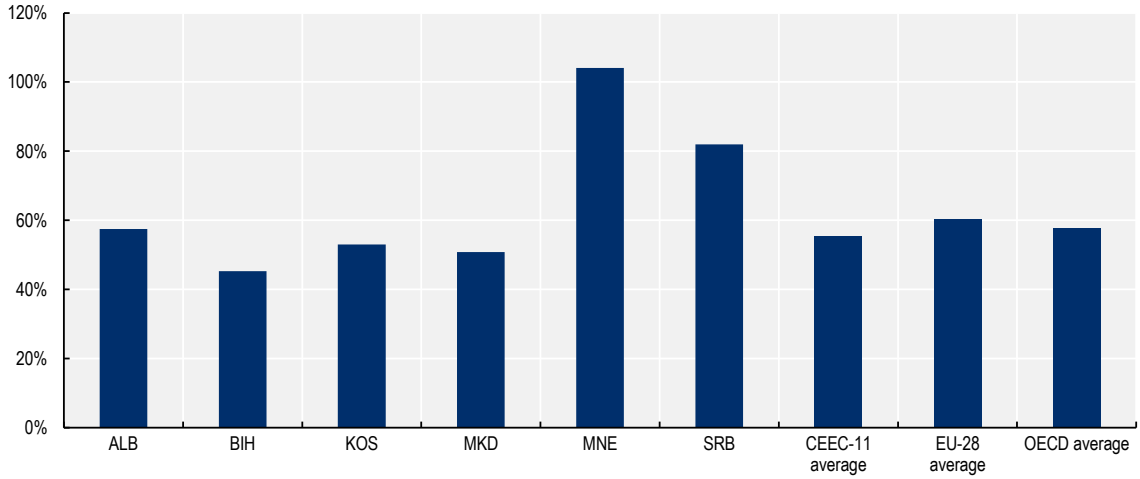

Note: CEEC 11 – Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia

Source: (UNCTAD, 2020[6]), *World Investment Report 2020 International Production Beyond the Pandemic*, https://unctad.org/system/files/official-document/wir2020_en.pdf.

StatLink https://doi.org/10.1787/888934253347

FDI stocks represented over 45% of GDP in the six economies in 2019, reflecting the important role FDI plays in the WB6 (Figure 4.5). Compared to the EU and to the peer economies of Croatia and Slovenia, FDI as a proportion of GDP is higher in Montenegro (104%) and Serbia (82%) and slightly below the EU (but higher than Croatia and Slovenia) in Albania (57%), Kosovo (53%) and North Macedonia (51%). Bosnia and Herzegovina has the lowest FDI stock-to-GDP ratio among the WB6 economies (45%), but is still higher than Slovenia. In comparison to the last assessment, FDI as a percentage of GDP remains largely the same in the WB6 economies, with the exception of Albania, where the FDI stock-to-GDP ratio increased by 16%.

## Figure 4.5. FDI stock as a percentage of GDP (2019)




Note: Data for Kosovo are from 2018. CEEC 11 – Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (UNCTAD, 2020[6]), *World Investment Report 2020 International Production Beyond the Pandemic*, https://unctad.org/system/files/official-document/wir2020_en.pdf; IMF statistics for Kosovo; (OECD, 2019[8]) *OECD International Direct Investment Statistics 2019*, https://doi.org/10.1787/g2g9fb42-en.

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FDI in the region is largely dominated by EU companies, accounting for 65.5% of total WB6 FDI stock in 2018 (European Commission, 2020[9]). For the past two decades, foreign investment in the WB6 economies has primarily originated from Western Europe (Austria, France, Germany, Italy, the Netherlands, and Switzerland) and the Russian Federation (Table 4.2). Investment in the region also comes from neighbouring economies such as Croatia, Cyprus, Greece, Slovenia, and Turkey, as well as the United Arab Emirates and Canada. It is also worth noting that Serbia is an important investor in the region, accounting for 14% of the FDI stock in Bosnia and Herzegovina and 5% of FDI stock in Montenegro in 2018. China is increasingly investing in the region, initially focusing on Serbia, as part of its Belt and Road Initiative (BRI).

## Table 4.2. Top five investing economies in WB6 economies (2018)

Share of FDI stock

| ALB | | BIH | | KOS | | MKD | | MNE | | SRB | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Switzerland | 19% | Austria | 19% | Germany | 13% | United Kingdom | 14% | Italy | 11% | Netherlands | 18% |
| Canada | 15% | Croatia | 16% | Switzerland | 12% | Austria | 13% | Russian Fed. | 11% | Austria | 11% |
| Netherlands | 14% | Serbia | 14% | Turkey | 11% | Greece | 9% | Cyprus* | 9% | Germany | 6% |
| Greece | 12% | Slovenia | 8% | Austria | 6% | Netherlands | 8% | Serbia | 5% | Cyprus | 6% |
| Italy | 8% | Netherlands | 6% | Slovenia | 5% | Slovenia | 7% | UAE** | 5% | France | 5% |

* Footnote by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus. Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus" issue; 2 Footnote by all the European Union Member States of the OECD and the European Union: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.
** UAE: United Arab Emirates.
Source: (IMF, 2020[10]), IMF Data (database), www.imf.org/en/data.

The sectoral distribution of FDI varies across the WB6 economies. In Albania, FDIs are concentrated in the energy sector, extractive industries, financial and insurance activities, utilities and real estate. In Bosnia and Herzegovina, manufacturing (34% of total FDI stock), and banking (25%) are the largest beneficiaries of FDI,

followed by telecommunications and trade (12% each) and by the tourism sector. In Kosovo, real estate and leasing activities are the largest beneficiaries of FDI, followed by financial services and energy, while food, information and technology, infrastructure, and energy are growing sectors. FDI in Montenegro is mostly concentrated in the tourism, energy and agriculture sectors. In North Macedonia, manufacturing remains the sector that attracts most FDI, ahead of financial and insurance activities. Finally, in Serbia, FDI is concentrated primarily in manufacturing, trade, real estate, logistics and financial mediation.

The composition of FDI stock in the Western Balkans underlines the region's vulnerability to the impact of the COVID-19 pandemic. The manufacturing sector accounts for the greatest share of FDI stocks in North Macedonia (36%), Serbia (32%), Bosnia and Herzegovina (28%), and Kosovo (12%). As EU investors have located export-oriented activities in the region to serve their home markets (Novik and de Crombrugghe, 2018[11]), a potential demand contraction might result in a fall in earnings affecting sectors such as automotive, machinery parts and textiles (OECD, 2019[8]).

## Investment policy (Sub-dimension 1.1)

Developing an enabling investment climate that attracts investors and promotes sustainable growth requires a sound legal framework including laws, regulations and policies that ease the admission of investors and protect their property. In addition, governments should ensure that policies and legislation are transparent, predictable and easy to implement.

These elements are covered in four sections: 1) the quality of the legal and regulatory framework for investment; 2) market access and exceptions to national treatment (assessed through the measurement of statutory restrictions to FDI); 3) investor protection (assessed through the guarantees against expropriation and alternative dispute resolution indicators); and 4) intellectual property rights (assessed through the intellectual property rights laws, enforcement and awareness-raising indicators).

### Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 1.1: Investment policy framework | Legal frameworks for investment | 3.5 | 2.0 | 2.5 | 3.0 | 3.5 | 4.0 | 3.1 |
| | Exceptions to national treatment | 3.5 | 3.5 | 4.0 | 3.5 | 4.0 | 4.0 | 3.8 |
| | Investor protection against expropriation | 3.0 | 4.0 | 2.0 | 4.0 | 3.0 | 4.5 | 3.4 |
| | Dispute settlement | 2.0 | 2.5 | 2.0 | 3.5 | 3.5 | 4.0 | 2.9 |
| | Intellectual property rights legal framework | 3.0 | 3.0 | 2.0 | 4.0 | 4.0 | 4.0 | 3.3 |
| | Intellectual property rights enforcement | 2.0 | 2.5 | 2.0 | 3.5 | 3.0 | 4.0 | 2.8 |
| | Intellectual property rights awareness raising and access to information | 3.5 | 2.5 | 2.0 | 3.0 | 4.0 | 4.0 | 3.2 |
| **Investment policy framework average score** | | 2.9 | 2.9 | 2.4 | 3.5 | 3.6 | 4.1 | 3.2 |

### *Frameworks for investment are sound; legislation could be more transparent and predictable*

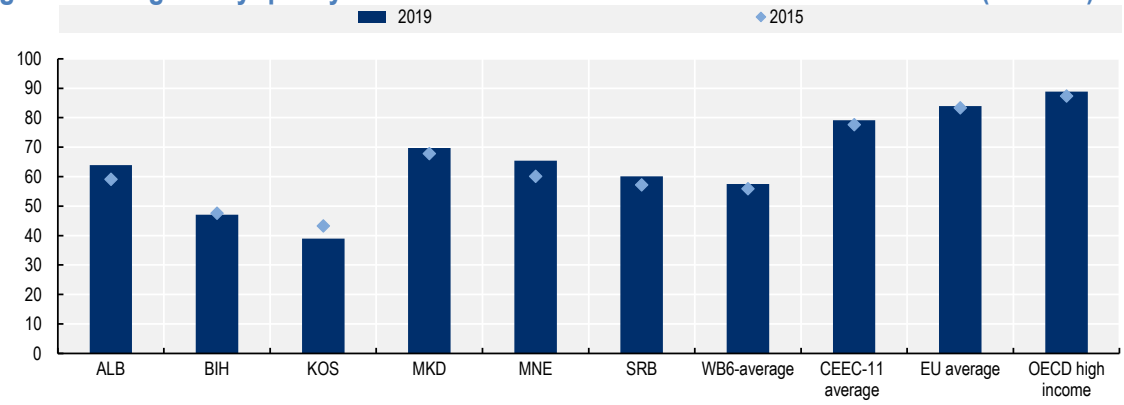
All WB6 economies have established sound legal frameworks for investment**.** Investment laws are the main instrument regulating investment in the majority of the WB6 economies. While North Macedonia and Serbia have unified investment laws covering both foreign and domestic investors, Albania, Bosnia and Herzegovina, Kosovo and Montenegro have dedicated foreign investment laws. In addition, legislation governing investment is complemented with strategic investment laws in Albania, Kosovo, and North

Macedonia, as well as with free economic zones laws in some economies, such as the Law on Technological Industrial Development Zones, which plays an important role in attracting investment in North Macedonia.

In recent years, governments have made some efforts to modernise their legislation. For instance, Kosovo adopted a law on strategic investment in 2017 and a law on business organisations in 2018, while Montenegro adopted a public private partnership law and public procurement law in 2019 that modernise the investment promotion institutional setting. Albania prepared a new draft investment law in 2017 that simplifies and unifies the legal framework for investment by replacing the former laws on foreign investments and strategic investments. While consultations have been initiated, the new investment law has yet to be adopted. In addition, governments have begun to improve and simplify their legislation. For instance, North Macedonia and the Republic of Srpska are implementing regulatory impact analysis (RIA) programmes to improve their regulatory environment and enhance consultations with stakeholders.

Overall, the quality of the investment frameworks is improving as governments progressively align their legislation with EU standards. According to the Worldwide Governance Indicators, Albania, Montenegro, North Macedonia and Serbia have solid frameworks (though they still rank below CEEC, EU and OECD benchmarks), whereas Kosovo and Bosnia and Herzegovina's legislation is lagging behind other economies in the region, as investors have to navigate differences in legislation across several levels of government, including the cantonal level (Figure 4.6). Nevertheless, in some economies, investment legislation remains unclear (US Department of State, 2020[12]). For example, in North Macedonia, frequent changes and inconsistent interpretation of the rules tend to create an unpredictable business environment.

## Figure 4.6. Regulatory quality in the WB6: the Worldwide Governance Indicators (2015-19)




Note: This dimension of the Worldwide Governance Indicators reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. Percentile rank among all economies, ranging from 0 (lowest) to 100 (highest) rank. EU includes all EU Member States in 2015-2019 period. CEEC-11= Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. OECD high income definition: The World Bank defines a high-income country as one with a gross national income per capita exceeding USD 12 056.
Source: (World Bank, 2020[13]) *World Bank, The Worldwide Governance Indicators (WGI) project*, http://info.worldbank.org/governance/wgi/.

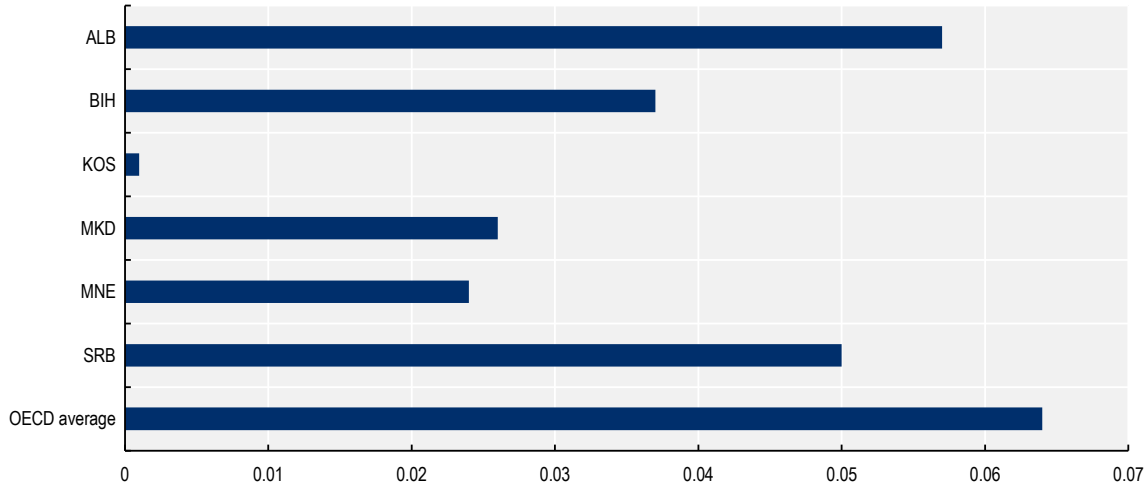
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Governments in the region are making efforts to increase transparency, the accessibility of legislation as well as public involvement in policy making. For instance, all WB6 economies publish and regularly update their investment legislation online. However, some economies do not have a single website or portal for investors and the legislative texts are not always available in English. In addition, public involvement in policy making is not sufficiently systematic and remains below EU standards overall (European Commission, 2020[14]). While all WB6 economies have established mechanisms for public consultation using online platforms, they often suffer from insufficient time allocated for comments, late inclusion of stakeholders in policy making, frequent use of urgent procedures for adopting legislation, and limited inclusion of shareholders' contributions in final texts.

### *Exceptions to national treatment remain low in the WB6*

WB6 economies are among the most open to FDI, as measured by the OECD FDI Regulatory Restrictiveness Index (which only covers statutory measures discriminating against foreign investors) (Figure 4.7). Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia maintain only a handful of restrictions, making their FDI regimes less restrictive than those of the average OECD economy. They also compare favourably with the average of the 22 EU Member States covered by the Index.

**Figure 4.7. OECD FDI Regulatory Restrictiveness Index (2020)**




Note: Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The OECD FDI Regulatory Restrictiveness Index only covers statutory measures discriminating against foreign investors (e.g., foreign equity limits, screening and approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment climate (e.g., the implementation of regulations and state monopolies, preferential treatment for export-oriented investors and special economic zone regimes) are not considered. Data reflect regulatory restrictions in December each year.

Source: (OECD, 2020[15]), *FDI Regulatory Restrictiveness Index* (database); OECD (2021), *FDI Regulatory Restrictiveness Index* (database), www.oecd.org/investment/fdiindex.htm.

StatLink https://doi.org/10.1787/888934253404

None of the six economies has established a foreign investment negative list to clearly delimit the sectors where foreign investment is prohibited or conditioned and outlining which discriminatory conditions apply. Negative lists can improve the accessibility of the legal framework for foreign investors as it relieves them of the burden of reviewing multiple laws to understand the market access and treatment conditions applicable to them.

There are no pre-establishment screenings requiring foreign investors to obtain approval from the host economy prior to making an investment in the WB6 economies. National treatment of foreign investors in the post-establishment phase is guaranteed. All foreign investors, when incorporated and headquartered in WB6 economies, are considered to be domestic legal entities, with all the rights and obligations applied to domestic investors. The WB6 economies maintain a few *de jure* restrictions, primarily in service sectors, which is common practice in OECD economies as well. Foreign equity restrictions are also used less in WB6 economies than in the other economies covered in the FDI index. They are generally limited to a few service sectors, while FDI in manufacturing is allowed in all sectors with the exception of arms and ammunition. Local legislation allows full foreign ownership of service companies, with restrictions limited to service sectors which regularly face restrictions in OECD and non-OECD economies such as defence, media and transport (Table 4.4). Sectors where foreign ownership restriction exists in the WB6 are also common in EU and OECD economies and the WB6 remain very open in comparison. It is also worth noting that some of these restrictions are lifted for nationals from EU economies, the United States and other economies that have signed bilateral agreements with the WB6.

### Table 4.4. Key sectoral restrictions to foreign service ownership in the WB6

| Albania | Bosnia and Herzegovina | Kosovo | Montenegro | North Macedonia | Serbia |
|---|---|---|---|---|---|
| Transport, media, fisheries, notary services, legal services | Media | Legal services | Transport, legal services | Transport, gambling | Media, legal services, defence sector |

Source: OECD, based on existing laws in the WB6 economies.

Yet despite the openness of the WB6 economies, there are still exceptions to national treatment for foreign investors in key sectors where historical monopolies dominated by state-owned enterprises (SOEs) persist. However, it should be noted that Kosovo, Montenegro and Serbia are undergoing a process of structural reforms and privatisations which should reduce these barriers.

Foreign ownership of non-agricultural land is generally permitted in the WB6 economies; however, some economies maintain some restrictions on the acquisition of land by foreign investors for business purposes. Restrictions primarily concern ownership by legal entities established abroad and can be circumvented by establishing a legal entity in the territory. For instance, Bosnia and Herzegovina, North Macedonia and Serbia maintain discriminatory restrictions on real estate ownership by legal entities established abroad. These are subject to reciprocity, with exceptions for the EU and the OECD member states' residents, who have the same rights as local residents. Ownership of commercial property in Albania is only permitted if the proposed investment is worth three times the price of the land. In Montenegro and Kosovo there are no restrictions on foreign ownership of real estate assets. All WB6 economies, with the exception of Kosovo, also impose restrictions on ownership of agricultural land by foreign investors (OECD, 2018[16]).

### *Investor protection against expropriation has been bolstered*

Investor protection is included in a wide range of policies, laws and regulations that provide investors with the legal guarantee that their rights will be respected, and their property protected. By enhancing investor confidence, sound investment protection is likely to increase not just the level, but also the quality of investment, its durability, and its contribution to economic development (OECD, 2015[2]). Key elements of investor protection include guarantees against unlawful expropriation and securing property protection; effective contract-enforcement mechanisms; an independent court system; and alternative dispute resolution mechanisms, including commercial and investment arbitration.

All WB6 economies provide investors with solid protection against expropriation without fair compensation. Policy makers have incorporated in their respective legislation guarantees that investors' rights will be respected and that their property will be protected against unlawful expropriation. They have also included transparent and predictable procedures in the event of expropriation and for determining financial compensation. Core protection standards are enshrined in the constitutions of Albania, Montenegro, North Macedonia and Serbia; in Bosnia and Herzegovina's Law on the Policy of Foreign Direct Investment;[2] and in the Law on Foreign Investment of Kosovo. The laws regulating investment across WB6 economies stipulate that expropriation can only occur when it is in the public interest without discrimination, against compensation and under due process of law. In all the WB6 economies, the modalities and procedures governing expropriations are regulated by the laws on expropriation. These laws also provide for calculating the amount of compensation, as well as judicial and administrative appeal mechanisms for reviewing or contesting decisions on expropriation. In practice, this assessment found that the business community does not perceive unlawful expropriation to be a major concern in WB6 economies; disagreements tend to be limited to the amounts of compensation.

The concept of indirect expropriation is ultimately covered by the respective legislation in the region. Indirect expropriation occurs when a state interferes indirectly with business operations, affecting the benefits, investments or use of an investor's property, but without actually taking the property. However, only Kosovo provides a clear definition of indirect expropriation.[3] Providing clearer definitions of expropriation that also

include indirect expropriation can provide additional protection to investors from the uncertainty of compensation linked to indirect expropriations.

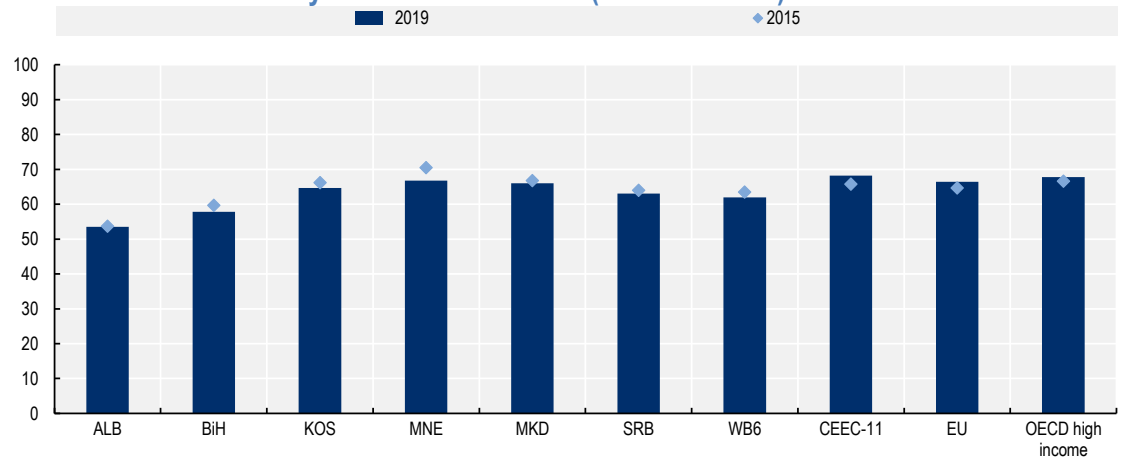
All six economies have also signed a large network of investment agreements, constituting an additional layer of protection for foreign investors. Several governments in the region, notably Albania and Montenegro, are also currently reforming their existing network of bilateral investment treaties (BITs) and defining a new BIT model that will balance investor protection provisions with national strategic interests, whilst also fully complying with EU standards and good international practices. This means ensuring that protection provisions are transposed into their respective national laws and are consistent with international standards of protection.

### *Enforcing contracts and settling disputes remain challenging*

Contract enforcement and dispute settlement mechanisms are fundamental if markets are to function properly. Good enforcement procedures enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. When procedures for enforcing contracts are overly bureaucratic and cumbersome or when contract disputes cannot be resolved in a timely and cost-effective manner, companies may restrict their activities (OECD, 2015[2]).

Overall, the quality of the justice system and its responsiveness to the needs of businesses and people alike remain a challenge for the majority of the WB6 economies. Economies' low ability to enforce contracts (Figure 4.8) is challenging for investors. The efficiency of the legal framework in settling disputes is underperforming compared to EU-28 and OECD averages (Figure 4.9). Confidence in the judiciary system and the courts is remarkably low in the Western Balkan region (OECD, 2015[17]). In 2019, on average, the level of confidence stood at 33% in the WB6, compared to 56% for OECD-EU economies. Only 22% of citizens in North Macedonia have confidence in the judiciary system – the lowest rate registered in the region.

**Figure 4.8. Economies' ability to enforce contracts (2015 and 2019)**

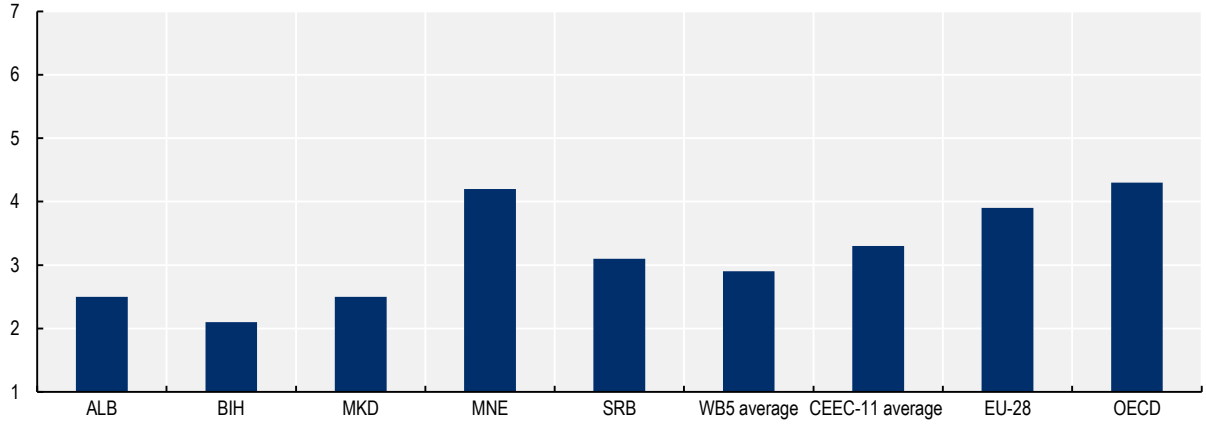



Note: The enforcing contracts indicators is scored on a scale of 1 (low ability to enforce contracts) to 100 (high ability to enforce contracts). The enforcing contracts indicator of the Doing Business Index measures the time and cost for resolving a commercial dispute through a local first-instance court, and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality and efficiency in the court system. EU includes all EU Member States in 2015-2019 period. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. OECD average includes high income economies (Colombia, Chile and Turkey are not included).
Source: (World Bank, 2020[18]), *Doing Business Index 2020*, https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf.

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## Figure 4.9. Efficiency of legal framework in settling disputes (2019)

1-7 (best)




Note: Value for the economy under review 1 (least efficient) and 7 (most efficient). This indicator measures the efficiency of the legal and judicial systems for companies in settling disputes. OECD average includes high income economies with a gross national income per capita exceeding USD 12 056. (Colombia, Chile and Turkey are not included). CEEC-11= Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. Kosovo is not included in the WEF ranking.

Source: (World Economic Forum, 2019[19]), *The Global Competitiveness Report 2019*, http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf.

StatLink https://doi.org/10.1787/888934253442

The quality of the region's judiciary is undermined by limited human and financial resources and inadequate training for judges, notably in commercial law. In addition, procedures for enforcing contracts and resolving disputes remain overly bureaucratic and cumbersome, and contract disputes are often not resolved quickly or cost-effectively enough. As a result, backlogs in the courts remain sizeable, especially in Kosovo (European Commission, 2020[14]). Local and foreign investors, which have the same rights and remedies before domestic court systems as domestic investors in the region, often complain that courts are slow in processing cases; that judicial procedures are complex; and that judges' decisions suffer from lack of capacity as well as interference, corruption, political pressure and nepotism in the justice system, particularly in Albania, Bosnia and Herzegovina, and North Macedonia (US Department of State, 2020[12]).

Several WB6 economies are pursuing comprehensive justice reform agendas as part of their accession negotiations and alignment with EU standards. Key reforms include streamlining the functioning of the judicial system, including by rationalising the courts network; modernising infrastructure and adopting modern information technologies; and promoting mediation as an alternative dispute resolution methods (see next section). However, while positive recent upgrades in Albania, Montenegro and North Macedonia have seen improvement both in terms of efficiency and effectiveness of commercial procedures, progress is still slow and difficult in Bosnia and Herzegovina and Kosovo (European Commission, 2020[14]).

As part of their efforts to improve justice efficiency on commercial matters, all WB6 economies have dedicated commercial courts or designated departments or units to handle commercial matters. Montenegro and Serbia have specialised commercial courts which have first instance jurisdiction on commercial matters. In Bosnia and Herzegovina, commercial cases are handled by commercial courts in the Republika Srpska, and by the commercial departments of municipal courts in the Federation of Bosnia and Herzegovina. In Albania, the Tirana District Court has a special division to judge commercial matters, known as the Commercial Section, while commercial disputes are handled by specialised court divisions in the basic courts with extended competence in North Macedonia. Finally, in Kosovo, commercial cases will be examined by a designated department for commercial matters within the Pristina Basic Court, pending the approval of the draft law on commercial courts.[4]

### *Alternative dispute mechanisms should be further reinforced*

Alternative dispute resolution (ADR) mechanisms, including arbitration, mediation and conciliation, are additional instruments that are increasingly used for resolving commercial disputes. Multiple economies are fostering the use of ADR to alleviate the burden on judiciary systems, especially for low-value commercial cases. They are favoured by investors as they allow for swift resolution of commercial disputes and/or to cope with an under-performing judiciary with limited commercial expertise, complex procedures, lengthy delays, and hefty costs. In most OECD economies, arbitration plays a primary role as an ADR mechanism, either to settle disputes between foreign investors and host states (international investment arbitration) or to resolve disputes between businesses (private commercial arbitration).

All six WB6 economies have ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the 1958 Convention on the Recognition and enforcement of foreign arbitral awards (New York Convention). Ratification of the New York Convention means that foreign investors can enforce their rights and contracts in the event of a dispute. In addition, in 2019 Montenegro, North Macedonia and Serbia signed the Singapore Convention on Mediation.[5] Nevertheless, stakeholders report that enforcement of arbitral decisions can be lengthy. For instance, the enforcement of an international arbitration award in Serbia can be a slow and difficult process and in some cases, it can take up to five years for Serbian courts to recognise International Court of Justice rulings (US Department of State, 2020[20]). However, the number of investor-state disputes in the region that are brought before international arbitration is limited and mainly involve large investors.

All WB6 economies provide for local arbitration and laws on arbitration exist in North Macedonia (2006), Serbia (2006), Kosovo (2007) and Montenegro (2015). These four economies host private arbitration centres in their local or foreign chambers of commerce. In Albania and Bosnia and Herzegovina, arbitration is less regulated. Nevertheless, their law/code on civil procedure regulates arbitration procedures if the parties agree to entrust the resolution of their dispute to arbitration. Montenegro is also in the process of adopting a new law on ADR, which notably provides for compulsory recourse to ADR mechanisms for specific types of cases. Mediation mechanisms are also increasingly promoted and regulated in the WB6 economies. All WB6 economies have mediation laws, with Albania and Kosovo having adopted dedicated legislation in 2018.

Despite the availability of out-of-court methods of dispute resolution in WB6 economies, in practice, the use of arbitration and mediation as an alternative to resolving disputes remains very low partly due to a lack of awareness. The use of mediation and of ADR mechanisms in general varies greatly between WB6 economies. For instance, Montenegro adopted a programme for ADR promotion and an accompanying action plan for 2019-21 and has seen a positive trend in the use of ADR mechanisms since 2017. In North Macedonia, on the other hand, the use of ADR mechanisms is not common, and arbitration is not yet considered a viable tool to ensure justice, either by parties or by the courts and as a result, “the number of mediation cases has decreased over recent years” (European Commission, 2020[21]).

### *Intellectual property rights laws are in place, but enforcement is a challenge*

The granting and protection of intellectual property (IP) rights is an important component of a sound legislative framework that attracts investments. Protection of IP rights through trademarks and patents fosters development and innovation by reinforcing linkages and transfers between local firms and multinationals. It is widely acknowledged that a well-functioning and balanced IP system is key to promoting innovation and creativity, which are the main drivers of economic development in knowledge-based economies.

Developing effective IP systems also requires: 1) a sound legislative framework; 2) effective implementation and enforcement; as well as 3) efforts to raise the awareness of businesses and citizens on the importance of IP rights. IP enforcement involves a high level of co-ordination among the various institutions in charge of implementing and enforcing IP, as well as strong legal structures.

All six WB6 economies generally have sound **intellectual property rights legal frameworks** which are in line with international practice. With the exception of Kosovo, they are all members of the World Intellectual Property Organization (WIPO) and have adhered to the main international treaties and conventions on IP rights, such as the Patent Co-operation Treaty, the Paris Convention, the Madrid Protocol and the Hague Agreement.

All the economies have progressively introduced IP-specific legislation over the past decade and are continuing their alignment with EU standards through amendments of IP laws and regulations. Albania adopted secondary legislation on trademarks and the legal protection of designs in 2018;[6] Bosnia and Herzegovina is largely aligned with the EU *acquis* on copyright and neighbouring rights; while Serbia has notably adopted a new trademark law that came into force in 2020 and amended its copyright law and related rights in 2019, further aligning with EU *acquis*. According to the (European Commission, 2020[14]), Serbia and Montenegro's IP legislation is the most aligned with the EU *acquis*, while the other four economies still have a way to go. Investors complain that their IP rights are poorly protected in the region, as illustrated by the WB6 economies' ranking in the Global Competitiveness Index Report 2019, where all economies score in the bottom half of the rankings on intellectual property protection,[7] with Bosnia and Herzegovina ranking 134 and Albania ranking 130 out of 140 assessed economies (World Economic Forum, 2019[19]). This policy area remains a challenge in most of the WB6 economies.

**Intellectual property rights enforcement** also remains a challenge in the region and intellectual property right infringement problems persist in all six Western Balkan economies. All WB6 economies have established IP institutions in charge of implementation and enforcement. However, IP enforcement institutions generally lack human and financial resources as well as the authority and means to co-ordinate the various institutions involved in IP enforcement.

Governments in the region are well aware of these challenges and are increasingly focusing on IP rights implementation and enforcement. Most of the WB6 economies have also adopted IP dedicated strategies and action plans and implemented reforms in order to better protect investors' rights. However, their implementation and outcomes vary greatly.

Albania, Kosovo, and Serbia have seen positive progress by reinforcing the resources and capacities of the agencies in charge of registration, protection, and enforcement of IP rights. For instance, the General Directorate of Industrial Property (GDIP) in Albania has seen its staff increase from 24 to 38 since 2018. The Industrial Property Agency (AIP) in Kosovo added three new staff in 2019, and Albania has progressed on IP implementation with increases in the number of applications to register trademarks since 2018.[8] Kosovo has reduced the backlog of applications for patents, trademarks and industrial designs (European Commission, 2020[22]), while in Serbia the procedures for registering industrial property rights and to deposit works and authorship are efficient and in line with EU standards (US Department of State, 2020[20]).

In Montenegro and North Macedonia, developments are more subdued. Montenegro is still to adopt its National Intellectual Property Strategy (2021-2024) and its already understaffed IP office has seen a further reduction in staff (OECD, 2018[16]). In the meantime, the government has stepped up its efforts to reinforce the capacity of enforcement agencies and specialised judges on IP matters through regular training. It has also reinforced co-ordination among relevant institutions. In North Macedonia, the State Office of Industrial Property (SOIP), in charge of industrial property rights, has improved its registration process. However, effective IP implementation and enforcement in the economy are still hampered by the myriad institutions in charge and their lack of human resources, which tend to limit their co-operation and efficiency.

IP enforcement is particularly problematic in Bosnia and Herzegovina as the enforcement agencies and the judicial system lack capacity and resources and their co-operation is limited in this very decentralised state. In 2019, the economy adopted the Strategy for the Enforcement of Intellectual Property Rights in Bosnia and Herzegovina for the period 2018-2022. This sets out guidelines and measures to develop and improve the legislative and institutional framework for IP enforcement and to establish inter-institutional co-operation.

However, progress has been slow, and the strategy has yet to be implemented (European Commission, 2020[23]).

**Intellectual property rights awareness raising and access to information** play an important role in the broader IP policy framework. However, with a few exceptions, there is generally little awareness of IP rights and obligations, either among the general public or the judiciaries of the six economies. In Albania, additional resources for the GDIP have improved IP rights awareness-raising efforts and access to information. Since 2018, the GDIP has intensified its IP rights awareness-raising activities in co-ordination with businesses and technical and scientific information centres through seminars and lectures in public and private universities as well as for interest groups. It has also enhanced access to information through various services including a help desk, Patlib (providing local access to patent information and related issues), information kits and other information brochures, etc.

### *The way forward for investment policy*

- **Continue reform efforts to improve the efficiency of the judiciary**. The ability to make and enforce contracts and resolve disputes is fundamental if investors' rights are to be protected. Good enforcement procedures enhance predictability and trust in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts. To this end, it is essential to further reinforce the ability of commercial justice to handle conflict resolution and enforce contracts, including by greater capacity building and training for judges in dealing with commercial and IP cases.
- **Streamline investment legislation** and improve its predictability. Throughout this process, governments should reinforce transparency and ensure well-structured and inclusive public participation in policy making. It is also important to ensure that the effectiveness of regulations is regularly monitored and evaluated. These reforms will help to build an environment of trust that fosters compliance with laws and regulations, strengthens investor confidence and reduces risk aversion.
- **Improve the clarity of the investment regime**, notably for foreign investors. To make the legislation more intelligible, governments could establish negative lists of the sectors that are prohibited or restricted for foreign investors, as well as the discriminatory conditions that apply – even if the latter are very limited in the WB6 economies. Gathering all relevant regulations into a single platform in English and regularly updating it would also increase accessibility.
- **Improve the definition of indirect expropriation** in order to reinforce investor property protection. Better definitions of indirect expropriation should also clarify whether the governments' actions require compensation for investors while better protecting the general public's interests and welfare.
- **Continue to strengthen the frameworks for alternative dispute resolution** and encourage their use by businesses. These mechanisms, which are generally appreciated by the business community, could help to alleviate the pressure on the judiciary systems and reduce the backlog of cases.
- **Reinforce IP implementation and awareness raising**. This will mean reinforcing the capacity and resources of IP agencies. IP policy and implementation requires a whole-of-government approach and strong co-ordination among various IP-related institutions, as recommended by WIPO guidelines (Box 4.2). Efforts to sensitise businesses and the public about IP matters should be bolstered. Doing so will help to reinforce linkages between local and multinational firms as well as fostering innovation.

### Box 4.2. WIPO guidelines and good practice for developing IP strategies

Private enterprises and academic institutions see patents, trademarks, copyrighted works and other forms of IP as economic assets. Solid IP regulations permit universities, enterprises or R&D institutions to assess existing stock of IP and human capital, which can also help entrepreneurs and innovative SMEs to access bank financing using IP capital as collateral. The WIPO guidelines on developing IP strategies include several key recommendations that may be useful for WB6 economies in the strengthening and reinforcement of existing IP action plans or developing new strategies:

- Including essential features of a strong IP strategy by specifying strategic goals and objectives, mechanisms, policies, actions, costs and resources, as well as links with other planning tools, including development, economic and education plans. While many economies opt to develop stand-alone IP plans, economies may also choose to establish economic plans with IP components, or multifaceted strategic plans integrating education, technology, health, agriculture, commerce, IP and finance.
- Targeting specific areas of competitive advantage allows economies to select clusters or target areas in which their enterprises or research institutions may have a competitive advantage, or which harmonise with national needs and capacities. This definition of cluster areas may also work as a strategy for researchers and enterprises.
- Incorporating incentives and awards by establishing multifaceted motivations and support for IP asset development and commercialisation. These may include tax incentives, payments, patent application funds, venture funds for SMEs in cluster areas and financial rewards in private enterprise for inventors and creators.
- Making the IP system easy to use, accessible and affordable through reduced fees for individual inventors and research institutions or those with incomes under an established threshold. Economies may also create funds to support patent applications by national research centres and individuals. Surveying research institutions, private enterprises and other users to understand the challenges of existing IP systems can allows governments to tailor IP strategies to their economy's specific needs.
- Building public awareness concerning IP by developing programmes for public secondary-level education to raise awareness of the importance of invention and creativity at an early age through information products like interactive websites and even comic books explaining the basic concepts of IP. Granting publicised awards to inventors, creators and IP professionals also raises recognition of the cultural and economic value of IP.

Source: (WIPO, 2006[24]) *IP Asset Development and Management: a Key Strategy for Economic Growth*, https://www.wipo.int/edocs/pubdocs/en/intproperty/896/wipo_pub_896.pdf.

## Investment promotion and facilitation (Sub-dimension 1.2)

Investment promotion and facilitation measures can be powerful means of attracting investment and maximising its contribution to development, but their success depends on the quality of investment-related policies, as reviewed in the previous section (OECD, 2015[2]). The roles of investment promotion and investment facilitation are complementary: the former focuses on marketing an economy or a region as an investment destination, while the latter aims at making it easy for investors to establish, operate and expand their existing investments.

The investment promotion and facilitation sub-dimension is assessed through five qualitative indicators (Table 4.5). As the scores indicate, the quality of the institutional framework for investment promotion and

facilitation varies across the region. Strategies to promote, attract and retain FDI are well established overall, but there is scope to further enhance their implementation.

### Table 4.5. Scores for Sub-dimension 1.2: Investment promotion and facilitation

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 1.2: Investment promotion and facilitation | Investment promotion agency structure and strategy | 4.0 | 2.0 | 2.0 | 3.0 | 2.0 | 4.0 | 2.8 |
| | Investment facilitation services and activities | 3.5 | 2.0 | 3.0 | 2.0 | 2.5 | 3.5 | 2.8 |
| | Investor targeting | 3.5 | 3.5 | 2.0 | 3.0 | 3.5 | 4.0 | 3.3 |
| | Investor incentives | 2.5 | 2.5 | 1.0 | 4.0 | 2.5 | 4.0 | 2.8 |
| | Aftercare activities | 3.5 | 3.5 | 4.0 | 2.0 | 3.5 | 4.0 | 3.4 |
| **Investment promotion and facilitation average score** | | 3.4 | 2.7 | 2.4 | 2.8 | 2.8 | 3.9 | 3.0 |

### *Institutional frameworks and strategies for investment promotion and facilitation are solid*

Most governments around the world have established investment promotion agencies (IPAs) to create awareness of investment opportunities, attract investors and support their expansion (Box 4.3) – although many functions can also be carried out by other public structures. Their institutional settings differ in their organisation, function and strategies as well as their levels of interaction with other government bodies.

All six Western Balkan economies have established solid investment promotion agency structures and strategies to efficiently promote and facilitate investment. The region's IPAs include the Albanian Investment Development Agency (AIDA), the Foreign Investment Promotion Agency (FIPA) of Bosnia and Herzegovina, the Kosovo Investment and Enterprise Support Agency (KIESA), the Agency for Foreign Investments and Export Promotion (ASIPI) of North Macedonia, the Montenegro Investment Agency (MIA) and the Development Agency of Serbia (RAS). In North Macedonia, the Directorate for Technological Industrial Development Zones (DTIDZ) also plays an important role in investment promotion and facilitation in Special Economic Zones. Investment promotion also largely takes place at the entity level, for example, through the Ministry of Economy and Finance in the Republika Srpska which, among other services, promotes investment potentials, attracts foreign investors, provides pre- and post-investment support, and promotes and regulates free zones.

Montenegro has recently modernised its institutional framework and strategy for investment promotion and facilitation. Following the adoption of the new Public Private Partnership Law in December 2019, the Montenegro Investment Promotion Agency (MIPA) and the Secretariat for Development Projects ceased to exist and were replaced by the Montenegro Investment Agency (MIA) in 2020 with a much broader set of responsibilities and reinforced resources. However, as this new institutional setting has yet to have an impact, this report mainly assesses the old institutional setting for investment promotion and facilitation.

### Box 4.3. Key success factors in high-performing IPAs in developing economies

World Bank and OECD research and operational experience have identified the following key success factors common to high-performing investment promotion agencies (IPAs) in developing economies:

- Strong strategic alignment stemming from consultations with public and private sectors and cascading from a national development plan or FDI strategy down to IPA corporate plans and industry-specific strategies.
- A clear, uncontested mandate, ideally focused on investment promotion, especially when starting or restructuring the IPA. Developing economy IPAs with multiple mandates take much longer to, or never do, deliver substantial FDI impact. Regulatory functions (including one-stop shops) are best performed by a separate public institution that ensures proper delivery of this essential function without compromising the equally essential investment promotion mandate of an IPA.
- A high degree of institutional and financial autonomy (or semi-autonomy), emulating private sector flexibility to act according to agreed-upon strategic plans and to hire staff using specified and transparent job qualifications; avoiding political interference; and providing sustainability through political cycles.
- An independent and well-functioning board of directors or advisory board with strong and active private sector representation to better understand investors and provide direction in catering to their needs.
- A strong investor-centric service orientation to design and provide relevant and high-quality services to investors throughout their investment cycle.
- Management and key promotion staff with strong private sector experience, as well as international exposure and language skills, within the IPA's mix of employees with public and private sector experience.
- Sufficient and sustained financial resources over three- to five-year periods to provide continuity of strategic efforts over the long-cycle nature of investment promotion and to avoid struggling over funds every year or having to charge fees.

Source: (World Bank, 2020[25]), *Global Competitiveness Report 2019/2020,* http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf; (OECD, 2018[26]), *Mapping of Investment Promotion Agencies in OECD Countries*, https://www.oecd.org/investment/investment-policy/mapping-of-investment-promotion-agencies-in-OECD-countries.pdf.

The governance of an IPA is related to the way it is supervised, guided, and managed. When IPAs are established, their legal status – often formalised by law – will determine many of their organisational and functional aspects. It will have a particular bearing on the IPA's level of autonomy vis-à-vis the government, especially in terms of financial and human resources management. From the least to the most autonomous forms of IPA, the most common types of legal status are the following: 1) governmental (often as a department or a unit within a ministry); 2) autonomous public agency; 3) joint public-private body; and 4) entirely privately-owned organisation (OECD, 2018[26]).

All economies in the region have established their IPAs as autonomous public agencies except for AIDA, which is a governmental entity under the Ministry of Finance and Economy. As a comparison, in OECD economies, the majority of IPAs (60%) are autonomous public agencies while 31% are governmental. Most of the IPAs around the world have also established boards providing supervisory or advisory roles to the agency, or both. For instance, 69% of the IPA agencies in OECD economies have included boards in their organisations (OECD, 2018[26]). When IPAs are public agencies or autonomous public agencies, it is

particularly important to include private sector and civil society – notably research and academia representatives – on their boards.

The IPA boards in the region have varying compositions and roles. For instance, AIDA's board has a supervisory role, while the boards of IPAs in Serbia and Bosnia and Herzegovina have advisory roles. With the exception of Kosovo's IPA KIESA, which did not report having a board, all of the economy's IPA boards comprise both public and private sector representatives. Kosovo's IPA reports directly to the National Council for Economic Development of Kosovo (NCEDK),[9] which is chaired by the Prime Minister of Kosovo and composed of the ministries with an economic orientation as well as the economic business associations.

The IPAs in the six economies differ in their mandates and functions (Table 4.6). All the national IPAs' official mandates include the promotion and facilitation of inward FDI. While the mandates of FIPA and MIA are more focused on foreign investment promotion, KIESA and AIDA have very large mandates, performing respectively 10 and 9 functions. It is also worth noting that domestic investment promotion, followed by export and innovation promotion, are the most frequent additions to the investment promotion mandate of the region's agencies. In the OECD economies, IPAs' mandates range from 2 to 13, with an average of 5.7 (OECD, 2018[26]).

### Table 4.6. IPA mandates in the WB6 economies (2020)

| | AIDA Albania | FIPA Bosnia and Herzegovina | KIESA Kosovo | MIA** Montenegro | ASIPI North Macedonia | RAS Serbia |
|---|---|---|---|---|---|---|
| Inward foreign investment promotion | X | X | X | X | X | X |
| Outward investment promotion | X | | X | | | |
| Domestic Investment promotion | X | | X | X | X | X |
| Operation of One stop Shop | X | | X | | | X |
| Screening and prior approval of investment projects with foreign participation or investor registration | X* | | | | X | |
| Issuing relevant business permits | | | | | | |
| Negotiation of international trade, investments or other agreements | | | X | | X | |
| Export promotion | X | | X | | X | X |
| Trade facilitation | X | | X | | X | |
| Innovation promotion | X | X | X | X | | |
| Management of free trade or Special Economic Zones (SEZ) or industrial parks | | | X | | | |
| Granting fiscal incentives | | | | | | |
| Granting financial incentives | X | | X | | | |

* For strategic investments

** MIA's official mandate is being expanded.

Source: OECD based on existing laws.

In addition to the above-mentioned mandates, IPAs in the region also perform other functions. These include participating in the design of policies related to FDI and overall economic development strategies. For instance, in Serbia, RAS is systematically involved in the design and implementation of all policies, programmes and measures for investment promotion, including the Strategy for Development of SMEs, Entrepreneurship and Competitiveness 2015-2020, the Strategy and Policy for Industrial Development 2011-2020, as well as work on the new strategy for 2021-2030. Meanwhile, in addition to designing and implementing policies, programmes and measures related to foreign investment, the Ministry of Economy and Entrepreneurship of Republika Srpska also establishes and implements several economic development strategies at the entity level, such as the Foreign Investment Encouragement Strategy for the period 2021-2025, Strategy for the Development of Small and Medium Enterprises for the period 2021-2027 and Strategy and Policy of Industrial Development for the period 2016-2020 (a new strategy is being drafted).

Most of the IPAs have well-established mechanisms for developing annual strategic plans and objectives derived from the national investment strategies. They also conduct annual reporting on their activities and spending. AIDA, ASIPI, MIA and RAS have established monitoring and evaluation units that primarily report to the board of the IPA. Most of these IPAs report on the performance of the agency itself using indicators such as the number of campaigns launched, time to respond to investors or number of assisted firms, etc. Only AIDA, and to a lesser extent RAS, reported monitoring the effectiveness and efficiency of their actions for investment promotion. It should be also noted that MIA only recently set up a monitoring and evaluation unit and that the evaluation indicators are yet to be discussed by the board.

Since the last assessment, all six economies have concluded national strategies that include provisions for attracting investment. For instance, Montenegro, North Macedonia, and Serbia have all established industrial strategies that aim to increase investments in the manufacturing sector, facilitate innovation and technology transfers, and incorporate green growth into future investment objectives. These three economies have also adopted long-term strategies on sustainable development until 2030 that aim to strengthen regulatory frameworks and incentives, especially for attracting FDI to infrastructure and green energy projects. Meanwhile, Albania has established the comprehensive National Diaspora Strategy 2021–2025. This lays out 72 specific actions to create a favourable climate for diaspora investment through fiscal stimulus activities, disseminating information, reducing corruption and risks, and improving other incentives, as well as the responsible institution and time limit for their implementation. Kosovo has also established the Strategy for Local Economic Development 2019-2023, which lays out innovative solutions to overcome barriers to attracting foreign investors, such as increasing vocational capacities, investing in human capital and infrastructure projects, as well as enhancing the regulatory environment to offer better protection and security for potential investors. All the IPAs in the region are also involved in developing linkages between local companies and multinationals, with services extending from match making to the management of funds aiming at reinforcing the capacities of local firms in Serbia[10] and Albania.

While the IPAs' financial and human resources should be adapted to their mandate and role, staffing levels in the region do not necessarily reflect important differences in mandates (Table 4.7). Only AIDA, RAS and MIA seem to be adequately staffed given their mandate and objectives, while KIESA has a very large mandate, but only 22 staff members. Since the adoption of the strategic law in Albania, AIDA has substantially increased its staffing from 28 employees in 2018 to about 38 employees in 2020. In 2019 alone, the agency concluded 20 new employment contracts and confirmed 17 existing contracts (AIDA, 2019[27]). These changes are a direct result of an expanded mandate and aim to achieve the most effective division of tasks. The agency is split into 5 directorates: directorate of investment (13 employees), SMEs and projects (8), marketing and research analysis (5), co-ordination (4), and support services (8). While there is no "one size fits all" staffing level for IPAs, the following 2017 examples from OECD economies can provide guidance on the balance between staff numbers and agencies' mandates: Hungary's IPA had 129 staff members to execute 7 mandates, the Czech IPA had 147 staff members to execute its 9 mandates, while the Estonian agency had 300 staff to execute 12 mandates (OECD, 2018[26]). Financial constraints are also an important common challenge for IPAs in the region. Most of the IPAs in the WB6 economies report that inadequate resources – along with the lack of political support and weak business climate or regulatory framework – are among the top three biggest obstacles to their ability to attract investment in the next 5-10 years (OECD, 2018[26]).

### Table 4.7. Investment promotion agencies: Number of employees and mandates (2019)

| | Number of employees | Number of mandates |
|---|---|---|
| AIDA (Albania) | 38 | 9 |
| FIPA (Bosnia and Herzegovina) | 7 | 2 |
| KIESA (Kosovo) | 22 | 10 |
| MIA (Montenegro) | 27 | 3 |
| ASIPI (North Macedonia) | 10 | 6 |
| RAS (Serbia) | 29 | 4 |

Note: Figure for MIA from 2020. Based on the MIA's personnel plan, 42 employees are planned by 2021.
Source: OECD based on existing laws/mandates.

Attracting FDI requires a whole-of-government approach as it entails effective co-ordination and co-operation among various stakeholders in the public sector (national and subnational administration and public or semi-public organisations) and the private sector (industry groups, associations, and chambers of commerce). In the OECD economies, IPAs have a dense interaction network as they deal on average with 25 different organisations, 50% of which are deemed strategic (OECD, 2018[26]). All the WB6 economies try to ensure effective co-ordination between the IPA and other public entities through formal co-ordination mechanisms, including the participation of key ministries on the IPAs boards, as well as joint task forces. However, in some economies, like Bosnia and Herzegovina, effective co-ordination with other government bodies involved in investment promotion and facilitation, both at economy-wide and entity levels,[11] continues to be challenging due to a lack of resources and sometimes the lack of political support.

None of the IPAs in the region have reported having offices abroad, whereas more than three-quarters of IPAs in OECD economies have a network of offices abroad that are affiliated to their headquarters (OECD, 2018[26]). However, most of the agencies report relying on their embassies to boost the image of their economies and attract foreign investment. Although how IPAs are presented overseas is primarily a matter of institutional setting and cost-benefit analysis, relying on embassies that are under the purview of a different line ministry requires a higher level of co-ordination and co-operation and additional effort.

The co-ordination of investment promotion and facilitation activities and monitoring of interactions with investors can be helped by using the Customer Relation Management System (CRM). According to the OECD-IDB survey, 94% of surveyed IPAs in OECD economies use CRM software (OECD and IDB, 2017[28]). AIDA, FIPA and RAS reported using CRMs, whereas ASIPI uses a dedicated platform for planning activities, keeping records, and supervising economic promoters.

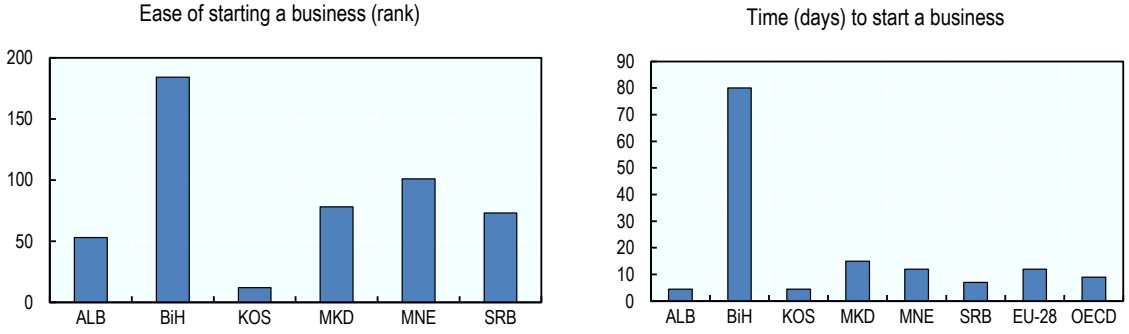
### *Investment facilitation could benefit from more IPA involvement*

Investment facilitation aims to make it easier for investors to establish, operate and expand their existing investments in an economy. Investment facilitation starts at the pre-establishment phase, when an investor shows interest in a location, and involves a whole-of-government approach to encourage investments by providing investors with a transparent, predictable, and efficient regulatory and administrative framework for investment. It combines policies, tools, and processes that should be adopted by host economies to reduce or eliminate potential and existing obstacles faced by investors once they have decided to invest and to maximise the positive contributions of investment to the economy (Novik and de Crombrugghe, 2018[11]).

Facilitation activities include: 1) policies aiming at developing sound and consistent legal frameworks for investment, as well as regulatory measures to simplify and streamline administrative procedures; 2) tools to help investors navigate the various regulations and procedures, such as setting up one-stop shops, online business registration systems, information portals for business establishment, etc.; and 3) processes to make these policies more useful and effective, such as building IPA capacity, bolstering inter-agency co-operation and co-ordination as well as reinforcing public-private dialogue (OECD, 2018[26]).

The WB6 economies have adopted a number of policies for developing sound and consistent legal frameworks for investment – see Investment policy (Sub-dimension 1.1). They also continue to streamline their regulations, and reduce the costs and steps involved in starting a business. For instance, several economies have begun digitalising business permit and licensing registration processes as well as improving access to information and administrative procedures by providing documentation online and opening governmental portals. Even so, some WB6 economies have regressed in the starting a business rankings of the annual World Bank Doing Business survey (World Bank, 2020[18]). For example, in Bosnia and Herzegovina, regulations for starting a business remain very complex, as they differ among the entities and cantons. This is illustrated in the 2020 Doing Business Index: the economy is among the most difficult environment in the world for starting a business (ranking 184th out of 190 economies) (Figure 4.10). It should be noted that some positive developments have been recorded in the entities. For instance, the Republika Srpska has conducted major reforms to its business registration, cutting the time necessary for business registration from 23 to 3 days, as well as cutting the number of procedures from 11 to 5.

## Figure 4.10. Ease and time to start a business in the WB6 (2020)




Note: The starting a business indicator is scored by rank and takes into account the number of procedures, time, cost and paid-in minimum capital requirement for a small- to medium-sized limited liability company to start up and formally operate in each economy's largest business city. Economies are ranked for their ease of doing business from 1–190. A high ease of doing business ranking means the regulatory environment is more conducive to the starting and operation of a local firm. Time to start a business is measured in days.
Source: (World Bank, 2020[18]) *World Bank, Doing Business Index*, https://www.doingbusiness.org

StatLink https://doi.org/10.1787/888934253461

WB6 economies have adopted tools to help investors navigate the various regulations and procedures. As part of this effort, they have also accelerated the digitalisation of the services dealing with investors, and are at different stages in developing electronic portals of administrative procedures and formalities for business activities. All the economies have established one-stop shops for business registrations. It should be mentioned that reforms in North Macedonia will facilitate business operations through the establishment of a virtual one-stop shop for investors that gathers 10 online services[12] in a single portal.

Some WB6 economies could further reinforce their processes and co-operation mechanisms for investment facilitation. All the economies have sound mechanisms to design and reform policies, and have established solid consultation mechanisms for public-private dialogue. However, burdensome procedures for investors in the region are still fuelled by the uncoordinated actions of the various government agencies and levels of government involved in approving and granting business licences, which result in suboptimal treatment of investors. Stakeholders have also indicated that difficulties in obtaining licences in some sectors prevent investment and affect the whole economy (UNCTAD, 2017[29]). However, governments in the region have engaged in processes to simplify their licensing requirements and improve their administration, notably at lower administrative levels.

Investment facilitation is further weakened by the limited role played by the IPAs in this area in the region. For instance, none of the IPAs are officially mandated to issue business permits and the issuance of business permits at the lower administrative level in WB6 economies creates confusion and overlap in responsibilities between the different levels of government (UNCTAD, 2017[29]). One-stop shops in the region are also

primarily operated by business registration agencies,[13] with limited involvement by the IPAs. Overall, the IPAs' role in facilitating investment in most of the WB6 economies is limited to providing information to foreign investors to help them navigate the administration while redirecting them to the relevant authorities as they do not have the authority to collect or approve documents. MIA is the exception, having recently been mandated to speed up administrative procedures and provide the conditions for efficient work (its predecessor MIPA was not involved in business registration procedures). It should also be noted that RAS and AIDA play more advanced roles in facilitating important or strategic investment projects.

Investment facilitation in the WB6 economies would benefit from greater involvement by the IPAs. Indeed, as IPAs are the first point of contact for international investors, they can play a central co-ordination and liaison role with other government entities in charge of managing and delivering business licences. It is therefore crucial to build the capacity of both the IPA and the relevant civil service agencies. Finally, regular monitoring and evaluation are also necessary to ensure that investment facilitation tools and policies are useful, up-to-date and respond to investors' needs (Novik and de Crombrugghe, 2018[11]).

### *Proactive investor targeting is progressively being adopted*

Investor targeting is one of the key functions of IPAs. It is one of the most resource-intensive, but also one that can lead to the best results in terms of securing actual FDI projects. Research has found that one dollar spent on investment promotion in a specific sector translates into USD 189 of FDI inflows (Harding and Javorcik, 2011[30]). It refers to the direct targeting of investors, sectors, projects or economies through events, including one-to one meetings with investors, pro-active campaigns, and inquiry and request handling (OECD, 2018[26]). It is the opposite of reactive promotion, in which IPAs answer investor-initiated inquiries. A clear prioritisation strategy that is in line with national development strategies is needed to guide IPAs' targeting activities.

IPAs in the six Western Balkan economies have historically focused on image building and strengthening their economies' profiles as competitive investment destinations. However, they are increasingly moving towards more proactive approaches for targeting sectors and economies. All WB6 economies have well-identified targets in terms of economic sectors and markets for FDI attraction. These are laid out in the strategic investment laws of Albania,[14] Kosovo and North Macedonia,[15] and in strategic documents and medium-term documents in Bosnia and Herzegovina, Montenegro and Serbia.

Since the last assessment, most of the WB6 economies have put in place more sophisticated mechanisms for targeting potential investors in a proactive and systematic manner:

- Albania's AIDA organised outreach campaigns for the agriculture sector in 2019 and the car manufacturing sector in 2020.
- In Bosnia and Herzegovina, outreach is conducted at both state and entity levels. FIPA and the Federation, in co-operation with the International Financial Corporation and the World Bank, launched an outreach programme in 2016 that targets the agriculture and automotive industries for investment. To date, Bosnia and Herzegovina has successfully conducted three outreach missions in Italy, Germany and the Netherlands, with a fourth having been postponed due to the pandemic. The Republika Srpska organised outreach campaigns in the fruit and vegetable processing sector targeting German companies in 2017 and Austrian companies in 2018.
- In Montenegro, MIA has already started to move from the reactive stance of MIPA to a more proactive targeting of potential investors and economies. It has defined target economies and started organising missions. For instance, it embarked on an investor outreach campaign for the furniture manufacture sector in 2020.
- Serbia has also continued to organise targeted outreach campaigns that are followed by analysis, lessons learned and follow-up mechanisms.

KIESA, on the other hand, does not have a clear strategy targeting priority sectors. It promotes the economy as an investment destination through participation in international fairs, and organising FDI conferences abroad. It should be noted that both Kosovo and Albania have also established mechanisms to target their respective diasporas, mainly relying on their representations abroad and embassies.

Most of the WB6 economies have also developed dedicated approaches to investment targeting in special economic zones, which have become a widely used instrument for attracting investment to the region (OECD, 2017[31]). For instance, in North Macedonia, DTIDZ has developed a more proactive and direct investor targeting strategy. It regularly reaches out to potential high value-added manufacturing companies to host in the zones in order to support a competitive environment and generate links with domestic firms. KIESA is also mandated with promoting the emergence of industrial clusters in special economic zones.

### *Investor incentives in WB6 economies are driving a "race to the bottom"*

WB6 economies have long used investor incentives as a key tool for attracting investors through an abundance of tax breaks, relief and incentives (IMF, 2018[32]). Such policies include profit tax breaks, exonerations from social contributions, custom tax relief, tax holidays for employee benefits, subsidies for salaries and grants for investments. Economies also often offer preferential treatment when dealing with the administration, notably for strategic investment (under the new strategic investment laws) as well as in special economic zones.

The economies of the region seem to be competing to attract foreign investors, with incentives being used as the main instrument in a "race to the bottom", or where host economies compete for foreign investment by unilaterally lowering standards due to co-ordination failure (Fitzgerald, 2001[33]). The positive impacts of these policies are often difficult to evaluate in terms of growth, development or job creation, but their negative consequences are rapidly felt as they lead to the erosion of public revenue. In addition, there is little evidence that lower taxes are a determining factor for attracting FDI. For instance, a World Bank survey found that predictability and transparency of public institutions, ease of setting up businesses and legal protection are considered more important than financial incentives for multinational companies when selecting an investment destination (World Bank, 2018[34]).

Over the last decade, most of the WB6 economies have increased their investment incentive schemes, rendering their incentive system more complex and sometimes difficult to navigate for investors. The management of these incentives is not always centralised as incentives are often managed by different and sometimes competing public bodies and at different levels of government, with limited accountability to a central authority. Comprehensive evaluations of the cost of these measures are often hampered by the multiplication of the structures as well as the lack of transparency in the management and implementation of FDI incentives.

For example, in North Macedonia, incentives are included in: 1) the 2018 Plan for Economic Growth, which provides incentives[16] to domestic and foreign companies operating in the 15 free economic zones; 2) the 2019 Law on Financial Support to Investment; 3) the 2018 Law on Technological Industrial Development Zones; and 4) the 2020 Strategic Investment Law. Albania also has a complex and multi-layered investment incentive regime characterised by multiple tax breaks included in various laws and changing fiscal measures (most recently the 2019 fiscal package) as well as incentives for strategic sectors in the 2015 Law on Strategic Investment and to investors in the Technological and Development Areas (TEDA). In Bosnia and Herzegovina, direct taxes and tax incentives, including supervision, are primarily provided at the entity level.

Nevertheless, some economies have simplified their investment incentive regimes by adopting a simple and predictable tax regime providing greater clarity for investors. For instance, Serbia has a 15% flat corporate profit tax and provides tax incentives that target large projects in which no special groups or regions benefit more than any others. The only tax incentive applied in Serbia is a 10-year corporate profit tax holiday for an investment superior to approximately EUR 8.5 million in fixed assets and with employment for at least 100

additional employees throughout the investment period. Kosovo has also adopted a 10% flat corporate profit tax and other investment incentives are provided in the 2016 Strategic Investment Law. These are directly negotiated with the government on a discretionary basis. It also offers customs breaks for investors in the free trade zones.

It is important to ensure that tax incentives do not place a disproportionate or unplanned strain on domestic resources. Reinforcing transparency and good governance allow for better distinction between beneficial and wasteful tax incentive programmes. A good practice to reinforce transparency and facilitate control by the relevant authorities is to include all tax incentives in the main body of tax law and under the authority of the tax administration (OECD, 2015[2]). This is the case in Serbia and Montenegro. In North Macedonia, tax incentives are provided through the tax laws and the Law on Technological Industrial Development Zones and are under the authority of the Public Revenue Office (PRO), which is the institution authorised for tax assessment and collection. In Albania, the Tax Administration and the Customs Administration oversee the introduction and granting of tax incentives, while the Ministry of Finance is in charge of avoiding unintended overlaps and inconsistencies in tax incentives policies. Finally, in Bosnia and Herzegovina, incentives for direct taxation are under the competence of the entities, while incentives for indirect taxation are the state's responsibility. The economy has nevertheless established mechanisms to avoid unintended overlaps and inconsistencies.

### *Aftercare services are more focused on policy advocacy*

It is crucial for investors, notably foreign investors, to understand that the government is listening to their problems and concerns and that they have a reliable and responsive counterpart that can settle their problems. A key outcome effect of aftercare is policy advocacy, as maintaining a regular and constructive dialogue with the private sector can provide crucial insights and feedback that influence policy design and reforms to enhance the overall investment climate (De Crombrugghe, 2019[35]). In addition, efficient and proactive aftercare services are important for investors to maintain and expand their activities in an economy.

Aftercare services are not limited to solving problems encountered by businesses – increasingly they support existing businesses to expand their activities by anchoring their operations in the local economy. Key aftercare functions and services that can be offered by IPAs include: 1) problem solving through structured trouble-shooting with individual investors; ombudsman intervention and mitigation of conflicts; and 2) business support services by providing databases of local suppliers, matchmaking between investors and local firms; capacity-building support for local firms; promoting cluster programmes; and facilitating the recruitment of local staff through assistance programmes and training or educational programmes (OECD, 2018[26]).

All six Western Balkan economies are increasingly reinforcing their aftercare services and formally including them in their IPAs' official mandates. In Serbia, aftercare activities have been defined as a permanent activity of the RAS following the adoption of its 2017-2019 strategic framework. In Albania and Kosovo, aftercare services are included in the official mandates of both AIDA and KIESA. In Bosnia and Herzegovina, post-investment investor support is recognised as a key component of FIPA's mandate, along with policy advocacy and drafting proposals for legislation and legal measures aimed at improving investment conditions. In Montenegro, the recent establishment of the new and better resourced investment promotion agency MIA is a positive step towards improving the economy's aftercare services, although the agency does not have a formal mandate to provide aftercare services.

In the WB6 economies, the sophistication of IPAs' aftercare services and their extension to business support activities are often hampered by the absence of dedicated units and structured services as well as their limited human and financial resources. A good model in the region is North Macedonia, where ASIPI has developed an online platform to make it easier to find local suppliers, and to communicate with other administrations and local authorities. The DTIDZ offers a broad range of aftercare services for investors in the zones, including dealing with administrative services (taxes, visas, construction permits, customs, etc.)

as well services for creating linkages with universities, developing company linkages, and identifying local suppliers, etc. In addition, DTIDZ is developing an online aftercare registration platform in order to improve the services for existing investors in the zones through improved communication protocols and aftercare services.

In addition, most of the WB6 IPAs organise targeted field visits to collect feedback from businesses on recurrent issues affecting their activities. In Bosnia and Herzegovina, such visits to investors are primarily conducted within the entities. For instance, between 2016 and 2019, joint teams including representatives from the Ministry of Economy and Entrepreneurship of the Republic of Srpska and local self-government units visited around 135 companies and discussed the business difficulties that investors are facing. By 2020, FIPA representatives (from all three offices: Sarajevo, Banja Luka and Mostar) had visited a total of 664 companies under the Post-Investment Support Programme or the Aftercare Programme. FIPA has also established a database of companies that includes the feedback received from field visits. It publishes an annual report of aftercare visits consisting of suggestions for improving the business environment, proposals for amending the legal framework, and recommendations for resolving business community issues. This is then submitted to the Council of Ministers of Bosnia and Herzegovina. Similarly, the Ministry of Economy and Entrepreneurship of Republika Srpska conducts aftercare visits and creates a report on the problems encountered by investors, which is then sent to the government. A regulatory impact assessment is done based on the results. In Kosovo, KIESA, despite its limited resources, visits 300 to 350 foreign investors each year to get their perspectives on the investment and business climate. It drafts a report with proposed measures that is submitted to the Kosovo Economic Council so it can take the measures proposed. In Albania, AIDA conducts an annual investor satisfaction survey, as well as on-site visits, to collect concerns and needs by sector.

The majority of the WB6 economies have well-established and structured public-private policy dialogue platforms that feed into policy making. These include Foreign Investors Councils or National Economic Councils that organise regular dialogue between representatives of foreign and multinational companies, as well as SMEs and local businesses, and high-level government officials. The IPAs' level of involvement in public-private dialogue depends on the characteristics of the overarching institutional framework for investment facilitation and retention. However, IPAs' involvement in aftercare and policy advocacy should be fostered. Their interactions with foreign investors mean they are best placed to understand their challenges and expectations and can provide invaluable insights and feedback to enrich the policy-making process and enhance the overall investment climate (Novik and de Crombrugghe, 2018[11]).

In Bosnia and Herzegovina, FIPA has developed a collaborative network for post-investment support to investors and prepares the annual Proposals for Improving the Business Environment and Investment Conditions in Bosnia and Herzegovina report. Similarly, the Ministry of Economy and Entrepreneurship of Republika Srpska has formed a collaborative network consisting of local government and line ministry representatives which annually gives proposals for improving the business environment, amending relevant laws and creating plans to attract investment. In Kosovo, KIESA organises regional conferences with the private sector in different municipalities in order to ensure public-private dialogue. In North Macedonia and Serbia, ASIPI and RAS maintain strong collaboration with business associations such as the Chamber of Commerce and Industry and Foreign Investment Council. They also maintain active dialogue through a working group consisting of representatives of the public and private sector within the Support Programme for Entering Supply Chains. Albania's Investment Council was established in 2015 as the main public-private dialogue mechanism and AIDA has permanent membership status on the council.

Most IPAs in the region are also involved in resolving the problems and issues faced by individual investors. However, their interventions are not structured and often conducted on an ad-hoc basis, redirecting the investors to the competent services and with limited follow-up. Around 81% of the IPAs in the OECD economies offer structured troubleshooting with individual investors (OECD, 2018[26]), which is becoming a popular approach to solving their problems; 45% of the IPAs engage in conflict mitigation.

The findings of this assessment, particularly in the domain of investment promotion and facilitation frameworks, are also relevant for the WB6 economies' implementation of the Common Regional Market Action Plan, which includes a component on regional investment (Box 4.4).

### Box 4.4. Towards co-ordinated investment promotion in the Common Regional Market

The following key findings of the CO2021 investment promotion and facilitation sub-dimension can inform the implementation of actions under the investment component of the Common Regional Market (CRM) 2021-2024 Action Plan (Regional Cooperation Council, 2021[4]):

- Albania, Bosnia and Herzegovina, Montenegro and Serbia already conduct targeted outreach campaigns and organise missions while promoting their economies through participation in international fairs.
- All WB6 economies have developed investment incentives to promote the emergence of industrial clusters in special economic zones and facilitate the establishment of businesses in these areas.
- All WB6 economies have outlined strategic sectors for investment targeting within their regulations or IPA mandates, with agriculture and manufacturing being the most commonly promoted industries, followed by the tourism, ICT and energy sectors.
- Regarding information databases, only AIDA, FIPA and RAS use CRMs, while ASIPI uses a dedicated platform for planning activities, keeping records, and supervising economic promoters.
- Albania, Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia have begun to implement green investment promotion schemes aimed at renewable energy and energy efficiency projects, with several of them having already released large public procurement opportunities in these fields.

Source: (Regional Cooperation Council, 2021[4]) *Regional Cooperation Council, Common Regional Market 2021-2024 Action Plan*, https://www.rcc.int/docs/543/common-regional-market-action-plan.

### *The way forward for investment promotion and facilitation*

- **Strengthen the IPAs' abilities to implement their mandates efficiently**. It is particularly important to clearly define the roles and objectives of the IPAs and to ensure that they have sufficient resources and capacity to conduct key investment promotion and facilitation functions, such as investor targeting, facilitation and aftercare.
- **Simplify and clarify tax incentive regimes for investors.** Unclear, complicated or overlapping tax legislation where incentives are dispersed across multiple laws can be difficult for investors to navigate and open the door for discretionary decisions. Reinforcing transparency, facilitating control by a single relevant authority, and including all tax incentives in the main body of tax law under the authority of the tax administration creates a clear incentive regime for investors to follow.
- **Ensure the effective participation of the IPAs in investment facilitation as well as in defining priority sectors and economies**. As the first point of contact between the government and the foreign investor, the IPA is often well placed to understand the concerns of investors, help resolve problems and provide useful feedback to inform public policy. Investment promotion agencies will play an even bigger role in the post COVID-19 investment landscape to reinvigorate foreign interest in the region. To this end, IPAs can support previous investors with ongoing projects and supply chain issues while creating a stable investment landscape for new investors through adapted policies and incentives (Box 4.5).

### Box 4.5. Investment promotion agencies in the time of COVID-19

The COVID-19 pandemic has not only provoked a worldwide health crisis, it has also halted global trade and international investment transactions, further hampering the ability of economies to best respond to and overcome the social and financial costs of the pandemic. IPAs, as key players in business attraction and supply chain management, have the unique ability to adapt and adjust to changes in the investment landscape to better mitigate the economic consequences of COVID-19.

To overcome these challenges in the short-term, IPAs have taken to reorganising their work methods and refocusing their priorities. Most OECD IPAs have switched to digital tools such as dedicated and regularly updated COVID-19 sections on their website to counter the inability to work through in-person investor visits, events, fairs, and missions. Meanwhile, focus has been shifted from marketing to new investors towards concentrating on existing clients, helping them cope with supply chain disruptions and business operations as well as actively updating them on COVID-related developments and ongoing government support programmes. IPAs are also using their business networks to mitigate supply chain issues in hard hit sectors by helping them acquire equipment necessary to avoid further disruptions.

IPAs are also implementing medium and long-term solutions in response to the pandemic. Agencies are creating long-lasting digital solutions for servicing existing clients and identifying future clients, such as video-conference systems, virtual sit-visit facilities and new investor facilitation tools such as digital signatures, one-stop shops and, electronic licenses or permits. They are also amplifying the reliability and accessibility of client databases. Finally, IPAs are also beginning to revise previously strategic sectors and are moving towards a narrower mix of industries, while putting more effort into better developed investor targeting practices for projects with the highest impact to help overcome revenue losses due to the pandemic.

Source: (OECD, 2020[36]) *Investment Promotion Agencies in the time of COVID-19*, https://doi.org/10.1787/50f79678-en.

## Investment for green growth (Sub-dimension 1.3)

Developing an investment landscape that prioritises green growth and sustainable development requires a strong commitment to environmentally conscious practices and legislation, as well as comprehensive strategies that promote economies as green destinations through well-crafted incentives, focused targeting and widespread awareness-raising campaigns.

The investment for green growth sub-dimension is assessed through two qualitative indicators (Table 4.8). As a newly assessed sub-dimension for the investment chapter of the Competitiveness Outlook 2021, the scores for the investment for green growth sub-dimension are lower than the first two sub-dimensions. This can be attributed to the very recent adoption of green investment strategies that have yet to be fully implemented, partially due to the effect of COVID-19 on foreign investment attraction. Kosovo was given a score of zero as information and data were too limited for a reliable analysis of the economy's green investment initiatives.

### Table 4.8. Scores for Sub-dimension 1.3: Investment for green growth

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 1.3: Investment for green growth | Green investment policy and promotion | 3.0 | 2.5 | 0.0 | 1.0 | 3.0 | 3.0 | 2.1 |
| | Choosing public and private partnerships for green growth | 2.5 | 1.5 | 0.0 | 2.0 | 3.0 | 3.0 | 2.0 |
| **Investment for green growth average score** | | 2.8 | 2.0 | 0.0 | 1.5 | 3.0 | 3.0 | 2.0 |

### *Green investment frameworks and initiatives are generally in the early stages*

Green investment projects, like most infrastructure projects, provide unique advantages for investors. These include steady, long-term, inflation-linked income streams for renewable energy and energy efficiency projects irrespective of returns on other investments. As these sectors typically provide low to modest interest rates and generally low yields for fixed income, governments should be inclined to provide an adequate enabling investment environment to attract institutional investors and exploit the industry's potential (Röttgers, Tandon and Kaminker, 2018[37]). However, green infrastructure projects often remain seriously constrained by specific investment barriers such as erratic and undefined policy frameworks, subsidies and regulator rigidities that promote inefficient resource use and an inability to capture the value of sustainable natural resource management, among others.

All WB6 economies are generally in the early development stages of green investment policy and promotion initiatives. Every economy has shown commitment to establishing and revising environmentally conscious legislation and long-term strategies for the environment (Box 4.6). Bosnia and Herzegovina and North Macedonia have recently amended their energy strategy and energy law (respectively), to further promote the use of renewable energy sources and energy efficiency. Governments can promote their economies as green investment destinations by creating campaigns to raise awareness of investment opportunities in energy efficiency or renewable energy projects, as well as eco-tourism, green transportation, circular economy, waste management and sustainable agriculture. However, only half of the WB6 economies (Albania, Montenegro and Serbia) have a clear strategy or programme for attracting and incentivising green investment, or clearly outline green growth priorities.

#### Box 4.6. Creating a green investment landscape in Montenegro

Montenegro has shown a particularly strong commitment to improving its green economy and increasing projects that ensure energy efficiency and encourage the use of renewable energy. The economy has adopted several policies to ensure good energy practices, including the Energy Policy of Montenegro until 2030, Energy Development Strategy by 2030, Energy Law, Strategic Environmental Assessment Law and National Renewable Energy Action Plan to 2020 and action plan for implementation of the Energy Development Strategy by 2030. The Government of Montenegro also introduced financial incentives for new projects in the renewable energy sector, leading the economy to achieve 41.6% of energy gross final consumption from renewable sources in 2018. From May 24 to June 2, 2019, for the first time, Montenegro produced all its electricity from renewable sources. In the field of energy efficiency, the Government of Montenegro is currently implementing three projects to improve the green landscape:

1. **Energy efficiency in Montenegro (MEEP)**: in partnership with the International Bank for Reconstruction and Development (IBRD), the project will improve energy efficiency and monitor energy and water consumption in 20 health facilities around the economy, and create a sustainable system of financing energy projects in the public sector by December 2023.
2. **Energy efficiency programme in public buildings (EEPPB)**: in partnership with KfW bank, Montenegro has reconstructed 20 primary and secondary schools to improve energy efficiency and will continue to implement measures for better energy efficiency in selected educational, social and administrative institutions. It has set energy consumption standards of maximum 150 kilowatt hours per metre squared (kWh/m²) for facilities in the north, 125 kWh/m² for facilities in the central zone and 100 kWh/m² for facilities in the south of Montenegro.
3. **Energy efficient home programme**: this provides a sustainable financial mechanism for applying energy efficiency measures in households. The Ministry of Economy subsidises interest rates and loan fees for households in Montenegro to:

- purchase and install heating systems based on modern forms of biomass (pellets, briquettes) including boilers, furnaces, piping and/or radiators
- install thermal insulation on the facade of a residential building
- install energy efficient facade joinery.

Additionally, since 2018, the UNDP has been implementing the Growing Green Business in Montenegro project which promotes private sector investment in low-carbon and green businesses, stimulating low-emission economic growth and green job creation in the economy. The project uses a combination of policy de-risking (implementation of favourable policy frameworks and provisions of business support services) and financial de-risking instruments (improving access to finance for innovative green businesses and partnerships, in particular agriculture, tourism and energy sectors).

Source: (European Commission and Government of Montenegro, 2020[38]) *Montenegro Progress Reports under Renewable Energy Directive 2009/28/EC as adapted by the Ministerial Council Decision 2012/04/MC-EnC*, https://energy-community.org/dam/jcr:5dfac2b4-b0bd-4204-a820-86555cb2d2fd/MO_3RES_progress_032020.pdf.

Governments can support private investment for green growth by establishing a predictable policy and regulatory environment for green investment. The OECD has created several references and recommendations to guide economies in creating policies to attract sustainable and green investment (Box 4.7). Most economies have implemented environmental strategies that include green investment objectives; however, they remain at varying levels of development and specificity. Only half of the region's strategies include in-depth details such as compliance requirements, cost estimates, financing sources and strategies, or project priorities. Institutional frameworks to support green investment remain complex and unclear in some WB6 economies. Montenegro's national strategy, the Smart Specialization Strategy of Montenegro or S3.me (2019-2024), promotes green growth and encourages green investments by defining the priorities and focal areas to be developed for sustainable and green growth. In 2020, Serbia also established its Multi-annual Investment and Financing Plan (MIFP) for the environment that includes detailed priorities and strategies for investment projects, particularly for waste, wastewater and drinking water infrastructure. Bosnia and Herzegovina and Kosovo have also implemented strategies aimed at promoting green investment – the Integrated Energy and Climate Plan of Bosnia and Herzegovina (NECP BiH) for the period 2021-2030 and Kosovo's Strategy for Supporting Innovation and Entrepreneurship (2019-2023).

### Box 4.7. OECD Centre on Green Finance and Investment

In 2016, the OECD established its Centre on Green Finance and Investment to support member states in transitioning to green, low-emission and climate-resilient economies. The centre aims to increase the attractiveness of economies for green investments by developing effective policies, institutions, and instruments to facilitate these transactions while further harmonsing members with the principles of the Sustainable Development Goals and Paris Agreement.

The centre holds a global annual forum on green finance and investment to enable knowledge exchange between leaders from the private sector, government and regulatory institutions, academic and civil society on integrating and prioritising green goals in their agendas. The institution also develops innovative analysis and practical recommendations for supporting the rapid scaling-up of green investment and financing flows that can help relevant actors implement policies to achieve these goals.

Source: (OECD, 2020[39]) OECD Centre on Green Finance and Investment (webpage), https://www.oecd.org/cgfi/.

Some economies have implemented strategies at the lower administrative level that align with economy-wide strategies to create a predictable strategic and legal framework for investors. In Albania, for instance, the municipality of Tirana has adopted its Sustainable Development Strategy 2019-2022, which covers sustainable economic, social, and ecological development in line with the national Green Development Agenda. Meanwhile, in 2019 Serbia launched its National Strategy for Sustainable and Integrated Urban Development as well as a three-year action for its implementation, further aligning all administrative levels with the EU Urban Agenda.

Governments can mitigate regulatory risk by providing greater certainty for investors through transparency and comprehensive regulations to afford investors equal opportunity and protection (OECD, 2015[2]). In this sense, all economies continue to respect core investment principles such as investor protection, intellectual property rights protection and non-discrimination in most areas of investment, including those inclined to attract green investment. These rights are typically enshrined in the economies' laws on investment or foreign investment.

### *Frameworks for public and private partnerships for green growth are improving*

Mobilising and scaling-up green investment implies leveraging domestic and international public and private investment. Public-private partnerships (PPPs) can be mutually beneficial, especially while economies battle the financial consequences of the COVID-19 pandemic and public spending on green infrastructure is likely to be low as decreasing deficits take priority. The private sector benefits from risk transfer, increased investment opportunities and business development. Most economies have developed strong frameworks for public-private partnerships and continue to show commitment to non-discriminatory public procurement opportunities for green projects.

Albania, Montenegro, North Macedonia and Serbia have developed relatively strong frameworks for choosing public and private partnerships for green growth. These economies not only have dedicated PPP laws, but have also shown a commitment to non-discriminatory public procurement opportunities in energy efficiency and renewable energy projects. For instance, the 140 MW Karavasta photovoltaic park project in Albania is being implemented by the winner of a non-discriminatory public procurement auction (the French company Voltalia). Meanwhile, the energy laws of both Albania and North Macedonia provide for feed-in premium tariffs for investment in renewable energy sources. However, Bosnia and Herzegovina only partially encourages PPP for green growth, as Republika Srpska and selected cantons of the federation have PPP laws and regulations that do not explicitly define investment in green growth, and the economy's regulatory framework is hindered by institutional complexities and unclear division of responsibilities.

### *The way forward for green investment*

- **Integrate green growth priorities into existing strategies on investment promotion**. While some economies have already established dedicated strategies to attract green investment, those economies without such frameworks could streamline green investment promotion efforts by incorporating these principles into existing investment strategies.
- **Create awareness-raising campaigns** to promote the region as a green investment destination. Economies can design national or regional campaigns that highlight successful energy efficiency or renewable energy projects, emphasise innovative or green product manufacturing, and promote opportunities in green sectors and activities (Box 4.8). Nominating as "brand ambassadors" the domestic enterprises that are pursuing green initiatives would show potential investors the real green opportunities available in the region. Campaigns could be accompanied by easily communicable information materials such as brochures, websites and videos that can be shared with investors at external events.

- **Promote public-private dialogue on green investments**. Although most WB6 economies are conducive to public-private partnerships, enhancing the dialogue between public and private institutional and financial entities on the challenges, areas in need of support, and opportunities that exist for green investment can enhance investor confidence in bidding for existing renewable energy and energy efficiency projects.

### Box 4.8. Slovenia's "Green. Creative. Smart." campaign

In recent years, Slovenia has renewed its commitment to encouraging green and sustainable projects, notably by providing EUR 10 million in cheap loans for environmental investments; approving grants on top of subsidised interest rates for investment in renewables and energy efficiency; and renewing subsidy schemes for companies and entrepreneurs dedicated to energy efficiency, renewables and measures to reduce pollution and greenhouse gas emissions.

In 2019, Slovenia's investment promotion agency, SPIRIT, launched an international communications campaign called "Green. Creative. Smart." In line with the CO2021 green investment recommendations, the campaign was incorporated under the existing business branch of the economy's tourism brand "I feel Slovenia". The campaign highlights key economically competitive advantages of the Slovenian economy in the fields of environmental technologies, robotics, mobility, research and development, digitisation, and creative industries.

The movement draws attention to Slovenian enterprises involved in, among others, light aviation, greenhouses powered by geothermal energy with production controlled by smart-censors, and self-sustainable zero emission houses. The campaign is disseminated through promotional videos, external fairs, outreach programmes and partnership ambassador testimonials. As part of this project, SPIRIT held a series of webinars for investors of ongoing projects and potential foreign investors in 2020, covering Slovenian sustainable mobile solutions for road, air and sea transport; top solutions in the field of health; and green solutions for transition into the circular economy.

Source: (SPIRIT Slovenia, 2020[40]), *SPIRIT Slovenia "Green. Creative. Smart."* (2020), https://www.sloveniabusiness.eu/.

## Conclusion

Overall, the WB6 economies have established solid legislative frameworks that have become the building blocks for open and favourable investment climates. In addition, they all benefit from solid institutional frameworks and well-crafted strategies for investment promotion and facilitation, with dedicated IPAs that conduct the core functions of investment promotion and facilitation. Several economies have also strengthened their investor incentive and aftercare services to simplify procedures for foreign investors.

Further efforts are required to reinforce their policy framework, notably in conflict resolution, enforcing contracts and intellectual property rights. The IPAs' ability to fulfil their mandates is often hampered by a lack of capacity and resources, as well as complex institutional settings and limited co-ordination with other government bodies. The WB6 economies should continue streamlining administrative procedures for investors and improving the predictability of their regulatory environment, while pushing for greater capacity and resources to ensure IPAs can carry out their investment facilitation roles. Leveraging on their strong investment frameworks, the WB6 economies are well-positioned to pursue their reforms and further align themselves with international standards.

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## Notes

[1] The Competitiveness Outlook 2021 assesses Bosnia and Herzegovina at the state-level and the entity-level. For more details on the methodology used to evaluate Bosnia and Herzegovina, please refer to the Assessment methodology and process chapter and Annex A on Bosnia and Herzegovina scoring models.

[2] Protection against unlawful expropriation is also enshrined in the constitution and the Law on Foreign Investment of the Republika Srpska as well as the Law on Foreign Investment for the Federation of Bosnia and Herzegovina.

[3] Kosovo's Law No. 04/L-220 on Foreign Investment defines expropriation as: "any act or measure, any series of acts or measures, any failure to act or series of failures to act, if the direct or indirect effect thereof is to deprive the concerned foreign investor of the ownership or control of, or a significant benefit or use of, an asset".

[4] As of December 2020, the draft law to establish a Kosovo commercial court was at the public consultation stage. The draft has received a wide and positive public response according to key stakeholders.

[5] The Singapore Convention on Mediation is a uniform and efficient framework for international settlement agreements resulting from mediation. It applies to international settlement agreements resulting from mediation, concluded by parties to resolve a commercial dispute.

[6] Albania has also prepared a draft law on trade secrets to further align with EU acquis. It is pending adoption.

[7] Kosovo is not included in the WEF Global Competitiveness Report.

[8] In 2018, the number of applications to register trademarks rose by 24.4% compared to 2017 and applications for patents and utility models increased by 11.7% in Albania.

[9] The NCEDK was reorganised in August 2020. It is now named the National Council for Economy and Investments (NCEI). The NCEI should act as an active forum for economic and investment promotion and is expected to be more active in the development and steering of KIESA. Detailed information on the new body and its mission is not yet available.

[10] In Serbia, RAS manages the Support Programme for Companies to Join the Supply Chains of Multinationals with a budget of circa USD 5 million. It provides advisory and financial support aiming at reinforcing the capacity of manufacturing firms in targeted supply chains.

[11] In addition to FIPA, numerous bodies are involved in FDI attraction activities at the entity level notably the Ministry of Economic Relations for Investment Promotion of the Republic of Srpska, which also undertakes investment promotion and facilitation activities.

[12] 1) e-Tax; 2) Central Registry; 3) e-Construction Permit; 4) Online Employment Registration; 5) E-Procurement; 6) EXIM (Export –Import licensing); 7) Automated System for Management of International Cargo Transport Licenses; 8) Government Land Auction; 9) Online Cadastre; 10) System for issuing Work and Residence permits to foreigners

[13] The National Business Centre in Albania, the Kosovo Business Registration Agency, the Central Register in North Macedonia, the Central Register of Business Entities in Montenegro and the Serbian Business Registers Agency

[14] The law on strategic investment in Albania considers strategic sectors to be: energy and mining; transport, electronic communications infrastructure and urban waste; tourism (tourist structures); agriculture (large agricultural farms) and fisheries; economic zones; and development priority areas.

[15] Strategic sectors defined in North Macedonia's 2020 Strategic Investment Law are: energy, transport, telecommunication, tourism, manufacturing, agriculture and food, forestry and water economy, health, industrial and technological parks, wastewater and waste management, sport, science and education.

[16] The incentives include a variety of measures including job creation subsidies, capital investment subsidies, and financial support to exporters.

# 5 Trade policy (Dimension 2)

A trade policy that facilitates cross-border economic activity promotes the competitiveness and growth of an economy. Trade liberalisation measures provide access to larger markets, leading to greater economies of scale and efficiency gains. This chapter assesses the frameworks, strategies, processes, and institutions in the six Western Balkan economies (WB6) related to trade policy. In doing so, it focuses on three key sub-dimensions. The first, the trade policy framework, examines governments' capacities to design, implement and evaluate trade policy, including institutional co-ordination, public-private consultations and monitoring and evaluation mechanisms. It also examines the development of market opening in the region through the evolution and outcomes of the network of trade facilitation agreements concluded by the WB6 economies. The second sub-dimension, trade in services restrictiveness, focuses on the regulations that govern and hinder the degree of openness of the economies in 12 service sectors. The third sub-dimension, e-commerce and digitally enabled services, focuses on the regulatory environments governing the most dynamic areas of trade flows – those operated through digital means. The sub-dimension analyses the regulations in force on e-commerce and the degree of restrictiveness of digitally enabled services. The chapter includes suggestions for policy enhancements for each of these sub-dimensions in order to improve trade performance and in turn increase the economies' competitiveness.

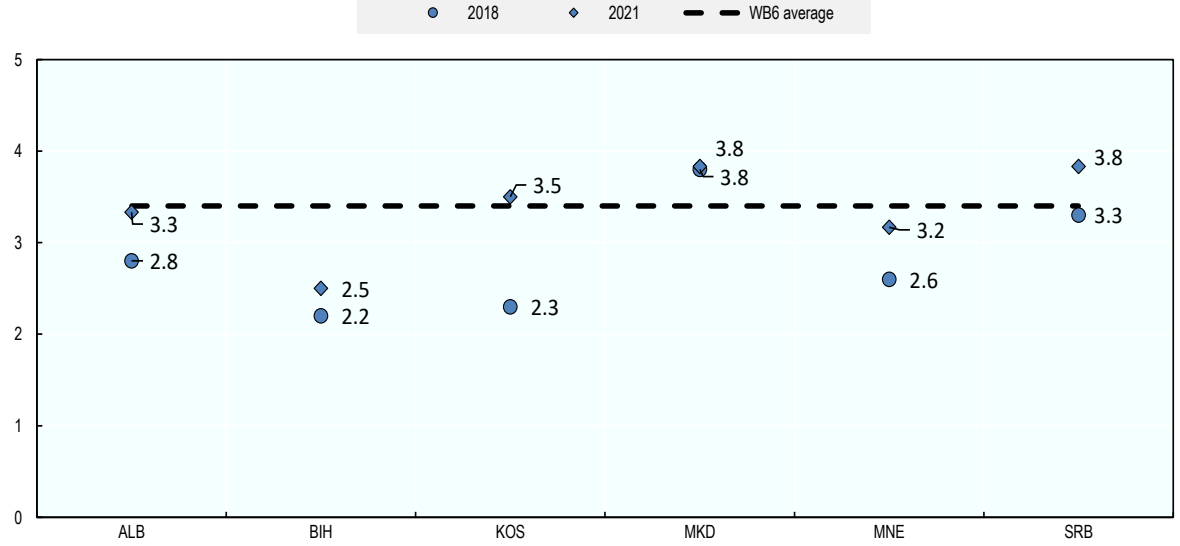
## Key findings

- **Trade policy institutional frameworks are functioning well and have been strengthened since the previous assessment**. Inter-institutional co-ordination of trade policy formulation is solid in most WB6 economies, usually involving official committees or working groups led by the ministry in charge of trade policy (either the trade or economy ministries). There are formal instruments for consultation with the private sector and civil society, and the economies have recently established trade facilitation committees.
- **The WB6 economies are well integrated commercially with their main trading partners.** Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia are signatories to the Central European Free Trade Agreement (CEFTA), alongside with United Nations Interim Administration Mission in Kosovo on behalf of Kosovo in accordance with the United Nations Security Council Resolution 1244, through which they have achieved full liberalisation of tariffs on trade in manufactured and agricultural products. They are also parties to bilateral free trade agreements and stabilisation and association agreements (SAAs) with the EU. Overall, while the six economies continue to develop their networks of bilateral and multilateral trade agreements, they do so at disparate rates and most of the efforts focus on the EU. Indeed, there have been no substantial developments in global trade integration since the last round of analysis. Bilateral treaties with non-EU member states are rare and the process of accession of Bosnia and Herzegovina and Serbia to the World Trade Organization (WTO) is still ongoing, which in particular may limit the benefits of a favourable foreign direct investment regulatory regime in the latter economy.
- **Significant improvements have been made in opening up trade in services** through the adoption of Additional Protocol 6 to CEFTA in December 2019 and its ratification by Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia, as well as through reforms to services trade policies. These and subsequent efforts will significantly reduce the costs of trade in the WB6. Nevertheless, the extent of liberalisation depends on the economy and the sector analysed, with a number of regulatory restrictions reducing the attractiveness of certain service sectors for foreign service providers. However, none of the economies have reported an increase in the restrictiveness of their regulatory environment.
- **All six economies have taken steps to strengthen their legal framework for e-commerce.** They have continued to align their sectoral laws and regulations with the EU e-commerce directive and have worked to remove non-legal barriers to the adoption of e-commerce, including raising awareness among small and medium-sized enterprises (SMEs). The emergence of the global pandemic and the increasing importance of e-commerce in world trade has boosted government responses. However, regulatory frameworks have evolved heterogeneously across the region and respond disparately to the challenges created for e-commerce globally in the context of COVID-19.
- **Regulations on digitally enabled services largely reflect international best practice**. The six economies' regulatory environments are more open than those of the OECD member states' average, and variations in performance across the region are very small, pointing to the potential for a high degree of regulatory harmonisation. The remaining restrictions mainly relate to infrastructure and connectivity measures. This indicates that telecommunications regulations could be further improved, particularly in the area of interconnection.

## Comparison with the 2018 assessment

Since the Competitiveness Outlook 2018, the economies of the WB6 have made progress in the areas of inter-institutional co-ordination and public-private consultations, and their evaluation and monitoring capacities have also improved overall, but at a slower and more irregular pace (Figure 5.1). Economies have also made progress on their e-commerce frameworks, but also at very variable speeds. The remaining elements of the current framework cannot be compared with the previous Competitiveness Outlook because this edition has prioritised different services sectors for analysis.

### Figure 5.1. Overall scores for the trade policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress on implementing the CO 2018 policy recommendations ranges from moderate to advanced (Table 5.1). Progress has been made in improving the regulatory framework by developing single strategies or action plans designed to increase trade performance, while advanced improvements have been made to enhance public-private consultation mechanisms. Implementation across economies however varies.

## Table 5.1. Implementation of the CO 2018 policy recommendations: Trade policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **The WB6 economies could consider developing single strategies or action plans designed to improve trade performance.** | • In Albania the National Plan for Trade Policy Coordination and Trade Facilitation (2017-2020) was adopted in 2017 and is aligned with Albania's National Strategy for Development and Integration 2014-2020. The new National Plan for Trade Policy Coordination and Trade Facilitation (2021-2023) is prepared. This plan contains concrete trade facilitation measures for Albanian businesses aiming to develop trade in the WB region, EU countries and beyond, and is harmonised with the trade policy developments undertaken by Albania in the framework of the implementation of the Protocol. Addendum 5 "On Trade Facilitation", Additional Protocol 6 "On Trade in Services" of the Regional Free Trade Agreement CEFTA 2006 and in full harmonisation with the Action Plan for the establishment of the Common Regional Market approved by the Prime Ministers of the economies of the Western Balkans at the Sofia Summit on 10 November 2020 (MAP REA 2021-2024).<br>• Kosovo has a trade facilitation strategy (covering the period 2017-2021) and an action plan (2017-2019)<br>• The other WB6 economies have incorporated trade elements in their recent development strategies but do not have or have not updated their strategies or action plans dedicated primarily to trade facilitation since 2018.<br>• The first action plan of Serbian Trade Facilitation Body was adopted for two-year period 2018/2019 and the second one was adopted for 2020/2021. | Moderate |
| **The public-private consultation mechanism could be improved.** | • In Bosnia and Herzegovina, progress has been made with the adoption of the Regulation for the Implementation of Public Consultation Standards at the state level within the 2017 *Regulation of Consultations in Legislative Drafting* which contains the provisions on minimum requirements for consultations. According to the regulation, BIH institutions at the state level are obliged to publish draft laws on a dedicated website (eConsultation) which allows the public to submit proposals and remarks. The use of the eConsultation website is growing by BIH institutions as well as the business community.<br>• In Kosovo progress has been made since the regulation on Minimal Standards for Public Consultation Process entered into force in 2017. According to the annual reports of the Office of Good Governance (OGG), the government has been consulting with an increased number of institutions and stakeholders. A dedicated website has been set up to enable free access to draft and final laws and regulations and for the private sector to comment on draft laws in a transparent manner. The OGG produces reports on the implementation of the minimum standards of PPCs set up in the law.<br>• In Montenegro, a mandatory consultation procedure for all draft legislation was introduced under the new Decree on State Administration (2018). The government now must conduct a public hearing when preparing laws and strategies. In addition, the government has formalised the requirements for participation in working groups, making it mandatory for it to invite relevant stakeholders to provide inputs and comment on draft laws. The decree has also extended the scope of public consultations to cover national strategies. An online participation platform was created to facilitate public consultations.<br>• North Macedonia has implemented the 2019 Rules for the Organization of the Public Consultation in starting the Legislative Process, which improved its regulatory transparency by simplifying public consultation mechanisms and making them more accessible via the centralised and dedicated PPCs website, ENER.GOV.MK.<br>• Serbia has made strides in increasing stakeholder participation by NGOs, academia, private sector, and Chamber of Commerce during both the formation and the implementation phases of policy making, as mandated by the Law on Planning System of the Republic of Serbia, Decree on Public Policy Management Methodology, Policy Analysis and Regulations, the content of individual public policy documents and amendments to the Law on State Administration. The Rulebook Governing the Guidelines of Good Practice for the Realization of Public Participation in the Preparation of the Draft Laws and Other Regulations and Acts in 2019 further defines the consultation process and methods. Additionally, in January 2020, the government adopted guidelines on including civil society in working groups for drafting regulations and public policies. | Advanced |

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Ease conditions on the temporary movement of natural persons and reduce the remaining barriers to market entry and competition in their services sectors.** | The WB6 economies have made efforts to reduce non-tariff restrictions in their services related regulations:<br>• Serbia, North Macedonia and Kosovo have been the most active in implementing reforms: Serbia in 2014-16 and North Macedonia in 2016-19, in particular targeting the architecture and engineering sectors. Kosovo has maintained a steady flow of reforms in the period 2014-20 with a notable highlight being the opening of its courier market in 2019.<br>• Montenegro has mainly opened up its construction, engineering and architecture sectors. Albania started with a more attractive environment in 2014 so that it has had a more stable environment until 2019. The exception is the 2015 reforms in the courier sector. It is also the economy that has lowered its degree of restrictiveness the most in 2019 and 2020. Finally, BIH has maintained a low degree of variation in its indices over the years.<br>• The six economies also refrained from implementing protectionist measures in 2020, which contrasts with the marked STRI increases observed in some OECD economies for the same period.<br>• Significant progress has been made in easing the conditions for the movement of persons between the CEFTA economies through the adoption of Additional Protocol 6 to the CEFTA agreement. | Moderate |

## Introduction

While decades of multilateral, regional and unilateral efforts have significantly reduced traditional trade barriers such as tariffs, many elements can still impede trade. Regulatory heterogeneity and non-tariff barriers are now increasingly seen as a major source of trade limitations and costs, affecting both domestic producers and foreign suppliers (OECD, 2017[1]). These latter barriers particularly affect services, which constitute a large part of the global economy, generating more than two-thirds of global gross domestic product (GDP), attracting more than three-quarters of foreign direct investment (FDI), employing the largest number of workers, and creating most of the world's new jobs (OECD, 2017[2]).

A trade policy that facilitates cross-border economic activity therefore promotes the competitiveness and growth of an economy. Trade liberalisation measures provide access to larger markets, leading to greater economies of scale and efficiency gains. Better market access also leads to greater competition from international firms in domestic markets, resulting in increased competition and better allocative efficiency.[1] In addition, transparent and well-designed policies facilitate access to global value chains (GVCs), which are very effective ways to integrate into the global economy and connect to modern technologies and skills (OECD, 2015[3]). Trade facilitation through transparent, predictable, and simple border procedures speeds up the movement of goods and allows firms to reduce losses of perishable goods, lower costs, be more responsive to changing consumer preferences and participate in time-sensitive global value chains (OECD, 2018[4]).

Economies are therefore faced with the need to put in place trade policies that on the one hand smooth trade flows, while at the same time refraining from putting in place measures that act as disincentives to trade, all the while maintaining a balance with the international environment and public utility considerations. In recent years, attention has grown on the regulatory heterogeneity and inclusiveness of other areas such as environmental protection and labour laws. While regulatory heterogeneity is often the result of diverging national public policy objectives, it may be the undesired result of rule-making that ignores the international regulatory environment and interconnectedness of our societies and economies (Basedow and Kauffmann, 2016[5]). Good regulatory practices involving stakeholder feedback and evaluation are therefore critical to ensure that regulations achieve their desired objectives.

This chapter is intended to provide guidance to help economies develop appropriate and balanced trade regulatory policies. In doing so, it is linked with other policy dimensions analysed in this Competitiveness Outlook:

- **Chapter 4. Investment** (and in particular FDI) depends on an open and liberal trade regime with effective trade facilitation measures in place, such as efficient customs administrations and reduced transaction costs. Moreover, investment is complementary to trade as foreign investment abroad stimulates the growth of exports by investing economies. Finally, both a sound investment framework and unrestricted trade are seen as facilitators of economic growth.
- **Chapter 11. Employment policy** and job creation for both skilled and unskilled workers are stimulated by more open goods and services markets and competitive environments. Exporters benefit from reduced barriers to the movement of people in services increases the demand for more highly skilled labour. Foreign skilled labour, on the other hand, can encourage a transfer of knowledge that increases the expertise of local workers.
- **Chapter 12. Science, technology and innovation** are sources of comparative advantage which drive trade. Exports, investments abroad or licensed technologies are driven by innovative and more productive companies. Open and more liberal markets contribute to the diffusion of innovation and the international transfer of technology (Ferencz, 2019[6]). Trade in capital goods and intermediate goods and services, the movement of people and licensing agreements, allow for new technologies to be transmitted across borders.
- **Chapter 13. Digital society** stimulates trade. High quality access to competitively priced communication networks and services is fundamental (OECD, 2019[7]), including to digital trade which has become vital for economic activity and innovation during the global COVID-19 pandemic. Digitalisation facilitates trade, the co-ordination of global value chains and the dissemination of ideas, changing the way companies engage in international trade, what they sell and to whom. Digitalisation creates new business opportunities for companies to sell more products to more markets, allowing economies to diversify their export baskets. It increases trade in goods and services across all sectors and allows economies to make better use of their trade agreements. However, barriers to digital services, which form the backbone of digital trade transactions, are increasing and are not necessarily only regulatory (OECD, 2019[8]).
- **Chapter 14. Transport** is key for trade facilitation, which depends mainly on physical infrastructure, traffic management, and customs and border crossing points. Sectors with high export intensity, such as manufacturing and agriculture, depend on quick, cost-effective, and reliable transport modes. Delays due to poor transport and logistics can be costly: an extra day can reduce exports by at least 1% and can also impede export diversification (OECD/WTO, 2013[9]). Poor logistics act as a heavy barrier to the growth of cross-border e-commerce for physical goods in many economies, especially the developing ones (Rodriguez, 2018[10])
- **Chapter 17. Agriculture policy** and trade are highly interdependent. Trade plays a crucial role in providing food to consumers around the world. It helps to provide a wider choice of consumer goods and has played a role in reducing global food insecurity. Over the past decade, international food and agricultural markets have undergone some significant changes, bringing national and international markets closer together. Since 2000, agri-food trade has grown strongly as world markets have responded to a more rules-based trading environment, lower tariffs, and reduced trade-distorting producer support (OECD, 2019[11]). But agri-food trade is not only growing, it is also becoming global. Food is increasingly made from a wider range of products, produced in more places around the world. Now a growing share of agri-food trade takes place in global value chains (GVCs) that link agri-food sectors with other sectors of the economy around the world (OECD, 2020[12]). Since agri-food products in GVCs may cross borders several times before reaching final consumers, their costs can be substantially increased by uncontrolled non-tariff measures – those

related to laws, regulations and requirements such as sanitary and phytosanitary measures (SPS), technical barriers to trade and customs procedures (OECD, 2019[11]).

## Assessment framework

### *Structure*

This chapter measures trade policies in the WB6 economies by assessing the following three broad sub-dimensions:

1. **Sub-dimension 2.1: Trade policy framework** focuses on the quality of the decision making in trade-related policies and the effectiveness of the government in formulating and implementing new trade policies. This is assessed by their degree of integration into the network of international trade agreements as well as their implementation of the OECD Trade Facilitation Indicators.
2. **Sub-dimension 2.2: Services trade restrictiveness** assesses restrictions to services trade in the WB6 economies. As services are a major part of the global economy, estimated at around 80% of global GDP, this chapter puts a strong focus on trade in services, which allows economies to specialise according to their comparative advantages in services and skills. To do so, it makes use of the main tool in this field, the OECD's Services Trade Restrictiveness Index (STRI). Compared to previous editions, the 2021 iteration of the WB6's STRI has been significantly expanded.
3. **Sub-dimension 2.3: E-commerce and digitally enabled services** assesses the regulatory environment for e-commerce and trade in digitally enabled services. This area of global trade is currently rising and the anticipation is that e-commerce will grow more in the near future, especially with new technologies. The sub-dimension therefore focuses on the two main components of trade: trade in goods and trade in services enabled through digital networks. They are assessed through two indicators: the quality of the e-commerce framework and the degree of restrictiveness of digitally enabled services.

Figure 5.2 shows how these sub-dimensions and their constituent indicators make up the assessment framework for the trade policy dimension. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. The main part of the analysis of trade in services in the WB6 region is based on a partial OECD Services Trade Restrictiveness Index (STRI) for the six economies that make up the region (Box 5.1). The regulatory databases set up for the partial OECD STRI for the WB6 were created thanks to co-operation with the WTO and CEFTA, which is gratefully acknowledged. They are based on the WTO/World Bank I-TIP Services regulatory databases, updated in November 2020 and to which the OECD STRI methodology has been applied. For more information on the methodology see the Methodology and assessment process chapter.

### Figure 5.2. Trade policy dimension assessment framework

| Trade policy dimension | | |
|---|---|---|
| **Sub-dimension 2.1**<br>Trade policy framework | **Sub-dimension 2.2**<br>Trade in services restrictiveness | **Sub-dimension 2.3**<br>E-commerce and digitally enabled services |
| **Qualitative indicators**<br>1. Institutional co-ordination on trade policy formulation<br>2. Public-private consultation<br>3. Network of free-trade agreements<br>4. OECD Trade Facilitation Indicators | **Qualitative Indicators**<br>Analysis of barriers to trade in selected services sectors<br>5. Transport and distribution supply chain<br>6. Market bridging and supporting services<br>7. Physical infrastructure services<br>8. Digital network services | **Qualitative Indicators**<br>9. E-commerce policy framework<br>10. Trade in digitally enabled services restrictiveness |
| **Quantitative Indicators**<br>1. Number of newly issued and number of modified trade measures (laws, regulations, trade agreements) | **Quantitative Indicators**<br>2. OECD Services Trade Restrictiveness Index<br>3. OECD Heterogeneity indices | **Quantitative Indicators**<br>4. OECD Digital Services Trade Restrictiveness Index |

The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan at the Berlin Process Summit held on 10 November 2020 in Sofia. The plan is made up of targeted actions in four key areas: (1) a regional trade area; (2) a regional investment area; (3) a regional digital area; and (4) a regional industrial and innovation area.

In the regional trade area, the WB6 economies commit to closely align rules and regulations with the core principles governing the EU Internal Market, based on the “four freedoms”: enabling goods, services, capital, and people to move more freely across the region. The findings of the services trade restrictiveness sub-dimension can inform the implementation of actions under this component (Box 5.6).

### *Key methodological changes to the assessment framework*

The assessment has undergone a substantial change in its 2021 iteration since the 2018 CO analysis framework.

This chapter aims to help the WB6 economies to put in place effective trade policies that maintain a balance between domestic considerations and the fluidity of trade flows while refraining from imposing or maintaining regulations that are not conducive to trade. In addition, in view of the region's new trade considerations, which aspire to greater regional integration and ultimately the adhesion into the EU, the chapter also aims to identify points of regulatory divergence and convergence with these goals. To do this, the trade policy assessment framework now gives pride of place to three sets of unique regulatory transparency tools from the OECD which serve to identify bottlenecks and give benchmark opportunities in trade related policies:

1. The OECD Services Trade Restrictiveness Index (STRI), an evidence-based tool that provides information on regulations affecting trade in services (Box 5.1).
2. The OECD Trade Facilitation Indicators (TFIs), which help policy makers assess the state of their trade facilitation efforts, pinpoint challenges and identify opportunities for progress (Box 5.3).
3. The OECD Digital STRI, the latest OECD tool that identifies, catalogues, and quantifies cross-cutting barriers that affect digital trade with a focus on services (Figure 5.20).

These three tools should be read together to help policy makers decide on trade reform options, benchmark them against global best practice, and assess their likely effects; for trade negotiators to clarify restrictions that most impede trade; and for businesses to understand the requirements when entering foreign markets. The use of these three sets of tools, together with the analysis of the qualitative and quantitative questionnaires, provides a comprehensive view of the state of trade policies in the region.

### Box 5.1. The OECD Services Trade Restrictiveness Index (STRI)

The OECD Services Trade Restrictiveness Index (STRI) was used to evaluate the WB6 economies' policies for 12 services sectors. The STRI is a unique, evidence-based diagnostic tool that inventories trade restrictions in OECD member states and partner economies (Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa, and Thailand). It covers 22 services sectors, allowing countries to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts.

For this CO assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices compute restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency, and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[1]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[2] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[13])

Relevant STRI tools include:

- **Compare your country:** (www2.compareyourcountry.org/service-trade-restrictions). This interactive website can be used to compare services trade restrictiveness across 22 sectors in all OECD countries and partner economies. Key economic indicators are projected onto a world map to give a comparative view of the importance of services in the economies covered by the STRI.
- **Policy simulator:** (http://sim.oecd.org). The policy simulator provides all STRI information by economy and by sector. It can be used to understand how the STRI indices are calculated, to analyse the contribution of each policy measure to the index, to compare economies in detail, and to simulate the impact of a policy change on the index value. The focus view option provides links to legal sources. Finally, simulations can be saved and shared with other users, and the relevant data can be downloaded.
- **Online regulatory database**: (http://qdd.oecd.org/subject.aspx?Subject=STRI). The online STRI regulatory database displays complete and up-to-date regulatory information collected for the sector composite indices. This qualitative database contains information on trade restrictions and behind-the-border regulations. The database entries are documented with reference to the sources (title and articles of the relevant law), with an internet link to each legal source.

- **Indices:** (http://stats.oecd.org/Index.aspx?DataSetCode=STRI). The STRI indices are easily accessed and extracted from OECD.Stat (under the heading: Industry and Services, subheading: Services Trade Restrictions). In addition to the five policy areas, the indices are presented by four additional classifications: GATS market access/national treatment and domestic regulation/other, GATS modes of supply, discriminatory versus non-discriminatory measures, firm's establishment versus on-going operations. The indices of regulatory heterogeneity based on the same information included in the STRI regulatory database are also displayed under this section.

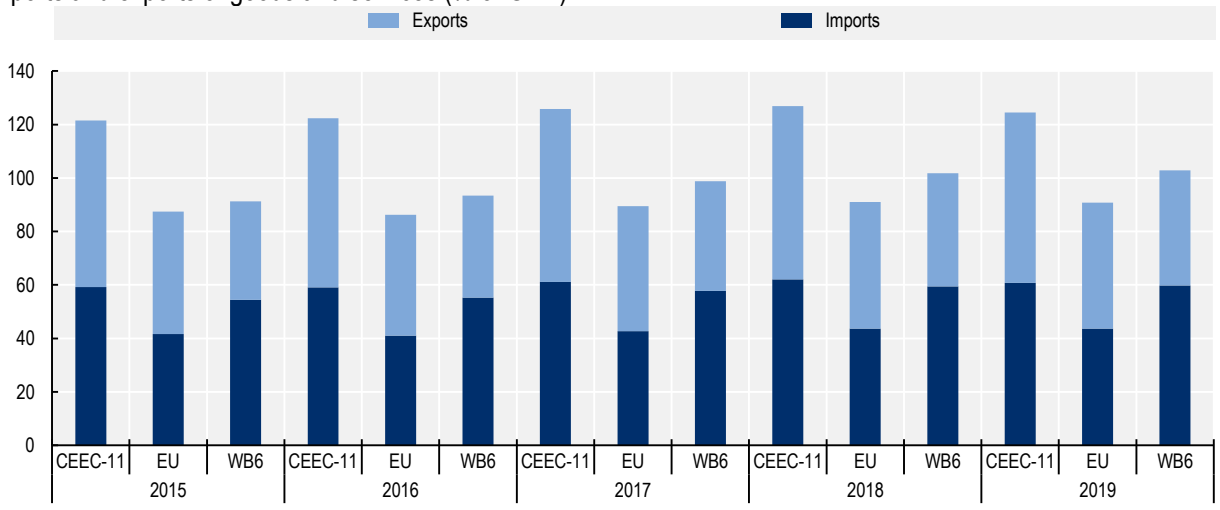
1: The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member and partner states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.
2: The complete list of measures sector by sector is also available on the OECD STRI website.
Source: (OECD, 2017[2]), *Services Trade Policies and the Global Economy*, https://dx.doi.org/10.1787/9789264275232-en.

## Trade policy dimension performance and context in the WB6

In the period 2009-19, the total foreign trade in goods and services of the six Western Balkan economies grew steadily, largely due to an increase in exports initiated after the economic crisis of 2009. The share of trade in the region's gross domestic product (GDP) reached 110% on average in 2019, compared to 80% in 2009. Despite this increase, the region remains below the average for Central and Eastern European countries (CEEC-11)[2] averages (Figure 5.3).

### Figure 5.3. Key trends in external trade in goods and services (2015-19)

Imports and exports of goods and services (% of GDP)

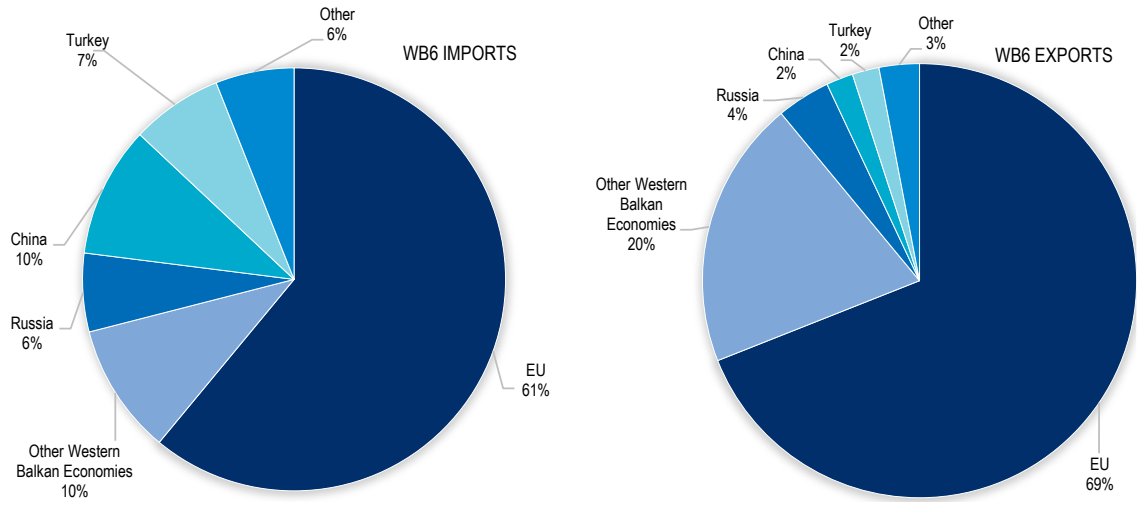



Note: CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (World Bank, 2021[14]), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink https://doi.org/10.1787/888934253480

The EU is the WB6 region's main trading partner, accounting in total for around two-thirds of the region's total trade (Figure 5.4). Germany and Italy play a predominant role, accounting for about one-third of all WB6 exports. The other EU Member States, and in particular the neighbouring states of Bulgaria, Croatia, Romania and Slovenia, are also important export destinations and account for 15% of the exports of the six economies. Trade among the WB6 represents 10% of the region's imports and 20% of its exports. Finally, China plays an increasing role in the region's trade, accounting for 10% of the region's imports, particularly as a source of raw materials needed for the region's integration into global value chains.

## Figure 5.4. Main trading partners of the WB6

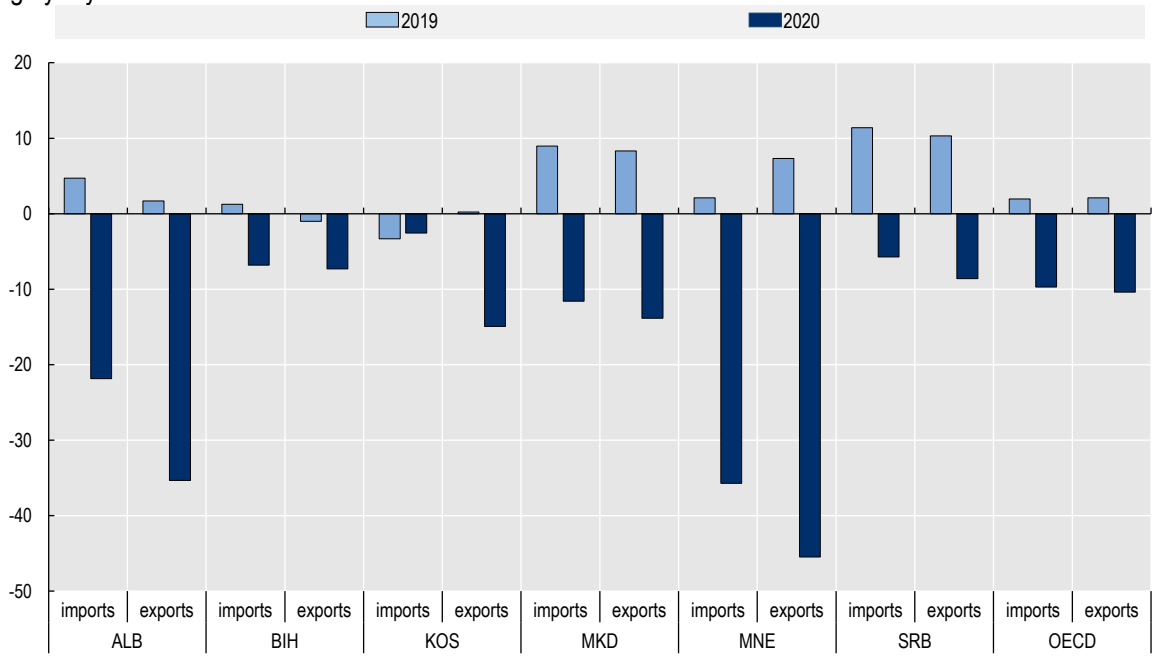



Source: (Eurostat, 2020[15]), https://ec.europa.eu/eurostat/web/international-trade-in-goods/data/database.

The COVID-19 crisis, combined with the related export bans, limitations on the movement of people and retail shutdowns, resulted in a significant drop in imports and exports in Q2-Q3 2020 relative to 2019 (Figure 5.5). On average, WB6 exports and imports dropped by 20% and 14% respectively (IMF, 2020[16]). While Albania, and Montenegro suffered the largest decrease of import and export volumes, ranging from -20% to -45%, Bosnia and Herzegovina and Serbia experienced the smallest fall (above -12%) in the region (OECD, 2020[17]).

## Figure 5.5. Impact of COVID-19 on import and export volumes (2019-20)

% change y-o-y




Source: (IMF, 2020[16]), *World Economic Outlook* (October), https://www.imf.org/en/Publications/WEO/weo-database/2020/October; (OECD, 2020[18]), *OECD Economic Outlook*, Volume 2020 Issue 1, https://dx.doi.org/10.1787/0d1d1e2e-en.

StatLink https://doi.org/10.1787/888934253499

The GVC links in WB6 economies are mostly oriented towards services and low-value manufacturing products (OECD, 2019[19]). In all WB6 economies, services account for the largest share of GDP – see Services trade restrictiveness (Sub-dimension 2.2) – followed by a sizeable manufacturing industry. However, the impact of the containment measures has varied according to the composition of the economies' export basket, which partly explains the differences in the region's declining trade flows. Overall, the sectors of tourism, transport and manufacturing have been the most affected.

Service-oriented economies, such as Albania and Montenegro, are mainly dominated by travel and tourism.[3] The latter contributes to 15% of the overall GDP of the region. It is also the sector most affected by the long-lasting restrictions linked to COVID-19. The industry suffered a 50% to 70% drop compared to 2019 (RCC Int., 2020[20]). In Kosovo, diaspora tourism fell by around 60% in the first three quarters of 2020 compared to the same period in 2019 due to restrictions on international mobility. The balance of services surplus is estimated to have contracted to 5.8% of GDP in 2020 from 13.1% in 2019 in this economy. (Tourism chapter)

In contrast, economies that maintain the highest share of manufacturing in the WB6 region, such as Bosnia and Herzegovina, North Macedonia and Serbia, initially saw their trade flows come to a halt. For North Macedonia and Serbia, trade in intermediate industrial goods linked to GVCs accounts for about two-thirds of exports (World Bank, 2020[21]). The disruption of supply chains resulting from the combined slowdown of manufacturing production in China, as well as reduced demand in the United States and the EU, initially brought trade to a virtual standstill in these two economies. Their GVCs are concentrated in a few sectors (automotive, electrical equipment, machinery, chemicals, and metals) in several European countries (mainly Germany). In mid-2020, exports resumed to some extent once the supply of relevant components was restored and demand from the EU stabilised.

Although less integrated into GVCs, the remaining economies have not escaped disruption, primarily due to the decline in demand from EU Member States rather than to supply shortages. For example, Albania's export basket is highly concentrated, mainly on outward processing in the fashion sector with Italy. As the latter alone accounts for almost 50% of the economy's exports and 27% of its imports, Albanian exports collapsed when Italy went into lockdown.

## Trade policy framework (Sub-dimension 2.1)

The recent contraction in world trade has demonstrated the importance of implementing structural policies that strengthen export competitiveness. Global trade policy now goes beyond its original focus on the simple reduction of tariffs and the elimination of quantitative restrictions. It involves policies aimed at reducing non-tariff restrictions that hamper trade. Non-tariff barriers can take the form of rules that go far beyond those that emanate from the legislator's aim to regulate trade. Conversely, trade now involves crosscutting policies. A global method is therefore necessary to respond to modern trade issues. This holistic approach to trade requires the establishment of strong institutional mechanisms for co-ordination, consultation, and transparency. Therefore, this first sub-dimension of the trade policy dimension assesses the effectiveness of governments in formulating, evaluating, and implementing trade policy.

Trade policy makers and negotiators need to regularly co-ordinate different ministries, government agencies and institutions when formulating and implementing trade policy. They should also consult a broad range of private and civil society actors, to ensure that policy development is transparent and inclusive. Governments also need to monitor and evaluate the impact of trade policy on the wider economy, including environmental and social impacts. Finally, building a comprehensive and structured network of bilateral and regional trade agreements promotes regulatory initiatives to open markets in a harmonised manner and encourages increased trade policy co-operation by stimulating trade flows.

The economies with the highest average score for this sub-dimension are Kosovo, North Macedonia and Serbia (each scoring 3.8; Table 5.2), which demonstrate strong implementation across all indicators and monitoring and evaluation activities. Albania and Montenegro score 3.5, meaning that policy frameworks are adopted and implemented. Bosnia and Herzegovina's score of 2.8 implies that policy frameworks are largely in place, but there is a need to improve implementation.

### Table 5.2. Scores for Sub-dimension 2.1: Trade policy framework

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 2.1: Trade policy framework | Institutional co-ordination on trade policy formulation | 3.5 | 2.5 | 3.5 | 4 | 3.5 | 4 | 3.5 |
| | Public-private consultation | 3.5 | 3 | 4 | 3.5 | 3.5 | 3.5 | 3.5 |
| | Network of free-trade agreements* | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| | OECD Trade Facilitation Indicators* | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Sub-dimension average score** | | 3.5 | 2.8 | 3.8 | 3.8 | 3.5 | 3.8 | 3.5 |

* Note: Indicator does not have a scoring system attributed to it and is therefore assessed descriptively.

### *Institutional co-ordination has been strengthened*

The institutional co-ordination indicator considers whether there is a leading ministry or institution[4] co-ordinating the work of the various stakeholders in trade policy while shielding trade policy from sectoral interests in order to facilitate coherent trade development.

All WB6 economies have solid inter-institutional co-ordination of trade policy formulation, usually through official committees, councils or working groups led by the trade or economy ministries. The work of these inter-ministerial committees is generally focused on implementing or negotiating regional and international commitments (CEFTA, WTO); facilitating the EU accession process (through the preparation of relevant trade policy-related EU *acquis* chapters); and designing or amending specific trade measures.

The economies are also establishing co-ordination mechanisms to address the more challenging areas of trade policy. All six economies have a National Trade Facilitation Committee (NTFC). These often function in co-operation with other working groups, sometimes in more specialised frameworks, on an ad-hoc basis as in BIH, or institutionalised. The most recent institutionalised example is Kosovo's Committee for Trade in Services, established in July 2020,[5] as a consultative body to propose trade policies in the field of services.[6] Economies have also improved their trade frameworks by implementing new Trade Facilitation Strategy Policies. However, implementation is uneven. All economies have trade-related goals in their latest development strategies,[7] but only Albania and Montenegro have dedicated trade facilitation strategies. Albania's National Plan for Trade Policy Coordination and Trade Facilitation (2017-2020) was recently revised reflecting new developments in Albania's trade policy, and now covers 2021-2023. Montenegro has a Strategy for Trade Facilitation 2018-2022. Overall, the relevant ministries are better equipped to improve trade-related co-ordination and consultation with an increased number of agencies and institutions.[8]

Inter-ministerial co-ordination and consultations with stakeholders (private sector and civil society) complement each other, mainly during the policy initiation and formulation stage. However, evidence suggests that involvement of the private sector in the policy implementation and evaluation phase varies across the region. It seems that the inter-institutional co-ordination mechanisms can be improved in all economies. Some NTFCs are not fully able to fulfil their objectives. The region's business sector stakeholders were critical about the actual impact of their participation in the NTFCs' work. OECD stakeholder consultations as part of the CO2021 assessment framework have highlighted the perception that the NTFCs do not always address sufficiently substantive issues related to the region's business development. These criticisms are more pronounced in some economies than in others, and also vary

according to the type of private actor. SMEs express more reservations about the frameworks established in the region, given their generally less organised nature; and as they are not always members of the business associations that are regularly included in co-ordination and consultation processes.

### *Public-private consultations are required in all economies, but implementation varies*

Effective public-private consultation (PPC) improves regulatory policy making, particularly for business, as it brings private sector expertise, perspectives and ideas to the design and implementation of policy changes. The participation of private actors in decision making helps to increase the transparency and openness of the legislative process as a whole, but is particularly important in trade-related matters as it ensures that the international commitments and needs of the business community are properly addressed and harmonised. Increased transparency and stronger private sector engagement in turn leads to greater acceptance of government programmes and projects and builds confidence in government institutions (OECD, 2018[22]). Consultations with the private sector should take place within a formal structure and at all stages of policy development, from preliminary discussions on possible legislation to monitoring and evaluation of a given policy.

The WB6 governments have continued their efforts to institutionalise consultations on trade with private stakeholders. All the economies have legal and regulatory frameworks in place that define the general principles and procedures for conducting PPCs. All business legislation in the region (both primary and secondary) is subject to a form of public consultation – either institutionalised (in all economies) or both institutionalised and informal, such as in Albania and Serbia. In Albania, business associations are members of the Inter-Institutional Working Group for Trade Policy and Trade Facilitation. Representatives of these associations are taking part intensively in trade co-ordination meetings and are coming up with concrete proposals. In terms of content, Kosovo, Montenegro, North Macedonia and Serbia go beyond consulting only on laws, and submit other relevant documents for PPCs or public availability as part of the transparency process.[9] As was already the case in the previous CO assessment, all WB6 economies require line ministries to report the outcomes of consultations and to publish reports on them, including suggestions that were accepted and those that were not, and, if not, specifying the reasons with legally binding deadlines. However, the public-private consultations in the WB6 differ as to frequency, the depth of stakeholder participation and the availability of information published online. There is also variability in the amount of time stakeholders are given to contribute to the consultation process.

In Albania and Serbia, formal consultations take place on a regular basis and are complemented by informal meetings to facilitate feedback. Draft laws are then published and comments from different types of stakeholders (citizens, NGOs, business organisations, chambers of commerce, etc.) are made available to the public via the ministries' websites. Similarly, in Montenegro, the ministry responsible for the draft regulation publishes a report on the consultation on its website and on the e-Government portal. However, its responsibility is to only disseminate the report to the entities that participated in the process.

The most effective and transparent way to solicit the participation of private stakeholders in legislation is through a centralised and dedicated website that serves as a hub for all PPC procedures, as well as a platform for reporting on these procedures. The advantage of a centralised system over publishing draft laws on ministry websites is that a dedicated website reduces the need to solicit institutions, such as chambers of commerce, to disseminate calls for consultation. This is particularly important in the case of trade, which is by nature a cross-cutting area.

All the economies have a centralised dedicated website except Serbia, which, however, is in the final stages of setting one up. Consultations are carried out via the ministries responsible for enacting laws and regulations in this economy. The most recent PPC online platforms have been established in Kosovo and Bosnia and Herzegovina – although the latter's only lists PPCs relating to BIH state-level institutions. The use of portals could still be perfected in all economies. Even though each institution proposing new trade related legislation is obliged to publish information on the PPC process on its dedicated website and on

the centralised government portal, it is left to the discretion of each institution to announce the future publication of such projects.

In all WB6 economies, participation in PPCs on the dedicated websites is open to all interested participants. There are, however, disparities in the *de facto* participation of private-sector stakeholders according to their legal nature and nationality. North Macedonia and Serbia have the largest number of non-government stakeholders participating in consultations as they incorporate into the process the full extent of civil society. In the other economies, consultations tend to take place through chambers of commerce and participation is often limited to their members, which does not always include all SMEs (OECD et al., 2019[23]) or non-business-related NGOs. Calls for public-private consultation therefore do not always reach all interested entities. However, statistics from Albania, Kosovo and Montenegro suggest that participation in commentary procedures is increasing. With the exception of Montenegro, which indicates involvement by foreign embassies in its PPCs (Montenegro Ministry of Public Administration, Digital Society and Media, 2020[24]), there is no evidence that the processes involve foreign private stakeholders. Involving foreign private stakeholders is good practice and promotes well-harmonised trade policies (Basedow and Kauffmann, 2016[5]).

Monitoring of the quality and shortcomings of public-private consultations is not yet systematic in the region. Public bodies that supervise consultations and monitor their quality remain an exception. However, some initiatives have been introduced. Kosovo has the most developed consultation evaluation mechanisms. PPCs, promotion tools and timelines of consultations are evaluated annually by the Office on Good Governance to determine whether an open, transparent, and non-discriminatory form of PPC was used from the beginning to the end of the legislative process. Moreover, the Office on Good Governance annually reports and monitors public consultation implementation based on effectiveness and inclusiveness goals (Box 5.2).

Albania, Montenegro and Serbia have ad-hoc systems for monitoring public consultations. In Albania, the Law on Public Consultations requires institutions that prepare acts to publish annual reports and analysis on the consultations they have conducted. However, the reports in question are only available for 2020 and not all institutions that conducted public consultations in the same year have published their reports. In addition, the system requires institutions to self-assess, which raises the question of harmonisation of approaches. In Serbia, the role of collecting data on public consultation procedures is assigned to an entity independent of the ministries that develop regulations, the Public Policy Secretariat, whose main role is to support the government in managing the quality of public policies and regulations through evaluation mechanisms. The secretariat produces statistics on the number of legislative proposals that have been subject to public consultation, but not on compliance with consultation standards. Moreover, these reports are still produced irregularly. According to the Serbian Government, in the future the E-participation website will enable monitoring and control of the implementation of consultations and public hearings on public policy documents and regulations, as well as control of reporting on implementation of consultations and public discussion processes. Similarly, in Montenegro, the Ministry of Public Administration, Digital Society and Media produces statistical data on the number of legislative projects that have been subject to PPCs. The reports are comprehensive and detailed but focus mainly on statistics, and do not comply with the standards mandated by Montenegro's legislation.

### Box 5.2. Monitoring public-private consultations in Kosovo

The Office of Good Governance is tasked with preparing an annual report on the public consultation process. It checks whether draft proposals comply with public consultation requirements before the proposals are submitted to the government for decisions. Kosovo's annual reports on the public-private consultation process present the results for 2017 and 2019. Based on the Minimum Standards for the Public Consultation Process (Regulation No. 05/2016), the reports are prepared in co-operation with all the institutions involved in the legislative development process.

Since 2017, the Office for Good Governance has established co-ordination structures involving public consultation co-ordinators in each ministry. It also carries out capacity-building activities, such as two rounds of on-the-job training on PPCs, using the electronic PPC platform and numerous information workshops. Introducing the electronic public consultation platform was one of the most important steps the government has taken to facilitate PPCs.

As the reports show, a total of 274 documents were drafted by all ministries in 2019, 100% of the acts approved by the government were opened to PPC (compared to 90% in 2017), 272 through the platform while 2 documents were consulted by other means. These were 5 concept documents, 31 draft laws, 77 draft regulations, 129 draft administrative directives, 6 strategies, 5 programmes, 7 action plans and 8 other documents. In addition to the portal, which was the most used tool by the PPC, other tools were used, including e-mail communication, stakeholder workshops and public meetings.

The total number of participants in the consultation process rose to 3 577 in 2019 – a 143% increase on 1 469 in 2018 (and 2 104 in the first report of 2017). A total of 1 339 comments were received; 688 of which (or 51%), were accepted and implemented by the drafting institutions; 97, (7.2%), were partially accepted, while 543 comments, (40%), were rejected. There is a lack of information for the last 6 comments.

Finally, the minimum standards provided for in the regulations were met by 183 consultations or 67% (compared to 52% in 2017), while 91 documents did not meet all the minimum standards (33%). It should also be noted that all documents submitted by the Ministry of Trade and Industry met the minimum standards in 2019.

Source: (Kosovo, 2018[25]), *Annual Report on Public Consultations 2017*, http://konsultimet.rks-gov.net/Storage/Docs/Doc-5b6d8625e8a92.pdf; (Kosovo, 2020[26]), *Annual Report on Public Consultations 2019*, https://konsultimet.rks-gov.net/documents.php.

## *The network of free trade agreements integrates the WB6 with their main trade partners but less into global trade*

The network of free trade agreements[10] indicator looks at the number of bilateral and multilateral free trade agreements in place and their scope. Free trade agreements are paramount as they aim to further co-operation in trade policy and boost trade flows within groups of two or more partners. Regional trade agreements (RTAs) also promote trade in services from the year they enter into force. This immediate effect is not surprising as RTAs take time to negotiate and ratify, allowing firms to prepare in advance (OECD, 2018[27]).

Integration with the main EU and regional trade partners is well established (Figure 5.4). All WB6 economies are signatories to the Central European Free Trade Agreement (CEFTA), through which they have achieved tariff liberalisation on trade in manufactured and agricultural products. In December 2019, the WB6 economies strengthened their treaty network through the conclusion of Additional Protocol 6 on trade in services to CEFTA, which will improve the fluidity of trade flows in services in the region. So far, the protocol has been ratified by Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. All six WB economies have signed a Stabilisation and Association Agreement (SAA) with the EU.[11]

Integration into global trade is still timid. Albania (2000), North Macedonia (2003) and Montenegro (2012) are WTO members, and while the six economies continue to develop their networks of bilateral and multilateral trade agreements, they do so at disparate rates.[12] Bilateral treaties with non-EU states are rare, with the WB6 integrating only with Turkey and to a lesser extent with Ukraine[13] and the United Kingdom (Table 5.3). Albania is in some ways a counter-example and is relatively active, with 7 agreements under negotiation.[14] Overall, however, the region has not significantly advanced its integration into the global trading system since the last round of analysis and major bottlenecks remain: the accession process of Bosnia and Herzegovina and Serbia to the WTO is still ongoing. Serbia compensates for this through bilateral treaties and partnerships, notably an FTA with the Eurasian Economic Union (EAEU) signed in 2019 (for its trade relations with the Russian Federation) but still not in force, and a limited strategic partnership agreement signed in August 2009 with China.

In consequence, the integration of the WB6 region into international trade is half-hearted, with economies having strong legal bases with major partners, in line with their regional integration policies and with the EU, but limiting their trade outside this scope. This is particularly negative for the largest economy, Serbia, as it may hinder the benefits of a favourable regulatory regime for foreign direct investment in this economy (see Investment policy and promotion chapter) and close the doors to third-country investors.

### Table 5.3. WB6 economies' bilateral and multilateral free trade agreements

| Economy | Bilateral free trade agreements | Multilateral free trade agreements |
|---|---|---|
| Albania | Turkey, United Kingdom, SAA | CEFTA, EFTA |
| Bosnia and Herzegovina | Turkey, SAA | CEFTA, EFTA |
| Kosovo | Czech Republic, Turkey, United Kingdom, SAA | CEFTA, EFTA Joint Declarations on Cooperation |
| Montenegro | Turkey, Ukraine, SAA | CEFTA, EFTA |
| North Macedonia | Turkey, Ukraine, SAA | CEFTA, EFTA |
| Serbia | Turkey, United Kingdom, SAA | CEFTA, EAEU FTA, EFTA |

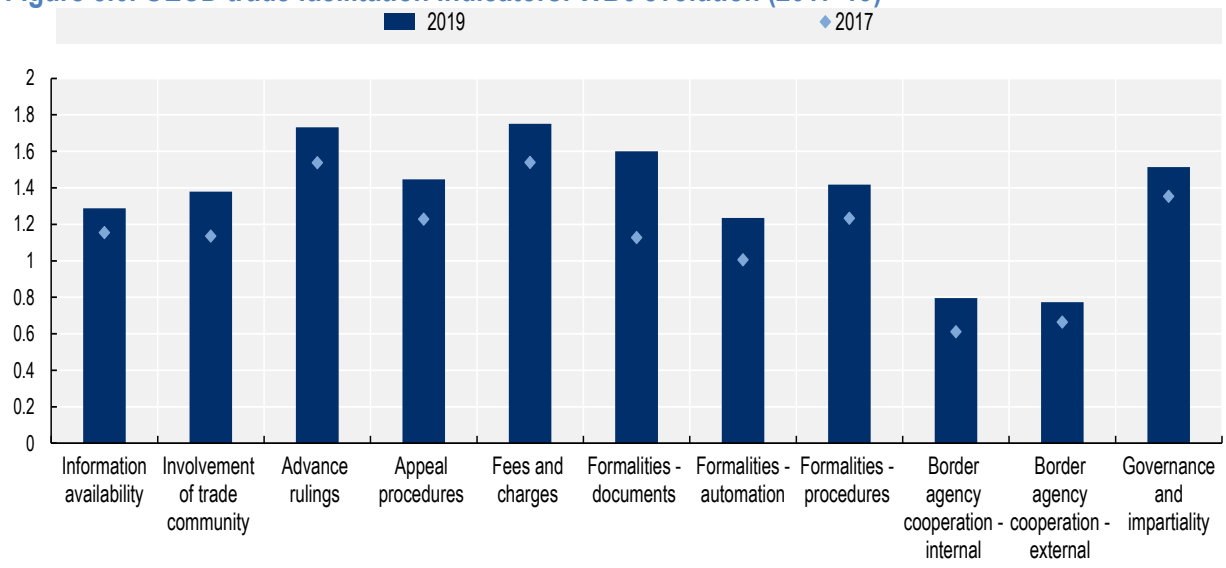
Note: CEFTA = Central European Free Trade Agreement; EFTA = European Free Trade Association; EAEU FTA = Eurasian Economic Union Free Trade Agreement; SAA = Stabilisation and Association Agreement.
Source: OECD Competitiveness Outlook 2021 qualitative questionnaires.

### *Trade facilitation has seen significant progress*

The implementation of the CEFTA Agreement, and in particular its Protocol 5, has led to significant progress on trade facilitation in the WB6 economies, but challenges remain. The OECD Trade Facilitation Indicators (TFIs) are a powerful tool to assess and monitor efforts to improve border procedures, reduce trade costs, stimulate trade flows, and contribute to inclusive growth.

They are the most precisely targeted instrument for monitoring and comparing the trade facilitation performance of economies Box 5.3. According to the OECD's 2019 TFIs, WB6 economies[15] have improved in all areas since 2017 (Figure 5.6).

## Figure 5.6. OECD trade facilitation indicators: WB6 evolution (2017-19)

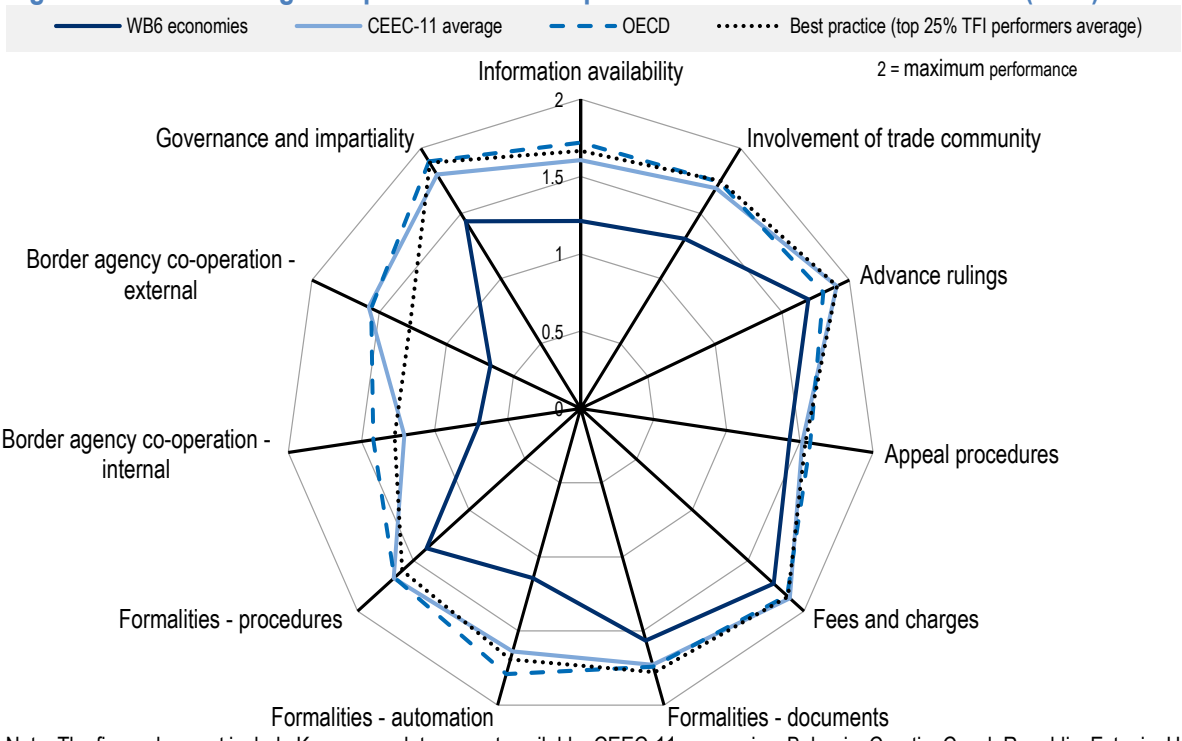



Note: The time comparison displayed is based on the same components covered both by the 2017 and the 2019 trade facilitation indicators (TFI). The figure does not include Kosovo, for which data are not available.
Source: (OECD, 2019[28]), *Trade Facilitation Indicators* (database), www.oecd.org/trade/facilitation/indicators.htm.

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As shown in Figure 5.7, in some areas they are close to global best practice (i.e., the top 25% of countries covered by the TFI indices) and to the average performances of CEEC and the OECD.

## Figure 5.7. WB6 average TFI performance compared with the OECD and CEEC-11 (2019)




Note: The figure does not include Kosovo, as data are not available; CEEC-11 economies: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia
Source: (OECD, 2019[28]), *OECD Trade Facilitation Indicators* (database), www.oecd.org/trade/facilitation/indicators.htm.

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### Box 5.3. The OECD Trade Facilitation Indicators (TFIs)

The TFIs consist of a set of variables measuring the extent to which countries have introduced and implemented trade facilitation measures, as well as their performance relative to others. The TFIs are divided into 11 sub-category indicators:

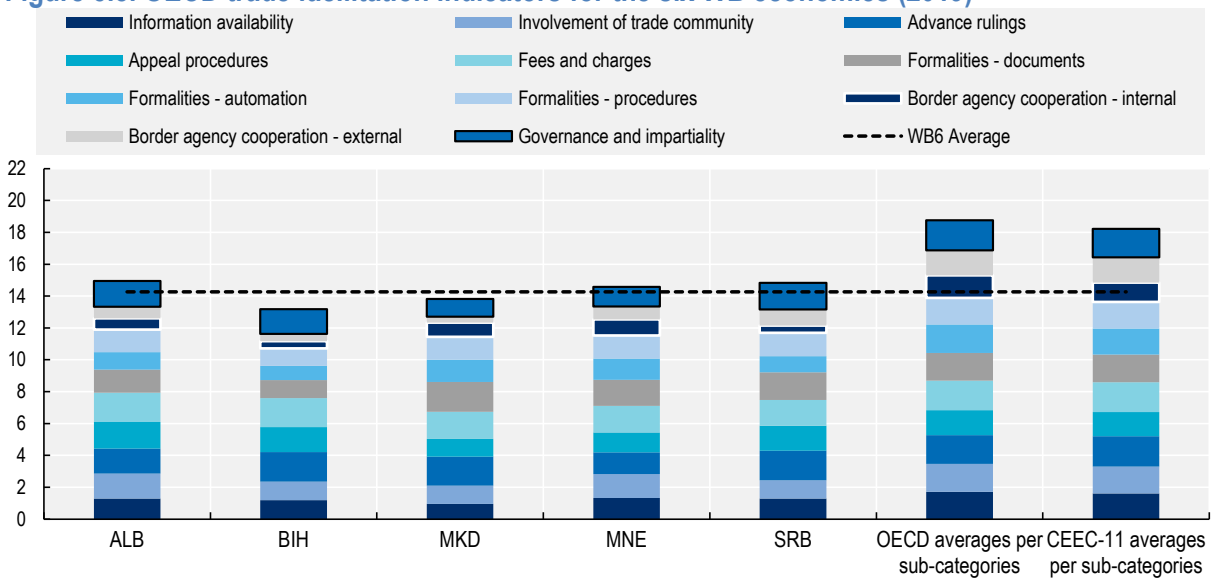
1. Information availability: Enquiry points; publication of trade information, including on the Internet
2. Involvement of the trade community (consultations): Structures for consultations; established guidelines for consultations; publications of drafts; existence of notice-and-comment frameworks
3. Advance rulings: Prior statements by the administration to requesting traders concerning the classification, origin, valuation method, etc., applied to specific goods at the time of importation; the rules and process applied to such statements
4. Appeal procedures: The possibility and modalities to appeal administrative decisions by border agencies
5. Fees and charges: Disciplines on the fees and charges imposed on imports and exports; disciplines on penalties
6. Formalities – documents: Acceptance of copies, simplification of trade documents; harmonisation in accordance with international standards
7. Formalities – automation: Electronic exchange of data; use of automated risk management; automated border procedures; electronic payments.
8. Formalities – procedures: Streamlining of border controls; single submission points for all required documentation (single windows); post-clearance audits; authorised operators.
9. Internal co-operation – Control delegation to customs authorities; co-operation between various border agencies of the country.
10. External co-operation – Co-operation with neighbouring and third countries.
11. Governance and impartiality – Customs structures and functions; accountability; ethics policy.

Each TFI indicator is composed of several specific, precise and fact-based variables on existing trade-related policies and regulations and their implementation in practice.

Note: Further information on how the TFIs are calculated is available at OECD Trade Facilitation Indicators' dedicated webpage: https://www.oecd.org/trade/topics/trade-facilitation/.
Source: (OECD, 2018[4]), *Trade Facilitation and the Global Economy*, https://dx.doi.org/10.1787/9789264277571-en.

The performance of the individual WB6 economies (Figure 5.8) is quite variable, with highs and lows. In the area of *advance rulings*, all economies except Albania and Montenegro performed better than the OECD averages. Bosnia and Herzegovina and Serbia scored just below best practice (i.e., average of the top 25% of all OECD TFI participants) in the same area.

## Figure 5.8. OECD trade facilitation indicators for the six WB economies (2019)




Note: The figure does not include Kosovo, as data are not available; CEEC-11 economies: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (OECD, 2019[28]), OECD Trade Facilitation Indicators database, http://www.oecd.org/trade/facilitation/indicators.htm.

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On *appeal procedures* Albania scored above the OECD and CEEC-11 averages, Bosnia and Herzegovina and Serbia reached best practice level and the OECD average, and only Macedonia and Montenegro scored lower. These areas were already solidly structured in 2015, and improvements to the regulatory frameworks have addressed the most challenging aspects of this sub-category – the timing of the appeals mechanisms (i.e., granting sufficient time to contest a decision; prepare, and lodge an appeal; and avoiding undue delays in the rendering of decisions).

*Fees and charges* and *formalities* are of particular interest as the region has seen the greatest improvement since 2017 (Figure 5.8). In the first area, *fees and charges,* Albania and Bosnia and Herzegovina are level with OECD average. Montenegro, North Macedonia and Serbia are slightly lower. Key challenges lie in making comprehensive information available online, as well as in conducting periodic reviews to ensure their continued relevance. Only Albania has a dedicated fees and charges webpage on its Customs website. In Montenegro, North Macedonia and Serbia, customs administrations charge fees for answering enquiries and providing forms and documents. All economies allow adequate time between publishing new or amended fees and charges and their entry into force. Provisions for penalties were especially challenging for Albania and Montenegro in 2015, but adequate measures were introduced in 2019. In 2021, Montenegro has gone further, introducing the Register of Fees, which includes 2 299 types of fees defined through 827 regulations at the local and state level.[16]

In the area of *formalities - documents*, North Macedonia and Serbia exceed the OECD and CEEC-11 averages. Border agencies in all economies periodically review documentation requirements; and unduly time-consuming and costly requirements for traders are being simplified, but this is still work in progress. Efforts have been made to simplify and harmonise documents, indicated by the lower number of documents currently requested for import and export compared to 2015 (except in Albania and Bosnia and Herzegovina). However, in Kosovo, Montenegro, North Macedonia and Serbia,the number of documents requested is still above the good practice thresholds. The average time necessary to prepare these documents is also still too long. The acceptance of copies is showing noticeable improvement in the majority of the economies, but copies are still only accepted as an exception in Albania, Montenegro, North Macedonia and Serbia.

WB6 performance in the remaining TFI areas is still below world best practice and OECD averages, although the gaps have narrowed since the last round of analysis. In 2019, economies still lagged behind in the areas of *information availability*, *formalities - automation* and *co-operation between internal and external border agencies*.

In *information availability*, Montenegro, North Macedonia and Serbia had shortcomings in the availability and user-friendliness of data on agreements with third countries. The first two economies also had a weak system of access to rules and examples of customs classification, while Bosnia and Herzegovina had flaws in the provision of information on trade policy changes.

In *formalities – automation*, all economies' IT systems capable of electronic data interchange (EDI) – essential for simplifying documentation requirements and reducing the complexity of document submission – are either being implemented or have been functional since 2015 (OECD, 2018[22]). Challenges remain in the set up and functioning of automated administrative procedures at borders, with most economies having weaknesses in their automated processing capacities. Bosnia and Herzegovina has yet to complete its automated risk management procedures, Albania needs to integrate the electronic payment system with a computerised declaration/cargo processing system, while North Macedonia and Montenegro's IT system capacity is insufficient to exchange data electronically. Serbia still has to promote the availability of full-time automated processing for customs.

*Border agencies co-operation* is still an issue for the economies, which consistently score around the average. However, economies have made progress in developing a strategy for co-ordination between state agencies. All have demonstrated co-operation and co-ordination of activities by agencies involved in managing cross-border trade, with a view to improving the efficiency of border controls and facilitating trade. However, the alignment of procedures and formalities and of working days and hours with neighbouring economies at land borders has not been fully achieved. The economies have made progress in co-ordinating inspections, but only the border agencies of Montenegro and partly those of Serbia have shared inspection and control results. The development of interconnected or shared IT systems and the real-time availability of relevant data, as well as inter-agency collaboration on certification of Authorized Operators (AOs), has been incomplete in all economies since 2015.

The next analysis of border agency co-operation should show marked improvement: in April 2020, at the peak of the first global wave of COVID-19, the Western Balkan economies set up the CEFTA co-ordination body to exchange all information on trade in goods. They also established priority "green lanes" and "green corridors to facilitate the free movement of essential goods through priority green border/customs crossing points (respectively with the EU-WB6 and within the WB6). Most road transport operators in the six economies used these green corridors. The border posts of the green corridor system operated continuously, as did the customs and other border services. The Systematic Electronic Data Exchange for Customs Administrations (SEED) was updated as a matter of urgency and was used to pre-code products on the essential goods list. The SEED system sends data electronically to customs and other border services (customs directly through the system, while the system generates emails that are automatically sent to phytosanitary, veterinary, and sanitary services for each crossing). These initiatives and the co-operation between the border agencies have helped to maintain a degree of international trade between the WB6 economies and the EU Member States. During the COVID-19 crisis, about 20% of the goods that benefited from the green corridor regime were necessities, the rest being normal trade. This regime, put in place in a time of crisis, has been the catalyst for further co-ordination among agencies and is becoming the basis for considering more efficient transit of goods within the WB6 and with the EU.

The economies have developed the mutual recognition of the national programmes of the Authorised Economic Operators (AEO) of the CEFTA Parties in the field of safety and security. The respective decisions entered into force on 1 April 2020 (CEFTA, 2021[29]). The AEO programme, as a voluntary co-operation between customs and business, allows operators to benefit from reduced customs controls and mutual recognition extends these benefits without additional costs within CEFTA.

### *The way forward for the trade policy framework*

- **Establish mechanisms for evaluating and monitoring public-private consultations** (an integral part of the RIA process) to regularly assess the degree of openness and transparency of consultations in economies that do not have such tools. Ideally, a monitoring programme with an adequate budget and independent office could be introduced to conduct systematic evaluations. In addition, training could be provided in the use of various quantitative and qualitative approaches to measure compliance with the minimum standards set by regulatory frameworks for public consultations. Economies could follow Kosovo's Office for Good Governance initiative (Box 5.2).
- **Improve public-private consultation mechanisms further** by publishing summaries of consultations on draft legislation more systematically. In addition to the regulations already in force, specific guidelines and principles on consultations with the private sector and civil society could be developed, setting out the precise steps and criteria to be followed and monitored. Similarly, a **policy to promote public consultations could be put in place** to invite stakeholders, especially SMEs – which are usually more reluctant or unaware – to become more involved in the legislative process as well as raising perceptions of their capacity to participate in the regulatory decision-making process. Economies could base their efforts on the 2015 EU Better Regulation Guidelines to improve stakeholders' involvement in trade regulatory processes (Box 5.4).
- **Continue to expand the network of bilateral and multilateral FTAs.** Despite progress, Bosnia and Herzegovina and Serbia have not advanced in their accession procedures to the WTO. Within the region, a certain number of bilateral treaties are in an embryonic phase. Similarly, not all economies have ratified the CEFTA's Additional Protocol 6 on Trade in Services. The common regional market is a priority for the WB6 region. However, integration into the global trade network opens up opportunities that should not be overlooked. The economies should therefore continue their efforts towards global trade integration.

#### Box 5.4. Stakeholder engagement throughout the policy cycle at the European Commission

Following the adoption of the 2015 Better Regulation Guidelines, the European Commission has extended its range of consultation methods to enable stakeholders to express their view over the entire lifecycle of a policy. It uses a range of different tools to engage with stakeholders at different points in the policy process. Feedback and consultation input is taken into account by the Commission when further developing the legislative proposal or delegated/implementing act, and when evaluating existing regulation.

At the initial stage of policy development, the public can provide feedback on the Commission's policy plans through roadmaps and inception impact assessments (IIA), including data and information they may possess on all aspects of the intended initiative and impact assessment. Feedback is taken into account by the Commission services when developing the policy proposal further. The feedback period for roadmaps and IIAs is four weeks.

As a second step, a consultation strategy is prepared setting out consultation objectives, targeted stakeholders and the consultation activities for each initiative. For most major policy initiatives, a 12-week public consultation is conducted through the website "Your voice in Europe" and may be accompanied by other consultation methods. The consultation activities allow stakeholders to express their views on key aspects of the proposal and the main elements of the impact assessment being prepared.

Stakeholders can provide feedback to the Commission on its proposals and their accompanying final impact assessments once they are adopted by the College. Stakeholder feedback is presented to the European Parliament and Council and aims to feed into the legislative process. The consultation period for adopted proposals is 8 weeks. Draft delegated acts and important implementing acts are also published for stakeholder feedback on the European Commission's website for a period of 4 weeks. At the end of the consultation, an overall synopsis report should be drawn up covering the results of the different consultation activities that took place.

Finally, the Commission also consults stakeholders as part of the ex-post evaluation of existing EU regulations. This includes feedback on evaluation roadmaps for the review of existing initiatives, and public consultations on evaluations of individual regulations and "fitness checks" (comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose). In addition, stakeholders can provide their views on existing EU regulation at any time on the website "Lighten the load – Have your say".

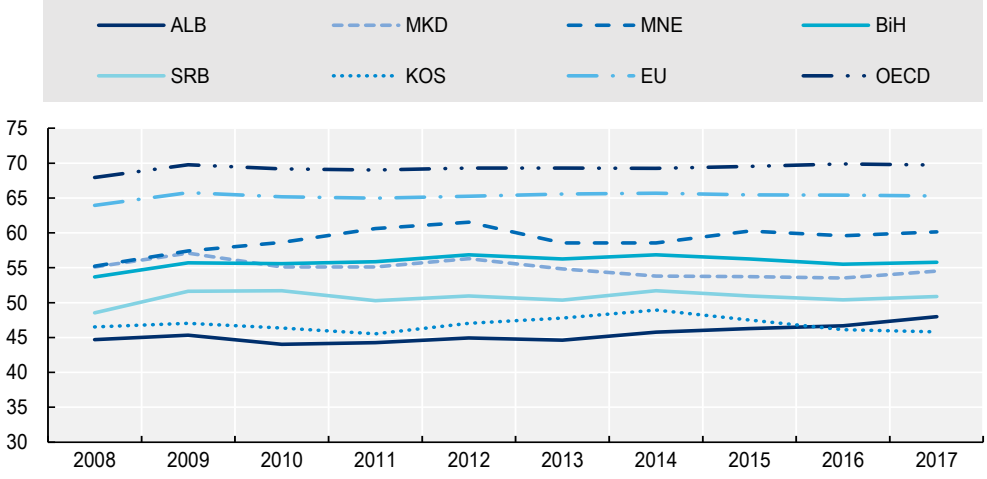
Source: (OECD, 2017[30]), *OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy* (draft), www.oecd.org/gov/regulatory-policy/public-consultation-best-practice-principles-on-stakeholder-engagement.htm; (OECD, 2016[31]), *Pilot database on stakeholder engagement practices in regulatory policy. Second set of practice examples.*, https://www.oecd.org/gov/regulatory-policy/pilot-database-on-stakeholder-engagement-practices.htm; (European Commision, 2015[32]), *2015 Better Regulation Guidelines*, https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

## Services trade restrictiveness (Sub-dimension 2.2)

Services contribute almost two-thirds of GDP in the WB6 economies (Figure 5.9). More and more business models rely on offering services rather than selling manufactured goods. This is the so-called "servitisation" of manufacturing (Miroudot and Cadestin, 2017[33]). Opening up trade in services can improve domestic firms' efficiency and productivity (Handjiski and Sestovic, 2011[34]). The potential gains from open markets in services trade are significant because greater domestic and foreign competition complemented by effective regulation can enhance trade performance (Hoekman, 2002[35]). They also lower the costs of doing business (Box 5.5).

### Figure 5.9. Contribution of services to GDP in WB6 economies (2008-17)

% share of GDP




Source: (World Bank, 2021[14]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

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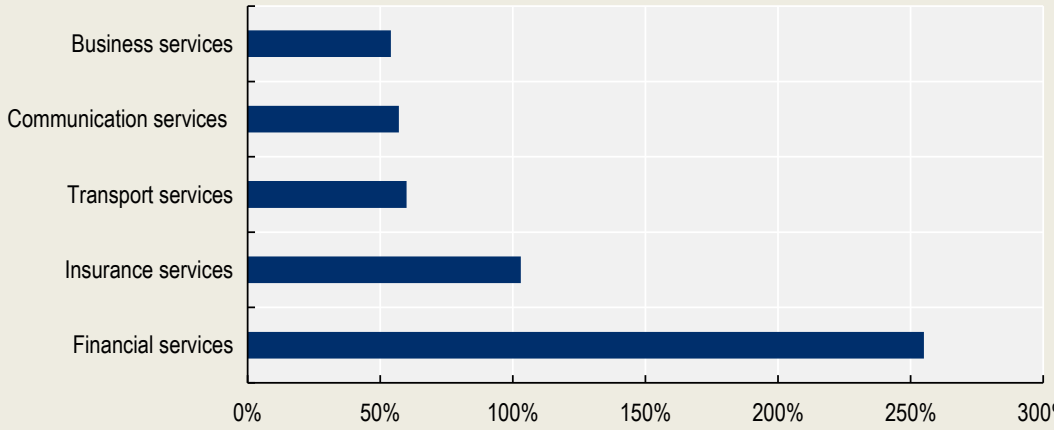
### Box 5.5. The costs of regulatory barriers to trade in services

Recent OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[36]). Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rulemaking. The costs resulting from barriers to trade in services are much higher than those of trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services (Figure 5.10).

#### Figure 5.10. Policy-induced average costs for cross-border services trade

% of total trade value




Source: (Benz and Jaax, 2020[37]), *The Costs of Regulatory Barriers to Trade in Services: New Estimates of Ad Valorem Tariff Equivalents*, https://dx.doi.org/10.1787/bae97f98-en.

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Even exporting to the most liberal countries still requires compliance with regulations at a cost that corresponds to around 30% of the export value in most sectors and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are around 10% in most sectors and around 32% for financial services.

Source: (Benz and Jaax, 2020[37]), *The Costs of Regulatory Barriers to Trade in Services: New Estimates of Ad Valorem Tariff Equivalents*, https://dx.doi.org/10.1787/bae97f98-en.

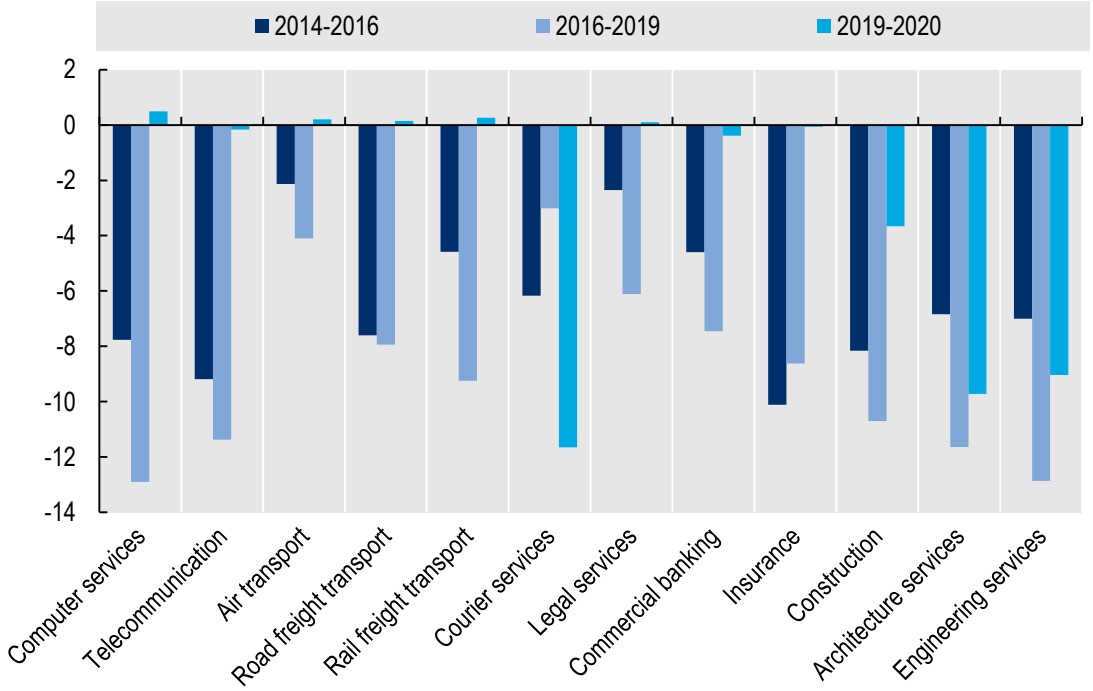
The assessment of this sub-dimension begins with a regional study of the recent evolution of the services sectors. It then presents a typology of sectors and the degree of regulatory harmonisation in the region. A sectoral analysis then studies the horizontal measures that are included in all sectors and that hamper trade in services across the WB6. These include general business regulation, restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and foreign investment screening. It then displays the STRI scores (for details see Box 5.1), explains sector by sector what drives the results, and provides a brief description of the most common restrictions and good practices.

### *The WB6 economies continue to lower regulatory restrictiveness in their service sectors*

This assessment finds a clear willingness in the WB6 to lower the degree of restrictiveness. A series of reforms has lowered the average STRI indices in the region in all the sectors analysed, and especially in the professional sectors (architecture, engineering and legal services), and the courier sector (following very recent reforms throughout the region) (Figure 5.11). These efforts, however, vary depending on the economy and the sector analysed. Kosovo, North Macedonia and Serbia have been the most active in implementing trade opening policy changes. North Macedonia was in particular active in the years 2014-2016. Serbia reformed the most in 2016-19 and in 2020 with targeted reforms in the architecture and engineering sectors. Kosovo has maintained a steady flow of reforms in the period 2014-20, with a notable highlight being the opening of its courier market in 2019. Montenegro has mainly opened up its construction, engineering and architecture sectors since 2014. Albania already had a more attractive environment in 2014, so it has shown more muted progress, with the exception of the 2015 reforms in the courier sector. It is also the economy that has improved the most from 2019 and into 2020. Finally, Bosnia and Herzegovina has seen little change in its indices over the years as a result of its slower-paced reforms. Nevertheless, an important factor is that restrictiveness has not increased in this economy in the period 2019-20 (Figure 5.11), which contrasts with the marked increases observed in OECD member states and key partners over the same period (OECD, 2021[38]).

**Figure 5.11. WB6 economies' evolution on the services trade restrictiveness index (2014-2020)**

% change




Note: negative values indicate a reduction in the restrictiveness of the economy's trade regulatory environment.
Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

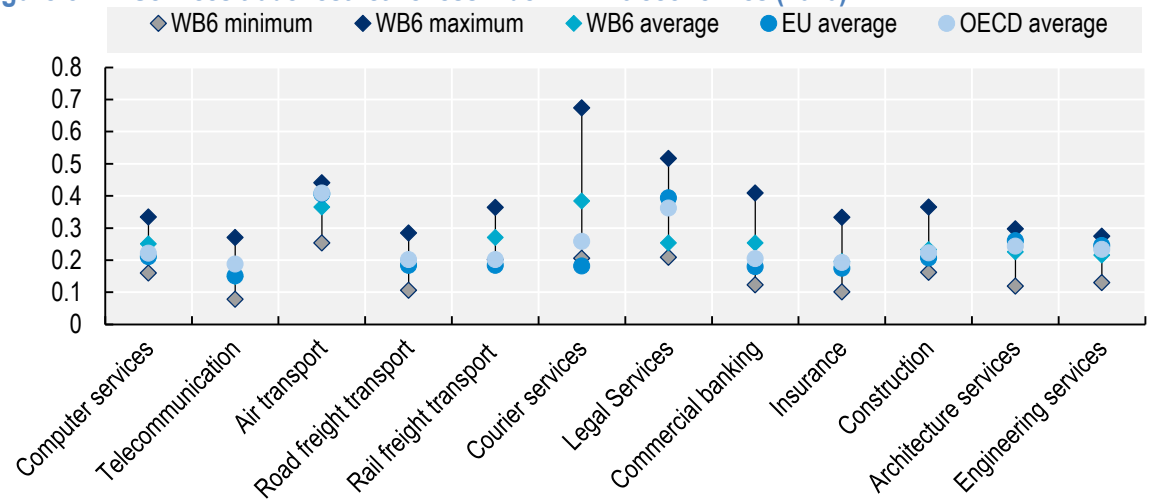
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Figure 5.12 shows the maximum, minimum and average STRIs for the WB6. The courier, air transport and legal services were the most restrictive in 2020. Conversely, the telecom, insurance and architectural services were the least restrictive.

Overall, the regulatory environments of the WB6 are in the liberal range compared to the averages of OECD member states, with the minimum scores for WB6 being well below the EU and OECD averages, particularly in traditionally restrictive sectors such as legal services. The noticeably small variation between

minimums and maximums across the region suggests that sectors are relatively harmonised from the regulatory point of view, with the exception of courier services, which, in addition to being the most restrictive and far from the EU average, also shows the greatest disparity across the region. The high degree of heterogeneity here is driven by the different levels of integration of local legislation with the standards set by the EU Postal Services Directive (97/67/EC), including measures related to postal monopolies and potential preferential treatment they may get (e.g on competition or taxes) (Figure 5.15).

**Figure 5.12. Services trade restrictiveness index – WB6 economies (2020)**




Note: (0=no restrictions, 1=fully restricted); EU: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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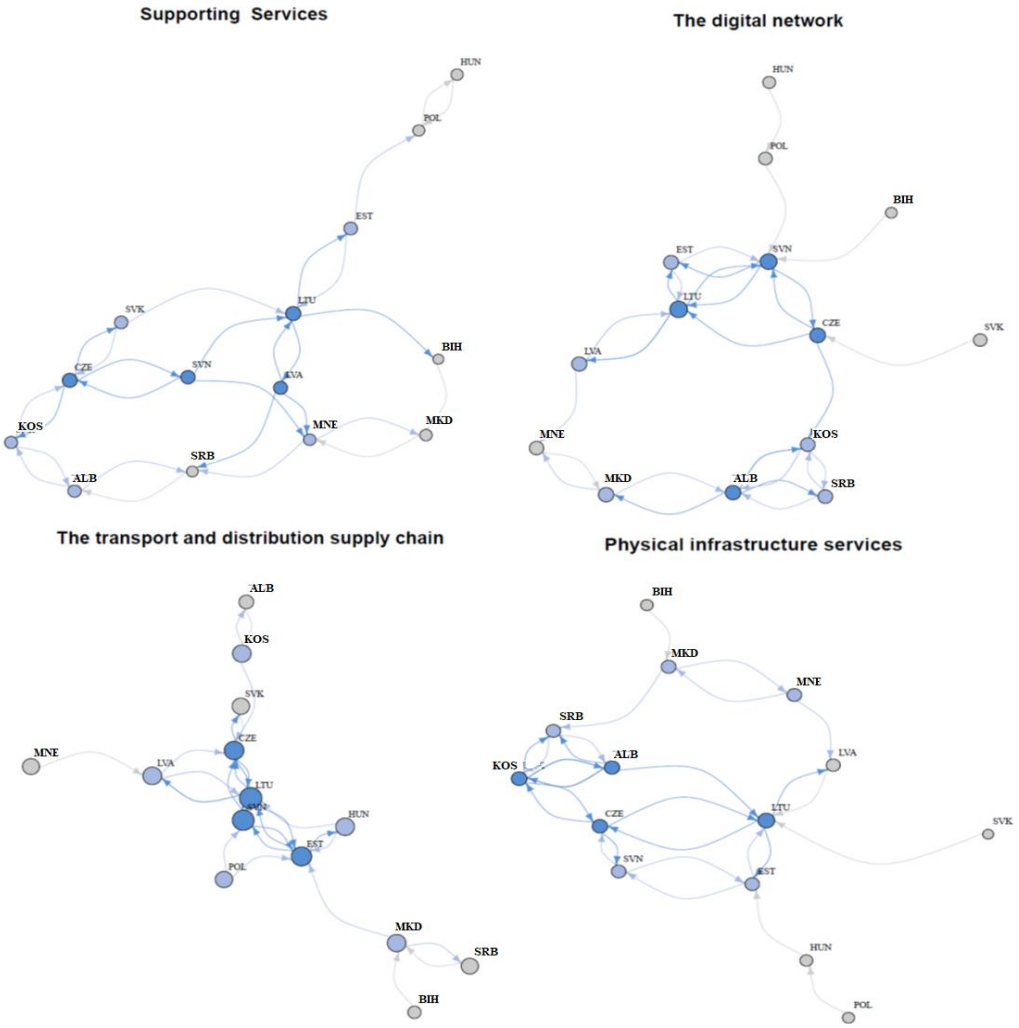
Studies of the relationship between regulatory heterogeneity and trade show that a reduction in regulatory heterogeneity across economies is associated with higher services exports; the lower the heterogeneity in the STRI score, the larger the impact. Moreover, unilateral trade liberalisation shifts trade towards economies to which the regulatory environment is more similar (Nordås et al., 2014[40]). The extent to which the regulatory frameworks of two economies diverge can be gauged through the OECD STRI Regulatory Heterogeneity Indices. The lower these indices, the more similar are the rules in force in each pair of economies.

The WB6 regulatory heterogeneity indices assess the similarity of economies' regulatory frameworks for services. For each economy and each sector, Figure 5.13 shows the share of measures for which the economies have different regulations. Although these figures vary by sector cluster, the heterogeneity indicators show there is great potential for future alignment of regulatory environments in the region. This coincides with the drive to create a common regional market harmonised with EU regulations (Box 5.6).

Most WB6 economies are already in an environment close to the CEEC states. They operate systematically in groups of the two or three closest jurisdictions in the different clusters that make up the STRI (Figure 5.13). For example, in the supporting services and digital network clusters, the heterogeneity indices indicate that six economies (except for BIH in the digital network) are more closely related to each other than to the CEECs. In the transport and distribution supply chain cluster, the results are more nuanced, but the economies operate in groups of two or three (Albania+Kosovo; Bosnia and Herzegovina+North Macedonia+Serbia). Finally, the physical infrastructure services cluster is interesting insofar as the six economies are closest to the core CEEC countries, closer than some of the more distant (from the regulatory point of view) countries such as Poland or Slovakia. This is particularly encouraging in view of the region's efforts to create a common regional market (Box 5.6).

## Figure 5.13. How harmonised are services regulations in WB6 and CEEC economies (2020)?

OECD STRI Regulatory Heterogeneity Indices for four services clusters




Note: The size of each economy node indicates centrality and reflects the similarity of the regulations to all other economies. The shade of the nodes also reflects regulatory harmonisation among jurisdictions, with dark blue nodes indicating more central economies than those in grey. The direction of the arrows indicates the most similar economy in an economy pair, while the thickness of the lines further illustrates the degree of bilateral similarity.

Source: (OECD, 2020[39]), "OECD Heterogeneity Indices (2020)", *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

### Box 5.6. Towards open trade in the Common Regional Market

The regional trade area of the CRM action plan includes the following five components: (1) cross-cutting trade measures; (2) goods; (3) services; (4) capital; and (5) people. The following key findings of the CO2021 services trade restrictiveness sub-dimension can inform the implementation of the services component:

- Significant improvements have been made to open up trade in services through the conclusion of Additional Protocol 6 to CEFTA in December 2019 and its ratification by Albania, Bosnia and Herzegovina, North Macedonia, and Serbia. Significant progress has been made in easing the restrictions on the movement of people within the CEFTA. These and subsequent efforts will significantly reduce the costs of trade in the Western Balkans 6 and pave the way to the CRM.
- The regulatory policy changes (Figure 5.8) in the six economies show clear regional willingness to open services trade. A series of reforms has lowered obstacles to trade in services in all sectors, especially in the courier sector. This contrasts with the recent rise of protectionist measures observed in OECD economies (OECD, 2021[38]).
- Analysis using the OECD heterogeneity indicators shows there is great potential for future alignment of regulatory environments in the region, which supports the objectives of the common regional market.

### *General business regulations and barriers to the movement of people undermine openness*

While the WB6 have relatively liberal sectoral regulations, general business regulations, i.e., those that apply to all markets, are acting as a brake on the openness of the economies. For example, the acquisition or use of land and real estate by foreigners is restricted in all the WB6 economies except Kosovo. A minimum capital requirement is mandatory in all the WB6 economies except Bosnia and Herzegovina.[17] Registering a company in the economies tends to involve costly, cumbersome, and lengthy procedures. Only Kosovo and Serbia are within the good practice thresholds in terms of cost and length involved in registering a company.

Restrictions on the movement of people are generally also an issue in WB6 economies. Although significant progress has been made to ease the conditions for the movement of people among the CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA agreement, people from third economies (i.e. outside CEFTA and the EU) are still subject to restrictive requirements, which limits their ability to operate. These restrictions are often the result of employment preservation policies and are very common, including in OECD countries. While sometimes justified, and present in most of the EU Member States, these policies have a potentially detrimental effect on trade in services when applied more than necessary, particularly in sectors where foreign labour could bring in expertise that is lacking in the region such as computer services or the professional services. These measures often take the form of quotas, labour market tests (LMTs) or restrictions on the length of stay of foreign suppliers. Albania, Kosovo and Serbia do not apply quotas to services providers seeking to deliver services on a temporary basis, such as intra-corporate transferees, contractual service providers or independent service providers. In contrast, Bosnia and Herzegovina, Montenegro and North Macedonia have introduced quotas, but they are limited to contractual and independent service providers. In order to balance the adverse effects of quotas and LMTs on trade in services with the legitimate issues of local employment protection, Montenegro has introduced exceptions in its Law on Foreigners. These are aligned with the relevant provisions of EU legislation and are based on reciprocity or exclusion of specific occupational categories from the quota system.[18] In addition, the economies apply economic needs tests to foreign suppliers.[19] Finally, the length

of stay of foreign service providers in the WB6 region is very limited, well below international standards and disproportionally restrictive compared to the local labour protection considerations.

### *Specific services sectors still have restrictions affecting trade*[20]

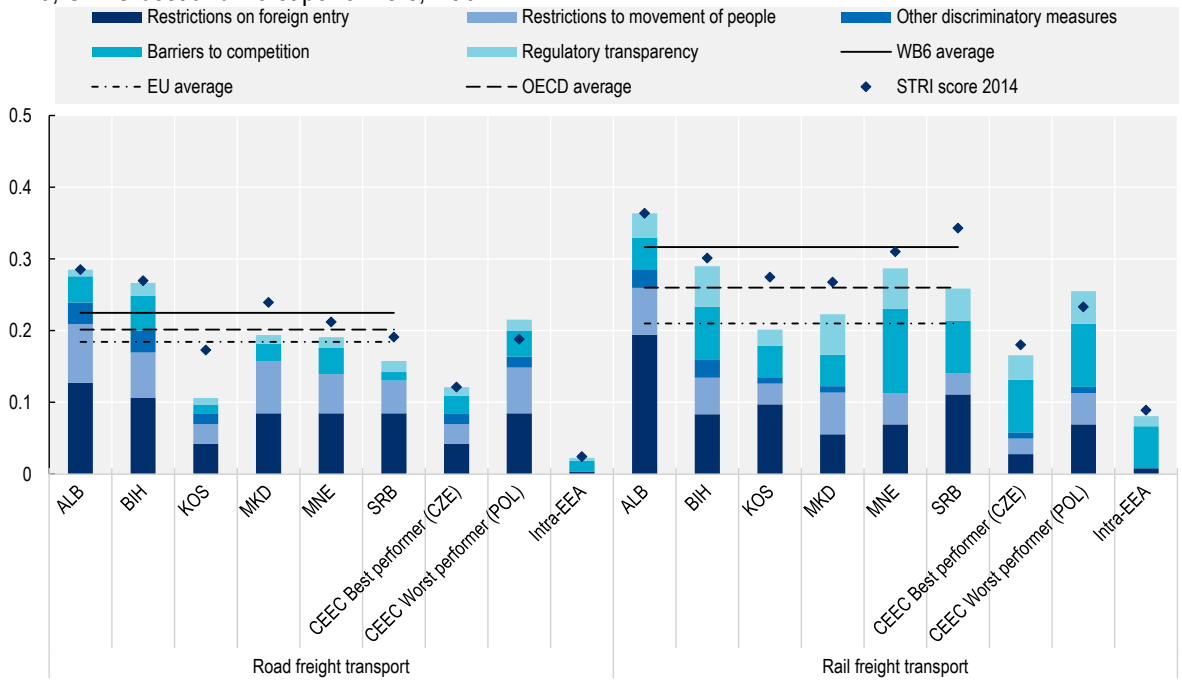
As well as the regulatory measures that affect WB6 economies' trade in services across the board (described above), a number of sector-specific restrictions are maintained in the 12 sectors analysed (listed in Box 5.1).

The following analysis describes the STRI scores for the six WB6 economies, as well as the best and worst CEEC performers who conducted the STRI exercise. In addition, the figures also present the OECD Intra-EEA STRI, which introduces data on regulatory barriers affecting services trade within the European Economic Area (EEA), to highlight the lowered degree of restrictiveness within an integrated single market.

#### *Transport and distribution supply chain*

**Road freight transport**.[21] The 2020 WB6 average STRI score is 0.225 (Figure 5.14), compared to the OECD and EU averages of 0.201 and 0.184 respectively. Overall, OECD member states and STRI key partners and WB6 scores range between 0.124 and 0.624. This sector largely dominates the other freight transport sectors in the region. At the regional level, the economies have generally less restrictive sectoral regulations than the averages found in the EU and OECD member states, apart from Albania and Bosnia and Herzegovina, which maintain more restrictive environments.

**Figure 5.14. Services trade restrictiveness in road and rail freight transport (2020)**
WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934253651

Restrictions on foreign entry are the main barriers in this sector. In all the economies except Kosovo a licence is required to operate road transport services, and licensing is conditional on economic needs. Positively, none of the WB6 economies has introduced limitations on cross-border mergers and acquisitions. In addition, Bosnia and Herzegovina, Kosovo, Montenegro, and North Macedonia have established processes and criteria for recognising foreign qualifications on a most favoured nation (MFN) basis, which is not the case for Serbia and Albania.

In road transport, barriers to competition play an important role. Montenegro and North Macedonia exempt road freight carriers' agreements from competition law and pricing guidelines or price regulation for road hauliers are found in Albania and Bosnia and Herzegovina. These measures have a negative impact on competition in this sector.

**Rail freight transport**.[22] The 2020 WB6 average score is 0.317, while scores for all OECD member states and STRI partners in this sector range between 0.129 and 1, and the OECD and EU averages are 0.259 and 0.209 respectively (Figure 5.14). The sector is mainly constrained by economy-wide measures, most notably on the movement of people and foreign entry. Measures included under this category are mainly related to general regulations on board members, cross border data flows, local presence requirements, and, in some cases, restrictions on access rights to the internal market. Albania subjects foreign investment in the sector to screening, only approving it if it brings net economic benefits to the economy.

Government ownership is recorded under barriers to competition and is widespread in the rail sector. Only in Albania are all major railway companies privately owned. In Bosnia and Herzegovina and Montenegro, where one of the main rail transport companies is state owned, the government can overrule the decisions of the rail regulator, with very negative impact for the whole sector. Another common restriction in this policy area, in the vertical separated market structures, is the restriction or outright prohibition in all the WB6 economies, except Albania, on transferring and/or trading infrastructure capacity. The benefits of Albania's more positive regulation are however mitigated by the existence of different types of rail agreements exempted from national competition law (a restriction also found in Montenegro).

**Air transport services**.[23] The STRI for this sector covers services provided through commercial establishment only.[24] The 2020 WB6 average is 0.421, while the scores for all OECD member states and STRI partners range between 0.165 and 0.601, and OECD and EU averages are 0.409 and 0.406 respectively (Figure 5.15).

The air transport sector is the archetype of a service industry whose legal environment is regulated by domestic laws driven by international agreement concerns. In absolute terms, the region's regulations are highly harmonised with EU standards, which could explain their relative restrictiveness compared to the best performing OECD Member States in this sector. The degree of restrictiveness in the aviation sector is explained by the balancing of strategic considerations, which are often more prone to trade protection, but not per se protectionist and trade openness considerations. However, given that freight transport in the region is dominated by road transport, especially in Kosovo, some of the measures on air transport that increase the scores of the WB6 economies may seem disproportionate to the real size of their markets.

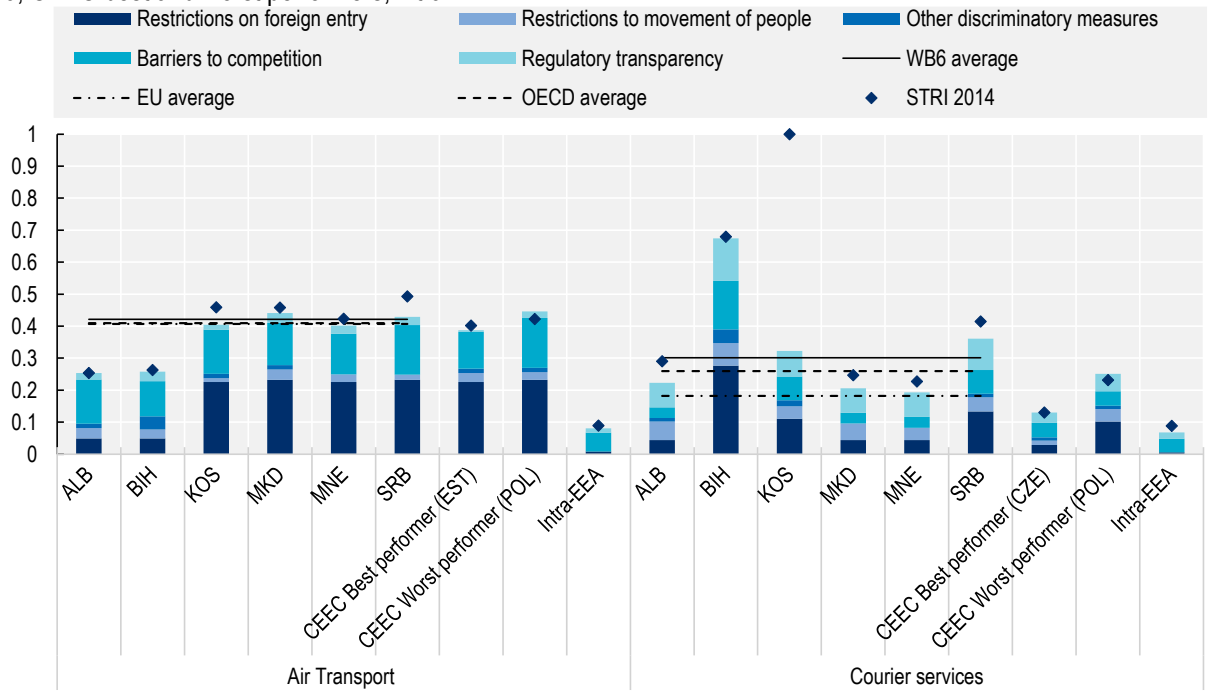
Restrictions on foreign entry feature prominently in the results. Most WB6 economies, except for Albania and Bosnia and Herzegovina, restrict foreign equity participation in the sector to (at least) less than 50%. The lack of these restrictions in those two economies explains the difference in scores with the rest of the region. Ownership restrictions are often coupled with specific limitations on the nationality of board members and managers of air carriers. The lease of foreign aircraft with crew (wet lease) is effectively prohibited in Kosovo, North Macedonia and Serbia, whereas it is allowed in Bosnia and Herzegovina, and is allowed subject to prior approval in Albania and Montenegro. Leasing foreign aircraft without crew (dry lease) is subject to prior authorisation in all the WB6 economies, except Bosnia and Herzegovina.

The other main category influencing restrictiveness is barriers to competition. All WB6 economies, except Bosnia and Herzegovina and North Macedonia, maintain public ownership in aviation. The maintenance

of state-owned enterprises (SOEs) in the sector is generally regarded as a restriction on trade in services as traditional national airlines normally enjoy a competitive advantage over foreign companies. Kosovo is a special case in that regard – while two SOEs exist in this sector, none of them has a fleet of aircraft. The airlines continue to work with other providers serving Pristina and to sell excursion trips. This situation is quite rare and negatively affects the STRI score in this sector. Non-competitive slot allocation is also common. All WB6 economies, except Bosnia and Herzegovina, assign slots in high demand airports based on historic rights, typically forbidding the commercial exchange of slots.

### Figure 5.15. Services trade restrictiveness in air transport and courier services (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934253670

**Courier services**.[25] While courier and postal services have traditionally been important means of communication, the rise in modern information and communication technologies has reduced the use of letters between individuals for this purpose. The 2020 WB6 average score is 0.301 in this sector, with scores for all OECD member states and STRI partners ranging between 0.106 and 0.881, and the OECD and EU averages at 0.259 and 0.181 respectively (Figure 5.15). The WB6 average is therefore relatively high compared to OECD member states. In consequence, special attention should be paid to this sector. It is in fact the sector that sees the greatest dispersion of results between performing and non-performing economies. However, this sector is not the most heterogeneous. This means that the degree of restrictiveness is mainly the result of a limited number of measures (Box 5.7).

### Box 5.7. Making the best of the STRI tools: Comparing courier services in Slovenia, Czech Republic and the WB6

Whilst the WB6, and Bosnia and Herzegovina in particular, have higher scores in the courier services sector than many OECD members, Slovenia and the Czech Republic both have a very open and liberal courier services market, with amongst the lowest STRI scores in the sector. The Czech Republic is the CEEC's best performer in this respect (Figure 5.14).

The Slovenian Postal Act of 1997 brought the economy's legislation in the postal sector partially in line with the EU *acquis*. Complete liberalisation of postal services was achieved with the adoption the new Postal Services Act in April 2002 and secondary acts in 2003. Currently, courier services are Slovenia's least-restrictive STRI sector. The economy maintains only a few sector-specific restrictions: the existence of a state-owned designated postal operator and limits to the proportion of shares that can be acquired by foreign investors.

The Czech Republic has undergone a similar liberalisation process, which began in the 1990s and materialised in the Acts of 2000 and 2005. The latest piece of legislation is the June 2012 act to amend the Czech Postal Services Act. The amendments followed the latest EU developments regarding the liberalisation of the postal market and came into force in January 2013. The amendments abolished the existing monopoly held by the state-owned Česká pošta (Czech Post) on deliveries of postal items weighing up to 50g and opened the market completely to competition.

Comparing the economies using the STRI policy simulator, it appears that only a limited number of regulatory measures dictates the scoring difference between Slovenia, the Czech Republic, and the Western Balkans. This suggests that the WB6 economies could substantially reduce their restrictiveness indexes to the average levels found in the best STRI performers by focusing on lifting specific restrictions:

- In the area of *restrictions on the movement of people*, scores are largely increased by the quotas and very short durations of stay for foreign service providers. Overall, lifting limitations on movement of people could potentially decrease the WB6 courier STRI scores by a maximum of 0.052.
- In the *barriers to competition* category, Slovenia and the Czech Republic do not apply any preferential tax or subsidy treatment to the national Designated Postal Operator, unlike some of the WB6 regulatory frameworks. Lifting this restriction could potentially decrease courier STRI scores by 0.011.
- Slovenia has incorporated a specific dispute resolution system into its regulatory environment governing the postal sector. No such mechanism exists in the WB6 economies – adding one could enable the economies to lower their degree of restrictiveness in the *barriers to competition* area by 0.011.
- In its 2002 reform of the postal market, Slovenia abolished all reserved services in the sector. This regulatory change is the most significant difference with all WB6 economies. Following Slovenia's example, the removal of these restrictions could potentially reduce the score by a maximum of 0.468, depending on the economy's regulatory situation.[1]

1: On state monopoly in courier services (see page 9 of OECD STRI Scoring Methodology for more detailed explanations).

Restrictions on foreign entry in this sector have a substantial impact on the economies covered by the STRI. Bosnia and Herzegovina limits the proportion of shares acquired by foreign investors in publicly-controlled firms including designated postal operators (DPOs). None of the WB6 economies requires

residency for managers or board members, but Bosnia and Herzegovina and Serbia require local presence for cross-border supply.

Barriers to competition also affect the score in all economies. All the WB6 economies stipulate in their laws and regulations that the DPO should provide universal service, which can benefit the DPO in the market. Practically all the DPOs in all six economies, except North Macedonia, obtain preferential tax or subsidy treatment. However, all the economies address the issue by requiring an accounting separation between universal services and other services as well as ensuring access to postal networks on a non-discrimination basis.

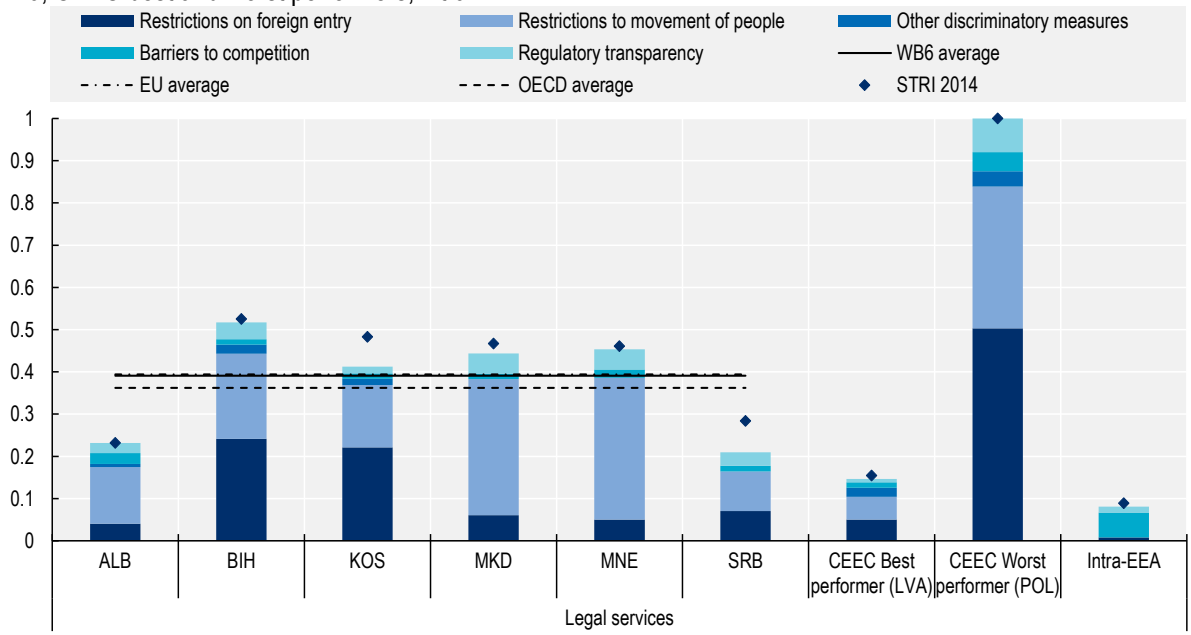
Regulatory transparency includes administrative procedures, such as customs clearance, obtaining a visa, or a licence to operate, which are key to trade in postal and courier services. Most of the economies have smooth customs clearance schemes in place, such as pre-arrival processing in Bosnia and Herzegovina and Montenegro, and a de minimis regime in place in Kosovo and in North Macedonia. As to the process of obtaining a licence, all the WB6 economies have objective criteria and an appeals procedure to ensure transparency.

### *Market bridging and supporting services*

**Legal services**.[26] The 2020 WB6 average score for this sector is 0.391 (Figure 5.16), which is aligned with the EU average (0.394) but is above the OECD average (0.360). Scores for all OECD member states and STRI partners in this sector range between 0.141 and 1. The results are driven by two policy categories: restrictions on the movement of people and restrictions on foreign entry. This reflects the characteristics of the sector and the policy environment in which it operates. Legal services depend on skilled intensive labour and are subject to licensing in a number of economies.

## Figure 5.16. Services trade restrictiveness in legal services (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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The movement of lawyers across borders is hindered significantly by licensing and procedures for recognition of foreign qualifications. All the WB6 economies have laws or regulations which establish a process for recognising qualifications gained abroad. Unfortunately, Kosovo is the only WB6 economy that has a temporary licensing system in place. In Bosnia and Herzegovina and Kosovo, nationality or citizenship is required to be licensed to practise domestic law in the economy. In Montenegro and North Macedonia, this is a requirement to practise both domestic and international law. In Serbia, which is the least restrictive economy in the legal services sector in the WB6 region, a foreign lawyer must be registered in the directory of lawyers and can only give oral and written legal advice and opinions related to the application of the law of their home country and international law.

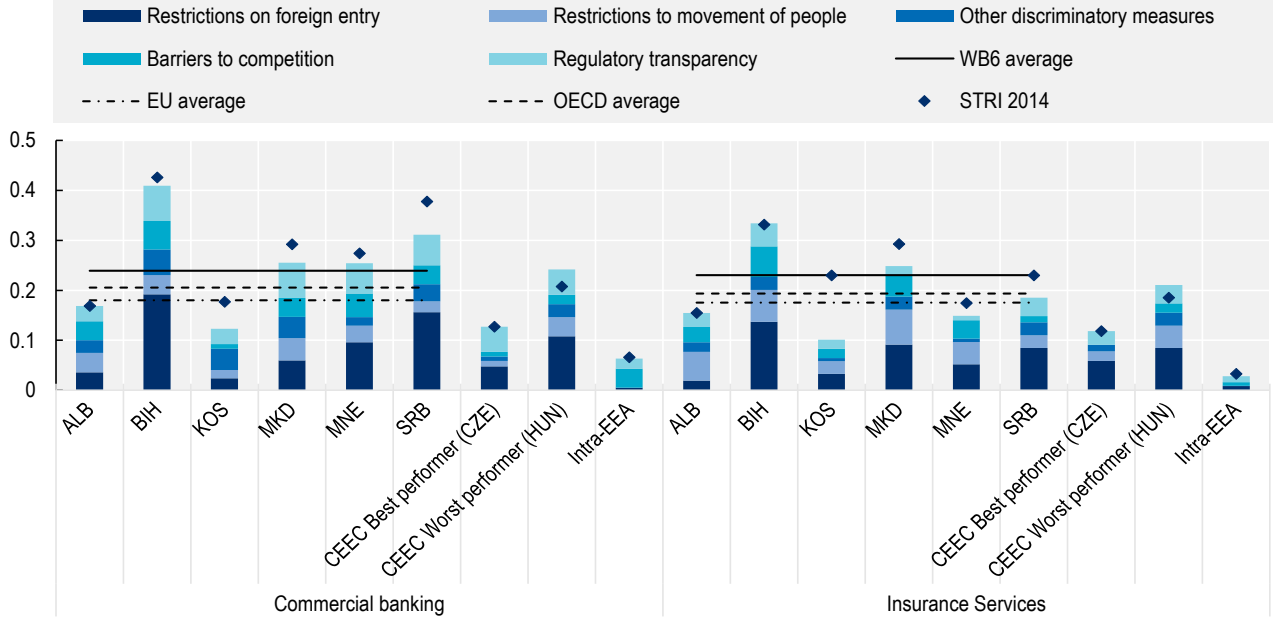
All the WB6 economies, except Bosnia and Herzegovina, require foreign lawyers to pass a local examination and to practise locally before their qualifications can be recognised. All the WB6 economies except Albania and Kosovo place restrictions on advertising legal services by foreign professionals.

**Commercial banking**.[27] The 2020 WB6 average score is 0.239 for this sector (Figure 5.17), while OECD and EU averages are 0.205 and 0.180 respectively. Scores for all OECD member states and STRI partners in this sector range between 0.131 and 0.517.

*Restrictions on foreign entry* feature prominently in the indices. A positive outcome is the fact that none of the WB6 economies limit the foreign equity share in local banks. Trade is however tempered by Bosnia and Herzegovina and Serbia's prohibition of the establishment of foreign bank branches. Moreover, Bosnia and Herzegovina imposes more stringent requirements when granting a licence to foreign-owned banks than domestic ones. All WB6 economies except Albania and Kosovo restrict cross-border bank mergers and acquisitions. In Bosnia and Herzegovina and Serbia foreign banks must be locally established in order to provide a full range of services to residents.

## Figure 5.17. Services trade restrictiveness in commercial banking and insurance services (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

Source: (OECD, 2020[39]), Services Trade Restrictiveness Index Regulatory Database, http://oe.cd/stri-db.

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*Barriers to competition* push up the scores of the economies with the highest index values. Product-level regulations – including prior approval requirements for individual financial products in Albania, Bosnia and Herzegovina, North Macedonia, and Serbia – are significant drivers of this result. Government ownership is not common in the sector, with only one of the largest commercial banks in Bosnia and Herzegovina being state-owned.

Regarding *regulatory transparency* when granting licenses, only Albania and Kosovo mandate the authorities to provide grounds for rejecting an applicant. All the WB6 economies specify a maximum time limit for deciding on a banking licence application.

**Insurance services**.[28] The 2020 WB6 average score is 0.231 for this sector, while the OECD and EU averages are 0.193 and 0.175 respectively (Figure 5.17). Scores for all OECD member states and STRI partners range between 0.104 and 0.565.

*Restrictions on foreign entry* feature prominently in the indices. None of the WB6 economies limit the foreign equity share in local insurance companies, but Bosnia and Herzegovina and Serbia restrict the establishment of branches of foreign insurers (for foreign reinsurer branches until the accession of Serbia to the WTO, and for foreign insurer branches four years after Serbia's accession to the WTO). Montenegro imposes supplementary prudential obligations on foreign service suppliers willing to obtain a licence to operate in the economy. These involve additional submissions, including a report on the last three years of operations, audit reports on the financial statements for the previous business year, the opinion of the home country's supervisory authority on the applicant's business and approval to establish the affiliate in Montenegro. Bosnia and Herzegovina and North Macedonia restrict cross-border bank mergers and acquisitions. In Bosnia and Herzegovina and Serbia, insurance carriers must be locally established in order to provide a full range of services to residents. Finally, Serbia requires at least one member of an insurance carrier's Board of Directors to be a resident.

*Barriers to competition* also contribute to the scores of the economies with the highest index values. Product-level regulations, including prior approval requirements for individual insurance products in all WB6 economies except Serbia are significant drivers of this result. Government ownership is observed in the sector in Bosnia and Herzegovina and Serbia.

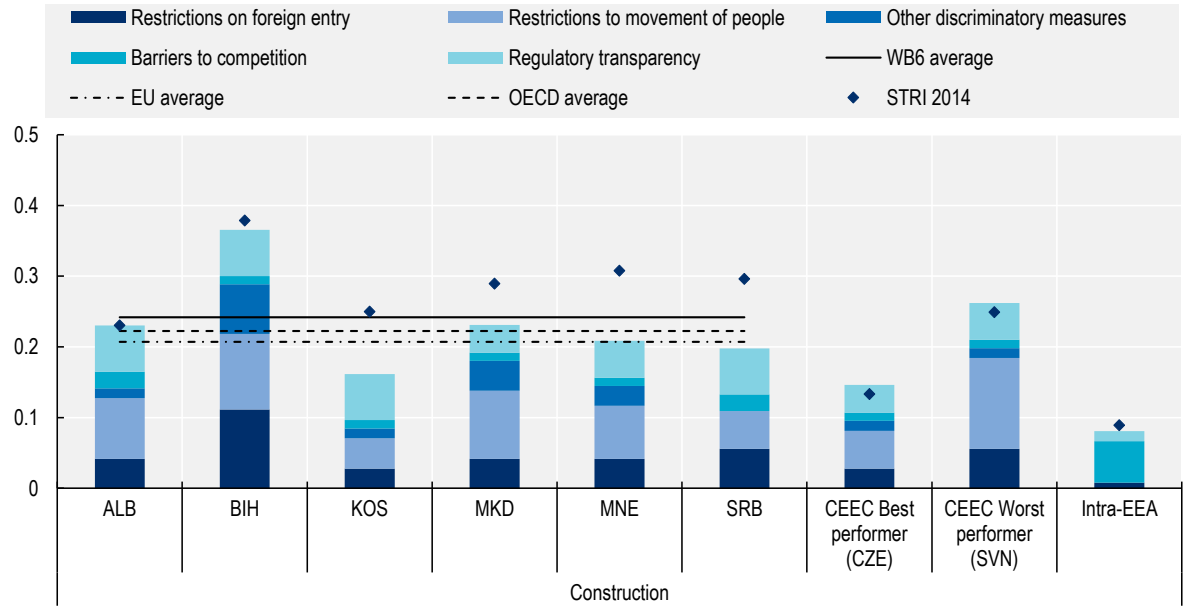
Regarding *regulatory transparency* in the process of granting licenses, all the WB6 economies mandate the authorities to provide grounds for rejecting an applicant, and all of them specify a maximum time limit for deciding on an insurer's licence application.

### *Physical infrastructure services*

**Construction services**.[29] The 2020 WB6 average score is 0.242 in this sector (Figure 5.18). The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464; the WB6 average is 0.242 while the OECD and EU averages are 0.222 and 0.207. The more elevated levels of restrictiveness in the construction sector can in part be attributed to general measures affecting all sectors of the economies. In terms of sector-specific regulations, only Bosnia and Herzegovina has limitations on foreign branches, and on cross-border mergers and acquisitions. Notably, all the WB6 economies except Kosovo place impediments on foreigners acquiring land and real estate, which typically have a direct bearing on construction services. For example, property developers cannot own real estate under construction until completion of the project.

## Figure 5.18. Services trade restrictiveness in construction services (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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Bosnia and Herzegovina and Serbia maintain government ownership of their major construction firms, which are among their few *barriers to competition* for construction services, at times coupled with limitations on foreign ownership of construction firms.

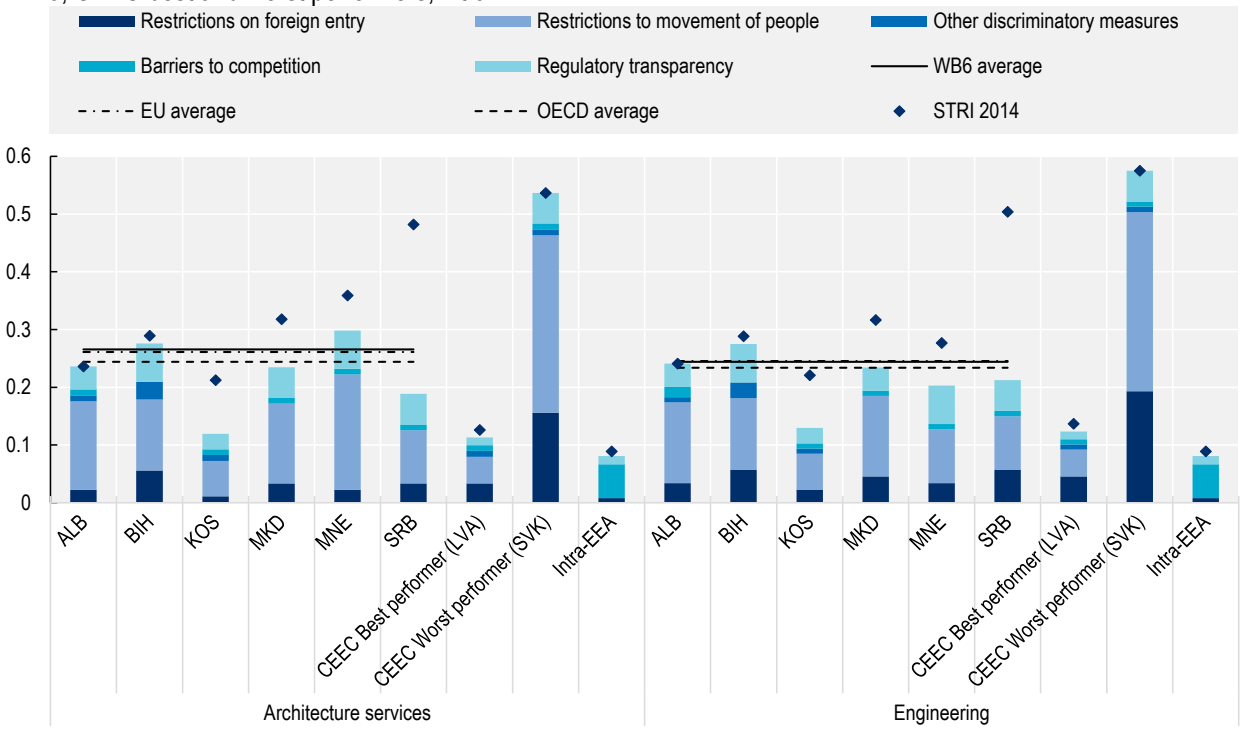
**Architecture services**.[30] Architecture services constitute the backbone of the construction sector, with key roles in building design and urban planning. An important feature is the regulatory complementarity between architecture, engineering, and construction services. Often, architectural and engineering activities are combined into projects offered by one company and are sometimes subsumed in the building and construction sector.

The 2020 WB6 average score is 0.266 in this sector (Figure 5.19). The 2020 scores for all OECD member states and STRI partners in this sector range between 0.113 and 0.684; the EU average is 0.260 and the OECD average is 0.244.

Architects are affected by economy-wide limitations on natural persons seeking to provide services on a temporary basis as intra-corporate transferees, contractual services suppliers, or independent services suppliers. In addition, architects are subject to issues related to licensing requirements. These include nationality and residency requirements to practise, as well as lack of recognition of foreign qualifications. All of the WB6 economies require a licence to practice architecture. Localisation requirements for professional liability insurance are in place in Serbia and North Macedonia. Other discriminatory measures can be found in regulations on public procurement, with Bosnia and Herzegovina having preferential measures for local suppliers.

## Figure 5.19. Services trade restrictiveness in architecture and engineering services (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA); key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934253746

**Engineering services**.[31] The 2020 scores for all OECD member states and STRI partners in this sector range between 0.118 and 0.575, the WB6 average is 0.244, while OECD and EU averages reach 0.233 and 0.245, respectively.

As in the case of architects, engineers are affected by economy-wide limitations on natural persons seeking to provide services on a temporary basis as intra-corporate transferees, contractual services suppliers, or independent services suppliers. In addition, engineers are subject to licensing restrictions. These include nationality and residency requirements to practise, as well as lack of recognition of foreign qualifications. A licence to practise engineering services is required in all of the WB6 economies. Montenegro is the only economy with a temporary licensing system in place. Laws or regulations that establish a process for recognising qualifications gained abroad are in place in all of the WB6 economies except Albania. As regards *barriers to competition*, none of the WB6 economies has restrictions on fee-setting or advertising, which has a positive effect on the STRI score.

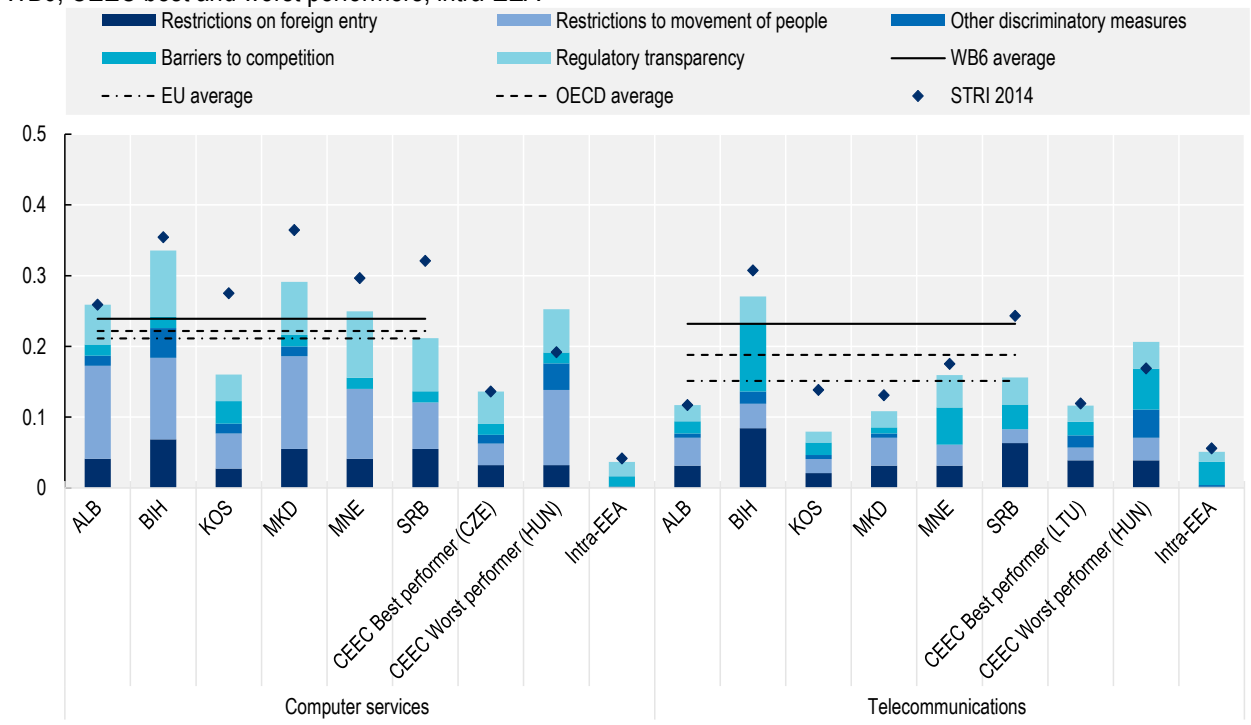
### *Digital network*

**Computer services**.[32] The 2020 WB6 average score is 0.239 (Figure 5.20) in this sector, while OECD and EU averages are 0.221 and 0.211, respectively. Scores for all OECD member states and STRI partners range between 0.123 and 0.448. None of the WB6 economies has increased the restrictiveness of this sector since 2014. In fact, scrutiny related to their future EU membership has led the economies to reform their regulatory frameworks. This sector is rarely regulated by sectoral legislation, with the WB6,

like most economies generally subjecting computer services to general laws that apply to the economies as a whole. Together, these factors mean that the STRI scores are better than in the previous cycle of assessments (Figure 5.11).

## Figure 5.20. Services trade restrictiveness in computer services and telecommunications (2020)

WB6, CEEC best and worst performers, intra-EEA




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; CEEC: Bulgaria and Croatia are not OECD members nor OECD STRI partner economies and are not covered by STRI indices. Intra-EEA = regulatory barriers affecting services trade within the European Economic Area (EEA).

Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934253765

**Telecommunication services**.[33] Telecommunication services are at the core of the information society and provide the network over which other services, including computer services, audio-visual services, professional services and many more, are traded. The 2020 WB6 average score is 0.232 in this sector, while OECD and EU averages are 0.188 and 0.151 respectively (Figure 5.20). Scores for all OECD member states and STRI partners range between 0.108 and 0.682.

These results are driven by two policy areas: restrictions on foreign entry and barriers to competition. This reflects the special characteristics of this sector, as well as the policy environment in which it operates. It is a capital-intensive network industry, and its strategic importance has prompted many OECD economies to restrict foreigners from investing and operating in the sector. However, none of the WB6 economies require that at least half of the board members in telecommunications companies be nationals or oblige the majority of board members to be residents.

In a network industry, access to essential facilities and switching costs may favour incumbent firms. These market imperfections may constitute a substantial entry barrier, even in the absence of explicit foreign entry restrictions. Therefore, pro-competitive regulation is considered a trade policy issue. Lack of pro-competitive regulation is scored as a trade restricting barrier to competition in cases where an incumbent operator has significant market power. In order to ensure fair competition in the telecommunications market, it is important to have an independent regulator that is separate from interested parties. In all the WB6 economies the national regulatory authority is independent from the government. This is particularly

important as the governments of Bosnia and Herzegovina, Kosovo, and Serbia maintain state-owned enterprises in this sector.

Another positive point is that all the WB6 economies regulate termination rates for fixed and mobile line service and in all of the WB6 economies foreign operators seeking interconnection benefit from regulated termination rates on a non-discriminatory basis. In terms of foreign entry, Bosnia and Herzegovina requires commercial and local presence for companies providing cross-border telecommunication services, while Serbia imposes only a local presence requirement. This measure, although common in OECD countries, raises the operating costs of foreign service providers.

All the WB6 economies regulate interconnection. Moreover, all the economies except Bosnia and Herzegovina apply a "use-it-or-lose-it" policy to frequency bands – an important measure that prevents incumbent operators from over-holding valuable frequency licences – as well as free tradable spectrum and telecom services. Bosnia and Herzegovina is the only economy that does not assign contracts for universal services obligations on a competitive basis.

### *The way forward for services trade restrictiveness*

In absolute terms, the region has competitive regulation, especially when compared to the averages in OECD economies or the CEECs. The region combines a number of pro-competitive legal measures while also maintaining a number of trade limitations. However, to continue their efforts, governments need to:

- **Ratify and implement CEFTA Additional Protocol 5 on trade facilitation and Additional Protocol 6 on trade in services.** This is a priority for economies that have still not fulfilled these commitments. This is important given that trade in services continues to be marked by regulations that are highly susceptible to modifications in the international normative environment.
- **Broaden efforts to open trade in services sectors**. Significant improvements have been made among the WB6 economies to open services trade through regulatory efforts and the conclusion of the CEFTA Additional Protocol 6 in December 2019. Nonetheless, the STRI analysis in this section has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness by:
  - **Easing conditions on the temporary movement of natural persons** beyond the obligation set in regional trade agreements. A starting point could be to amend limitations on the length of stay of foreign services providers from third countries, as it falls short of international best practice in most of the economies. Remaining quotas and labour market test should also be assessed.
  - **Reducing the remaining barriers to market entry and competition i**n courier services (described in Box 5.7), legal services and air transport sectors. Further efforts could be made to increase competitiveness.
- **Pave the way for a regional common market with harmonised regulations** by adopting a twin-track approach: increasing regulatory homogeneity while reducing their degree of restrictiveness. Doing so would allow the WB6 economies to benefit from a revitalised post-COVID-19 trade in services. The first step would be to reduce trade restrictions identified in this study to a level significantly below an STRI score of 0.4 in sectors that maintain high levels of restrictiveness. As a second step, economies should consider harmonising the content of their legislation, including through multilateral channels such as the CEFTA regulatory databases and the OECD heterogeneity indices (Figure 5.12). Harmonised and unrestricted service regulations are associated with a strong increase in trade in services.

## E-commerce and digitally enabled services (Sub-dimension 2.3)

E-commerce can bring about significant gains for businesses and can also boost firms' process innovation (OECD, 2019[41]). In addition, it enlarges businesses' market scope, reduces operational costs at various stages of business activities and lowers barriers to entry, thus intensifying competition. E-commerce also benefits consumers by providing information on goods and services, helping them identify sellers and compare prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[42]).

The COVID-19 crisis has accelerated the expansion of e-commerce to new businesses, new customers and new types of products. It has allowed customers to access a wider variety of products (such as groceries and other first necessities) from their homes, and businesses to maintain their operations despite containment restrictions. It is likely that some evolutions in e-commerce will be prolonged over time, such as the shift towards basic necessities. Nevertheless, some challenges remain, despite the efforts of some governments to promote e-commerce during the COVID-19 crisis, the persistence of the digital divide means that not everyone has been able to participate (OECD, 2020[43]). Regulations that are not adapted to e-commerce can create barriers for businesses. The current crisis and the new role of e-commerce for individuals and businesses have reinforced the need for policy action. For consumers, systemic challenges related to connectivity, financial inclusion, skills and trust (e.g. digital security, privacy and consumer protection) have been highlighted (OECD, 2020[44]).

An electronic commerce law ideally ensures the proper functioning of the digital market by facilitating the establishment of digital services and their free movement within the region (if co-ordinated and harmonised). Its aim should be to provide legal certainty for business and consumers by establishing harmonised rules on issues such as the transparency and information requirements for online service providers, commercial communications, electronic contracts and liability limitations for intermediary service providers. Examples of what the EU Directive on Electronic Commerce[34] covers include shopping, newspapers, databases, financial services, professional services (such as lawyers, doctors, accountants, and real estate agents), entertainment services, direct marketing, advertising, and internet intermediary services (such as hosting and search engines). Modern e-commerce regulations should focus on a number of key elements, such as electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property regulations and intermediary liability. On the other hand, an attractive regulatory environment should refrain from maintaining disproportionately restrictive policies such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows. This sub-dimension assesses these policies in the WB6 economies. First, it analyses the content and implementation of existing legislation. Secondly, it uses the OECD Digital STRI to quantify the WB6's performance in trade in digital services by identifying the elements that restrict digital trade in different economies.

### *E-commerce policy frameworks are in place in all of the WB6 economies*

E-commerce policy frameworks exist in all the WB6 economies, but their implementation, monitoring and evaluation vary greatly across the region (Table 5.4). The economies with the highest average score for this sub-dimension are North Macedonia and Serbia (4.0), followed by Albania and Kosovo (3.0). They demonstrate strong implementation of their e-commerce policy frameworks as well as monitoring and evaluation activities. Montenegro scores 2.5 meaning that e-commerce frameworks are adopted, and their content respects the requirements of e-commerce, but implementation is incomplete. Bosnia and Herzegovina scores 2.0: the minimum policy framework is in place, but there is a need to improve implementation activities and related action plans that are not fully effective.

## Table 5.4. Scores for Sub-dimension 2.3: E-commerce and digitally enabled services

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 2.3: E-commerce and digitally enabled services | E-commerce policy framework | 3.0 | 2.0 | 3.0 | 4.0 | 2.5 | 4.0 | 3.1 |
| | Trade in digitally enabled services restrictiveness* | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Sub-dimension average score** | | 3.0 | 2.0 | 3.0 | 4.0 | 2.5 | 4.0 | 3.1 |

* Note: Indicator has a different scoring system so results are presented in the sub-section below, not in the table.

North Macedonia, Serbia and to some extent Kosovo, have the most advanced and modern legal environments for e-commerce. Serbia and North Macedonia amended their legislation in 2019 and 2020, respectively. Kosovo has updated its law, which should come into force in 2021. North Macedonia has put a new e-commerce programme in place: the Economic Reform Programme (ERP) for 2019-2021 in North Macedonia highlights new legislation and initiatives under the competence of Ministry of Information Society and Administration (MISA) on the digital economy and e-commerce.[35] In October 2019, Serbia adopted the Programme and Action Plan for E-commerce Development for the period 2019-2020. Serbia is also the only economy to report on performance indicators for the e-commerce law, reported annually by its Statistical Office.

Although solid, the frameworks in these three economies are not without gaps. Serbia does not have a dedicated Online Dispute Resolution (ODR) platform for litigation linked to e-commerce. The ODR platform is a single point of entry for consumers and traders seeking to resolve their disputes out of court. To mitigate this, Serbia has focused primarily on improving the Alternative Dispute Resolution (ADR), which is a decentralised system. Currently, 13 ADR bodies are registered with the Ministry of Trade, Tourism and Telecommunications (MTTT) and their services are free of charge. Moreover, MTTT is starting to implement its Instrument for Pre-accession Assistance IPA2018 (the project will start on the 9 June 2021), which supports the process of ADR improvement through training and recommendations, as well as an IT support platform for ADR organisations.[36] Kosovo and North Macedonia suffer from limitations in e-payment regulations and consumer protection awareness.

Montenegro and Albania have modern e-commerce laws, updated in 2013 and 2016 respectively, but implementation and monitoring are weak. Favoured by their willingness to gradually harmonise their frameworks with the EU *acquis*, most of the elements of a comprehensive regulatory framework are in place in both economies. Regulations on data governance, online consumer protection, electronic signature and intermediary liability are in line with international best practice and harmonised with EU regulations.[37] The framework balances protecting individuals and consumers with limiting the costs and restrictions faced by digital businesses, especially in the area of services (Figure 5.21). With the regulatory framework largely in place in both economies, implementation remains a challenge due to their institutional capacity constraints. In the area of cyber security, modern and effective independent regulatory bodies are not yet in place. Similarly, the consumer protection regimes currently lack effective supervisory authorities to monitor compliance, raise consumer awareness of their rights and resolve e-commerce disputes.

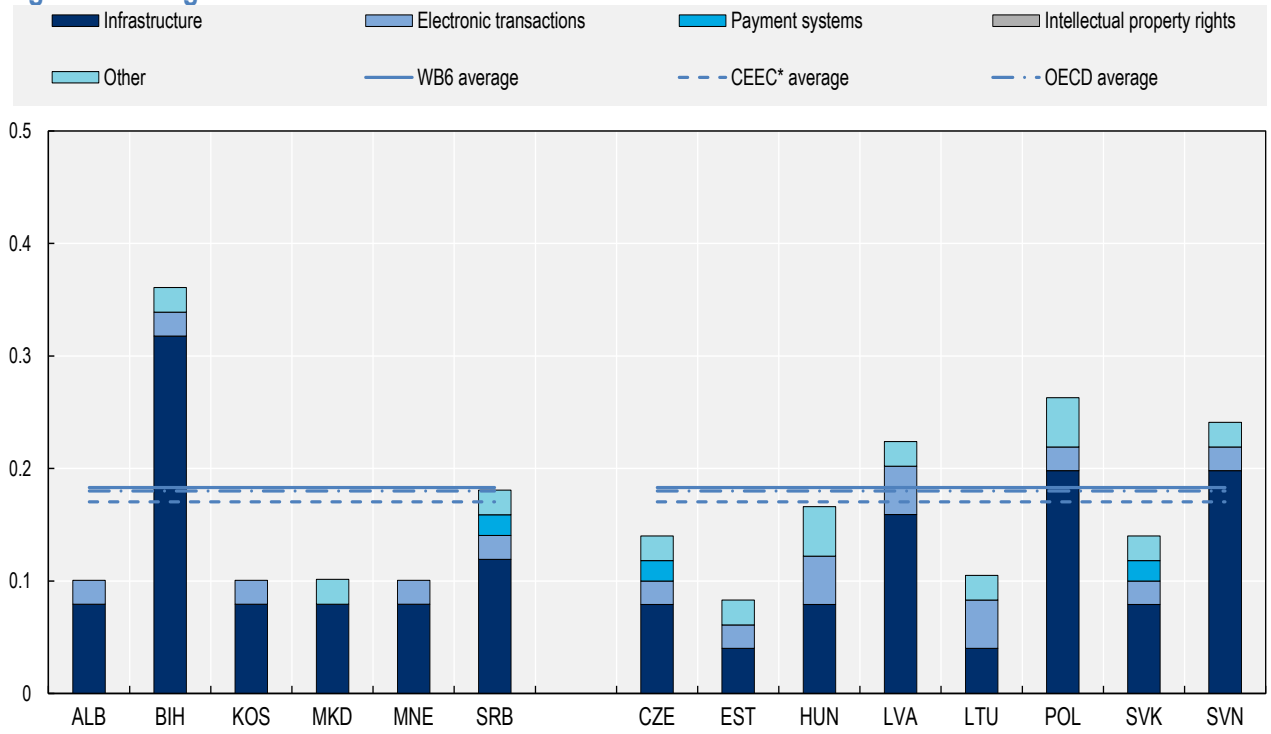
To mitigate these issues, the Ministry for Public Administration of Montenegro is to propose a new strategy for digital transformation to the government for the period 2021-2025. In September 2020, Albania launched an action plan for e-commerce and established an inter-ministerial working group, headed by the Deputy Minister of MOFE, to draft an electronic trade strategy aimed at removing obstacles to the development of this sector.

Finally, the regulatory policy framework on e-commerce in Bosnia and Herzegovina is still in the early stages. There have not been any substantive changes in the framework since the last cycle of assessment, and very little progress has been made on implementation. The economy adopted the 2017-2021 Policy for Development of the Information Society in May 2017, but there has been no progress in adopting an economy-wide strategy or associated action plans for e-commerce.

### *Digital STRI scores reveal low levels of restrictiveness*

The OECD digital STRI captures cross-cutting barriers that inhibit or completely prevent firms from supplying services using electronic networks, irrespective of the sector in which they operate. The regulatory data underlying the digital STRI were extracted from the existing OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. The rating takes into account the specific regulatory and market characteristics as well as the links and hierarchies between regulatory measures affecting digitally enabled services. WB6 economies' scores on the STRI index in the digital sector covered by the STRI project are shown in Figure 5.21.

**Figure 5.21. Digital services trade restrictiveness index: WB6 and CEEC economies**




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[39]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934253784

The WB6 economies' 2020 Digital STRI scores are moderate to high, ranging from 0.1 to 0.36, with an average of 0.183, compared to OECD countries which range from 0.043 to 0.488. This means that the economies of the WB6 region are much less restrictive than other economies covered by the digital STRI. Restrictions in the digital STRI sector in the WB6 are related to *infrastructure and connectivity* measures. This is the consequence of the lack of effective telecoms regulations, especially in the area of interconnection (see above). Positively, all the WB6 economies mandate interconnections for both fixed and mobile networks. Only Bosnia and Herzegovina does not regulate interconnection prices and conditions for mobile and fixed networks. Non-discriminatory Internet traffic management is mandatory in Kosovo, North Macedonia, and Serbia, but not in the other economies. Vertical separation for fixed networks, a particularly important measure, is required in all of the WB6 economies except Albania. Vertical separation for mobile networks, on the other hand, is only required in Bosnia and Herzegovina, North Macedonia, and Serbia.

No specific licences or authorisations for e-commerce activities in addition to ordinary commercial licences are required in any of the WB6 economies. This eases the establishment of electronically enabled services and makes the economies attractive to foreign suppliers. The implementation of international standards for electronic contracts and key electronic authentication measures such as recognition of electronic signatures are in place.

From the perspective of the OECD STRI, all six economies perform well in the policy area of *intellectual property rights*. In particular, none of them have introduced regulations on protection of intellectual property that treat foreigners differently to nationals.

Similarly, in terms of *payment systems*, there are no payment barriers such as discriminatory access or total prohibition for foreign providers of certain payment solutions, or a lack of enforcement of international security standards for common payment methods such as credit cards. Again, the WB6 compare well with the OECD digital STRI partner states with the lowest levels of digital restrictiveness.

### *The way forward for e-commerce and digitally enabled services*

In absolute terms, the six Western Balkan economies have regulations in place for, but present few regulatory barriers to, digital trade. Nevertheless, e-commerce in the WB6 region still has much potential for improvement and could benefit even more from the explosion of e-commerce in the context of COVID-19. It should be borne in mind, however, that the factors limiting electronic trade may also be related to economic and social conditions that go well beyond purely regulatory frameworks, including rural-urban divides (see Agriculture policy chapter), income distribution, unequal access to education (see Education policy chapter) and an ageing society. These conditions may manifest themselves in low connectivity, lack of digital skills and low levels of trust (including security and privacy concerns) (see Digital society chapter), all of which can be addressed through policy action. The WB6 economies should therefore take into consideration the recommendations made throughout this publication. Relevant measures include targeted information campaigns, confidence-building initiatives, adult education and public-private partnerships that target the participation of low-income and rural households (OECD, 2019[41]). The economies could start by considering replicating Serbia's e-commerce good practice (see Box 13.8 Digital society chapter), by increasing the financial resources allocated to awareness campaigns, capacity building and workshops for businesses looking to launch into e-commerce.

All the economies should also strengthen their regulatory environment for e-commerce and digitally enabled services to adapt them to the new post-COVID-19 reality by considering economy-specific recommendations as follows:

- **Serbia should strengthen its Online Disputes Resolution (ODR) system for e-commerce transactions**. As a first step, Serbia should start implementing the IPA2018 project without delay in 2021, as planned, to support its ADR improvement process. As part of this a platform should be built and connected to the NCCR (National Consumer Complaint Register) to allow a consumer to submit their complaint directly online to the relevant consumer organisation. The next step should be to establish a national ODR platform based on the EU ODR system (Box 5.8), designed to resolve disputes over the online purchase of goods and services without the intervention of a national court. It should not be affiliated with any merchant, and should be impartial, approved by the authorities and enforce quality standards of fairness, transparency, efficiency and accessibility.
- **North Macedonia should adopt the draft strategy on consumer protection** and promote consumer awareness of their rights and how to exercise them in e-commerce. The strategy should address legal and regulatory gaps, particularly with regard to electronic payments. It should also ensure that consumer protection legislation does not fail to address fraudulent or deceptive practices and that it allows for dispute resolution and redress in electronic transactions. The economy can learn from the Serbian Strategy for Consumer Protection for 2019-2024 promoting trust in e-commerce and online consumers education (see Box 13.8 Digital society chapter).

- **Albania, Bosnia and Herzegovina and Kosovo should implement their legal initiatives** to resolve the shortcomings in their regulatory frameworks. Albania should implement the e-business development initiative, part of the new Business and Investment Development Strategy 2021-2027, in order to improve SMEs' competitiveness and access to markets by helping them to adopt digital solutions for e-commerce and e-business, strengthen digital capabilities and skills and ensure a sound business and regulatory environment for e-commerce. Bosnia and Herzegovina should finalise the entry into force of its Law on Electronic Communication and Electronic Media and adopt new legislation on electronic identification and trust services for electronic transactions (e-signature). Kosovo should bring into force the new Law on Electronic Identification on Trusted Services in Electronic Transactions that will replace the existing Law on Information Society Service.
- **Bosnia and Herzegovina and Montenegro should create co-ordination mechanisms for an effective monitoring and evaluation process** to improve policy revision. A first step could be to review and assess the impact of programmes on the digitisation of Montenegrin businesses in order to identify gaps in the design of regulatory measures governing e-commerce. A set of indicators for private sector ICT take-up, including e-commerce, should be developed, and regularly monitored.

### Box 5.8. The European Online Dispute Resolution (ODR) platform

The European Online Dispute Resolution (ODR) platform is provided to make online shopping safer and fairer through access to quality dispute resolution tools. All online retailers and traders in the EU, Iceland, Liechtenstein, and Norway are obliged to provide an easily accessible link to the ODR platform and an e-mail address for the platform to contact consumers.

The EU ODR platform can be used to solve the problem directly with the trader. The platform initially acts as an intermediary between the parties in the dispute by notifying the traders of the requests. If the requested trader is willing to discuss, the platform allows the exchange of messages directly via a dashboard. This allows one to send attachments such as product photos and to schedule an online meeting. If the parties request it or if the dispute cannot be resolved amicably within 90 days, the ODR platform refers the dispute to a dispute resolution body. Although the model is mainly aimed at disputes initiated by a consumer, some European countries allow traders to file a complaint against a consumer. However, the consumer must reside in Belgium, Germany, Luxembourg, or Poland.

Source: (EUR-Lex, 2013[45]), Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR); The European Online Dispute Resolution (ODR) platform, https://ec.europa.eu/consumers/odr/main/?event=main.trader.register.

## Conclusion

WB6 economies are generally performing well on trade policy. Since the last assessment cycle, they have made efforts to improve their trade performance by adopting trade strategies while enhancing their public-private consultation mechanisms. New evaluation and monitoring mechanisms and bodies have been created to strengthen public-private partnerships and improve business community involvement in the formulation of trade related policy.

Significant progress has been made to ease the conditions for the movement of people between the CEFTA economies through the conclusion of the Additional Protocol 6, establishing a framework for unrestricted trade in services. Once in force, companies will benefit from guaranteed market access and national treatment in key services sectors. The protocol also lays the foundations for enhanced co-operation to remove remaining barriers, such as licensing or professional qualifications, as well as the

development of regional e-commerce, all with a view to the effective creation of an integrated market based on the European model. The domestic ratification processes are underway and all CEFTA parties are expected to have completed these procedures during 2021.

Overall, the six economies have managed to reduce restrictiveness in trade in services by amending their legislation and removing some of their non-tariff barriers. However, many burdensome regulations continue to hinder trade. WB6 economies should focus on easing conditions on the temporary movement of people applied to third-country nationals outside of the scope of the preferential treatment present in regional trade agreements, which would further encourage innovation and knowledge transfer, contribute to economic growth, and promote an alignment of their legislations to facilitate the creation of an intra-regional single market in the medium term. Finally, progress has been made in recent years to improve the WB6 economies' e-commerce regulatory frameworks to meet the challenges of this growing commercial sector. At the same time, the regulations applied to digitally enabled services are very competitive in all six economies.

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## Notes

[1] Allocative efficiency is a state of the economy in which production represents consumer preferences; in particular, every good or service is produced up to the point where the last unit provides a marginal benefit to consumers equal to the marginal cost of producing.

[2] CEECs: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.

[3] More than 55% of Montenegro's, and around 40% of Croatia's and Albania's exports.

[4] Institutional bodies include ministries (e.g. finance, agriculture, foreign affairs and industry), customs agencies, standardisation bodies and export promotion agencies.

[5] 6 July 2020, Official Gazette, protocol no. 01/3387

[6]Apart from the newly created NTFCs the following permanent advisory bodies are in place in the WB6 economies: an Economic Council in Albania; Export Councils in Bosnia and Herzegovina (one at the state level and another one in the Republika Srpska); an Economic Council in Kosovo; an Advisory Council within the customs administration and an Economic Council in the Republic of North Macedonia; a Council for Competitiveness in Montenegro and a National Convention on the European Union in Serbia.

[7] Albania Economic Reform Programme (ERP) 2021-2023; Bosnia and Herzegovina Economic Reform Programme (ERP) 2021-2023; Kosovo Economic Reform Programme (ERP) 2021-2023; North Macedonia Economic Reform Programme (ERP) 2021-2023; Serbia Economic Reform Programme (ERP) 2021-2023.

[8] i.e. Ministries of Economy, Agriculture, Infrastructure, Industry, Customs authorities, National Standards Body, etc.

[9] These are mainly RIA reports or certain targeted strategies.

[10] This indicator does not have a scoring system attributed to it and is therefore assessed descriptively.

[11] Albania (2009), North Macedonia (2004), Montenegro (2010), Serbia (2013), Bosnia and Herzegovina (2015) and Kosovo (2016).

[12] Albania established an FTA with Turkey in 2008. Bosnia and Herzegovina has a bilateral trade agreement with Turkey which entered into force in 2003. A revised FTA with Turkey was signed in 2019, and the ratification process is underway. In June 2019, Kosovo ratified its FTA with Turkey (signed in 2013). In July 2019, Kosovo signed an Economic Cooperation Agreement with the Czech Republic and signed a Partnership, Trade and Cooperation Agreement with the United Kingdom in December 2019 (in anticipation of the United Kingdom's withdrawal from the EU-Kosovo SAA). Montenegro replaced Protocol II of the original FTA with Turkey from 2010 in June 2019, redefining the term "originating products" and methods of administrative co-operation. Additionally, Protocol I was revised in order to include additional agricultural concessions, and a new Protocol III on trade in services was concluded in 2020. North Macedonia signed an FTA with Turkey in 2000. Serbia has negotiations underway on a bilateral investment treaty with South Korea since December 2018. Discussions on a future trade agreement with the United Kingdom started in 2019.

[13] Trade integration with Ukraine is ongoing: North Macedonia concluded a bilateral agreement in 2001; Montenegro a Free Trade Agreement in 2012. Finally, Serbia has ongoing negotiations for a future FTA.

[14] With Slovakia, Iran, Canada, Morocco, Lebanon, Saudi Arabia and Iceland and ongoing negotiations with Turkey on the free trade agreement signed in 2008

[15] The analysis does not include Kosovo, as data are not available in 2019.

[16] http://www.javninameti.gov.me/

[17] Although the minimum capital requirement exists in Serbia, the amount is RSD 100, which is less than one euro.

[18] Law on Foreigners from 2018 and 2019 in its Article 78 defines work of a foreign national beyond the annual quota.
A temporary residence and work permit beyond the annual quota may be issued to a foreign national: 1) who carries out business activities in Montenegro under an international treaty concluded between Montenegro and other state, under the condition of reciprocity; 2) who teaches in the educational institutions in the language and script of the members of minority nations and other national minority communities; 3) a professional athlete or sports worker who works in Montenegro in accordance with the law governing sports; 4) an executive director of a company and an entrepreneur who is registered in Montenegro in accordance with the law governing the form of carrying out business activities and their registration; 5) who possesses higher education and is employed by the employer at managerial job positions; 6) who is temporarily posted as a manager, a specialist or an intern, in accordance with Article 74 of this Law; 7) for the purpose of provision of the agreed services as per Article 72 of this Law; 8) with domicile in a neighbouring country, who is employed and works in Montenegro and at least once a week returns to the place of domicile (daily migrant); 9) who is included in the implementation of development projects from the list of development projects determined by the Government, upon the proposal of the administration authority in charge of development projects, not later than until 30 November of the current year for the subsequent year.

[19] Bosnia and Herzegovina and North Macedonia apply economic needs tests to intra-corporate transferees, contractual service providers and independent service providers. Albania applies economic needs tests to contractual and independent service providers and Montenegro to intra-corporate transferees. Only Kosovo and Serbia do not apply economic needs tests.

[20] In order to facilitate comparison with OECD Member States that have undergone the Services Trade Restrictiveness Index exercise, the paragraphs below have been drafted in accordance with the methodology of the STRI project publications. The OECD Member's Country Notes, as well as the Sector Notes, are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/.

[21] Defined as ISIC (rev 4) category 4293 freight transport by road. The STRI for this sector covers commercial establishment only; cross-border trade is governed by a system of bilateral and plurilateral agreements which provide for permits, quotas and other regulations.

[22] Defined as ISIC code 4912. Rail transport provided over a dedicated network where the market structure may take different forms, the two most common ones being: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between infrastructure management and operations.

[23] Defined as ISIC code 51. Air transport services are defined as passenger and freight air transport carried domestically or internationally. The partial WB6 STRI excludes domestic transport in Montenegro as there is no traffic or regulation for this.

[24] In light of the range of air transport subsectors, the approach in the STRI project is to focus on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant in so far as regulations enacted by relevant authorities can have an impact on the ability of foreign carriers to transport passengers and goods between points.

[25] Defined under ISIC Rev 4 code 53 as postal and courier activities.

[26] Defined as ISIC Rev 4 code 691, and covering advisory and representation services in domestic and international law. Where relevant measures are entered separately for each of them.

[27] Defined as deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking.

[28] Defined as ISIC Rev 4 code 651 and 652 and covering life insurance, property and casualty insurance, reinsurance and auxiliary services. Private health insurance and private pensions are not covered.

[29] Defined as ISIC Rev 4 codes 41 and 42 and covering residential and non-residential construction services, as well as construction work for civil engineering.

[30] Defined as ISIC Rev 4 code 711 and covers architectural services and related technical consultancy.

[31] Defined as ISIC Rev 4 code 711 and covers several related activities, such as engineering and integrated engineering services, and engineering related scientific and technical consulting services.

[32] Defined as ISIC Rev 4 code 62 and 63, covering computer programming, consultancy and related activities and information service activities.

[33] Defined as ISIC Rev 4 code 611 and 612), covering wired and wireless telecommunications activities.

[34] Directive 2000/31/EC

[35] Such as the Law on electronic documents, electronic identification and Trust Services (2019), the Law on Electronic Management and Electronic services (2019), the National Cyber Security Strategy and Action plan (2018-2022) and the National Operational Broadband Plan (2019-2023).

[36] The draft law on consumer protection (expected to enter into force in Q3 2021) will introduce novelties in the ADR system. It will be able to receive and register complaints and support the internal ADR process as a way to build on the successful implementation of the ODR solution. The proposal is to build the platform and connect it to the NCCR (National Consumer Complaint Register) – a platform that allows a consumer to submit their complaint directly online to the relevant consumer organisation.

[37] 'Directive on electronic commerce' 2000/31/EC

# 6 Access to finance (Dimension 3)

Access to finance is crucial for the development of the private sector in all economies. Businesses must be able to access financing sources to start up, grow, diversify and expand. Moreover, well-functioning capital markets will not only support near-term recovery in the post-pandemic period, but also long-term resilience in the corporate sector. This chapter assesses policies in the six Western Balkan (WB6) economies that support private businesses' access to sources of finance. It starts by providing an overview of the assessment framework and progress since the last assessment in 2018. It then analyses three sub-dimensions considered key to access to finance. The first sub-dimension, access to bank finance, focuses on the structure of the banking industry and the legislation facilitating bank finance. The second sub-dimension, access to alternative financing sources, assesses the legal framework and the use of factoring, leasing, private equity, venture capital and business angel networks. It also examines the existence of crowdfunding and initial coin offerings. The third sub-dimension, mobilisation of long-term financing, focuses on the regulatory framework related to public-private partnerships and access to capital markets.

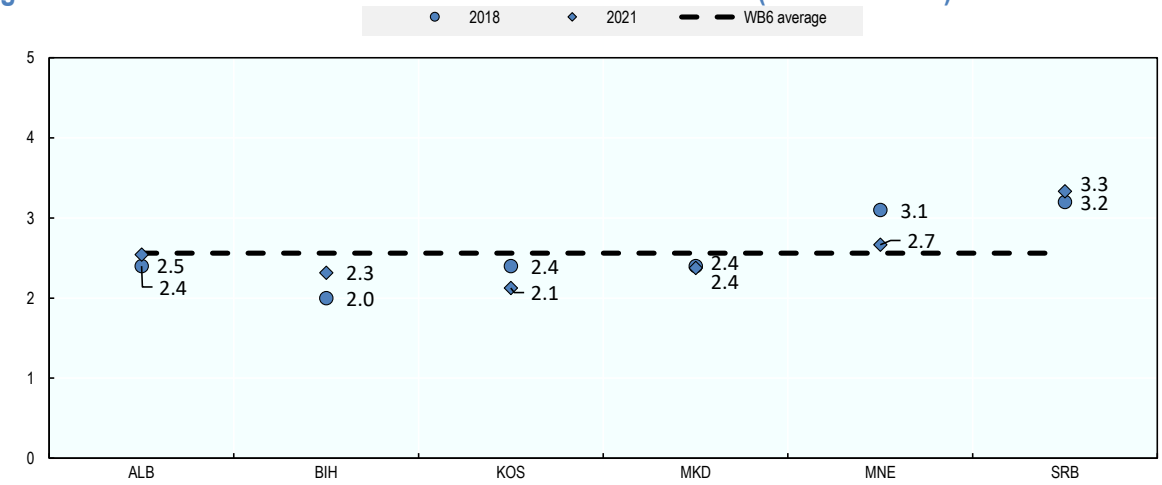
## Key findings

- **Legal and regulatory frameworks are generally well developed in the region**. All WB6 economies have recently amended their banking laws and have made progress in increasing the coverage of public and/or private credit information.
- **Bank lending continues to be the dominant source of finance for firms** and collateral requirements remain high. Despite functioning asset registers to ensure accurate and verifiable property information, high collateral requirements hinder the ability of small and growing businesses to access credit and secure loans.
- **Alternative financing sources are still in the early stage of development.** Factoring and leasing are the main alternative financing instruments used by firms; however, their financial contributions to the economy are limited.
- **There is no dedicated legislation targeting private equity investment funds, venture capital, business angels or crowdfunding** in most WB6 economies. The regulatory frameworks governing these alternative financing options remain underdeveloped and contingent upon vaguely applicable general legislation.
- **Capital markets are in place, but underdeveloped.** Initial public offerings are underutilised as a way of raising capital for the private sector. All WB6 economies have established government bonds markets, but they are shallow and illiquid.

### Comparison with the 2018 assessment

The regional average score for access to finance is 2.6, which is the same as for the 2018 assessment. All WB6 economies except Kosovo and Montenegro have made progress in the areas assessed under access to finance; however, it should be noted that due to differences in the assessment methodology, the economies' scores are not directly comparable. The WB6 economies perform best in the sub-dimension on access to bank finance, and worst in the sub-dimension on access to alternative financing sources. Overall, Serbia remains the strongest performer in this dimension, followed by Montenegro and Albania. Bosnia and Herzegovina has made the biggest progress since the last assessment followed by Serbia and Albania. Figure 6.1 summarises the performance of the WB6 economies since the last assessment.

## Figure 6.1. Overall scores for the access to finance dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

### *Implementation of the Competitiveness Outlook 2018 recommendations*

Progress on implementing the policy recommendations made in the Competitiveness Outlook (CO) 2018 has been limited (Table 6.1). Partial progress has been made in supporting alternative financing instruments.

## Table 6.1. Implementation of the Competitiveness Outlook 2018 policy recommendations: Access to finance dimension

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| Complete the implementation of legal frameworks for ensuring timely payments and managing insolvency | This indicator has not been assessed in this cycle. For more information please refer the chapter on "Bankruptcy and second chance" in the OECD SME Policy Index for the Western Balkans and Turkey (OECD et al., 2019[1]). | n.a |
| Reduce the high collateral requirements | • None of the economies have made substantial changes regarding collateral requirements for loans.<br>• The majority of the WB6 economies remain well over the OECD average regarding loans requiring collateral and the amount of the loan needed as collateral. | None |
| Support alternative financing instruments | • Most WB6 economies still lack dedicated regulatory frameworks on alternative investment funds, such as venture capital, crowdfunding and initial coin offering, with few economies planning initiatives to draft regulation on alternative financing instruments. | Limited |

## Introduction

A well-functioning financial system and a dynamic private sector are key catalysts for economic growth and competitiveness. Promoting better access to finance is crucial for supporting private sector development, as businesses must be able to access financing sources to start up, grow, diversify and expand. As small and medium-sized enterprises (SMEs) are more vulnerable to disruptions in local markets, business networks, and global and local supply chains, ensuring access to finance for small businesses is key to helping them better withstand and endure severe economic shocks.

Globally, domestic credit lending to the private sector stagnated and became more stringent following the 2008 financial crisis. Moreover, typical bank financing options have proved more difficult for SMEs to attain than larger firms due to higher perceived lending risks. Although all lending schemes include some form of risk, SMEs suffer from increased financial challenges and intrinsic weaknesses including limited capital, an inability to pay high interest rates and credit deficiencies that make banks cautious to extend loans. Small businesses also typically have infrastructural and intrinsic weaknesses such as inadequate or non-existent business planning, accounting practices and bookkeeping, as well as a lack of awareness and knowledge about financing options and instruments, which limits their ability to access both traditional and alternative financing options.

Addressing the challenges and needs of the private sector in accessing finance will entail enabling a more hospitable environment for private sector lending by improving collateral and insolvency schemes, enhancing risk-mitigating services, and supporting banks in extending credit facilities to businesses without credit. A lack of progress in this area will limit the ability of private sector actors to create new employment opportunities, start new businesses, and generally contribute to economic growth and development. Access to finance has implications for several other policy areas assessed in this Competitiveness Outlook; however, it is particularly relevant for the following dimensions:

- **Chapter 3. Investment policy and promotion** is relevant as green investment projects, like most infrastructure projects, provide unique advantages for investors looking for steady, long-term and inflation-linked income streams for renewable energy and energy efficiency projects, irrespective of returns on other investments. Access to finance is particularly important in the area of public-private partnerships to ensure the adequate financing of green investment projects.
- **Chapter 9. State-owned enterprises** should not be exempt from the application of general laws and regulations applicable to private companies, including notably competition rules and other market regulations. Concerning their access to finance, state-owned enterprises should not benefit from any direct or indirect state support – including implicit or explicit guarantees on commercial debt – that may confer a competitive advantage over private enterprises.
- **Chapter 12. Science, technology and innovation** (STI) related businesses rely on funding from venture capital and business angel networks to support their high upfront costs. Access to finance is particularly important for innovative businesses as investors rarely target knowledge-intensive sectors and government financing of research and development remains low.
- **Chapter 13. Digital society** is dependent on the ability of SMEs to implement better information and communication technology (ICT) infrastructure. The digitalisation of SMEs can be costly and unfeasible without proper access to financing. Government financial support programmes for ICT adoption have had little impact in the region, and difficult bank guarantee processes make digitalisation challenging.

## Assessment framework

### *Structure*

This chapter assesses policies related to access to finance in the WB6 economies through three broad sub-dimensions:

1. **Sub-dimension 3.1: Access to bank finance** focuses on the structure of the banking industry and the legislation facilitating access to finance. It also assesses the use of collateral and credit information and the availability of credit guarantees.
2. **Sub-dimension 3.2: Access to alternative financing sources** assesses the legal framework and the use of factoring, leasing, private equity, venture capital and business angel networks. It also

examines the existence of crowdfunding and initial coin offerings for firms operating under blockchain technology.

3. **Sub-dimension 3.3: Mobilisation of long-term financing** focuses on the regulatory framework related to public-private partnerships (PPPs). It also looks at access to capital markets, which is composed of three sub-indicators: 1) institutional investors and asset management; 2) access to stock markets; and 3) access to bond markets.

Figure 6.2 shows how the sub-dimensions and their indicators make up the access to finance dimension assessment framework. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information on the methodology see the Methodology and assessment process chapter.

## Figure 6.2. Access to finance dimension assessment framework

**Access to finance dimension**

**Outcome indicators**
1. Domestic credit to the private sector (% of GDP)
2. Non-performing loans (share in total loans)
3. Gross Domestic Savings ratio (% of GDP)

| Sub-dimension 3.1<br>Access to bank finance | Sub-dimension 3.2<br>Access to alternative financing sources | Sub-dimension 3.3<br>Mobilisation of long-term financing |
|---|---|---|
| **Qualitative indicators**<br>1. Banking industry<br>2. Register<br>3. Credit information services<br>4. Collateral requirements<br>5. Credit enhancement and risk mitigation | **Qualitative indicators**<br>6. Factoring<br>7. Leasing<br>8. Private equity and venture capital<br>9. Business angel networks<br>10. Crowdfunding<br>11. Blockchain – initial coin offerings | **Qualitative indicators**<br>12. Access to long-term financing: public-private partnerships<br>13. Access to capital markets<br>1. Institutional investors and asset management<br>2. Access to stock markets<br>3. Access to bond markets |
| **Quantitative Indicators**<br>1. Cumulative market share of top three banks (% of total banking assets) – concentration rate<br>2. Number of state-owned banks<br>3. Cumulative market share of state-owned banks<br>4. Effective interest rate<br>5. Value of collateral needed for a loan (% of the loan amount)<br>6. Value of SME government loan guarantees | **Quantitative Indicators**<br>7. Value of venture and growth capital<br>8. Value of leasing and hire purchases<br>9. Value of factoring and invoice discounting<br>10. Total crowdfunding investment<br>11. Value of initial coin offers | **Quantitative Indicators**<br>12. Population (above age 15) that hold a bank account<br>13. Stock market capitalisation and value traded (% of GDP)<br>14. Turnover ratio (total shares/market capitalisation)<br>15. Number of initial public offering by companies<br>16. Value of initial public offering by companies<br>17. Number of secondary public offering by companies<br>18. Ratio of private sector bonds to GDP<br>19. Outstanding corporate bonds to GDP |

Note: GDP = gross domestic product.

The leaders of the WB6 economies endorsed the Common Regional Market (CRM) 2021-2024 Action Plan at the Berlin Process Summit held on 10 November 2020 in Sofia. The Action Plan is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area (RCC, 2020[2]).

Within the goal of creating a regional trade area, the WB6 economies have committed to increasing the availability of long-term financing; expediting establishment and service supply enabled through "passporting" or a similar trade facilitation system; decreasing insurance-related costs of movement of people, goods and services in the region; and increasing the attractiveness of financial markets for investment. In terms of COVID-19 relief, the economies committed to enhancing regional co-ordination and co-operation on topics such as partial credit guarantees and the use of public financial institutions. The WB6 economies also agreed to work on upgrading the industrial base and innovation infrastructure by launching regional start-up and early-stage innovation support schemes, as well as blending public and private sector financing.

The regional trade and innovation areas of CRM 2021-24 Action Plan include several sections relevant to the access to finance sub-dimension of the CO2021: 1) financial services; 2) strengthening regional co-operation and co-ordination regarding the COVID-19 response as part of relief, recovery and resilience; and 3) regional innovation. See Box 6.6 for further information.

### *Key methodological changes to the assessment framework*

For this edition of the Competitiveness Outlook, two sub-dimensions from the 2018 cycle (sub-dimension 1 on policy, regulatory and institutional framework and sub-dimension 2 on access to bank finance) were merged under sub-dimension 1 on access to bank finance to better capture the regulatory framework and lending conditions. Two new indicators were also added under sub-dimension 2, crowdfunding and initial coin offerings. A new sub-dimension was also added on the mobilisation of long-term financing to gather more information on long-term financing tools and the capital markets.

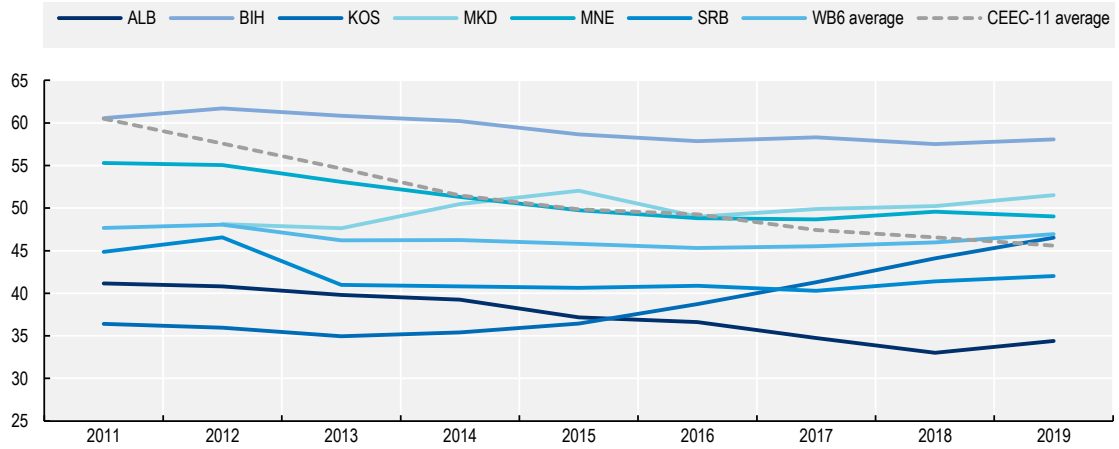
## Access to finance performance and context in the WB6

Over the past decade, and prior to the crisis triggered by the COVID-19 pandemic, access to finance was a major concern in Western Balkan economies. In 2019, one in five firms identified access to finance as a major constraint to growing their business (World Bank, 2020[3]). The outcome indicators selected for this Competitiveness Outlook are designed to assess the performance of the Western Balkan economies in creating the conditions to facilitate access to finance.

Domestic credit to the private sector as a share of GDP has remained at similar levels, around 45-48%, since 2011 in the WB6 region, and reached the CEEC-11[1] average in 2018 (Figure 6.3). Kosovo and North Macedonia are the only WB6 economies that saw an increase between 2012 and 2019 of around 10.6 and 3.4 and percentage points, respectively; Albania recorded a decline of 6.4 percentage points. There is significant room to increase the level of financial intermediation in the region, for example the European Union (EU) average for domestic credit to the private sector was 86.6% of GDP in 2019 (100.5% in 2011).

## Figure 6.3. Domestic credit to the private sector in WB6 economies (2011-2019)

% of GDP




Note: No data available for North Macedonia for 2011. The data for Bosnia and Herzegovina are expressed cumulatively at the state level, based on data for the banking sectors of Republika Srpska and Federation of Bosnia and Herzegovina. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

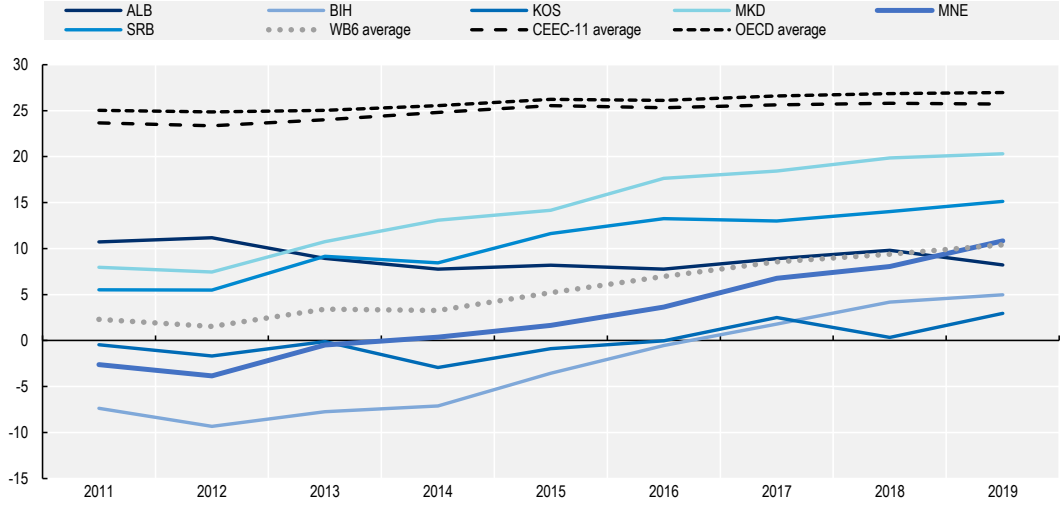
Source: (OECD et al., 2019[4]), *World Development Indicators*, https://datacatalog.worldbank.org/dataset/world-development-indicators.

StatLink https://doi.org/10.1787/888934253803

Gross domestic savings in the region range from around 3% in Kosovo to 20% in North Macedonia. Despite a constant increase since 2011 in all Western Balkan economies except Albania (Figure 6.4), the regional average of around 10% is almost half the CEEC-11 and OECD averages of 26% in 2019. This indicates that most Western Balkan economies have room to further increase their internal financing. Low savings rates in Albania, Bosnia and Herzegovina, Kosovo and Montenegro undermine the ability of households and individuals to absorb the economic shock related to COVID-19. Low domestic savings have also led to challenges for authorities in terms of how they absorb external shocks.

## Figure 6.4. Gross domestic savings in WB6 economies (2011-2019)

% of GDP




Note: CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

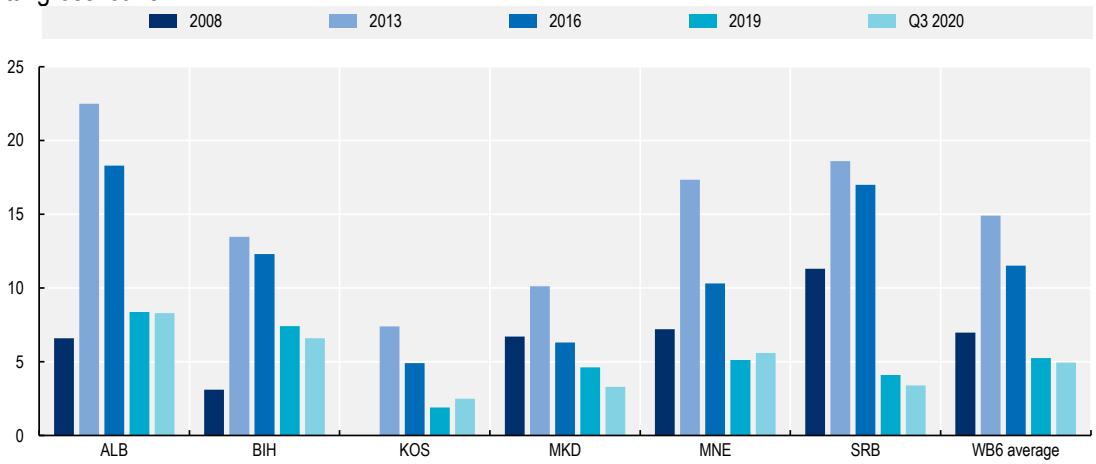
Source: (OECD et al., 2019[4]), *World Development Indicators*, https://datacatalog.worldbank.org/dataset/world-development-indicators.

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There were positive signs until the COVID-19 outbreak regarding non-performing loans (NPLs), which can impinge on banks' willingness and ability to provide credit in the Western Balkans, especially to innovative businesses or younger firms with no credit history (Thomadakis, 2016[5]). NPL levels reached the pre-financial crisis level (around 5% in the WB6) in quarter 3 of 2020, following a peak of around 15% in 2013 (Figure 6.5). This shows that the action plans on NPLs implemented in the last decade have helped improve shortcomings in the credit market (OECD, 2018[6]). The potential effects of COVID-19 on NPLs should be closely monitored in the post-pandemic phase.

### Figure 6.5. Non-performing loans in the WB6 economies (2008-2020)

% of total gross loans




Note: World Bank data are not available for Kosovo for 2008.

Source: (OECD et al., 2019[4]), *World Development Indicators*, https://datacatalog.worldbank.org/dataset/world-development-indicators; statistical institutes; (EC, 2021[7]), *EU Candidate Countries' & Potential Candidates' Economic Quarterly (CCEQ) 1st Quarter 2021*, https://ec.europa.eu/info/publications/economic-and-financial-affairs-publications_en.

StatLink https://doi.org/10.1787/888934253841

## Access to bank finance (Sub-dimension 3.1)

Bank finance is a major source of external finance for businesses in the region, with banks accounting for between 66% and 92% of financial sector assets; however, obtaining credit is still a significant challenge for firms in WB6 economies. If banks effectively fulfil their role as intermediaries between owners and users of funds, they ensure the more efficient allocation of financial resources to support the private sector in accessing sufficient capital to operate, expand and innovate.

WB6 economies have made progress regarding asset registers since the last assessment (see Table 6.2). For example, half have improved the accessibility of their asset registers through online searching options and increased the availability of necessary documentation through new e-services. However, WB6 economies have regressed in terms of credit information services. While collateral requirement scores remain largely unchanged since the last assessment, and continue to be well above OECD averages for the majority of WB6 economies, credit enhancement and risk mitigation could not be scored during this assessment period due to the numerous temporary credit guarantee schemes and credit lines put in place in response to the COVID-19 pandemic.

### Table 6.2. Scores for Sub-dimension 3.1: Access to bank finance

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 3.1: Access to bank finance | Banking industry | 3.5 | 3.3 | 3.0 | 3.0 | 3.5 | 4.5 | 3.5 |
| | Register | 4.0 | 3.0 | 4.0 | 3.0 | 4.0 | 4.5 | 3.8 |
| | Credit information services | 4.0 | 3.5 | 4.0 | 4.0 | 2.5 | 5.0 | 3.8 |
| | Collateral requirements | 2.5 | 2.5 | 2.5 | 2.0 | 2.5 | 3.5 | 2.6 |
| | Credit enhancement and risk mitigation | n.a. | | | | | | |
| **Sub-dimension average score** | | 3.5 | 3.1 | 3.4 | 3.0 | 3.1 | 4.4 | 3.4 |

Note: The access to bank finance sub-dimension is not directly comparable to the 2018 assessment due to the merging of bank industry regulations, asset register and credit information indicators with the existing collateral requirement and credit enhancement and risk mitigation indicators included in the previous sub-dimension 2.

### *The WB6 are aligning banking industry regulatory frameworks with Basel III requirements*

Establishing strong and stable banking industry regulations improves institutional supervision and risk management, which can help economies better withstand economic crises and lessen the effects of fiscal shocks. Strengthening the regulation, supervision and risk management of banks through safeguarding rules such as strong transparency, liquidity and capital bases improves the ability of an economy to absorb fiscal stresses and manage uncertainty.

Legal and regulatory frameworks in the banking industries of the regional economies are generally well developed, with all WB6 economies having recently amended their banking laws. Albania, Bosnia and Herzegovina[2], and Serbia have implemented measures to encourage local currency transactions, while North Macedonia has introduced additional requirements for banks to adequately assess credit risks arising from foreign currency lending (although this does not explicitly facilitate local currency lending). Kosovo and Montenegro are euroized economies, which excludes the need for special foreign exchange capital requirements or the mandatory disclosure of foreign exchange borrowing risk.

All WB6 economies show strong alignment to Basel II[3] principles and are undertaking ongoing harmonisation efforts with Basel III[4] requirements. Most WB6 economies have implemented revised liquidity coverage and leverage ratios in line with Basel III recommendations, while several have also employed the internal capital adequacy assessment process (ICAAP),[5] introduced capital buffers and improved minimum capital requirements. However, implementation of the internal ratings-based approach (for credit risk)[6] and the advanced measurement approach (for operational risk) are still lagging in most economies.

### *There has been progress in increasing public accessibility to asset registers*

Real estate remains the most widely relied upon form of collateral in the region as it is typically the most valuable asset owned by individuals and firms. However, using land titles as collateral is sometimes difficult in emerging economies due to the absence of well-functioning and accurate land registries and cadastres.[7] Verifiable and accessible registry systems give individuals and small businesses security by legally recognising and protecting their property, enabling them to use it as official collateral when seeking formal financing.

All WB6 economies have cadastral systems to register land and real estate and record value and ownership, as well as any existing pledges over the asset. In addition, Bosnia and Herzegovina is attempting to centralise and unify its currently misaligned system through a joint project with the World Bank, launched in March 2020. The project aims to support the development of a sustainable real estate registration system with harmonised land registry and cadastre records in urban areas of the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS).

While Albania, Kosovo and Serbia had previously low ratios of information searches to new registrations, all three economies have made progress in increasing the accessibility of their cadastres since the last assessment. In Albania, the Registry of Security Charges has been expanded to cover the entire territory and has made all documents required for applications of cadastre services available online through the e-Albanian portal. Meanwhile, Serbia has made its real estate cadastre available to all interested parties for online searching, with data updated on a daily basis. Kosovo has also launched an online module for mortgage registration and communication with banks and non-bank financial institutions that provide credit; however, it remains in the testing phase.

### *There has been progress in increasing public and/or private credit information coverage*

Small and growing businesses typically face challenges accessing finance due to limited information on the worthiness of their credit. Credit information services compile data on loan repayment and bankruptcy histories, among other things, to minimise information asymmetries between lenders and borrowers on default risks. Research has shown that information collected by bureaus and registries on credit history has a strong predictive influence on the likeliness of default, which greatly decreases risk for lenders (Kallberg and Udell, 2003[8]). Credit information services are either publicly owned and usually managed by the central bank, or privately owned and commonly established by financial institutions and associations.

No major changes concerning credit information services in the WB6 have occurred since 2017. All Western Balkan economies continue to have either a public or private credit information system in place, or both. North Macedonia and Bosnia and Herzegovina remain the only two WB6 economies to have both public and private credit bureaus. In Albania, where only a public credit registry exists, an attempt by the Association of Banks to expand the economy's credit information services by establishing a private credit registry could not be finalised due to legal barriers.

The coverage of both public and private credit information services continues to vary across the region (Table 6.3). While the private credit bureaus of North Macedonia and Serbia have already reached full coverage, Bosnia and Herzegovina has increased private credit registry coverage to 14% from 10.4% since the last assessment. Unlike private structures, the data from public credit information systems enable officials to adapt policies and strategies to the needs of the population. All WB6 economies have increased the coverage of their public credit registries since the last assessment, with Albania marking a notable 17.3% increase in coverage, the highest in the region. However, fewer than 45% of the adult population is covered in Kosovo, Montenegro and North Macedonia. In OECD economies, 66.2% of the adult population is covered by private and 24.5% by public credit information systems.

**Table 6.3. Coverage of public and private credit bureaus in WB6 economies (2019)**
% of adult population

| | ALB | BIH | KOS | MKD | MNE | SRB | OECD |
|---|---|---|---|---|---|---|---|
| Coverage of public credit registry | 56.2 | 47.1 | 41 | 41.7 | 41.4 | n.a. | 24.5 |
| Coverage of private credit bureau | n.a. | 14 | n.a. | 100 | n.a. | 100 | 66.2 |

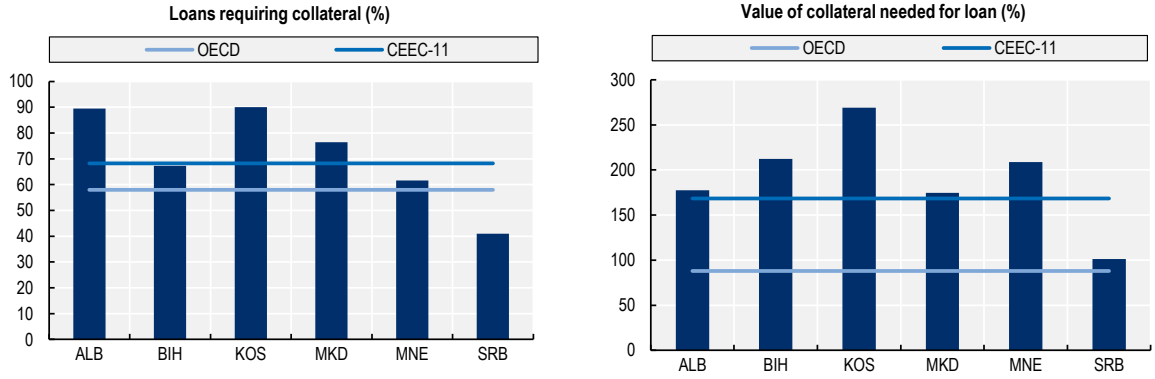
Source: (World Bank, 2021[9]), *Doing Business: Measuring Business Regulations (database)*, www.doingbusiness.org.

### *Collateral requirements remain high, and few firms use movable assets as collateral*

Collateral requirements for loan contracts is a common practice within financial institutions to lower interest rates for SMEs and mitigate risks stemming from other barriers, such as a lack of credit information However, collateral requirements remain high throughout WB6 economies, hindering the ability of small and growing businesses to access credit and secure loans. According to the World Bank Enterprises Survey from 2019, Albania, Kosovo and North Macedonia demand collateral requirements on over 70% of

loans, compared to the OECD average of 58% (Figure 6.6) (World Bank, 2020[3]). While loans requiring collateral in Bosnia and Herzegovina and Montenegro are generally on par with the OECD average, only 41% of loans in Serbia require collateral (16% lower than the OECD average). However, all WB6 economies require a higher percentage of the loan in collateral than the OECD average, although Serbia requires only 13% more (Figure 6.6). All other WB6 economies require more than around 175% of the loan amount in collateral, with Kosovo imposing collateral of almost 270% of the total loan.

## Figure 6.6. Loans requiring collateral in WB6 economies, and the value of collateral (2019)




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (World Bank, 2020[3]) *Enterprise Survey (database),* https://www.enterprisesurveys.org/en/enterprisesurveys.

StatLink https://doi.org/10.1787/888934253860

Although real estate remains the most common collateral for loans, most WB6 economies allow for the use of non-fixed assets such as movable assets and intangibles to secure loans. However, while most EU and OECD member states widely accept intangible assets as collateral under well-developed intellectual property structures, financial institutions in WB6 economies often opt out of using movable assets and prefer more traditional forms of collateral such as land. This may be because the economies' legal frameworks do not always provide sufficient protection for difficult valuations, ownership issues, licensing and cross-licensing issues.

### *WB6 economies enhanced their credit guarantee schemes in response to COVID-19*

SMEs often face challenges in securing bank loans and accessing sufficient credit from the formal financial system due to perceived high risks such as insufficient collateral and credit information, which limits their ability to implement economically viable projects. Credit enhancement and risk mitigation measures such as credit guarantee schemes and credit insurance provide banks surety that they will recover the value of loans in cases of default, which improves the capacity of banks to lend to SMEs and thereby alleviates the financing constraints faced by SMEs.

The WB6 economies vary in terms of the development, scope and funding of risk mitigation and credit enhancement schemes, although generally such schemes continue to be absent from the credit support landscape. Kosovo has one of the most comprehensive credit guarantee schemes in the region through its Kosovo Credit Guarantee Fund (KCGF), which has increased lending by local financial institutions to micro, small and medium-sized enterprises (MSMEs). The fund has enhanced opportunities in the industrial and agriculture sectors by covering up to 50% of the loan risk for MSMEs, which benefitted almost 3 500 businesses with EUR 75 million by the end of 2019. The KCGF follows good practice standards for credit guarantee schemes by clearly defining eligibility criteria for lending decisions in line with international lending institutions, and regularly monitoring the fund through robust *ex post* evaluation mechanisms. The KCGF became a self-sustainable organisation in 2020 and began targeting additional support at certain vulnerable markets. For example, it has provided women in business, young entrepreneurs, the

manufacturing sector and the agricultural sector with additional guarantees, and foresees providing increased financing support for renewable energy projects.

Some economies continue to have solely donor-sponsored credit guarantee schemes instead of domestic structures. For example, Albania, in partnership with the European Bank for Reconstruction and Development (EBRD), complemented its Italian-funded SME development programme, which guarantees loans of up to 60% of the loan amount, with the Albania Agrobusiness Support Facility, which backs 20% of loans for Albanian agribusinesses. Montenegro still lacks a credit guarantee scheme; however, its Investment Development Fund signed a EUR 75 million agreement with the European Investment Fund under the COSME Loan Guarantee[8] programme in 2019 to improve SMEs' access to finance.

The COVID-19 pandemic has compelled all WB6 economies to establish initial or supplementary national credit guarantee schemes to mitigate the impact of the crisis and increase the liquidity of SMEs (Table 6.4). Montenegro and Bosnia and Herzegovina have launched new credit lines targeting SMEs, agribusinesses and manufacturing sectors, and established export and employment-oriented activities. In Montenegro, a new credit line for SMEs was established under the Investment Development Fund for up to EUR 3 million per business using a simplified procedure and low interest rate. The FBiH implemented a credit guarantee scheme worth over EUR 125 million through the FBiH Development Bank, while RS has expanded the competences of its existing guarantee fund to approve loans of up to approximately EUR 120 million.

### Table 6.4. WB6 credit guarantee schemes established in response to COVID-19

| | | Beneficiaries | Coverage (EUR million) | Interest cap | Loan maturity |
|---|---|---|---|---|---|
| Albania | | All enterprises | 211 | 2.85% to 5% | 2-5 years |
| Bosnia and Herzegovina | *FBiH* | SMEs and large enterprises | 77 (for SMEs)<br>51 (for large enterprises) | n.a. | 5 years |
| | *RS* | MSMEs | 122 | n.a. | 4 years |
| Kosovo | | MSMEs | 46.5 | n.a. | 1 year |
| Montenegro | | Entrepreneurs, SMEs, and large enterprises | 120 | 1.5% | 2 years |
| North Macedonia | | MSMEs, trades and crafts | 84.5 | 0% | 2-3 years |
| Serbia | | Self-employed, co-operatives and MSMEs | 728 | 1M BELIBOR + 2.5 p.p.<br>3M EURIBOR + 3.0 p.p. | 1-5 years |

Note: Coverage information reflects public authority allocated funds and does not consider donor-funded schemes. Interest caps for Bosnia and Herzegovina and Kosovo are contingent on commercial bank practices. Serbia's interest cap is calculated based on the Belgrade Interbank Offered Rate (BELIBOR), which is the benchmark rate offered on dinar deposits by the BELIBOR panel.

Bosnia and Herzegovina, North Macedonia and Serbia have opened donor-based credit lines in partnership with institutions such as the EBRD, the European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) to mitigate the impact of COVID-19. For instance, Serbia has been supported with a EUR 210 million credit line by the EBRD to finance banks focused on SMEs that generate positive socio-economic impact, and EUR 50 million by the CEB for banks that have requested assistance for liquidity shortages.

### *The way forward for access to bank finance*

- **Facilitate access to traditional bank financing**. Although asset registration systems are in place in all WB6 economies, high collateral requirements impede the ability of small and growing businesses to access credit and secure loans. Fostering the use of intangible assets as collateral (while ensuring that international guidelines are followed, such as the OECD G20 principles) would ease small business access to traditional financing. Economies may also lower security interest for

non-fixed assets to encourage the use of intangibles as collateral and provide incentives for businesses to expand. Moreover, one way could be to implement regulations with fixed thresholds.

- **Transition from temporary credit guarantee schemes to permanent structures**, for those economies without existing mechanisms**.** The COVID-19 pandemic has compelled economies to take the first steps to initiate widespread credit guarantees and lines to both SMEs and large enterprises. By building upon the preliminary framework established during the pandemic these schemes can continue to play an important role in enabling the flow of credit to the productive sectors. Box 6.1 describes how OECD economies have supported businesses during the pandemic.

### Box 6.1. COVID-19 government financing support for businesses in OECD economies

The OECD has conducted a simulation analysis to further understand and support the design of government financial support programmes. The OECD report, *COVID-19 Government Financing Support Programmes for Businesses*, assesses whether governments should consider other ways to support businesses without incentivising further indebtedness or undermining their financial flexibility. It maps government financial support programmes in OECD economies and can serve as a guide for WB6 economies to better understand how to ensure available financing for businesses heavily affected by the pandemic, and beyond.

The report lays out recommendations on crucial components of successful government financing programmes, such as structuring support initiatives to address the specific needs of businesses and corresponding risk preferences. Many OECD economies have successfully implemented credit guarantee schemes and credit mediation schemes to address the immediate SME financing gap, while other government financing programmes have facilitated equity financing for SMEs by supporting the venture capital industry. Other financing options explored in the report include temporary collateral easing and several crisis liquidity and lending programmes for purchases in the public capital markets, mortgage and corporate bonds, and the private loan market. In addition to addressing short-term liquidity solutions, the report also covers immediate and targeted financial support to address acute insolvency risks including loan guarantees, direct loans and grants, equity investment, and the facilitation of central bank lending.

Source: (OECD, 2020[10]), *COVID-19 Government Financing Support Programmes for Businesses*, https://www.oecd.org/daf/fin/financial-markets/COVID-19-Government-Financing-Support-Programmes-for-Businesses.pdf.

## Access to alternative financing sources (Sub-dimension 3.2)

Economies need to develop more comprehensive financing options for businesses to support sustainable economic growth and boost the resilience of the financial sector. They should particularly target enterprises more likely to be under-served by the banking sector.

The WB6 average has improved its scores for all four comparable indicators since the last assessment (Table 6.5), with the most progress made in regulations on factoring and leasing policies. For instance, Montenegro and Kosovo both established specific regulations concerning factoring in 2018, while Republika Srpska adopted a new Law on Factoring in 2020. Four of the economies have also implemented comprehensive laws on leasing since the last assessment.

### Table 6.5. Scores for Sub-dimension 2: Access to alternative financing sources

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 3.2: Access to alternative financing sources | Factoring | 3.5 | 3.5 | 3.5 | 2.5 | 4.0 | 4.0 | 3.5 |
| | Leasing | 3.5 | 4.0 | 4.0 | 3.5 | 3.5 | 4.0 | 3.8 |
| | Private equity and venture capital | 1.0 | 1.0 | 1.5 | 1.5 | 2.0 | 2.0 | 1.5 |
| | Business angel networks | 0.0 | 0.0 | 1.0 | 1.0 | 1.0 | 1.0 | 0.7 |
| | Crowdfunding | 0.0 | 0.0 | 0.0 | 0.5 | 1.0 | 0.0 | 0.3 |
| | Blockchain – Initial coin offerings | 4.0 | 1.0 | 1.0 | 0.5 | 1.0 | 4.0 | 1.9 |
| **Sub-dimension average score** | | 2.0 | 1.6 | 1.8 | 1.6 | 2.1 | 2.5 | 1.9 |

Note: The sub-dimension average score is not directly comparable to the 2018 assessment due to the introduction of crowdfunding and initial coin offering indicators, as well as the removal of access to stock markets.

### *Despite legislative improvements, factoring and leasing services remain underused*

Factoring and leasing are alternative asset-based financing instruments that allow small businesses to access to finance when they struggle to meet banks' collateral or credit history requirements. Unlike bank financing options, factoring enables immediate liquidity for SMEs in urgent need of cash flow to keep their businesses running or growing by bypassing traditional loan obligations that are typically inaccessible for SMEs. Due to the overall difficulty of SMEs in the region to fulfil high collateral and credit worthiness requirements, factoring and leasing can help growing businesses access asset-based financing and manage cash flow volatility.

Factoring and leasing services remain under the auspices of the central banks in each WB6 economy except North Macedonia, where it falls under the supervision of the Ministry of Finance, and Bosnia and Herzegovina, where it falls under the entity agencies.[9] In Serbia, the factoring law is under the auspices of the Ministry of Finance, while supervision is divided between the Ministry of Finance, which oversees factoring services performed by factoring companies, and the National Bank of Serbia, which oversees factoring services performed by banks. All WB6 economies possess legal frameworks to regulate factoring options except North Macedonia, which has no dedicated law on factoring. Montenegro and Kosovo, with assistance from the EBRD, developed dedicated laws on factoring in 2018 that cover general requirements for factoring and outline the legal treatment of factoring services. North Macedonia was also supported by the EBRD to draft amendments to existing legislation covering factoring in detail; however, the process has been postponed due to the COVID-19 pandemic. The Albanian Government has also put in place several incentives to promote the use of factoring. Despite this progress, factoring penetration remains insignificant in the region, at 1.6% of GDP compared to an average of 7.6% in EU countries (EUF, 2021[11]).

Leasing services are regulated under dedicated legislation in all economies. Legislation generally covers clear definitions and lessors' ownership rights, as well as how the process should be instigated, the steps to follow and guidance on any required involvement of third parties. The vast majority of leasing profiles in most WB6 economies is concentrated on personal and working vehicles (over 70%), followed by machinery and equipment (roughly between 15% and 40% except in North Macedonia, where work equipment accounts for less than 1%).

Although leasing options remain severely underused in the region, despite functioning legal frameworks, the use of leasing services has grown substantially over the last few years. In Serbia, at the end of 2020 total leasing assets had increased by 66.8% since 2013, reaching approximately EUR 981 million. In North Macedonia, leasing assets increased by 24.4% between 2017 and 2019 to reach around EUR 165 million. Albania has also seen a rise in leasing volumes from around ALL 5.91 million (Albanian lek, around EUR 48 000) in 2015 to ALL 8.85 million (around EUR 72 000) in 2019. However, despite these improvements, leasing volumes remain below potential in the Western Balkans at less than 1% of GDP, compared to 1.7% of GDP on average in EU countries (OECD et al., 2019[1])

### *Most WB6 economies lack dedicated regulatory frameworks for private equity and venture capital*

Private equity and venture capital investors offer a unique opportunity for SMEs to access alternative finance options. They are particularly relevant for SMEs focused on innovative projects or technology-based businesses with strong growth potential that often face challenges in accessing traditional banking sources. Private equity and venture capital funds can provide young firms with managerial expertise and network contacts and have the unique ability to provide SMEs with large sums of long-term financing for novel products, technology or projects that have a higher risk of return. As these types of business often require significant capital rapidly to cover start-up and manufacturing costs, private equity and venture capital funds allow SMEs to be strong competitors in the market.

Private equity and venture capital investments in WB6 economies are generally in the early stages of development. While private equity and venture capital markets are virtually non-existent in Albania and Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro and Serbia are more actively using the Enterprise Innovation Fund, which is a stand-alone venture capital fund covering the Western Balkans region (see Box 6.2). Although there is no regulatory framework in Kosovo and North Macedonia, the FBiH, RS, Montenegro and Serbia regulate some aspects of private equity and venture capital investments through general legislation, which is at varying stages of development. For instance, in Montenegro the 2018 Law on Investment Funds allows private equity and venture capital groups to be established as specialised investment funds, and provides basic provisions regarding rules on the methods for determining net asset values and detailed requirements for investors.

#### Box 6.2. Venture capital fund for the Western Balkans: The Enterprise Innovation Fund

The Enterprise Innovation Fund is an equity investment fund that constitutes Western Balkans Enterprise Development and Innovation Facility's (WB EDIF) Equity instrument pillar. It is a stand-alone venture capital fund, managed by South Central Ventures (SCV), with EUR 41.4 million available for investments in innovative SMEs in the Western Balkans. The fund focuses on early stage high-growth companies mainly in the technology sector. SCV offers seed funding of up to USD 100 000 per company, while StartLabs offers up to USD 50 000 for an equity stake of 10-15%. Eleven Ventures is based in Bulgaria, but also invests in Serbia with pre-seed funding of up to EUR 100 000 for an equity stake of 10-12%. The Enterprise Innovation Fund (ENIF) offers tickets ranging from EUR 500 000 to EUR 1.5 million of early stage and growth investments per company; Eleven Ventures also offers additional funding. All companies offer mentorship to the companies they invest in and connections to boosters, angel investors and venture capital internationally. Eleven Ventures also acts as an accelerator. By December 2020, ENIF's portfolio was composed of 28 active companies, out of which 1 is later stage, 3 are growth, 17 are start-ups and 7 are seed capital investments (for a total disbursed directly from the fund of around EUR 30 million). The focus of the SCV team has gradually shifted from intensive pipeline building towards portfolio management and the identification of exit opportunities for some of the earlier investments. In the last quarter of 2020, the ENIF team was focused primarily on monitoring portfolio companies and intensively working with those raising additional funds following the first round of investments.

Source: (World Bank, 2019[12]), *Serbia New Growth Agenda: Financing for Growth*, https://pubdocs.worldbank.org/en/358601577293558709/SRB-CEM-Financing-for-Growth-wg.pdf; (WB EDIF, 2019[13]), *WB EDIF Annual Report*, http://www.wbedif.eu/wp-content/uploads/2020/05/WB_Edif_AR_2019.pdf. (WB EDIF, forthcoming[14]), *WB EDIF 2020 Annual Report*.

Serbia has made progress in providing a clear regulatory framework for private equity and venture capital investors under the Law on Alternative Investment Funds, which came into effect in May 2020, and by-laws

enacted by the Securities Commission. The legislation covers the manner of investment and the instruments in which alternative investment funds may invest. It also covers restrictions, types and timeframes for member and shareholder subscriptions, restrictions on investment, calculation of subscriptions, and the determination of relevant costs.

### *Business angel networks are increasingly being used in WB6 economies*

Business angels, individuals with business or managerial experience who invest personal funds in enterprises at early and risky stages, are a crucial component of alternative financing sources as they provide first rounds of equity capital to SMEs (OECD, 2016[15]). Business angels are different from other types of alternative financing as they offer additional benefits to entrepreneurs and small businesses such as mentoring, business, advice and access to networks. These added benefits can be of significant help for innovative firms and start-ups and help to address financing gaps for activities and projects where traditional financing options have proven particularly difficult to attain.

Business angel networks are relatively active in Kosovo, Montenegro, North Macedonia and Serbia; however, as shown in Table 6.6, their financial contribution to the economy remains limited. The region recorded the highest number of investments (47) in 2018, representing a total value of EUR 4.6 million. North Macedonia is the only economy that recorded a constant decrease in terms of value between 2016 and 2019 (around 96%), while Montenegro recorded an increase of 2020% between 2017 and 2019. In 2019, Serbia recorded four business angel investments totalling EUR 310 000, breaking a gradually increasing trend between 2014 (EUR 1.8 million) and 2018 (EUR 2.5 million) (EBAN, 2017[16]).

**Table 6.6. Business angel activity in the Western Balkans**

| | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|
| | Total investment (EUR million) | Number of investments | Total investment (EUR million) | Number of investments | Total investment (EUR million) | Number of investments | Total investment (EUR million) | Number of investments |
| KOS | 0.5 | 12 | 0.68 | 15 | 0.25 | 15 | .. | (15) |
| MKD | 1.4 | 11 | 0.15 | 1 | 0.25 | 2 | 0.06 | 2 |
| MNE | .. | .. | 0.1 | 2 | 1.55 | 10 | 2.12 | 3 |
| SRB | 2.3 | 21 | 2.44 | 22 | 2.55 | 20 | 0.31 | 4 |
| Total | 4.2 | 44 | 3.37 | 40 | 4.6 | 47 | 2.49 | 9 (24) |

Note: No business angel investments recorded in Albania and Bosnia and Herzegovina. No business angel investment recorded in Montenegro in 2016. No data on the total invested amount available for Kosovo for 2019. For 2019 for Kosovo the number of investments is an estimation.
Source: (EBAN, 2019[17]), *Statistics Compendium: European Early Stage Market Statistics*, https://www.eban.org/wp-content/uploads/2020/12/EBAN-Statistics-Compendium-2019.pdf; (EBAN, 2017[16]), *2017 Annual EBAN Statistics Compendium*, http://www.eban.org/2017-annual-eban-statistics-compendium/.

In all WB6 economies where business angel networks are active, there are no initiatives to establish legal frameworks for defining and regulating business angels. Support for business angel investment was included in Serbia's recently expired Development Strategy and Action Plan 2015-2020, but no measures have been developed since the previous assessment.

There continue to be no business angels operating in Bosnia and Herzegovina and Albania. While some small initiatives exist in Republika Srpska, such as the Innovation Centre Banja Luka, which is a full-time member of the European Business Angels Network (EBAN),[10] no activity could be identified over the assessment period. For the most part there are no planned initiatives to expand or develop the business angel networks in either economy.

### *Several WB6 economies are developing laws and programmes to regulate crowdfunding*

As a relatively new form of alternative financing, crowdfunding brings together vast networks of people through social media and platforms to connect entrepreneurs with interested investors from the general public, beyond those established through venture capitalists and private institutions. Crowdfunding offers funding without traditional rigorous and unfeasible financing prerequisites, and encourages innovative ideas and initiatives that might otherwise be impossible to realise when relying solely on traditional financing methods. In addition to being a strong marketing tool, crowdfunding platforms allow investors to provide entrepreneurs with insight and information on their ideas.

Crowdfunding continues to be in the early development stages in the region, with most economies reporting no activity in this regard. None of the WB6 economies have dedicated laws concerning crowdfunding, and Montenegro remains the only economy to regulate crowdfunding activities under general financial laws, albeit with several gaps in terms of coverage. However, the development of crowdfunding regulatory frameworks and initiatives to encourage this type of financing is under way in several economies.

The National Bank of Serbia is in the process of drafting a law on crowdfunding that would regulate the conditions and manner of providing group financial services in line with the European Commission's regulation for crowdfunding service providers.[11] Similarly, Montenegro is in the project phase of a potential dedicated crowdfunding law under the Danube Transnational Programme; however, no concrete date had been set at the time of drafting. Kosovo and North Macedonia are also developing initiatives to encourage crowdfunding. In co-operation with the EBRD, Kosovo is developing a donation/reward-based system to support start-ups, which is expected to be launched in 2021, and the Macedonian Stock Exchange has established co-operation with a foreign crowdfunding platform, Funderbeam, to promote and guide businesses and help them become suitable for listing on the stock exchange.

### *Initial coin offerings are nascent, with few economies regulating crypto-assets*

Policy makers have an interest in raising awareness and enhancing the uptake of initial coin offerings (ICOs) by SMEs and entrepreneurs as this may lead to overcoming longstanding size-related constraints in accessing markets and finance, higher productivity and more competitiveness (OECD, 2019[18]). More specifically, digital assets operating under the blockchain technology can offer SMEs easier access to finance and avoid cash flow issues through tools such as smart contracts that automatically enforce payment contracts, strong security benefits to protect small businesses, and resilient supply chains with transparent audit trails. ICOs, much like initial public offerings (IPOs, see below), can raise funds related to a specific project, company or asset; for example, companies looking to raise money to create a new coin, application or service may launch an ICO.

Albania has adopted dedicated legislation that specifically covers cryptocurrencies and the regulation of blockchain technology. Serbia has adopted a law governing digital assets (including virtual currencies and digital tokens) that is based on a technology-neutral approach, which means that the provisions of the law applies to all digital assets regardless of the underlying technology, including stable digital assets. Both economies have established or expanded their regulations since the last assessment, with competencies falling under their financial supervisory authorities, as well as the National Agency of Information Society in Albania. The laws in both economies regulate the issuance, purchase, selling, transfer and exchange of digital currencies. The Albanian law also regulates the financial infrastructure through which these currencies are transacted.

Albanian legislation also requires the publishing of a prospectus or white paper[12] for security token offerings and ICOs, and provides a clear definition of the responsibilities of the issuer. It also provides additional protection for investors by stating that the Albanian Financial Security Authority has the power to impose administrative sanctions or send cases to prosecution for breaches of the Albanian penal code. The Serbian Law on Digital Assets regulates the initial offering of digital assets and the publishing of a

white paper. It also prescribes the obligations for issuers in this process and establishes a supervision mechanism over the digital assets' issuance. Both regulations are in line with the prevention of money laundering and terrorism financing FATF[13] recommendations.

The central banks of Bosnia and Herzegovina, North Macedonia and Serbia have all issued public warnings on the risks associated with the use of cryptocurrencies. North Macedonia is the only WB6 economy to discourage the use of cryptocurrencies and blockchain technology. However, since 2019, when it entered the second phase of its Stabilisation and Association Agreement, residents of North Macedonia have been allowed to invest in foreign securities and foreign real estate, but they are still generally not allowed to open foreign bank accounts, except for some specific exceptions in accordance with the National Bank of the Republic of North Macedonia (NBRNM) by-law, which makes the legality of investment in crypto-assets unclear. No activity has been reported in Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia regarding initial coin offerings based on blockchain technologies.

### *The way forward for access to alternative financing sources*

- **Support the market penetration of factoring and leasing**. Although all WB6 economies already have a legal framework, there is room to increase the contribution of factoring and leasing to the economy. This could be done by increasing awareness-raising programmes and providing incentives to smaller firms.
- **Continue efforts to build a business environment with diverse financing sources**. Given the limited success in attracting venture capital in the region, supporting crowdfunding by adopting dedicated legal frameworks could be a more feasible approach.
- **Consider reviewing business angel networks.** A comprehensive assessment of existing business angel investments could help WB6 governments better capture the requirements and needs of business angel networks. Additional policy tools could be deployed to promote further interest in such networks, including tax incentives.

## Mobilisation of long-term financing (Sub-dimension 3.3)

Policies to mobilise long-term savings and use them to finance infrastructure investment by long-term institutional investors can contribute to bridging the financing gap of such investments. This needs to be accompanied by the development of capital markets and appropriate financial instruments for encouraging both debt and equity financing. This section maps the legal and regulatory framework that enables governments to mobilise funds for infrastructure investments. It then assesses access to capital markets by exploring the availability of sources to mobilise long-term capital around the two main asset classes: bonds and equities.

Serbia is the most advanced economy in terms of access to capital markets (Table 6.7). All Western Balkan economies except Kosovo have achieved a similar level of development, with scores converging. Albania lags behind due to the nature of its security exchange market, and Kosovo's performance is directly linked with the absence of a stock market in the economy.

## Table 6.7. Scores for Sub-dimension 3.3: Mobilisation of long-term financing

| Sub-dimension | Qualitative indicator | | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|---|
| Sub-dimension 3.3: Mobilisation of long-term financing | Access to long term financing: public-private partnerships | | n.a | | | | | | |
| | Access to capital markets | Institutional investors and asset management | n.a | | | | | | |
| | | Access to stock markets | 2.5 | 3.0 | 0.0 | 3.5 | 3.5 | 3.5 | 2.7 |
| | | Access to bond markets | 2.0 | 3.0 | 1.0 | 3.5 | 3.5 | 4.0 | 2.8 |
| | **Sub-dimension average score** | | 2.3 | 3.0 | 0.5 | 3.5 | 3.5 | 3.8 | 2.8 |

### *There are legal frameworks for public-private partnerships, but they are rarely used*

Access to long-term financing is key to infrastructure investment. Even before the COVID-19 crisis, expected levels of public investment based on current trends would not have been sufficient to meet the projected infrastructure needs of the Western Balkans. Governments have a central role in driving recovery and provide the bulk of infrastructure investment, and it is crucial that they mobilise long-term capital for public infrastructure investment (OECD, 2020[19]). A well-established PPP regulatory framework harmonised with EU regulations[14] can provide useful tools to bridge infrastructure investment gaps, while ensuring value for money without undermining fiscal sustainability.

Each WB6 economy has adopted a dedicated legal framework for PPP that enables private participation in infrastructure (PPI) projects. Montenegro was the last economy in the region to adopt a dedicated PPP law in December 2019. Albania and Montenegro's regulatory frameworks are harmonised with the EU Concessions Directive,[15] and although North Macedonia's current law is not fully harmonised it respects the general principles of public procurement that cover transparency, equal treatment and non-discrimination. At the time of drafting, a new PPP law for North Macedonia was in the parliamentary validation process. In Bosnia and Herzegovina, Kosovo and Serbia the provisions of the EU Concessions Directive have not yet been transposed.

All WB6 economies have a specialised government entity that facilitates PPP programmes, but only Albania and Kosovo have a dedicated PPP unit with permanent staff that operates across sectors and establishes projects – the Concession Treatment Agency (ATRAKO) in Albania and the PPP Committee supported by the Central PPP Department in Kosovo. Both units are created under the authority of the ministries of finance.

According to an external assessment conducted by the World Bank (Table 6.8), which assesses four components of PPPs, the WB6 are performing close to CEEC-11 and OECD high-income economy averages. The region performs best regarding procurement, which concerns the activities and requirements for selecting a private partner, but there is room for improvement regarding the preparatory activities that take place prior to launching the procurement process for a PPP project.

### Table 6.8. Infrastructure development in the WB6: Performance of public-private partnerships
(0 lowest – 100 highest scores)

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average | CEEC-11 average | OECD high income average |
|---|---|---|---|---|---|---|---|---|---|
| Preparation | 65 | 45 | 54 | 51 | 30 | 48 | 49 | 56 | 53 |
| Procurement | 86 | 79 | 72 | 77 | 60 | 90 | 77 | 85 | 76 |
| Contract management | 66 | 66 | 64 | 66 | 54 | 68 | 67 | 70 | 66 |
| Unsolicited proposals | 75 | 67 | not regulated | not regulated | 50 | 67 | 65 | 75* | 72 |

Note: CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. *The average covers Bulgaria, Lithuania and Slovenia.
Source: Based on the (World Bank, 2020[20]), *Benchmarking Infrastructure Development 2020: Assessing Regulatory Quality to Prepare, Procure, and Manage PPPs and Traditional Public Investment in Infrastructure Projects*, https://openknowledge.worldbank.org/handle/10986/34608.

Despite increasing PPI activity in the Western Balkans, a limited number of new contracts have been successfully concluded. In 2019, Bosnia and Herzegovina and Kosovo saw the first PPI transactions in five years, while Serbia had the highest investment amount in the region, with commitments of EUR 346 million in the first half of 2020.

### *Dedicated legal frameworks covering institutional investors exist, but the investment base is underdeveloped*

Savings generally reflect the disposable income of households, general economic conditions and the rate of poverty. Savings in financial institutions reflect the income of households plus the level of trust in these institutions. The lower the rate, the lower the potential liquidity that could be used by institutional investors or asset management firms for potential local investments. Savings rates are generally low in the region (30%) compared to the CEEC-11 economies (54%). Household savings within financial institutions are even lower, at 11% compared to 33% in CEEC-11 economies (Table 6.9), which limits the liquidity in the market.

All WB6 economies except Kosovo have a dedicated legal framework regulating institutional investors. In North Macedonia, the laws on securities and investment funds that govern institutional investors also regulate market manipulation and insider trading. However, they do not clearly govern voting rights, which allows for potential conflict of interest.

Montenegro made some progress in 2018 by amending the Law on Investment and the Law on Voluntary Pension Funds, which clarified conditions such as situations where institutional investors should exercise their voting rights, prevention of conflict of interest and transparency of fees. In May 2020, Albania adopted a dedicated Law on Capital Markets that regulates institutional investors.

In Serbia, the Law on Open-End Investment Funds Subject to Public Offering and the Law on Alternative Investment Funds regulate investment funds and clearly cover transparency of fees, and the Law on Capital Markets covers the prohibition rules of insider trading and market manipulation. In Bosnia and Herzegovina, the regulatory framework falls under the entities' competences. Both FBiH and RS have adopted dedicated legal frameworks on the securities market and investment funds. The legal framework is well-developed in RS and covers the conditions for institutional investors' exercise of voting rights, conflict of interest, prohibitions related to insider trading and market manipulation. Conversely, the legal framework in the FBIH does not cover provisions such as the voting rights attached to the share held on behalf of clients, transparency of fees or prohibitions related to insider trading.

### Table 6.9. Accounts and savings held with WB6 financial institutions (2017)
(% age 15+)

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average | CEEC-11 average | OECD high income |
|---|---|---|---|---|---|---|---|---|---|
| Financial institution account | 39 | 59 | 52 | 77 | 68 | 71 | 61 | 83 | 95 |
| No account because financial services are too expensive | 27 | 3 | 23 | 5 | 5 | 3 | 11 | 8 | … |
| Saved at a financial institution | 9 | 10 | 9 | 17 | 10 | 12 | 11 | 33 | 56 |
| Saved any money in the past year | 26 | 21 | 39 | 36 | 29 | 30 | 30 | 54 | 73 |

Source: (World Bank, 2017[21]), *The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution*, https://globalfindex.worldbank.org/.

### *Open active stock markets, when in place, make limited contributions to the economy*

All WB6 economies except for Kosovo have established stock or securities exchanges. The stock exchanges of Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia are open to the public. Albania has an operational privately owned securities exchange, the Albanian Securities Exchange (ALSE), which was created in 2017 and trades only government debt. The securities exchange started trading securities officially in February 2018, and up to October 2019 the turnover was EUR 23.2 million (around 0.2% of GDP).

Overall, the contribution of stock markets to financing the economy is limited across the region. The low level of activity and liquidity in the stock markets is a barrier for companies that might want to use it to raise new capital. In July 2020, the Belgrade Stock Exchange registered a total turnover of securities of RSD 2 795.4 million (Serbian dinar, ~EUR 23.7 million; around 0.06% of GDP), from which turnover of shares totalled RSD 133.9 million (~EUR 1.1 million; around 0.002% of GDP). In July 2020, the Macedonian Stock Exchange registered a total turnover of securities of MKD 382 million (Macedonian denar, ~EUR 600 000; 0.01% of GDP), from which turnover of shares totalled MKD 344 million.

Both stock exchanges have joined the EBRD-supported SEE Link (Box 6.3). Conversely, the Montenegro Stock Exchange withdrew its application submitted in 2016, and its market capitalisation remains illiquid, with a turnover ratio of 1% in 2019 vs. 3% in 2017.

In Bosnia and Herzegovina, both entities have their own stock markets: the Sarajevo Stock Exchange (SASE) in the FBiH and the Banja Luka Stock Exchange (BLSE) in RS. Both stock exchanges joined the EBRD-supported SEE Link in 2017. In both entities, the contribution of capital markets to financing the economy is limited. In 2019, the SASE registered a total turnover of securities of BAM 144 million (Bosnian convertible mark, ~EUR 72 million), a 3.6% increase compared to 2018, from which the turnover of shares was BAM 136 million (~EUR 68 million; 94.4% of total securities). Over the same period, the BLSE registered a total turnover of securities of BAM 472 million (~EUR 236 million), an increase of 10.3% compared to 2018, from which the turnover of shares was BAM 76.6 million (~EUR 39.1million; 16.2% of total securities).

#### Box 6.3. SEE Link: Connecting regional markets

SEE Link was set up in 2014 by three regional stock exchanges, the Bulgarian Stock Exchange, the Croatian Stock Exchange and the Macedonian Stock Exchange, with the support of the EBRD. It aims to integrate regional markets using technology rather than mergers or acquisitions. It has provided investors with easier and more efficient access to markets through a local broker. Since the launch of the network, five more stock exchanges have joined, including two from Bosnia and Herzegovina, Slovenia's Ljubljana Stock Exchange, the Belgrade Stock Exchange, and the Athens Stock Exchange.

This regional collaboration among the stock exchanges could enhance stock market liquidity in the participating economies; however, challenges for market operators include the different legal and regulatory frameworks, the lack of a central securities depository link and the different currencies, which limit more intense trading activity on this platform.

Indices were introduced in 2016 and have performed well. In roughly the first six months of operation, the SEELinx index increased by 14.41% and the SEELinx EWI index by 1.98%. As of April 2021, there had been a 57.09% increase in performance for SEELinx and a 46.49% increase for SEELinx EWI, since 2016 year-on-year. The indices were originally composed of the 10 most actively traded regional companies. The number of index components increased to 18 after the Banja Luka and Sarajevo Stock Exchanges joined in 2017.

Source: (SEE LINK, 2021[22]), *SEE Link homepage*, http://www.see-link.net/.

### *Initial public offerings are underused as a way of raising capital for the private sector*

All WB6 economies with active stock markets have different listing rules for equity listings. In Montenegro, the law on capital market details how listed companies should submit their financial reports to the Capital Market Authority (CMA) on a quarterly basis. All submitted reports are publicly available on the CMA website. However, the stock market is static with no IPOs. Consequently, SMEs do not perceive it as a potential source of alternative financing (see Box 6.4 on raising awareness in OECD member states).

Regarding admission to trade, on the Belgrade Stock Exchange an issuing company may apply for one of three listing segments: prime listing, standard listing or smart listing. However, there has been only one IPO in recent decades, which involved shares of Fintel Energy being included as a prime listing. After the successful completion of the IPO, the company's stocks started trading on 20 November 2018, representing an approximate total value of RSD 755 million.

Concerning the listing of companies in North Macedonia, the law clearly details requirements for issuers and lists flexible requirements for smaller companies. The listing rules of the Macedonian Stock Exchange defines four categories under the market that represent listed securities (super listing, exchange listing, mandatory listing and listings of small joint stock companies). Only one IPO has taken place since 2018 with a value of MKD 575 million (around EUR 9.3 million), but the secondary public offering (SPO) market was slightly more active. Since 2018 there have been two SPOs of shares, representing MKD 320 million (around EUR 5.2 million).

In Bosnia and Herzegovina, the legal frameworks for capital markets are aligned in both entities. The listing procedures for companies operating in both entities are clearly defined in their respective laws on securities markets and are organised on the same regulatory principles; however, neither entity offers a separate market for low capitalisation firms.

#### Box 6.4. Awareness-raising campaigns for capital market participation in OECD member states

Awareness-raising campaigns aim to share knowledge and information on the benefits of accessing capital markets for SMEs through informative platforms, public seminars, conferences, IPO summits and workshops. Increasing awareness of the procedures and advantages of issuing financial products eases the process of issuing stocks or bonds for enterprises and increases the likelihood of SME participation in capital markets. Several OECD member states have successfully launched initiatives to inform SMEs about the benefits of accessing capital markets as a financing instrument for their growing businesses.

In 2012, under the National Plan for Financial Education, the Banco de Portugal, the Portuguese Securities Market Commission and the Insurance Institute of Portugal jointly launched the **Todos Contam Portal**, a platform aimed at promoting the financial education of the Portuguese population and new businesses. The portal provides information on access to finance for SMEs through the capital market, highlights the circumstances under which a new or growing company would benefit from capital market inclusion, and informs SMEs of the risks associated with this type of financing.

In Mexico, **The Bolsa Mexicana de Valores** (the Mexican Stock Exchange) has launched a digital interactive tool to inform SMEs of the costs and benefits of seeking financing through the capital market, and guides businesses through the process of listing their company on the Mexican Stock Exchange. The platform provides information on available financing instruments and equips users with registration forms, helps with implementing an effective corporate governance model and International Financial Reporting Standards, guides businesses through working with brokerage and rating firms, and provides information on maximising sales, promoting securities and securities maintenance.

The Spanish National Strategy for Financial Education has established a dedicated website, **Finanzas para Todos**, to provide educational tools to better equip entrepreneurs and SMEs with the financial literacy necessary to further SME opportunities for growth. The initiative covers the advantages of using capital markets and stock exchanges as a source of financing from both investor and business perspectives. The State Agency for SMEs in Spain regularly organises working seminars on the convenience of developing SME access to capital markets for stakeholders from academia and private and public sector institutions.

Source: (OECD, 2020[23]), *Capital Market Review of Italy 2020 Creating Growth Opportunities for Italian Companies and Savers*, https://www.oecd.org/corporate/ca/OECD-Capital-Market-Review-Italy.pdf; (OECD, 2020[24]), *OECD Capital Market Review of Portugal 2020 Mobilising Portuguese Capital Markets for Investment and Growth*, https://www.oecd.org/corporate/OECD-Capital-Market-Review-Portugal.htm; (National Plan for Financial Education, n.d.[25]), *National Plan for Financial Education homepage*, https://www.todoscontam.pt/pt-pt.

### *WB6 economies have markets of bonds, but they are shallow and illiquid*

All WB6 economies have a regulatory framework in place for bond markets, and their scope is heterogeneous. In Albania, there are no legal restrictions with respect to the offering of bonds to the public, but in practical terms the bond market consists only of bonds issued for corporate private placement. Kosovo presents a more restrictive approach than other WB6 economies for potential investors. Only the primary market of government bonds is available and only banks can invest in these bonds. Other non-financial corporates do not have access to the bond market.

As described above, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia have active stock markets, which *de facto* broadens the scope of their corporate bond markets. In 2018, Serbia had the biggest bond market in terms of value, followed by Bosnia and Herzegovina. Conversely, in North Macedonia and Montenegro the markets remained shallow, with two and one government bonds, respectively, listed in 2018 (Table 6.10).

### Table 6.10. Number and value of bonds listed in WB economies with active stock markets (2018)

| | BIH | | MNE | MKD | SRB |
|---|---|---|---|---|---|
| | FBiH | RS | | | |
| Number of government bonds listed | 4 | 7 | 1 | 2 | 60 |
| Number of corporate bonds listed | 1 | 6 | .. | 0 | 0 |
| Value of government bonds listed (EUR million) | 372 | 90 | 145 | 55 | 4 284 (+8 885 million dinar) |
| Value of corporate bonds listed (EUR million) | 9 | 0.7 | 14 | 0 | 0 |
| Outstanding corporate bonds to GDP (%) | .. | 0.259% | .. | 0.0094% | 0% |

Note: Albania and Kosovo were not included due to the nascent nature of both their capital markets. Kosovo has no stock exchange and in 2018 in Albania there was a limitation on the exchange to trade only government securities, which was removed in 2019. This made both economies unequitable for statistical comparison. In Serbia, both dinar and euro denominated bonds are listed on the Belgrade Stock Exchange, therefore the value of +8 885 represents the bonds traded only in local currency.
Source: OECD calculation based on information collected from statistical offices; (EBRD, 2020[26]), *Effectiveness and Efficiency of Debt Capital Markets – A Comparative Study*, http://www.ebrd.com/documents/local-currency-and-cap.-markets/effectiveness-and-efficiency-of-debt-capital-markets-a-comparative-study.pdf.

### *The way forward for the mobilisation of long-term financing*

- **Promote access to equity capital through the stock market.** The low level of activity and liquidity in the stock market is a barrier for companies that could use it to raise new capital. To stimulate capital market development, WB6 governments could encourage listing state-owned enterprises, such as the example of the Ignitus Group in Lithuania (Box 6.5), to help obtain critical stock market size and visibility among international institutional investors. To increase the attractiveness of the domestic stock market, the WB6 governments could consider introducing a tax credit system for costs related to initial listings, as well as secondary equity offerings by already listed companies. Such a system would allow companies to deduct listings costs, including any advisory service costs, from the corporate income tax payable up to a certain amount.
- **Consider strengthening connectivity in the region**. The lack of depth in the existing stock markets and the small market sizes are limiting the potential contribution of the stock markets to the development of businesses. Strengthening the use of the SEE Link could help to increase the liquidity of the markets in the long term and would provide more certainty and security to foreign investors.

### Box 6.5. Listing a state-owned enterprise on the stock exchange: Ignitus Group in Lithuania

Ignitus Group is a Lithuanian state-owned international energy company focusing on renewable energy transitions. It is one of the largest energy groups in the Baltic region. In October 2020, the previously fully state-owned group was listed on the Nasdaq Vilnius and London stock exchanges. Ignitus Group's IPO became the largest transaction in the Baltics in several decades, with EUR 450 million of primary capital raised by offering 26.9% of shares and global depository receipts to institutional and Baltic retail investors.

Ignitus Group's IPO has already proved beneficial to Baltic capital markets, with a 70% increase in Nasdaq Baltic turnover in 2020 and a doubled increase in turnover on the Nasdaq Vilnius market, making Ignitus shares the most traded and accounting for 35% of the total increase on the Vilnius stock exchange. Priority investments were given to high-quality and local investors, with approximately 9% of shares allocated to long-term investors and remaining shares going to retail and other hedge funds. The group's IPO attracted strong interest from the Baltic states as well as international Nordic, European and other international institutional investors, with the largest minority shareholder the EBRD, with a 4% ownership.

According to a statement of the Lithuanian Ministry of Finance, the attracted funds will help with the implementation of the National Energy Independence Strategy by promoting green energy production and ensuring energy security and self-sufficiency. As the Bank of Lithuania requires a prospectus for listings on the Vilnius stock exchange, in line with international best practices, Ignitus Group published a document that included information on risk factors, the offering, payment policies and corporate government strategies.

Source: (EBRD, 2020[27]), *EBRD Board Report: Ignitus Group IPO*, https://www.ebrd.com/what-we-do/project-information/board-documents/1395294375006/Ignitis_Grupe_IPO.pdf?blobnocache=true; (Ignitis Group, 2020[28]), *Press Release: Ignitis grupė completed the largest IPO in the Baltic States*, https://ignitisgrupe.lt/lt/ignitis-grupe-ivykde-didziausia-baltijos-salyse-ipo.

### Box 6.6. Access to finance in the Common Regional Market

The following key findings of the CO2021 access to finance, mobilisation of long-term financing sub-dimension can inform the implementation of the actions related to the regional trade and innovation components of the Common Regional Market (CRM) 2021-24 Action Plan:

- Regarding long-term financing, each economy has adopted a dedicated legal framework for PPP that enables PPI projects. Each economy also has a government body that facilitates PPP programmes.
- Access to alternative financing sources for start-ups and early-stage innovation enterprises remains underutilised in the region, with limited regulatory coverage in existing legislation. However, the use of business angel networks in WB6 economies has been increasing since 2016.

Although most WB6 economies continue to be absent from the credit support landscape, all have established or enhanced their national credit guarantee schemes in response to COVID-19, with Bosnia and Herzegovina, North Macedonia and Serbia also opening donor-based credit lines in partnership with donor institutions.

## Conclusion

Overall, the Western Balkan economies have made progress in improving access to finance. The assessment found that the legal and regulatory frameworks put in place perform relatively well, but that the region's private sectors continue to suffer from high collateral requirements imposed by the banking industry, which dominates the financial sectors.

The region's stock market and business angel networks have become slightly more active since the last assessment and the economies have made some progress in updating the legislative framework for institutional investors, crowdfunding and factoring. They have also increased asset registration.

Despite this progress, further efforts towards ensuring better access to finance will be crucial to support private sector development, especially in the post-COVID-19 recovery climate, and will likely entail the successful implementation of the recommendations set out in this chapter. The region still needs to adapt collateral requirements to the needs of businesses, while ensuring financial stability for banks. Moreover, despite an existing framework for alternative financing tools, such as factoring and leasing, WB6 governments need to take full advantage of these alternative tools.

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World Bank (2017), *The Global Findex Database: Measuring Financial Inclusion and the Fintech Revolution*, World Bank, Washington DC, https://globalfindex.worldbank.org/. [21]

## Notes

[1] The Central and Eastern European Countries (CEEC) are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] This falls under the competence of both entities. In the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS), the law on foreign exchange operations encourages local currency lending. Banks are not allowed to lend in foreign exchange to a resident, except to enable a resident legal person or entrepreneur to pay for imported goods and services. For the governance structure of Bosnia and Herzegovina please refer to (Scope and methodes)

[3] Basel II is an international business standard developed prior to the 2008/09 crisis by the Basel Committee on Banking Supervision. It requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.

[4] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks' risk management.

[5] The Internal Capital Adequacy Assessment Process (ICAAP) allows firms to assess their capital adequacy and requires them to have appropriate risk management techniques in place. For more information: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.icaap_guide_201811.en.pdf.

[6] Under ICAAP requirements a bank needs to have in place internal procedures and processes to ensure that it possesses adequate capital resources in the long term to cover all of its material risks. These processes and procedures together are known as the Internal Capital Adequacy and Assessment Process (ICAAP).

[7] Cadastres are defined as a comprehensive register of the real estate or real property's metes and bounds of an economy.

[8] For further information: https://ec.europa.eu/growth/access-to-finance/cosme-financial-instruments_en.

[9] In FBiH, supervision over the performance of factoring activities is entrusted to the Banking Agency of the FBiH. In Republika Srpska supervision is divided, with the Banking Agency of Republika Srpska supervising banks performing factoring activities, and the Securities Commission supervising the factoring of companies and other factoring service providers, in accordance with the law.

[10] EBAN is the pan-European representative for the early stage investor community gathering over 150 member organisations in more than 50 countries. For more information see: https://www.eban.org/.

[11] EU Regulation 2020/1503 on European crowdfunding service providers for business adopted in October 2020

[12] A white paper is created by the founders and/or developers to guide investors with charts and technically focused information on how to addresses and solve issues that might be encountered in the chain.

[13] The Financial Action Task Force (FATF) Recommendations. As amended October 2020. The FATF Recommendations set out a comprehensive and consistent framework of measures which countries should implement in order to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction. For further information see: https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html.

[14] The analysis takes into account the EU Public Sector Directive 2014/24, EU Utilities Sector Directive 2014/25 and the EU Concessions Directive 2014/23.

[15] Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts.

# 7 Tax policy (Dimension 4)

A well-designed tax system is the cornerstone of an economic and social environment which guarantees competitiveness, innovation, investment, entrepreneurship and prosperity. This chapter assesses tax policy in the six Western Balkan (WB6) economies. It starts with a brief assessment of progress made in implementing the main recommendations from the 2018 report. It then presents the assessment framework for the tax policy dimension and reviews the main changes, and the evolution of the economies' self-assessed scoring since the last report. The chapter then focuses on three sub-dimensions. The first, tax policy framework, explores whether tax policy fosters an environment conducive to inclusive economic growth and how its design affects revenues raised, investment and competitiveness. The second, tax administration, assesses the efficiency of the tax administrations across the region. Finally, the international co-operation sub-dimension explores the extent to which the economies have engaged with the international tax community on recent international tax trends and are co-operating with each other on common tax issues. For each sub-dimension, the chapter includes suggestions to strengthen the various tax policies and their implementation, which in turn would foster the competitiveness of the WB6 economies.

## Key findings

- **Most of the WB6 economies have implemented broad response packages to combat the effects of COVID-19** on their economy and citizens, in line with measures carried out in OECD countries.
- **The average tax-to-GDP ratio has increased slightly in recent years** but remains below the OECD average, suggesting there is scope to increase tax revenue.
- **The tax mix is much more dependent on taxes on goods and services and social security contributions** (SSCs) than in OECD countries. There is scope to diversify tax revenues.
- **High SSC rates place a heavy tax burden on labour income and raise the cost of labour**. This may affect labour market outcomes, especially for low-skilled and low-income workers.
- **The WB6 economies provide an investment-friendly environment** with low corporate income tax (CIT) rates and generous cost and profit-based tax incentives. But these come at a significant revenue cost; CIT revenues are below the average for OECD countries.
- **The WB6 economies tend to place a higher tax burden on labour income than on capital income**. This creates an incentive for entrepreneurs to incorporate and receive income in the form of capital income rather than labour income, reducing tax revenues and the overall progressivity of the tax system.
- **Most taxes in the region are levied at the same rate across income levels, making them non-progressive**. The impact of the tax system on reducing income inequality is thus expected to be modest. However, a low level of progressivity does not necessarily mean a poor redistribution model – public spending should be factored in to assess the full equity implications of the economies' redistributive policies.
- **Revenues from taxes on goods and services are high despite being levied on a narrow base**. Relatively high value-added tax (VAT) registration thresholds, as well as a wide range of goods and services that are taxed at a reduced VAT rate, leave scope to broaden the VAT base.
- **The informal sector in WB6 economies is large**, meaning there is significant scope to broaden the tax base by bringing more taxpayers into the tax system.
- **The WB6 economies have strengthened their use of micro-simulation models** to assess the distributive effects of tax reforms; they also use models to forecast tax revenues.
- **Tax expenditure reporting is still weak in the region**. Most WB6 economies would benefit from the publication of a regular and systematic tax expenditure report.
- **The WB6 economies have made significant efforts to strengthen their tax administrations** since the last report.
- **Tax administrations continue to lack strong procedural safeguards guaranteeing their independence** across the region.
- **The WB6 economies have strengthened their involvement with the international tax community** in recent years and have taken significant steps to align their system with current international tax trends.
- **International proposals for a global minimum tax** arising from Pillar 2 of the OECD's Tax Challenges Arising from Digitalisation tax proposals, could have a strong impact on the economies' tax systems.
- **The WB6 economies continue to implement a worldwide taxation system** for resident corporations, in contrast to the OCED trend.

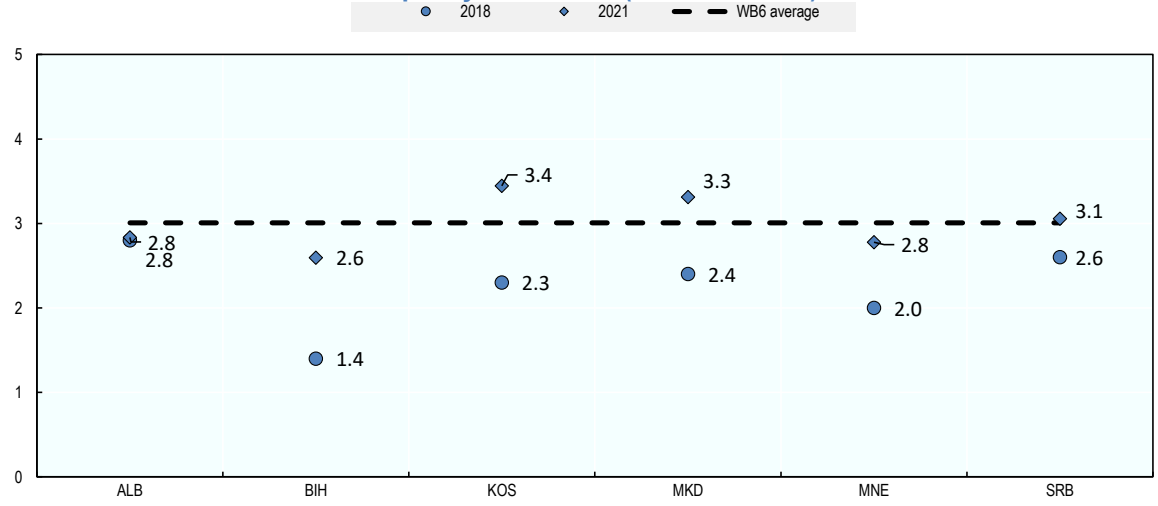
- **Tax co-operation and co-ordination remains weak** amongst WB6 economies.

## Comparison with the 2018 assessment

The average scores for the WB6 economies have increased for this dimension since the last Competitiveness Outlook (CO) assessment, from 2.3 in 2018 to 3.0 in 2021. The scores for the WB6 economies are relatively similar for this dimension overall, ranging from 2.6 for Montenegro to 3.4 for Kosovo. All the economies have improved their performance, with Kosovo seeing the most significant increase, from 2.2 in 2018 to 3.4 in 2021, while the improvement for North Macedonia was more modest, from 2.4 to 2.9 (Figure 7.1).

For the first sub-dimension (tax policies), scores range from 2.0 for Montenegro and Serbia to 3.0 for Albania and North Macedonia. The average score rose from 2.0 to 2.6, driven by significant improvements in the modelling and forecasting and tax expenditure reporting indicators. For the second sub-dimension (tax administrations), the range is from 2.4 for Bosnia and Herzegovina to 4.0 for Kosovo and the average rose from 2.4 in 2018 to 3.3 in 2021 due to relatively strong performances in the independence and transparency and taxpayer services indicators.

### Figure 7.1. Overall scores for the tax policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Assessment methodology and process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

The Competitiveness Outlook 2018 highlighted a number of policy recommendations for the WB6 economies to strengthen tax policies and administrations in the region. They are presented in Table 7.1 along with a description of the progress made and an overall progress status ranging from none to limited, moderate or advanced.

In the last report, WB6 economies were advised to strengthen their tax administrations to improve overall tax compliance and to align their tax systems with international tax trends. Advanced progress has been made in implementing both recommendations across the region, due to the significant efforts made in

these areas. The WB6 economies also strengthened their tools to assess the effects of tax policies on the economy or plan to do so in the near future, and have made moderate progress on this recommendation.

The implementation of other recommendations has been slower. Only limited progress has been made in areas such as the design of corporate tax incentives, adjusting the balance between personal income tax (PIT) and SSCs, broadening the VAT base, bringing additional workers and businesses into the tax base, and regional co-operation. No progress has been made on the remaining recommendations, with a lack of significant efforts in those areas.

## Table 7.1. Implementation of the CO 2018 policy recommendations: Tax policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Evaluate the design of corporate tax incentives** | • Albania and Serbia have reformed their corporate income tax incentives since CO 2018.<br>• Most of the economies implement a mix of cost and profit-based tax incentives. | Limited |
| **Analyse the combined impact of personal income tax (PIT) and SSCs on labour market outcomes** | • Reforms have been modest in this area: Bosnia and Herzegovina and North Macedonia plan to introduce a progressive PIT rate schedule in the near future.<br>• Overall, most of the WB6 economies have high SSC rates and low PIT rates, resulting in a tax burden on labour income that is high and not progressive. | Limited |
| **Reduce the gap between taxes on labour and capital income** | • All the WB6 economies place a higher tax burden on labour income than on capital income. The few reforms that have been carried out have not significantly reduced the gap. | None |
| **Broaden the VAT base** | • Albania and North Macedonia raised their VAT registration thresholds, while Kosovo reduced its threshold.<br>• None of the WB6 economies reduced the list of goods and services taxed at a reduced VAT rate. | Limited |
| **Develop tax policy tools to assess tax systems and their economic impacts and measure the tax revenue forgone through tax expenditures** | • Albania implemented a regular tax expenditure report in 2019, with North Macedonia planning to do so in 2021.<br>• All the economies except Kosovo, implement micro-simulation models. Albania and Montenegro started doing so in 2019. | Moderate |
| **Continue to strengthen tax administrations to improve tax collection and compliance** | • The overall score for the features of tax administration sub-dimension has increased significantly since CO 2018.<br>• Significant reforms have taken place to improve the independence and transparency of the tax administrations and the taxpayer services offered. | Advanced |
| **Bring informal workers and businesses into the tax base** | • The informal sector is estimated to be large, partly induced by the design of the tax system and its administration.<br>• Efforts directly targeted at reducing the informal sector remain limited. | Limited |
| **Bring international taxation rules in line with international best practice** | • All economies except Kosovo have joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and launched a series of initiatives on BEPS minimum standards, administrative assistance and exchange of information. | Advanced |
| **Evaluate the use of worldwide tax system and implement measures to protect the domestic tax base** | • All the WB6 economies currently implement a worldwide taxation system. No evaluation of the costs and benefits of such an approach has been carried out since CO2018. | None |
| **Strengthen co-ordination and co-operation among the economies in the region** | • All the WB6 economies are engaged in modest regional co-operation and co-ordination.<br>• No wide-scale initiatives have been launched since CO 2018. | Limited |

## Introduction

Public finances are under stress as result of the COVID-19 outbreak and the resulting global pandemic. Governments worldwide face tremendous challenges to finance their public policies and fund their welfare system, while maintaining an environment conducive to economic recovery and inclusive growth. In this context, tax policies are even more crucial. Taxes provide governments with the revenue they need to finance public expenditures. A well-designed tax system is the cornerstone of an economic and social environment which guarantees competitiveness, innovations, investment, entrepreneurship and prosperity.

Tax systems should be designed to encourage economic growth in a sustainable and inclusive way. This implies creating rules that aim to increase prosperity and productivity among citizens, which entails managing several trade-offs. Tax reforms should find a balance between fostering equity, achieving budgetary efficiency and circumventing distortive effects, while accounting for various distributional effects. Tax and benefit policies that contribute to fostering wealth redistribution will be conducive to economic growth within each WB6 economy and across the region.

A strong tax administration is necessary to achieve a well-functioning tax system. By implementing efficient management practices and transparent institutions, governments reduce compliance costs for individuals and businesses, lower administration costs, and create trust in the tax system. All these factors optimise tax collection and positively influence tax policies as a whole.

As globalisation fosters cross-border economic activity, tax systems should incorporate well-designed and comprehensive international tax rules. A high level of international co-operation and co-ordination helps governments tackle tax avoidance and reduces mismatches between tax systems. International and regional co-operation are therefore crucial for the WB6 economies to tackle base erosion and profit shifting (BEPS) practices and strengthen administrative co-ordination.

This chapter examines the extent to which WB6 economies have established competitive tax systems. The tax dimension is linked to several other policy areas examined in this report, especially:

- **Chapter 4. Investment policy.** Well-designed investment tax incentives in a sound and non-distortive tax environment are a key part of attracting investment.
- **Chapter 8. Competition policy**. Competition is strengthened by transparent and equitable tax policies that help prevent tax avoidance that gives some firms an unfair advantage over their competitors.
- **Chapter 11. Employment policy**. Tax policies can influence choices in the labour market. Labour taxation determines the difference between the total labour costs faced by employers and the after-tax wage received by employees, thus affecting labour demand and supply decisions.
- **Chapter 12. Science, technology and innovation.** Predictable tax rates and well-designed investment incentives can encourage firms to innovate.
- **Chapter 16. Environment policy.** Tax-related incentives can help reduce the environmental impact of economic activity.
- **Chapter 19. Anti-corruption policy.** A strong tax administration with robust safeguards that ensure the transparency of its policies and agents helps fight corruption.

## Assessment framework

### *Structure*

The tax dimension in the 2021 Competitiveness Outlook examines the extent to which governments have established competitive tax systems. Without seeking to be exhaustive, it considers three broad sub-

dimensions which are critical to healthy fiscal environments that favour economic growth and well-being across the population:

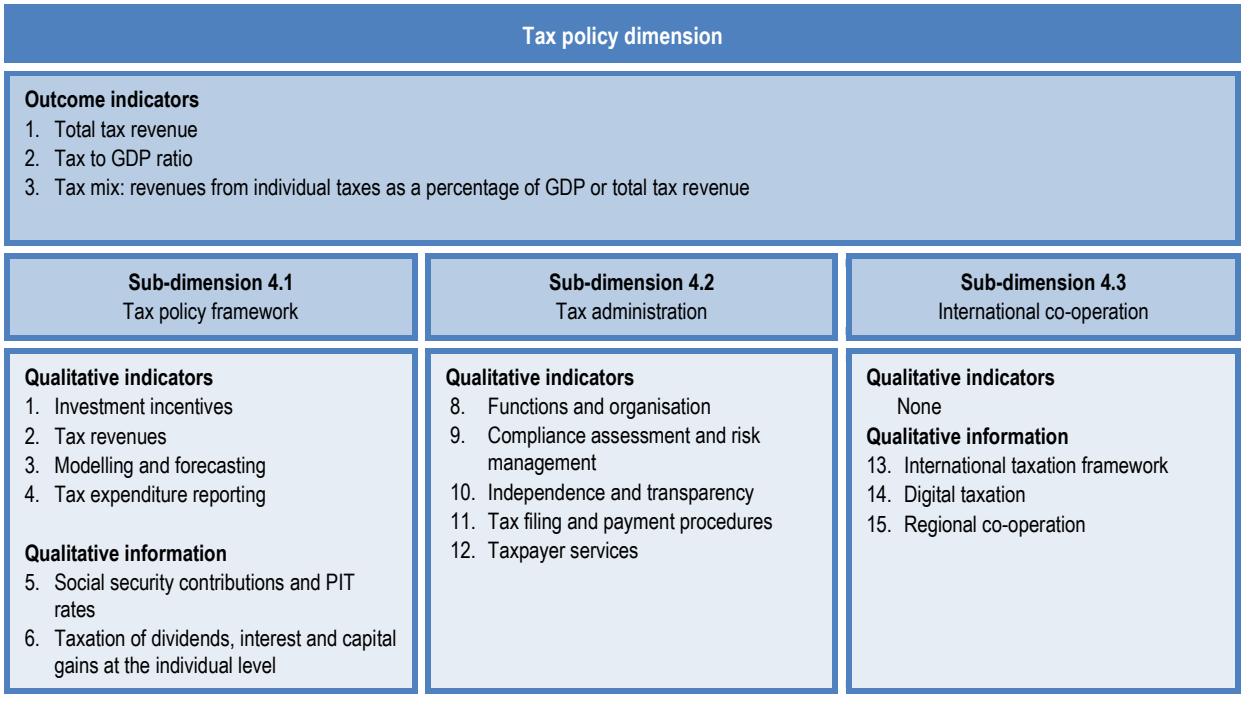
1. **Sub-dimension 4.1: Tax policy framework** focuses on how tax policy fosters an environment conducive to inclusive economic growth, how the design of tax policy affects revenues raised and how it influences investment and competitiveness.
2. **Sub-dimension 4.2: Tax administration** focuses on the different functions of tax administrations and how effective they are in ensuring tax compliance.
3. **Sub-dimension 4.3: International co-operation** focuses on how the WB6 economies co-operate with the international tax community and implement recent international tax trends, how they deal with the digital economy from a tax perspective, and how they co-operate with other economies in the region.

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders for this dimension. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. Figure 7.2 shows how the sub-dimensions and their indicators make up the tax policy dimension assessment framework. For more information on the methodology, see the Assessment methodology and process chapter.

### *Key methodological changes to the assessment framework*

In contrast to other dimensions, the tax policy assessment framework has not changed significantly since the last report. For Sub-dimension 4.1, the only significant change has been the addition of the investment incentives indicator. Sub-dimension 4.2 remains identical to CO 2018. Sub-dimension 4.3 does not include qualitative or quantitative indicators. This virtually identical assessment framework means the region's performance between the two assessments can be usefully compared.

## Figure 7.2. Tax policy dimension assessment framework



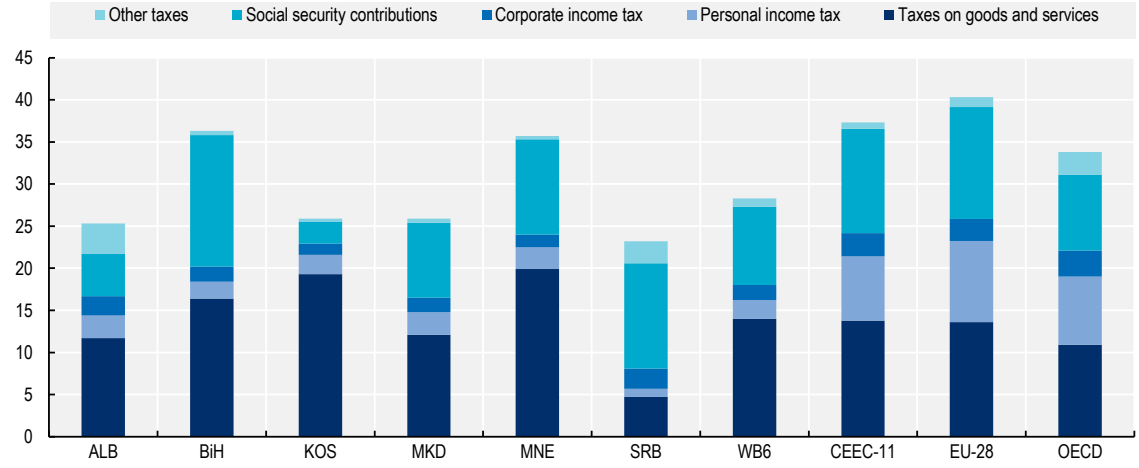
| | | |
|---|---|---|
| 7. Design and functioning of VAT and environmentally related taxes | | |
| **Quantitative indicators**<br>Statutory corporate income tax rates | | |

## Tax policy performance and context in the WB6

Tax revenues have increased as a share of GDP between CO 2018 and CO 2021. In 2019, on average, tax revenues were 30.6% of GDP, which represents a significant increase from 28.0% in 2015. The regional tax-to-GDP ratio remains below the OECD average of 33.8% in 2019, a fall from 34.3% in 2015 (Figure 7.3). The difference is even larger compared to EU countries (41.1% of GDP on average in 2019) and the CEEC-11[1] economies (34.6%).

### Figure 7.3. Tax revenues by tax type (2019)

% GDP




Note: To calculate the OECD average tax-to-GDP ratio for 2019, 2018 data were used for Australia and Japan; the CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (OECD, 2019[11]), *Global Revenue Statistics Database*, www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm; CO2021 questionnaire.

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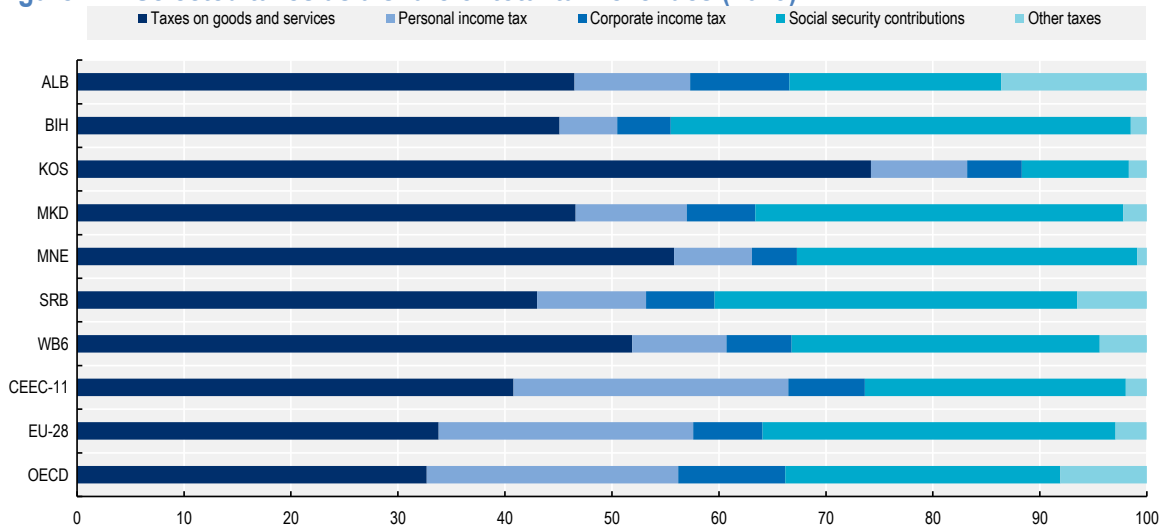
These average regional figures mask wide disparities, as both the revenue raised and the change since 2015 vary widely across the WB6 economies. Tax revenues are particularly low in Kosovo (25.9% of GDP), Albania (25.3%) and North Macedonia (25.9%), while the shares for Montenegro (35.7%), Bosnia and Herzegovina (36.3%) and Serbia (36.8%) exceed the OECD average. There are also variations in how revenues have changed since 2015. Serbia has increased its tax revenue relative to GDP by 0.6%, Albania by 1.2%, Bosnia and Herzegovina by 7%, and North Macedonia by 9.2%. In contrast the ratio fell by 0.8% in Kosovo and 1.9% in Montenegro.

The average tax mix in the Western Balkan region differs greatly from that found in OECD countries (Figure 7.4). The WB6 economies rely significantly on revenues from social security contributions and taxes on goods and services to fund their health system and public spending programmes. Together, these taxes accounted for 80.7% of total tax revenues on average in 2019, compared to the OECD average of 58.4%, the EU average of 67.9% and the CEEC average of 78.9%. The share also varies across the WB6 economies, ranging from 66.3% in Albania to 88.1% in Bosnia and Herzegovina.

Consequently, other taxes play a smaller role. Personal and corporate income taxes only account on average for 14.9% of total tax revenues in the WB6 economies, less than half the OECD average (33.5% in 2018). In some economies, such as Albania, the share is slightly higher (20.1%) but remains in broad alignment with the regional average. On average EU countries levy 29.9% of their tax revenues from these sources, and the CEEC-11 20.1%.

Most of the WB6 economies have implemented broad response packages to combat the effects of COVID-19 on their economy and citizens, in line with measures carried out in OECD countries (Box 7.1).

## Figure 7.4. Selected taxes as a share of total tax revenues (2019)




Note: To calculate the 2019 OECD averages, 2018 data were used for Australia, Japan and Mexico; the CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (OECD, 2019[1]), *Global Revenue Statistics Database*, www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm; CO2021 questionnaire.

StatLink https://doi.org/10.1787/888934253898

### Box 7.1. Tax policy responses to the COVID-19 outbreak

Governments worldwide have taken rapid and unprecedented actions to address the health crisis and the fall in economic activity caused by the outbreak of COVID-19. Containing and mitigating the spread of the virus has been a priority of public authorities. With containment measures in place, governments have focused on alleviating hardships while maintaining the productive capacity of the economy (OECD, 2021[2]).

As with OECD countries, the WB6 economies have implemented a number of tax policies to mitigate the effect of COVID-19 on their economy and citizens. Their response has been relatively heterogeneous. Some have mainly implemented tax administrative support measures, such as deferring tax payments. Others have implemented a wider response package, closely resembling measures implemented in OECD countries.

While the response measures varied in the region, some tax measures were implemented by most or all of the WB6 economies. They have all implemented tax filing or tax payment deferrals for some or all their major taxes. These measures were usually complemented with more flexible tax-debt repayments, including in some cases the suspension of interest for tax arrears. All of the WB6 economies have also implemented measures to reduce or exempt medical goods from VAT or custom duties, to make it easier for medical professionals and the wider public to access them. Serbia and Kosovo have largely limited their approach to these types of measures, although they also implemented a wage subsidy scheme and Kosovo implemented a public loan guarantee. scheme

Albania, Bosnia and Herzegovina, Montenegro and North Macedonia have introduced a wider range of measures. These include wage subsidy schemes, public loan guarantees or public loan schemes, direct cash transfers to households, loss carry-forward extensions, VAT reductions for certain economic sectors, and the deferral of fixed costs for households and businesses (notably rent or loan payment deferrals).

## Tax policy framework (Sub-dimension 4.1)

Tax policies aim to create a competitive tax environment conducive to inclusive economic growth, which raises sufficient tax revenues to finance public expenditure and ensures that the tax burden is shared fairly across the population. This sub-dimension analyses the tax policy frameworks in the WB6 economies. It includes four qualitative indicators to assess tax policy tools applied in WB6 economies: 1) investment incentives; 2) tax revenues; 3) modelling and forecasting; and 4) tax expenditure reporting. This section also looks at other types of taxes, the level of SSCs and the overall tax burden on labour income, the taxation of dividends and interests at the individual level, and key design features of the VAT system.

The average score for this sub-dimension is 2.6 (Table 7.2). For the investment incentives and tax revenues indicators, all of the WB6 economies have relatively similar scores, while for modelling and forecasting and tax expenditure reporting, their scores differ more widely.

### Table 7.2. Scores for Sub-dimension 4.1: Tax policy framework

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 4.1: Tax policy framework | Investment incentives | 3.0 | 3.0 | 2.0 | 3.0 | 2.0 | 2.5 | 2.6 |
| | Tax revenues | 3.0 | 2.8 | 3.0 | 3.1 | 2.0 | 3.0 | 2.8 |
| | Modelling and forecasting | 3.0 | 3.3 | 3.0 | 5.0 | 3.0 | 2.5 | 3.3 |
| | Tax expenditure reporting | 3.0 | 2.5 | 3.0 | 1.0 | 1.0 | 0.0 | 1.8 |
| **Sub-dimension average score:** | | 3.0 | 2.9 | 2.8 | 3.0 | 2.0 | 2.0 | 2.6 |

### *WB6 economies provide an investment friendly environment with low CIT rates and generous investment incentives, which come at a certain revenue cost*

Statutory CIT rates in the WB6 economies are low, at 11.5% on average across the region, well below the OECD average of 23.3% in 2020. Statutory rates range from Montenegro's standard rate of 9% to Albania and Serbia's rate of 15%, with Bosnia and Herzegovina, Kosovo, and North Macedonia applying a 10% rate. No major CIT rate reform has been conducted since the last report. Consequently, regional revenues from CIT only account for 1.8% of GDP on average, ranging from 1.3% of GDP in Kosovo to 2.3% in Serbia. This is below the OECD average of 3.1% in 2018. These low CIT revenues may be partly explained by the low rates and generous tax incentives, but could also be influenced by the structure of activities in the economy. The vast informal sector and high number of unincorporated small enterprises restricts the CIT tax base and could explain below-average revenues.

The WB6 economies implement a diverse set of cost and profit-based tax incentives,[2] but most either focus on profit-based tax incentives or implement a mix of cost and profit-based tax incentives. Serbia is the only economy to focus primarily on cost-based tax incentives. The economies' overall score for investment incentives is 2.6 (as this indicator was introduced for this assessment, no comparison is available). North Macedonia, Albania and Bosnia and Herzegovina scored 3, while Serbia scored 2.5 and, Montenegro and Kosovo scored 2.

Many of the profit-based tax incentives are focused on small and medium-sized enterprises (SMEs). In Albania, companies operating in software production/development, agricultural co-operatives, agritourism or the automotive industry are eligible for a reduced 5% CIT rate. North Macedonia also implements a simplified tax regime for micro enterprises based on annual turnover. Companies with annual turnover under MKD 3 million (EUR 48 700) are exempt from CIT and those with an income of up to MKD 6 million (EUR 97 400) may opt for a simplified tax regime with a 1% rate levied on their turnover, instead of the standard 10% levied on their profits. Kosovo also implements profit-based incentives through special turnover tax rates of 3% and 9% – the rate varies with the type of economic activity – applied to the gross income of SMEs in certain sectors with an annual turnover below EUR 50 000. In general, such size-based thresholds are not necessarily an effective way to support investment and may restrain growth by encouraging businesses to remain below the threshold to continue benefiting from the tax regime. They may also encourage SMEs to split into different companies, or deflate their revenues/inflate costs, to continue to receive preferential treatment. Reduced turnover-based rates also tend to penalise low profit margin businesses, which end up being taxed at higher rate than those with a lower turnover but higher profits. The design of size-based tax incentives therefore needs to be evaluated regularly and, possibly, could be replaced by other measures that reduce compliance costs for SMEs.

Other profit-based tax incentives focus on special economic zones. In Montenegro, companies investing in so-called underdeveloped areas can benefit from profit-based tax incentives. These companies are exempt from CIT for an eight-year period, provided the total amount of tax paid without the incentive would not exceed the EUR 200 000 threshold. In Albania, companies established in so-called areas of technology and economic development are exempted from 50% of their CIT liability for a five-year period. In North Macedonia, companies in special economic zones (referred to as Technological Industrial Development Zones) are exempt from CIT for up to 10 years.

Given the WB6 economies' low CIT rates, the policy rationale for generous investment incentives, particularly profit-based ones, is weak. Tax incentives increase the after-tax return of investments that would have occurred anyway, thereby yielding "windfall gains" for capital owners and investors. Tax incentives also increase costs for the tax administration, which has to monitor compliance with eligibility criteria. Research also shows that profit-based incentives can lead to a high redundancy of expenditure since the investment may have proceeded anyway, and that cost-based incentives are preferable (UNCTAD, 2015[3]).

### *Tax revenues are based on social security contributions and taxes on goods and services*

The WB6 economies raise significant tax revenues from SSCs; they accounted for 28.8% of total tax revenues on average in 2019, ranging from 10.0% in Kosovo to 43.0% in Bosnia and Herzegovina. Such a heavy reliance on SSCs can raise a number of issues. On the one hand, high SSCs can support the direct funding of the welfare system, preventing the need for social welfare funds to be funded partly from general tax revenues, which would create challenges from a budget perspective. On the other hand, high SSCs distort labour markets, especially for low-skilled, low-income or informal workers. Furthermore, as SSCs are mostly levied at the same rate across income levels, they do not contribute to making the tax system more progressive. This is the case in the WB6 economies, where high SSC rates may be having adverse effects on the labour market and are levied at flat rates rather than progressive rates, as for PIT.

Social security contribution rates are high across the region. In 2020, the average SSC rate for the WB6 economies was 28.6%, above the OECD average of 26.9%. Kosovo has a very low rate compared to the regional average (10%, but with an additional voluntary contributions of up to 20%), but apart from that, rates range from 27.9% in Albania to 41.5% in the Federation of Bosnia and Herzegovina (FBiH). These high rates partly explain the high SSC revenues in the region. These averaged 9.3% of GDP in 2019, slightly above the 9.0% OECD average (in 2018). SSC revenue varies widely in the WB6 economies, ranging from 2.6% of GDP in Kosovo to 15.6% in Bosnia and Herzegovina. Furthermore, the average employee SSC rate is 19.9% in the region, while the average rate for employers is 9.5%. This balance between employer and employee SSCs is atypical by OECD standards, as OECD countries tend to place a greater burden on the employer than on employees.

Revenues from personal income tax are low in the region, partly explained by low PIT rates and high basic allowances. Montenegro has a flat PIT rate of 9%, while North Macedonia and Bosnia and Herzegovina have a flat rate of 10%. The other economies implement a progressive rate schedule, with top PIT rates of 10% in Kosovo, 15% in Serbia and 23% in Albania. Overall, these rates remain relatively low by international standards. Among OECD countries, the average top PIT rate was 42.8% in 2020. These low rates partly explain the region's low PIT revenues, which amounted to 2.7% of GDP on average in 2019, drastically below the 8.1% average in OECD countries (in 2018). PIT revenue ranges from 2% of GDP in Bosnia and Herzegovina to 3.8% in Serbia. In some of the WB6 economies, low revenues could also be partly explained by high or rising PIT basic allowances. In Albania, the basic allowance was raised in 2019 from ALL 130 000 (EUR 1 050) to ALL 150 000 (EUR 1 215). In Serbia, the basic allowance grew from 31% since 2017. In Bosnia and Herzegovina, the basic allowance in the FBiH is 31% of the average net wage, while in the Republika Srpska (RS) it is 43%. In most of the WB6 economies the tax burden on capital income is low, which creates an incentive for entrepreneurs to incorporate and receive income in the form of capital rather than salaries. This incentive is further emphasised by the high tax burden on labour income described above.

Some WB6 economies levy higher tax rates on labour income than capital income, notably due to reduced rates or exemptions on dividend payments. In Albania, labour income is taxed following a progressive PIT rate schedule of 0%, 13% and 23% rate, while most types of capital income are taxed at 15%, with dividend income taxed at 8%. In Bosnia and Herzegovina and Kosovo, PIT on labour income is mostly levied at a 10% rate. Although some types of passive income are included in the PIT tax base and taxed at 10%, dividends and income from interest are excluded from the PIT tax base. Even where PIT rates are the same as those on capital income, high SSCs levied on labour income still drive the difference (see above).

While a differentiated taxation of labour and capital income allows for more targeted tax policies, the WB6 economies could conduct a cost-benefit analysis to understand the merits of retaining this differentiated taxation and perhaps consider reducing the wedge between capital income and labour income taxes.

The imbalance between PIT and SSCs may affect labour market outcomes, especially for low-skilled, low-income or informal workers. SSCs increase the cost of employing workers and reduce workers' after-tax earnings. In general, high SSCs are an incentive to work in the informal sector, particularly when controls by tax administrations are weak. High labour taxes may also push low-productivity workers into the informal sector or unemployment. The greater the difference between total labour cost and after-tax disposable income for workers in the formal sector, the greater the incentive for employers and employees to avoid taxes by remaining or joining the informal economy. High levels of informality in turn may negatively affect productivity, growth and trust in government institutions.

Furthermore, this imbalance means taxes on labour income are less progressive, as SSCs are mostly levied at the same rate for all income levels. The WB6 economies could explore the option of rebalancing revenue from SSCs to PIT, perhaps by introducing a progressive PIT rate schedule among those with flat rates. The three WB6 economies with progressive schedules could strengthen their design to improve their wealth redistribution impact. In Albania, despite a high top rate of 23%, effective rates can be much lower:

workers earning ALL 150 000 (EUR 1 215) (the income threshold for the top PIT rate), have an effective tax rate of only 12%. In Serbia, despite a progressive rate schedule with a top PIT rate of 15%, the majority of individuals are liable for the lower 10% rate. In Kosovo, the income threshold for the top PIT rate is placed slightly above the average wage, meaning the PIT system does not target high earners effectively.

The WB6 economies also rely heavily on taxes on goods and services, which accounted for 51.9% of total tax revenues in 2019. This ratio varies widely across the region, from 20% in Serbia to 74.2% in Kosovo. Revenues from these taxes amounted to 15.9% of GDP on average, compared with 10.9% for the OECD average (in 2018), ranging from 11.7% in Albania to 19.9% in Montenegro. Value-added tax rates are close to average levels found in OECD countries: 19.0% in the region in 2020, slightly below the OECD average of 19.3%.

OECD research has found that consumption taxes, and particularly VAT, may be less distortive on the decisions of households and firms, and thus on GDP per capita, than income taxes (Johansson et al., 2008[4]). The OECD's Tax Policy Reform and Economic Growth report, which assessed the impact of four major categories of taxes on long-run GDP per capita, ranked consumption taxes as the second least damaging, after recurrent taxes on immovable property and before other property taxes and personal and corporate income taxes (OECD, 2010[5]). Furthermore, a well-designed VAT system may encourage workers and businesses to enter the formal economy. Systems based on VAT could therefore be more conducive to economic growth than systems focused on more distortive taxes, such as CIT. However, the WB6 economies could contemplate diversifying their tax resources, notably by strengthening recurrent taxes on immovable properties or environmentally related taxes.

Two factors narrow the VAT base in the WB6 economies. First, all WB6 economies have opted for a turnover-based VAT registration threshold, which is common among OECD countries but not universal. On average, the threshold is relatively high, at EUR 42 500 in 2021, ranging from EUR 18 000 in Montenegro to EUR 81 000 in Albania. A relatively high threshold may give small businesses an advantage when in competition with larger companies, while a relatively low threshold may act as a disincentive to grow or as an incentive to split activities artificially to avoid VAT. Therefore, the threshold is often the result of a trade-off between minimising compliance and administration costs and the need to avoid jeopardising revenue or distorting competition. By setting rather high VAT registration thresholds, the WB6 economies chose to concentrate their VAT administration capacities on larger businesses. As they continue to strengthen their tax administration capacity, they may consider gradually lowering registration thresholds over time.

Second, the WB6 economies have extensive lists of goods and services which are either exempt or taxed at a reduced VAT rate. All the economies except Bosnia and Herzegovina levy reduced VAT rates: 10% in Serbia, 8% in Kosovo, 7% in Montenegro, 6% in Albania and 5% in North Macedonia. While reduced VAT rates may represent good tax policy in certain cases, many of the exemptions and reduced rates in the WB6 economies are not well targeted from an equity perspective. Only Serbia, which has a relatively broad VAT base, does not have a long list of VAT exempted goods and services. For example, all the economies exempt rents on residential properties from VAT while Bosnia and Herzegovina and Montenegro exempt any activity that can be seen to be connected to the public interest. North Macedonia exempts the cross-border transport of people. Albania and Kosovo exempt newspapers, magazines and certain other types of print media. Albania exempts certain services linked to sports, services provided by dental technicians, advertisements through electronic and written media, and some printing services. Kosovo also exempts public transport. Moreover, OECD research has found that reduced rates are generally not an effective way to target low-income individuals as it may even be regressive in certain cases (OECD, n.d.[6]).

The tax burden in the WB6 economies is borne by a small number of taxpayers. Although, by its nature it is complicated to precisely estimate the size of the informal sector, it is large in the region. According to estimates by the World Bank, the informal sector in the WB6 economies accounts for around 25-35% of

both GDP and the total working population (World Bank, 2021[7]). In comparison, informality in EU Member States averages around 15-20% of GDP. North Macedonia has the lowest estimated informal sector (less than 20% of the working population), while Kosovo has the highest (more than 35%). This raises a number of tax issues: informality limits the amount of tax revenue raised, restricts the ability of the tax system to help reduce inequalities, places a drag on economic growth and creates distortions between the formal and informal economy.

There are several options available for governments attempting to reduce the size of the informal sector and bring businesses and workers into the formal economy. These options can be divided into two categories. The first concerns tax administration measures, where governments implement simplified tax regimes for certain type of individual and businesses, or target their audit capacities on taxpayers most likely to evade taxes and operate in the informal economy. For example, Kosovo has developed a special unit within its tax administration in charge of SMEs and Albania has developed an IT risk module system based on the riskiest taxpayers to guide its audit plan. The second covers tax policies that aim to reduce the disincentive to work in the formal economy, by example reducing high SSC rates on labour income or high VAT registration thresholds. Bosnia and Herzegovina plans to lower the SSC rate from 41.5% to 32.5% in 2021, which should lower the overall cost of labour and therefore increase the incentive to register in the formal economy.

### *The WB6 economies have strengthened their use of micro-simulation models to assess the distributive effects of tax reforms on their economy*

The 2018 assessment identified the modelling and forecasting of tax revenues as an area in need of progress. Overall, the WB6 economies scored 2.3 on average for the modelling and forecasting indicator in CO 2018. The assessment found that although the economies' finance ministries maintained aggregate tax revenue forecasting models for each main tax, there was insufficient analysis of the information and a lack of micro-simulation models.

Since then, several initiatives have been carried out and good progress made, particularly in the area of micro-simulation models, with the average score for this indicator rising to 3.3. In 2018, Albania, Kosovo, and Montenegro did not use micro-simulation models at all, while Bosnia and Herzegovina, North Macedonia, and Serbia made limited use of them. Now all the WB6 economies except Kosovo are using these models. Albania and Montenegro started using them for the first time in 2019, and others have expanded their use. For example, North Macedonia developed a micro-simulation model for PIT that includes 1 million taxpayers, can carry out analysis by income groups or can estimate different type of redistributive indicator (Gini, Atkinson, etc.). Albania is also currently working with the International Monetary Fund (IMF) to develop new micro-simulation models (Box 7.2).

### *Tax expenditures are not reported in a regular and systematic way across the region*

The last assessment identified tax expenditure reporting as an area where efforts should be strengthened. The average score was 0.7 in CO 2018, the lowest score in any indicator for the tax policy dimension. This could be explained by the lack of calculation and accounting of forgone revenues due to tax expenditures in all the WB6 economies.

The score for this indicator has increased to 1.8 on average across the WB6 economies, driven by two initiatives. Albania implemented a regular tax expenditure report in 2019, which will be issued every two years. North Macedonia is currently implementing a New Organic Budget Law, taking effect in 2021. Among other things, this law aims to instigate a regular tax expenditure report. Despite these two initiatives, the use of tax expenditure reporting remains limited in the region. Some economies, such as Montenegro, collect basic statistics on tax expenditures, but this information is not made public and only used for internal government use.

Other WB6 economies should consider publishing regular tax expenditure reports, which would increase transparency and accountability. They would allow them to monitor the use and effectiveness of tax incentives along with the tax revenue forgone (OECD, 2010[8]). These reports should identify, measure and report the cost of tax expenditures in a way that enables their monetary value to be compared with direct spending programmes (IMF, 2019[9]). The economies could also conduct cost-benefit analyses to evaluate whether specific tax incentives meet their stated objectives and, if not, whether they should be abolished or replaced.

### *The way forward for the tax policy framework*

- **Continue COVID-19 support with targeted tax and subsidy measures, while focusing future efforts on measures to spark an economic recovery**. Most WB6 economies have implemented a broad response package to mitigate the effects of COVID-19 on the economy and its citizens, in alignment with measures carried out in OECD countries.
- **Avoid the use of generous profit-based tax incentives in a context of a low standard statutory CIT rate**. Instead, WB6 economies could shift the focus to cost-based tax incentives, which are less likely to lead to high redundancy of expenditure.
- **Weigh the advantages and disadvantages of a differentiated taxation of capital and labour income**. Policy makers could consider aligning tax rates to prevent negative spillover effects and reduce the incentive for entrepreneurs to incorporate and receive income in the form of capital rather than salaries.
- **Increase tax revenues and diversify the tax mix.** Half of the WB6 economies have relatively significant scope to increase tax revenues, as Albania, Kosovo and North Macedonia's average tax-to-GDP ratios remain far below the OECD average. Increasing revenues would help these economies finance their public spending programmes and healthcare systems. It could also strengthen their welfare state and help reach wealth redistribution objectives. Governments should also aim to diversify the tax mix by reducing their reliance on SSCs and taxes on goods and services and instead strengthening the role of corporate and personal income taxes, environmentally related taxes, and recurrent taxes on immovable property.
- **Rebalance the taxation of labour income away from high employer and employee social security contributions.** The current imbalance raises the cost of labour and consequently affects labour market outcomes, especially for low-income, low-skilled and informal workers. Shifting revenues away from SSCs and introducing progressive PIT rate schedules where necessary would help rebalance the taxation of labour income.
- **Strengthen the design and progressivity of PIT.** Some of the WB6 economies use progressive PIT rate schedules but design issues hinder their impact on wealth redistribution. These economies could analyse the distribution of the PIT burden across income levels and, if necessary, redesign their rate schedule to target high earners more effectively and provide relief for low earners.
- **Evaluate options to broaden the VAT base**. Currently, the VAT base of most WB6 economies is narrowed by high registration thresholds and extensive lists of goods and services taxed at reduced VAT rates. Broadening the VAT base, if scope exists to do so, would bring additional revenue and could increase the size of the tax base.
- **Reinforce efforts to broaden the tax base and encourage the registration of informal businesses and workers in the formal economy**. These efforts could come through both tax administration and tax policy measures. Potential measures could range from simplified tax payment and declaration regimes to targeted tax rates and threshold reductions. Furthermore, the co-ordination between different measures and their effects should be the focus of future tax reforms.

- **Expand the use of micro-simulation models to forecast tax revenues and to assess the distributive effects of tax reforms**. While the WB6 economies have greatly improved their use of micro-simulation models since the last report, efforts could be strengthened. Current models remain limited to a few specific taxes and could be expanded to the majority of taxes and used systematically when planning future tax reforms.
- **Implement regular and systematic tax expenditure reports**. Current tax expenditure reporting capacities are very limited across the region and only Albania currently produces a regular and systematic report (Table 7.2). Such reports would help the WB6 economies manage their investment tax incentives and link their management with other public spending programmes.

### Box 7.2. Albania's tools to assess the effects of tax policies on the economy

Sound policy making, especially in tax matters, requires a comprehensive set of tools to precisely forecast and estimate the effects of reforms on the economy. They allow governments to effectively quantify the impact of potential reform options in terms of revenue forecasting, distributive effects or impact assessments. Among the WB6 economies, Albania has been particularly proactive in this field in recent years, with strong initiatives in micro-simulation models and tax expenditure reporting.

#### Micro-simulation models

On top of its widespread use of macro-simulation models, Albania has expanded its use of micro-simulation models since the 2018 Competitiveness Outlook.

In 2019, the Ministry of Finance and Economy developed a set of micro-simulation models for VAT, PIT, excise and CIT. These models were created in co-operation with the World Bank. For VAT, the model is based on a supply use table from INSTAT, corrected for economic growth for 35 levels of activities and products. For PIT, the model calculates the effects of changes in tax rates for different categories of salaries. For CIT, the model includes firm-level data and can analyse revenue effects from CIT reforms across different economic sectors.

The models were expected to be first used in 2020 to forecast yearly revenues from each tax and develop the monthly distribution plan. However, due to the outbreak of COVID-19 and a significant earthquake in the country, some taxes were not paid on a regular basis, which reduced the precision of the revenue forecasting process. The process should resume in 2021. Albania is also currently working alongside the International Monetary Fund (IMF) to develop new models for VAT, PIT and CIT.

#### Tax expenditure reporting

Tax expenditure was identified in the CO 2018 as an area in need of reform for the WB6 economies. Since then, only Albania has started producing a regular and systematic tax expenditure report, although North Macedonia plans to do so in 2021.

In 2019, Albania instigated its first regular and systematic tax expenditure report. This report should be published every two years, with the next report expected in 2021. Previously, a limited set of basic tax expenditure information was published alongside the annual budget, but in an aggregated form. The information included in the report is published in the official website of the Ministry of Finance and Economy. Furthermore, the expenditure and their accounting are audited by the State Audit every year. The State Audit report is sent for approval to the Parliament, along with the Report of Budget Execution that is prepared by the Ministry of Finance and Economy.

The introduction of a regular tax expenditure report in Albania should help it to efficiently manage its newly founded set of investment incentives and other tax expenditures. This reform is welcomed and will bring Albania's public finance management system closer to international best practice.

Source: CO2021 questionnaire for Albania.

## Tax administration (Sub-dimension 4.2)

Sound tax policies and clearly drafted legislation are not enough to guarantee competitive tax systems. The consistent and transparent implementation of tax policies and legislation through effective administration must also be a top priority for governments. Maximising tax compliance and revenue collection is not manageable without an efficient administration. Indeed, administrative capacities are part of the calculation when determining the optimal tax mix for an economy and are therefore a cornerstone of sound tax policies. From a business perspective, an efficient tax administration is important as it limits the costs of complying with tax obligations. The tax administration sub-dimension assesses the efficiency of the tax administration in the WB6 economies through five qualitative indicators: 1) functions and organisation; 2) compliance assessment and risk management; 3) independence and transparency; 4) tax filing and payment procedures; and 5) taxpayer services. Scoring the economies from 0 to 5 against these indicators can help to understand the degree to which they are building effective tax administrations.

In general, the WB6 economies have made significant efforts to strengthen their tax administrations, with the average score increasing from 2.4 in 2018 to 3.3 in 2021 (Table 7.3). Strengthening their tax administrations helps them to maintain low direct tax rates. There have been significant improvements in taxpayer services, tax filing and independence and transparency but the scores have not changed for compliance assessment and functions and organisation.

### Table 7.3. Scores for Sub-dimension 4.2: Tax administration

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 4.2: Tax administration | Functions and organisation | 3.0 | 1.5 | 4.0 | 3.0 | 3.0 | 5.0 | 3.3 |
| | Compliance assessment and risk management | 3.0 | 3.5 | 4.0 | 3.9 | 3.0 | 3.5 | 3.5 |
| | Independence and transparency | 0.5 | 0.0 | 4.0 | 3.0 | 3.0 | 2.5 | 2.2 |
| | Tax filing and payment procedures | 3.0 | 3.3 | 4.0 | 3.3 | 4.0 | 3.5 | 3.5 |
| | Taxpayer services | 4.0 | 3.8 | 4.0 | 4.5 | 4.0 | 5.0 | 4.2 |
| **Sub-dimension average score:** | | 2.7 | 2.4 | 4.0 | 3.5 | 3.4 | 3.9 | 3.3 |

### *Functions and organisation of the tax administration have changed little overall*

The organisational structure of tax administrations is a crucial component of operational efficiency and effectiveness. One of the key factors behind an efficient tax administration is a unified administrative body which covers all taxes and all core tax administration functions.

The WB6 economies' performance in the functions and organisation indicator has been mixed. Since the 2018 assessment, Bosnia and Herzegovina, Kosovo, and Serbia have improved their score and Albania, North Macedonia and Montenegro have scored worse, leaving the average for the region unchanged at 3.3. Serbia is the best-scoring economy, with a score of 5.0.

All the WB6 economies except for Bosnia and Herzegovina have a unified tax administration body. Due to its specific political structure, Bosnia and Herzegovina's tax administration is divided, with the entities (FBiH and RS) responsible for all direct taxes, while the top level administration is responsible for indirect taxes. The other WB6 economies follow OECD good practice and have a unified body that covers all taxes and all the core tax administration functions. In all the economies, the tax administration's organisation follows a mix of a taxpayer and a functions approach. This means that its internal organisation mostly follows the different functions of a tax administration (audit, tax collection, taxpayer services, etc.), but there are also divisions targeted at specific taxpayer groups. All the WB6 tax administration bodies have a division for large taxpayers while Kosovo also has a division for SMEs. All the economies provide regular training for their tax administration officials.

### *Tax compliance assessments follow a risk-based approach*

Being able to assess where the greatest compliance risks lie is a great tool for the efficient monitoring of tax compliance. Risk-based selection is a central part of modern compliance programmes as it allows tax administrations to make effective trade-off decisions and make the most efficient use of their scarce resources. Audit programmes should be regularly assessed and reported to ensure that operations are transparent to the wider public.

The high average score for the compliance assessment and risk management indicator (3.5) has not changed since the last report. All the economies received a score of 3 or more for this indicator. This high score is mainly due to the relatively widespread use of risk management in their tax compliance functions.

All the WB6 economies follow a risk-based approach to compliance assessment, which means that they focus on taxpayers showing certain abnormalities against a pre-determined set of risk criteria. Albania uses a monthly audit plan, 70% of which is based on recommendations from an IT risk module system. The remaining 30% is based on proposals from regional directorates. In the Federation of Bosnia and Herzegovina, an annual audit plan is developed, using a broad set of 19 criteria. In North Macedonia, the tax administration prepares a monthly tax audit plan, based on three methods: electronic risk assessment, analysis of individual cases and random audit based on a certain sample of risk activity. Some, such as Kosovo, have set up special risk divisions to manage this function. All the WB6 economies carry out similar types of audits: comprehensive audits (covering all types of tax), fiscal visits (focused on a single type of tax and fiscal year) and field verifications (focused on issues such as registration of taxpayers or use of non-cash register for businesses).

### *Tax administrations are increasingly transparent but still lack independence*

Independence and transparency are crucial features of an efficient and well-developed tax administration. They allow the tax administration, and by extension the tax system as a whole, to be seen as a legitimate public authority with the necessary protections in place when collecting money from taxpayers. The tax system needs to ensure transparency to prevent tax administrations from being influenced by political or financial actors who may seek to evade established tax laws or take advantage of it. Implementing comprehensive policies to establish independent and transparent tax administrations represents a strong commitment by governments that they will maintain the integrity of the tax collection process.

In the last assessment, the WB6 economies scored an average of 0.3 in the independence and transparency indicator. This low score highlighted a lack of policies to ensure that their tax administrations act in an independent and transparent manner, leaving significant scope for reform. In this assessment the average score has risen to 2.2 and Kosovo is the best-scoring economy with a score of 4.0.

The establishment of independent tax administration management boards has been uneven across the region. The Montenegro Tax Administration (MTA) became an independent administrative body in 2019 (it was previously integrated into the Ministry of Finance). The head of the MTA is now nominated for a five-year period and reports to the Minister of Finance. In Serbia the Tax Administration Transformation Programme 2015-20 led to the development of an action plan for 2018-23 that foresees the creation of several permanent committees, including a committee on organisational transformation. Kosovo and North Macedonia have implemented policies to establish independent management boards for their tax administrations. In Albania and the FBiH, no steps have been taken to establish independent management boards.

All the tax administrations of the WB6 economies have rules to deal with staff abusing tax collection powers. In Bosnia and Herzegovina, North Macedonia and Serbia, employees of the tax administration are subject to disciplinary measures in cases of abuse of power. In Albania, staff abusing tax collection powers are subject to the criminal code and the law on tax procedures. In, Kosovo and Montenegro, staff have a code of ethics. All the economies also provide a protection framework for whistle-blowers.

The use of e-filing is widespread across the region

Compliance with tax obligations may be burdensome and require businesses and individuals to access a certain number of resources. This can mean high costs for taxpayers, which might be a burden on low-earners and SMEs. For that reason, streamlining and simplifying tax compliance procedures should be a central objective for tax administrations.

The WB6 economies report that filing and paying taxes is a reasonably quick and relatively simple process. Their average score for the tax filing and payment procedures indicator is 3.5, an increase from the average of 2.8 in 2018. All the economies make widespread use of e-filing. In Albania, e-filing is mandatory for all taxes. In Bosnia and Herzegovina, Kosovo, and North Macedonia e-filing is available for all major taxes but only mandatory for VAT and excise duties. In Montenegro, it is mandatory for CIT and PIT and available for all major taxes, but only to taxpayers who have purchased a EUR 110 digital certificate. In Serbia, e-filing is only mandatory for taxes paid by businesses, while individuals may choose between electronic and paper forms.

### *WB6 economies have improved their taxpayer services since the last report*

Taxpayers need a certain level of assistance and information to meet their tax obligations and achieve voluntary compliance. Taxpayer services play a crucial role in meeting these needs. These services can take different forms, and typically include responding to in-person and telephones enquiries, providing general information, and online filing and payment systems. Tax administrations should also use surveys to gauge taxpayer satisfaction, and guarantee an easy and accessible service to taxpayers. Governments may also provide taxpayer ombudsmen.

The WB6 economies have improved their performance in the taxpayer services indicator from an average score of 1.5 in 2018 to 4.2 in 2021. All the economies obtained high scores for this indicator, ranging from 3.75 for Bosnia and Herzegovina to 5 for Serbia. Various services are at the public's disposal in all the economies, including online access to information, electronic communications with taxpayer and in-person inquiries. Each of the WB6 economies, except Albania, implements customer segmentation models to better meet taxpayer needs. In the 2018 assessment, only Albania and Kosovo had taxpayer ombudsmen. Since then, Serbia, North Macedonia and the FBiH have nominated taxpayer ombudsmen, partly explaining the increase in their scores since the last report. Kosovo, the only economy that did not conduct surveys of taxpayer's satisfaction in the last report is now conducting such surveys.

### *The way forward for tax administration*

- **Continue efforts to strengthen tax administrations,** which would bring more taxpayers into the tax system and broaden the tax base. It could also improve tax certainty, lower the costs of compliance and enforcement, increase tax revenues, and make the tax system more efficient.
- **Develop strong procedural safeguards to guarantee the independence of tax administrations across the region.** An independent tax administration board is a crucial aspect of sound tax policy management and the WB6 economies would benefit from implementing procedural safeguards that protect these boards' independence.
- **Streamline taxpayer services and tax filing procedures further to increase tax compliance.** The WB6 economies have carried out significant efforts in this area since the last assessment and are encouraged to continue in that direction.

## International co-operation (Sub-dimension 4.3)

International and regional co-operation on tax policy is vital for addressing tax evasion and avoidance and ensuring that profits are taxed in the economies where the profit-generating activities are performed and value is created. A strong international taxation framework allows economies to protect their domestic tax base from erosion due to tax avoidance and evasion. Regional co-operation over tax matters also allows economies to learn from each other's best practices. The international tax co-operation sub-dimension considers whether the tax codes of the WB6 economies include key international tax rules. It examines whether the economies participate in international taxation frameworks and co-operate with other economies, particularly within the region. It also considers recent developments on digital taxation, in particular the OECD's Tax Challenges arising from digitalisation and its expected global minimum tax. The information in this sub-dimension is not scored, but analysed using descriptive information.

### *Involvement with international tax initiatives and alignment with international tax trends are increasing*

Base erosion and profit shifting arises when businesses can exploit gaps and mismatches between different tax systems. BEPS negatively affects tax revenues, the efficiency of tax systems and their ability to create a level playing field for all firms. While BEPS is a worldwide concern, it is of particular importance to developing and emerging economies whose tax legislation and administrations may struggle with the complexities of modern business. Aligning with international standards ensures a coherent and efficient application of the tax system, eliminating tax uncertainty.

The CO 2018 assessment identified co-operation with the international tax community and the implementation of international best practices as areas where the WB6 economies could strengthen their efforts. At that time, no WB6 economy had joined the Inclusive Framework on Base Erosion and Profit Shifting or the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. The assessment also highlighted the lack of initiatives in areas such as administrative co-operation and exchange of information.

Since the last assessment, the WB6 economies have made significant efforts to align their tax systems with international best practices. North Macedonia and Serbia joined the Inclusive Framework on BEPS in 2018, followed by Albania, Bosnia and Herzegovina, and Montenegro in 2019. This led to a series of initiatives to tackle harmful tax practices (Action 5), prevention of tax treaty abuse (Action 6), country-by-country reporting (Action 13) and mutual agreement procedures (Action 14). Only Kosovo has not joined the framework but it has indicated use of the OECD Model Tax Convention as a basis for its double-tax treaties, which informally, leads to the implementation of some BEPS minimum standards. Albania, Bosnia and Herzegovina, North Macedonia and Serbia have also implemented the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS since the last assessment.

The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes has developed two different international standards for the exchange of information for tax purposes: exchange of information upon request (EOIR) and automatic exchange of information (AEOI). Economies are evaluated for compliance with the EOIR standard through peer review. For the purpose of AEOI, a common reporting standard has been developed that is incorporated into the domestic law of participating jurisdictions. The Convention on Mutual Administrative Assistance in Tax Matters is also an important part of recent initiatives of the international tax community with regard to exchange of information. In 2018, only Albania had signed the Convention on Mutual Administrative Assistance in Tax Matters and the Multilateral Competent Authority Agreement for AEOI. Albania and North Macedonia had also been subject to peer review for EOIR, performed by the assessment team of the Global Forum, and both economies were found to be largely compliant. Since the 2018 assessment, there have been several notable initiatives. Bosnia and Herzegovina, North Macedonia, Montenegro and Serbia have joined the Convention on Mutual

Administrative Assistance in Tax Matters. Bosnia and Herzegovina, Montenegro and Serbia have also been subject to or have scheduled a peer review for EOIR by the OECD Global Forum. Finally, Montenegro has signed the Multilateral Competent Authority Agreement for AEOI.

In theory, there are two models for the taxation of cross-border income: 1) worldwide taxation systems, which tax corporations on their worldwide income; and 2) territorial tax systems, which only tax income that has its source in the economy. In recent decades, most OECD countries have adopted territorial tax systems although in practice most apply a combination of both systems. Pure territorial tax systems are rare as most OECD countries have adopted some form of exemption. OECD members with territorial tax systems commonly exempt most active earnings from tax if they were repatriated from subsidiaries incorporated in host countries.

The WB6 economies all have pure worldwide tax systems, in which income earned abroad by resident corporations is integrated into the domestic CIT tax base. Such systems create a heavy administrative burden for the economies implementing them. In practice, income earned abroad will have been taxed in the host economy where the income has its source under that economy's CIT (or via withholding tax for payments made directly to corporations with their tax residence in the region). The WB6 tax administrations then have to assess the difference between taxes paid abroad and the remaining domestic tax liability (if the host economy has a lower tax rate), granting a tax credit as a relief against double taxation. This administrative burden has to be balanced against potential revenue from foreign sourced income to assess whether a worldwide taxation system offers a net benefit. In practice, potential revenues are limited by the low CIT rates across the region, meaning that taxes paid at source on foreign income are very likely to be higher than those payable in the WB6 economies.

As a result, the WB6 economies are unlikely to raise enough revenue from the taxation of foreign-sourced income to justify the high administrative costs. Small open economies like the WB6 economies typically have territorial tax systems. The WB6 economies should conduct a cost-benefit analysis of the merits of their worldwide taxation systems. They could also contemplate introducing additional tax base protection measures, such as limiting of how much expense incurred to earn foreign-source income is deductible from the domestic CIT base.

### *Digital taxation is improving but can still be strengthened*

Digital taxation has been a subject of growing importance in recent years for the international tax community. Tax systems have had to adapt in order to capture these new and growing forms of revenues, which raise challenges from a tax perspective. The WB6 economies have engaged in some initiatives in this area but could strengthen their efforts.

Only Albania implements international VAT and goods and services tax (GST) guidelines on cross-border digital services, which it has done since 2014. Although it is the only economy formally implementing these guidelines, four of the remaining five economies levy VAT on cross-border digital services using a logic similar to the destination principle (i.e. levying tax in the place where the service recipient is established, the cornerstone of international VAT/GST guidelines). Only Kosovo currently levies VAT on cross-border digital services in the place where the service provider is established. However, WB6 economies would still benefit from the implementation of international VAT/GST guidelines.

Only two of the WB6 economies integrate revenues from digital platforms into the PIT tax base; North Macedonia and Montenegro levy PIT on these revenues at their default flat tax rate. Some of the other economies are currently assessing possible actions in this area. Albania's tax administration has requested from Airbnb the list of individuals renting out properties through their platform. Once this information is obtained, it will be cross referenced with these individuals' tax returns, which should allow this income to be included in the PIT tax base in the future. The Strategic Risk Department of Serbia's tax administration carried out an analysis of tax compliance on this subject. It found that the reporting of revenues from digital

platforms was weak and that there was a low rate of tax compliance among individual taxpayers. As a result, Serbia's Tax Administration requested data from commercial banks on payments received by individuals from digital platforms. It is currently developing a risk response plan to audit these taxpayers.

The OECD's Tax Challenges Arising from Digitalisation project, especially the global minimum tax under its Pillar 2, could have a substantial impact on the WB6 economies' tax systems if consensus is reached among members of the Inclusive Framework. The GLOBE proposal intends to define a minimum taxation rate for corporate profits. Even though the final rate is subject to ongoing discussions, there is a high risk that it will be set above the current CIT rates in the region (as discussed above, the average CIT rate in the WB6 in 2020 was 11.5%, ranging from 9% to 15%). The risk is particularly acute for Montenegro (9% rate), as well as for Kosovo, North Macedonia, and Bosnia and Herzegovina (10% rate). If the minimum tax rate was set above these levels, economies would face the choice of either raising their CIT rate to the minimum tax, or risk forgoing domestically sourced tax revenues to foreign jurisdictions. This does not mean the remaining WB6 economies with a higher CIT rate would be spared. Albania and Serbia (15% CIT rate) would most probably be still affected by the GLOBE proposal.

Even if any minimum tax is set below their statutory CIT rate, it could still have an impact on their taxation of corporate profits. As discussed above, most of the WB6 economies offer generous CIT investment incentives, which may lower the effective rates on corporate profits to a level below the global minimum tax. The economies would then be faced with a similar choice, of either redesigning their investment incentives to raise their effective rates to a level above the minimum tax or risk forgoing domestically sourced tax revenues to foreign jurisdictions. They are advised to carefully assess their position on this issue and draft an action plan in response.

### *Regional co-operation and co-ordination are modest*

The WB6 economies all carry out some form of regional co-operation and co-ordination. Albania and Kosovo work together to strengthen the functioning of their VAT and to provide training to their staff. Montenegro has concluded agreements on mutual co-operation with Bosnia and Herzegovina, Croatia, Serbia and Slovenia to exchange information and provide assistance in the detection of VAT fraud and avoidance. North Macedonia exchanges information with Albania, Bosnia and Herzegovina, Kosovo and Serbia.

The WB6 economies would benefit from greater regional tax co-ordination and tax co-operation. The intensification of co-operation efforts will help them to tackle tax avoidance and evasion in a coherent manner across the region. As the economies all face similar tax challenges, they would gain mutual benefits from intensifying their information sharing and learning together.

### *The way forward for international co-operation*

- **Define an action plan in case of international consensus on a global minimum tax**. This could greatly affect the taxation of corporate profits in the region; the economies should define their position on this issue.
- **Continue to engage with the international tax community and implement international best practice.** The WB6 economies' strong engagement to align their system with recent international tax trends should be continued. Among other elements, automatic exchange of information could be an area of focus for future initiatives.
- **Carry out a cost-benefit analysis on the merits of retaining a worldwide taxation system for resident corporations.** Such systems are uncommon in the OECD, particularly for small open economies like the WB6. Their worldwide taxation systems may, among other issues, be incurring high administrative costs without raising significant additional revenue.

- **Foster regional co-operation and co-ordination on common tax issues within the region**. The WB6 economies face similar challenges in many areas such as tax compliance, training of tax administration staff and the exchange of information. These areas would greatly benefit from a co-ordinated regional approach.

## Conclusion

Since the 2018 Competitiveness Outlook, the WB6 economies have been strengthening their general taxation framework and tax administration. However, from a domestic and international tax policy standpoint, they continue to face major challenges which have only been deepened by the global pandemic. Taxes are levied on narrow bases, particularly VAT and CIT. SSCs are levied at high rates, imposing a heavy tax burden on labour income and restricting the use of PIT to reduce inequality. All the WB6 economies need to develop their tax policy measurement tools, such as enhanced tax revenue statistics, efficient tax rate analysis and strengthened tax expenditure reporting. They should also keep strengthening their tax administrations to achieve efficient management practices and transparent institutions. They will need to reconsider their wide variety of corporate tax benefits and take action to avoid falling victim to a tax race to the bottom. Instead, they should strengthen their tax co-operation, both within the region and more globally.

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## Notes

[1] The 11 Central and Eastern European countries (CEECs) which have joined the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] Profit-based incentives generally reduce the tax rate applicable on taxable income, while cost-based incentives lower the cost of an investment and increase with the size of the investment.

# 8 Competition policy (Dimension 5)

By contributing to well-functioning markets and competitive neutrality between private firms and state-owned enterprises, as well as between domestic and foreign companies, competition policy drives productivity, encourages innovation and supports economic growth. This chapter assesses the competition policy settings, processes and institutions in the six Western Balkan (WB6) economies through an analysis of five key policy areas, four of which are qualitative, while the fifth is quantitative. The first policy area, scope of action, assesses to what degree competition authorities are invested by law with the powers to investigate and sanction anti-competitive practices. The second area, anti-competitive behaviour, reviews policies to prevent and prosecute exclusionary vertical and horizontal agreements and anti-competitive mergers. The third, probity of investigation, examines the independence and accountability of institutions that enforce competition law and the fairness of their procedures. The fourth, advocacy, looks at further actions to promote a competitive environment. A new fifth policy area, implementation, quantifies the actual enforcement and advocacy activity by competition authorities in the following major spheres of action: cartels and abuse of dominance cases, merger reviews, and advocacy initiatives. The chapter includes suggestions for enhancing policies to foster the competitiveness of the WB6 economies.

## Key findings

- **The legal and institutional competition frameworks of the WB6 economies are largely aligned with best international practices**, in particular with European Union (EU) competition rules. National competition authorities are independent bodies and invested by law with appropriate powers to confirm and sanction competition infringements.
- **The six competition authorities are committed to enforcing competition rules and advocate against competitive restrictions in laws and regulations**. However, they lack the necessary financial and professional resources to perform their wide range of duties in the most effective way.
- **In general, implementation of competition decisions is still insufficient, particularly for cartels**. Albania and Serbia lead the way in strengthening their enforcement records, and there are promising signs in the other jurisdictions, but the current number of decisions, and most importantly the amount of sanctions, is still limited.
- **Sanctions for infringers are not high enough to deter firms from engaging in anti-competitive conduct**. Moreover, the fight against cartels requires competition authorities to make full use of their investigative powers, including unannounced inspections of premises. Some competition authorities have not yet carried out inspections, while others have started very recently.
- **All WB6 competition authorities have engaged in competition advocacy**, which is a necessary complement to competition enforcement to avoid legal constraints and promote a competition culture. Most competition authorities in the region have sent formal opinions to policy makers to urge them to remove competition restrictions in laws and regulation. All regularly offer training activities and events to increase competition awareness among citizens, firms and institutions, and to explain the benefits of competition.

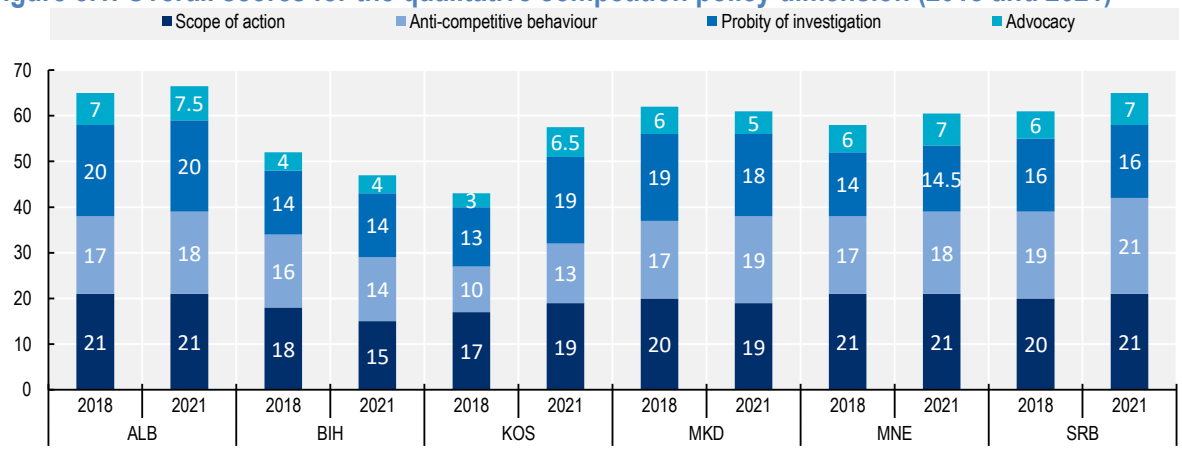
### Comparison with the 2018 assessment

There have been few changes to the scores for the competition policy dimension since the 2018 Competitiveness Outlook (CO) assessment (Figure 8.1).

The remit of competition authorities covers two pillars: enforcement and advocacy. Competition enforcement in the WB6 economies is still limited, despite an increase in the score for infringement decisions in Albania and Serbia, and some promising recent signs in other competition authorities. WB6 competition authorities are endeavouring to progress on the second pillar of competition advocacy to urge policy makers and regulators to remove competition restrictions and ensure a level playing field for firms.

Competition authorities are still limited by professional and financial resources. Officials are usually skilled and motivated, but their number is insufficient to perform all the activities of a well-functioning competition authority.

## Figure 8.1. Overall scores for the qualitative competition policy dimension (2018 and 2021)




Note: In the present edition of the Competitiveness Outlook, a new quantitative policy area, implementation, has been introduced (see below). Given that implementation was not addressed in 2018, no comparison is possible as part of this assessment.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress on implementing the policy recommendations made in the Competitiveness Outlook 2018 has been modest overall (Table 8.1), although there are differences in implementation across economies. Moderate advances have been made in providing stakeholders with guidance on competition authorities' practices and in removing or preventing restrictions to competition in laws and regulations. There have been limited improvements in the competition law enforcement record and in the amount of financial and human resources available to competition authorities.

## Table 8.1. Implementation of the CO 2018 policy recommendations: Competition policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Improve the competition law enforcement record further** | • Competition authorities still need to strengthen their enforcement record, focusing especially on cartels, which are the most serious and harmful competition infringement. | Limited |
| **Put in place guidance for stakeholders on competition authorities' enforcement practices** | • Most competition authorities have adopted and published some regulations and guidelines, for example regarding the investigative procedure, the procedure for concentrations of undertakings, the assessment of horizontal and vertical agreements, and the calculation of fines. | Moderate |
| **Ensure that competition authorities have sufficient resources** | • Competition authorities still lack adequate financial and human resources to express their full potential and duly implement their enforcement powers. | Limited |
| **Give more weight to competition authorities' recommendations** | • Although most competition authorities are still struggling to establish themselves as influential institutions, they are largely committed to removing or preventing restrictions to competition in laws and regulations, as well as to increasing public awareness and understanding of the benefits of competition. | Moderate |

## Introduction

Competition policy is at the top of the agenda in most jurisdictions in the world as it provides firms with the right conditions and incentives to perform efficiently and to innovate, which ultimately benefits consumers

and the economy. A competitive economic environment helps boost economic growth and increase living standards, thereby also helping to reduce inequality. Competition policy stimulates competitiveness by giving businesses incentives to lower their costs and reduce their prices, to better respond to customers' needs and to be more innovative. Furthermore, it motivates firms to supply internationally competitive products and services and to upgrade in global value chains.

Competition authorities tackle unlawful agreements between competitors to raise prices, as well as abusive practices by dominant firms to exclude smaller, innovative or more efficient companies from the market. At the same time, competition authorities promote a level playing field in open markets by advocating for the removal of restrictions in laws and regulations, and by prohibiting restrictive mergers.

For economies of limited size such as the WB6 economies, competition policy also plays a key role in fostering access to domestic markets by foreign and international firms, leading to increased allocative efficiency. By contributing to well-functioning markets and competitive neutrality between private firms and state-owned enterprises, as well as between domestic and foreign companies, competition policy drives productivity, encourages innovation and supports economic growth (Ospina, 2010[1]; Gutmann, 2014[2]).

Competition policy has significant interplay with other policy areas. Level playing fields and transparency attract international investors and help reduce unnecessary barriers to trade in laws and regulations. The fight against bid rigging in public procurement also contributes to corruption prevention.

In light of the above, this chapter has links to the following chapters:

- **Chapter 4. Investment policy and promotion** will benefit from the competent and predictable implementation of competition rules that apply to foreign and domestic investors alike. Competition laws that are aligned with international standards and applied according to best practices will create legal security that benefits investment decisions.
- **Chapter 5. Trade policy** and facilitation and competition policy can and should be mutually supportive. In general, trade and competition policies share the ultimate objective of achieving the efficient allocation of resources and promoting economic growth. In particular, trade liberalisation can generate competitive pressure by encouraging more domestic and foreign direct investment (Bartók and Miroudot, 2008[3]). Competitive markets also create opportunities for trade and investment and enhance the gains from trade and investment liberalisation. However, potential tensions or inconsistencies may arise when markets are not contestable, when there are barriers to entry or exit, and when important sunk costs or other market imperfections prevent foreign products or companies from reaching domestic markets.
- **Chapter 9. State-owned enterprises.** Competition policy can help ensure that state-owned enterprises (SOEs) compete on a level playing field with private companies, thus establishing a robust competition environment. Competition authorities can promote competitive neutrality by discouraging the public authority from granting selective aid to SOEs and resisting political pressure to adopt a more lenient approach when investigating SOE conduct.
- **Chapter 12. Science, technology and innovation** are facilitated by competitive environments. However, the relationship is not simple as the empirical evidence shows that moderately competitive markets innovate the most, while both monopoly and highly competitive markets show lower levels of innovation. Competition policy focuses not on making moderately competitive markets hyper-competitive, but on introducing or strengthening competition in markets where it does not work well. The inference is therefore that competition policy serves to promote innovation (Aghion, 2005[4]).
- **Chapter 19. Anti-corruption policy** and competition both focus to a large extent on public procurement markets. Competitive bidding in public procurement markets will be encouraged if the risk of corruption is low. Research generally finds an inverse relationship between competition and corruption: low levels of competition correlate with high levels of corruption (OECD, 2010[5]). Cartels

favour corruption and benefit from co-conspirators among public procurement officials. A successful anti-corruption policy will also lead to more competitive and cost-effective tender results.

## Assessment framework

### *Structure*

This edition of the Competitiveness Outlook is based on the same four qualitative policy areas used in the past editions and a new quantitative policy area on implementation.

The four qualitative policy areas explored in the past editions of the Competitiveness Outlook focus on the foundations of a competition policy regime: scope of action, anti-competitive behaviour, probity of investigation and advocacy. They are meant to verify whether the *de jure* characteristics of the WB6 economies are appropriate to support well-functioning and effective competition policy.

The questionnaire used for the past edition (see below) has been maintained to enable the monitoring over time of evolutions in the key policy areas:

1. **Policy area 5.1: Scope of action** explores whether the competition authority is invested by law with the power to investigate and sanction anti-competitive practices, as well as to investigate, remedy or block anti-competitive mergers. It also assesses whether the authority's budget and number of staff are adequate.
2. **Policy area 5.2**: **Anti-competitive behaviour** focuses on how competition policy prevents and prosecutes exclusionary vertical and horizontal agreements and anti-competitive mergers. It assesses which factors are considered when ascertaining if anti-competitive practices have taken place.
3. **Policy area 5.3: Probity of investigation** focuses on the independence and accountability of the institutions that enforce competition law. It also addresses the transparency and fairness of their procedures.
4. **Policy area 5.4: Advocacy** focuses on activities other than enforcement of competition law used to further promote a competitive environment. It explores whether market studies and reviews of new laws and regulations are conducted to highlight and prevent a distortionary impact on competition.

Unlike the other chapters, where indicators are allocated a score from one to five, the assessment of the four qualitative policy areas in the competition policy chapter is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire listed in Annex 8.A. Competition Questionnaire. Where a response to a question is yes (coded as 1), this is referred to as an adopted criterion. Each of the five policy areas has a different number of possible criteria that can be stated as having been adopted (Table 8.2). Each policy area is assessed through data collected from the questionnaire indicators and by measuring the number of criteria adopted.

## Table 8.2. Competition policy qualitative dimension assessment framework

| Competition policy dimension | | | |
|---|---|---|---|
| **Outcome indicators**<br>1. Number of adopted criteria | | | |
| **Qualitative policy areas** | | | |
| **Policy area 5.1**<br>Scope of action | **Policy area 5.2**<br>Anti-competitive behavior | **Policy area 5.3**<br>Probity of investigation | **Policy area 5.4**<br>Advocacy |
| 1. Competences<br>2. Powers to investigate<br>3. Powers to sanctions/remedy<br>4. Private enforcement | 5. Mergers<br>6. Horizontal agreements<br>7. Vertical agreements<br>8. Exclusionary conduct | 9. Independence<br>10. Accountability<br>11. Procedural fairness | 12. Advocacy |
| **Quantitative policy areas** | | | |
| n.a. | **Policy area 5.5**<br>13. Cartels and abuse of dominance cases<br>14. Merger reviews<br>15. Advocacy initiative | n.a. | n.a. |

### *Key methodological changes to the assessment framework*

As discussed, the analytical framework for Competition Policy for this edition of the Competitiveness Outlook is broader than the framework applied in 2018, with a new policy area added. The new policy area investigates the actual implementation of competition rules by competition authorities in terms of infringement decisions and advocacy initiatives. The complementary set of questions enables a quantitative assessment of the extent to which competition authorities have been able to translate legal and institutional competition frameworks into actual enforcement and advocacy activity.

The new set of quantitative data has enabled meaningful comparisons and benchmarking with other jurisdictions. The questionnaire mirrors the data collected by the OECD through the General Competition Statistics (CompStats) database, which scrutinises competition agencies in 56 OECD and non-OECD jurisdictions (Box 8.1). The resulting database enables a comparison of the activity of competition authorities with similar characteristics and at an equivalent stage of development to assess the effectiveness of their programmes of work and their tools, and to monitor improvements. Over the years it will also be possible to use the evidence from past scrutiny to assess the development of enforcement and advocacy records, and it will be easier to assess the effectiveness of strategies and prioritisation choices. Competition agencies could use this tool to enhance their transparency and accountability polices.

### Box 8.1. CompStats: The OECD's General Competition Statistics database

In 2018 the OECD launched an initiative to develop a database of general statistics on competition agencies, including data on enforcement and information on advocacy initiatives. The database currently covers the period 2015-19 and data will be collected annually in the future.

The OECD publication OECD Competition Trends presents unique insights into global competition trends based on data analysis from the CompStats database. The 2021 edition provides an update on the competition enforcement trends for the competition authorities of 56 jurisdictions (OECD, 2021[6]).

The 56 jurisdictions in question include 37 OECD countries (36 OECD countries and the European Union) and 19 non-OECD economies with remarkable geographic diversity: Argentina, Brazil, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas); Australia, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other).

The publication supports informed policy making and contributes to improving competition law and policy around the world by providing multi-year data on a large number of economic and legal indicators, including the number of anti-trust decisions, the sanctions imposed, the unannounced inspections performed, and activity on merger review and competition advocacy.

Source: (OECD, 2021[6]), *OECD Competition Trends 2021, Volume I: Global Competition Enforcement Update 2015-19*, http://www.oecd.org/daf/competition/oecd-competition-trends-2021-vol1.pdf.

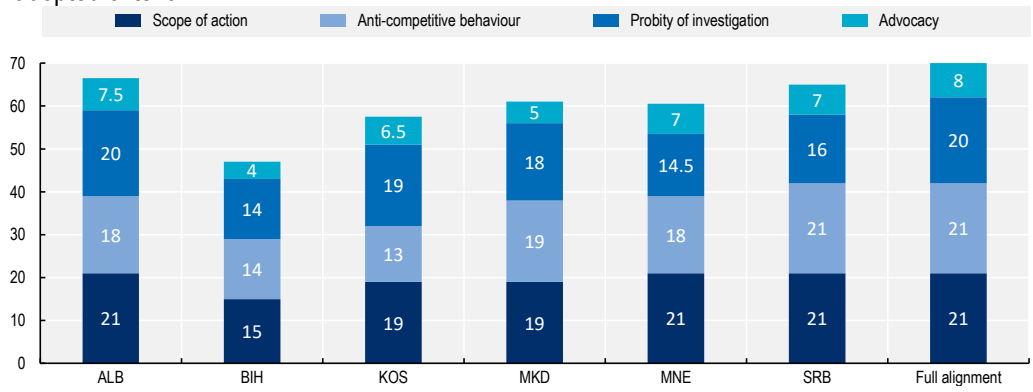
## Competition policy performance and context in the WB6

The legislative frameworks for competition in the WB6 economies are in line with international good practice. Competition rules reflect EU provisions on restrictive agreements and the abuse of dominant position (Articles 101 and 102 of the Treaty on the Functioning of the European Union) and include the *ex ante* control of mergers, following the principles of the EU Merger Regulation.

The competition authorities of the six jurisdictions have appropriate powers to investigate and to sanction possible anti-trust infringements, such as restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms. Moreover, their institutional setting appears good in terms of independence, accountability and procedural fairness. However, they lack adequate financial and human resources to express their full potential and implement their enforcement powers. Among the WB6, Albania is the closest to full alignment, followed by Serbia and North Macedonia. Albania, Montenegro and Serbia are fully aligned regarding the scope of action. The only economies that are fully aligned with anti-competitive behaviour and probity of investigation are Albania and Serbia (Figure 8.2).

## Figure 8.2. Competition policy scores (2021)

Number of adopted criteria




The actual implementation of the rules through competition enforcement is generally poor. The competition authorities particularly need to strengthen their enforcement record, focusing especially on cartels as they are the most serious and harmful competition infringement. Cartel investigations require valid detection tools and the wide use of unannounced inspections. Albania and Serbia are leading the way in this area, with recent promising signs in the other jurisdictions, but the number of infringement decisions and related sanctions are still low in the region. Severe sanctions are crucial to ensure deterrence and to enhance the effectiveness of other key competition tools, such as leniency programmes and settlements. Targeting bid rigging in public procurement could be a promising area for expanding competition authorities' activity regarding cartels, particularly given the increased role played by public authorities in response to the COVID-19 crisis.

The competition authorities of the WB6 economies have performed well in the fourth policy area, competition advocacy. In particular, most are committed to removing or preventing restrictions to competition in laws and regulations, as well as to increasing public awareness and understanding of the benefits of competition.

## Scope of action (Policy area 5.1)

Proving competition infringements and drafting solid decisions requires in-depth and thorough investigations, particularly for cartels. Competition authorities should be able to collect evidence of unlawful contact between the parties and have a clear understanding of the characteristics and dynamics of the markets at stake, as well as of the effects of the alleged practices. Competition authorities are therefore usually equipped with strong powers to conduct unannounced inspections, request information and hold hearings. At the end of the investigation they need to be able to impose severe sanctions to discourage anti-competitive conduct by others. Deterrence is more effective if private enforcement enables individuals, firms and public entities harmed by an anti-trust infringement to seek compensation before the civil courts.

Competition provisions should apply to any undertakings that engage in economic activities, be they public or private, domestic or foreign, in order to guarantee competitive neutrality and equal opportunities to all market players. Competition authorities should also be able to rely on adequate and stable professional and financial resources to perform their duties.

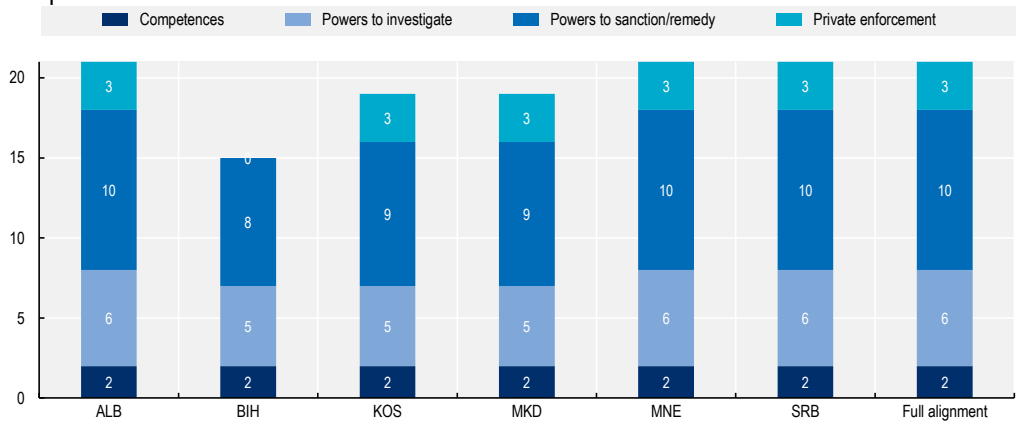
The scope of action policy area addresses these issues by exploring the competencies of the competition authorities in terms of the scope of application of competition rules (public/private, domestic/foreign firms); their financial and human resources; their statutory powers to investigate and to sanction/remedy competition law infringements and anti-competitive mergers; and the provisions allowing private

enforcement, i.e. civil action by individuals, firms or groups of consumers seeking compensation for financial damage incurred as a result of competition law violations.

Albania, Montenegro and Serbia achieved full alignment for the scope of action policy area. Moreover, all WB6 economies except Bosnia and Herzegovina are fully aligned with the competences and private enforcement policy areas (Figure 8.3).

## Figure 8.3. Degree of alignment for scope of action (Policy area 5.1)

Number of adopted criteria




### *Powers to investigate and sanction are adequate, but professional and financial resources are limited*

The domestic competition laws of the WB6 economies ensure competitive neutrality, in that the **competences** of the competition authorities encompass any domestic or foreign undertakings (and associations of undertakings) that have or may influence domestic markets, including public undertakings and undertakings entrusted with services of general economic interest.

Competition authorities have appropriate powers to investigate and powers to sanction anti-trust infringements, as well as to review mergers and acquisitions. During an investigation, all competition authorities in the WB6 economies can compel investigated firms and third parties to provide relevant information and can perform unannounced inspections of their premises. The final decision is based on a thorough scrutiny of the collected evidence, which may include an economic analysis of the competitive effects. If anti-trust infringements are found the authorities can impose cease and desist orders and remedies and sanctions on the firms concerned. In particular, the authorities have the power to directly impose significant fines, which can be up to 10% of the aggregate turnover of the undertaking, in line with EU provisions. The only exception is Montenegro, where investigations fall under the remit of the Agency for Protection of Competition and the imposition of fines under the Misdemeanour Courts, which can conduct the relevant procedure and determine the amount of the fines.

The competition authorities can also adopt interim measures *ex officio* and based on preliminary evidence (*prima facie*) if the alleged competition breach poses a risk of serious and irreparable damage. They may also order behavioural and structural measures to eliminate harmful effects on competition, or accept and make binding commitments offered by the parties to address the competition concerns.

All domestic legal regimes also provide for leniency programmes, which grant total or partial immunity from sanctions to firms that report the existence of the agreement and submit appropriate evidence to the competition authority.

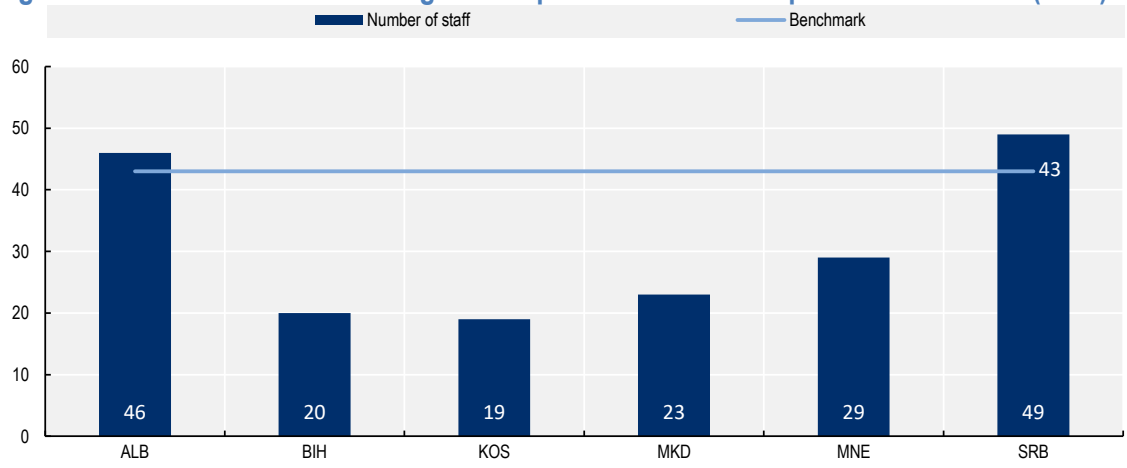
With the exception of Bosnia and Herzegovina, all WB6 competition authorities can enter into settlements with the parties under investigation for alleged anti-trust infringements, and thus close the investigations.

Regarding merger reviews, domestic competition laws provide for *ex ante* control, following the principles of the EU Merger Regulation. The competition authorities must prohibit concentrations that significantly restrict effective competition, in particular as a result of the creation or strengthening of a dominant position. They can authorise the transaction subject to structural and/or behavioural remedies – i.e. divestiture of assets and/or obligations to act or refrain from acting in a certain way – suitable to address the competition concerns.

The assessment of notified mergers must follow thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration. For merger reviews, the competition authorities of the WB6 economies can compel merging firms and third parties to provide relevant information and may perform unannounced inspections on the premises of the parties.

To enforce competition law effectively, competition authorities need adequate financial and human resources, which is not the case for most WB6 competition authorities. According to the CompStats database, except for Albania and Serbia, the number of staff in WB6 competition authorities is lower than in other OECD and non-OECD economies (Figure 8.4). In 2019 the average total staff of the 15 competition authorities in small economies (with a population below 7.5 million) was 114, of whom 43 were working on competition (benchmark economies in Figure 8.4) (OECD, 2020[7]).

## Figure 8.4. Number of staff working on competition in WB6 competition authorities (2019)




Note: The benchmark refers to the average of the 15 competition authorities in small economies that participated in the OECD CompStat database. See the Methodology and assessment process chapter for information on the Competitiveness Outlook assessment process.
Source: Information collected from WB6 authorities.

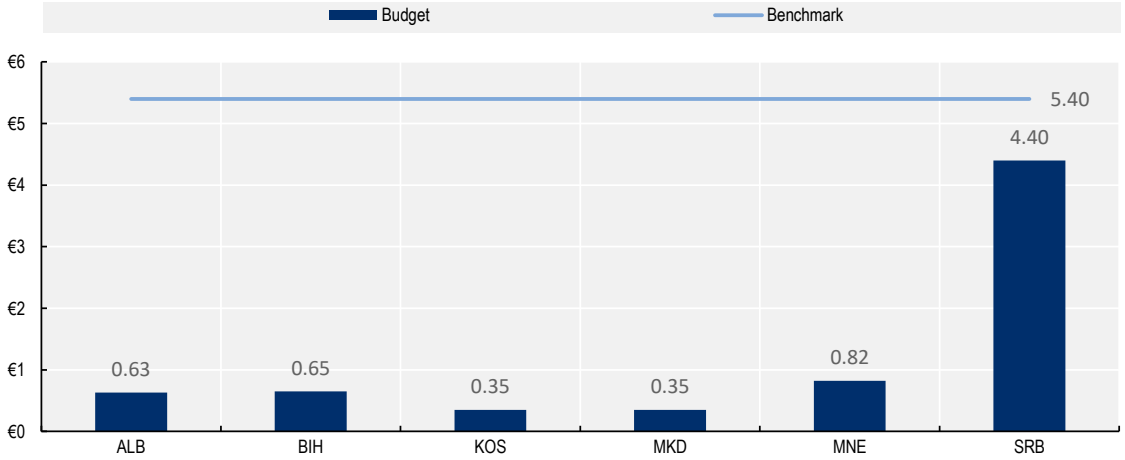
The budgets of competition authorities in the WB6 economies are extremely low compared to international averages. The competition authorities of Albania, Bosnia and Herzegovina, Kosovo, North Macedonia and Montenegro rely on annual budgets of between EUR 347 000 (North Macedonia) and EUR 820 000 (Montenegro), which is significantly below the average financial resources of the 15 competition authorities in small economies that participated in the OECD CompStats database (EUR 5.4 million in 2019). Only the Serbian competition authority approaches this figure (Figure 8.5).

The reasons behind the limited financial and human resources could include the low gross domestic product, the small size of the populations, the low cost of living and the young age of the institution. Nevertheless, a competition authority needs a minimum level of qualified officials to be able to fulfil its tasks, which include monitoring all sectors of the economy, conducting complex investigations, and analysing existing and draft legislation to advocate the removal of competition restrictions. Similarly, adequate economic resources are necessary to attract skilled officials and retain them over time. Many authorities are confronted with a high staff turnover, with many qualified officials trained by the authority

eventually recruited by the private sector. At the same time, effective enforcement increasingly requires the use of costly digital devices, which are often indispensable for collecting and analysing evidence. Italy has developed a way of achieving financial independence for its competition authority, which is worth considering (Box 8.2).

## Figure 8.5. Budget of WB6 competition authorities (2019)

Million euros




Note: For Montenegro, the budget also covers the additional competence of the authority for state aid control. The benchmark refers to the average of the 15 competition authorities in small economies that participated in the OECD CompStats database. See the Methodology and assessment process chapter for information on the Competitiveness Outlook assessment process.
Source: Information collected from WB6 authorities

All WB6 economies except Bosnia and Herzegovina allow private enforcement, meaning that individuals, firms and consumers – either collectively or through consumer associations – can bring legal action to seek damages from firms that have committed anti-trust infringements.

### Box 8.2. Financial independence for the Italian competition authority

Until 2012, the financing of the Italian Competition Authority (AGCM) was based on two main sources: annual funding from the state and fees paid by companies subject to merger notification requirements.

Legislative Decree no. 1/2012 modified the AGCM's funding system, which is now based on mandatory contributions imposed on companies incorporated in Italy whose turnover exceeds a threshold of EUR 50 million. The revenues from these contributions replace all previous forms of funding. The level of contribution, originally fixed at 0.06 per thousand, has been gradually lowered by the AGCM to 0.055 per thousand. The authority's financial statements have to be approved by 30 April of the following year, and are subject to auditing by the Court of Auditors (OECD, 2014[8]).

This funding system can be regarded as an indirect recognition of the positive role played by AGCM in supporting a healthy and level competition field, which justifies the imposition of a small contribution on the largest businesses incorporated in Italy.

Importantly, the previous funding system entailed the risk of possible fluctuations in the amount of the annual budget, due to unpredictability in the number of notified mergers and levels of state funding. The new system shelters the AGCM from that risk, thus allowing for more stable and forward-looking recruitment planning.

Source: (OECD, 2016[9]), *Independence of competition authorities: from designs to practices*, https://one.oecd.org/document/DAF/COMP/GF(2016)5/en/pdf.

### *The way forward for scope of action*

- **Provide competition authorities with adequate and predictable financial and professional resources**. The current competition budget and the number of specialised staff appear insufficient for them to perform their duties effectively. A substantial increase in the budget of WB6 competition authorities seems necessary to align them with other comparable competition authorities. Additional financial resources would enable the authorities to recruit additional officials with appropriate competition skills, while motivating and retaining existing staff, and thus develop their potential in terms of competition enforcement and advocacy (see example in Box 8.2).
- **Co-operate internationally and carry out targeted training initiatives to successfully address the fast-moving economic environment.** Given the increasing complexity of anti-trust issues, and the frequent cross-border nature of competition infringements, the management and staff of WB6 competition authorities should have frequent opportunities to meet and share good practices with international competition experts and colleagues from other jurisdictions. International organisations such as the OECD, the International Competition Network and the United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities for this, including the OECD-GVH Regional Centre for Competition in Budapest (Box 8.3). The WB6 competition authorities are already regular participants in the centre's events and would benefit from actively continuing.

#### Box 8.3. International co-operation on competition: OECD-GVH Regional Centre for Competition

The OECD Competition Committee promotes the regular exchange of views and analysis on competition policy issues. The outcomes of these discussions, including submissions from economies and invited experts, are published in the Best Practice Roundtables on Competition Policy series (https://www.oecd.org/competition/roundtables.htm). Furthermore, every year over 100 competition authorities, international organisations and invited experts worldwide participate in the OECD Global Forum on Competition. In addition, the OECD Competition Open Day offers a unique opportunity to discuss cutting-edge topics recently addressed by the OECD Competition Committee. It is a free event open to the broad competition community and those interested in the work of the OECD on competition, including legal practitioners, economists, consultants, in-house counsel, regulators, academics and the media.

The OECD Regional Centres for Competition (RCCs) are initiatives aimed at fostering competition policy in specific regions, mainly through seminars and training programmes on competition law and policy. The OECD-GVH RCC was established in 2005 by the OECD and the Hungarian Competition Authority (GVH) and covers 18 competition authorities in Eastern and Central European. There are two other RCCs: the first is managed in co-operation with the Korean Competition Authority and is dedicated to competition authorities in the Asia-Pacific region; and the second was created in 2019 with the Peruvian Competition Authority and targets competition authorities in Latin America.

The International Competition Network provides competition authorities with a specialised yet informal venue for maintaining regular contacts and addressing practical competition concerns. Members produce work products through their involvement in flexible project-oriented and results-based working groups. They participate in working groups over the Internet and by telephone through webinars and teleseminars. Annual conferences and workshops provide opportunities to discuss working group projects and their implications for enforcement.

The UNCTAD Intergovernmental Group of Experts on Competition Law and Policy meets each year to discuss ways to improve worldwide co-operation on competition policy implementation and enhance convergence through dialogue. The United Nations Set of Principles on Competition provides the basis for intergovernmental consultations (UNCTAD, 2000[10]).

Note: For more https://www.oecd.org/daf/competition/

## Anti-competitive behaviour and implementation (Policy areas 5.2 and 5.5)

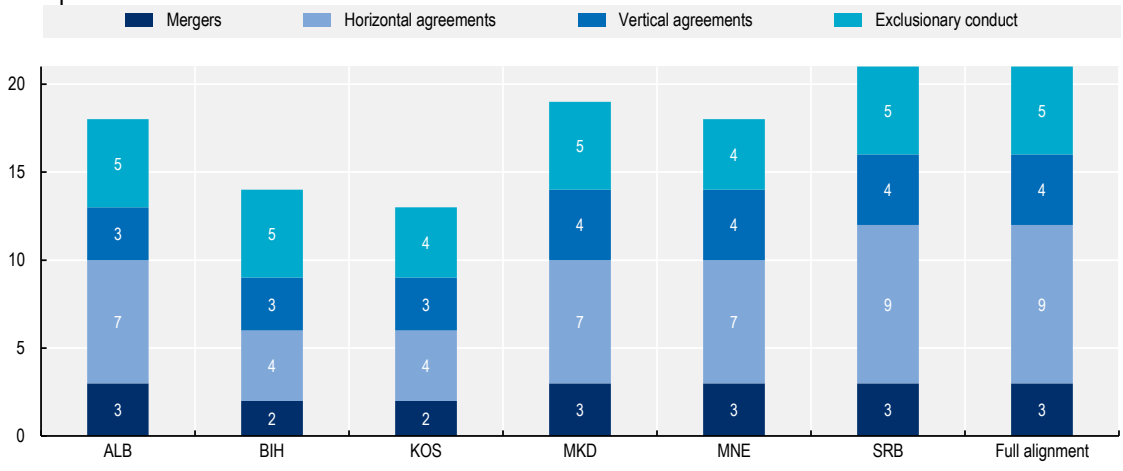
An appropriate legal and institutional competition framework is not enough to promote competition policy; competition authorities must make full use of their powers and engage in competition enforcement by detecting, investigating and punishing infringements. The implementation of the legal framework is necessary to address breaches and to deter possible future anti-competitive behaviour by conveying a credible message that such behaviour will be identified and severely sanctioned by the competition authority.

The Anti-competitive behaviour and Implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers.

Policy area 5.2, Anti-competitive behaviour, is a qualitative analysis that verifies to what extent competition authorities are aligned with best practices when conducting enforcement actions and using their anti-trust toolkit and powers. Figure 8.6 shows that the WB6 economies perform relatively well in terms of the number of adopted criteria. The new policy area 5.5, Implementation, is a quantitative analysis that explores how many competition decisions have been adopted by the competition authorities. The WB6 economies perform less well in this area (Figure 8.7), although there have been some recent positive signs.

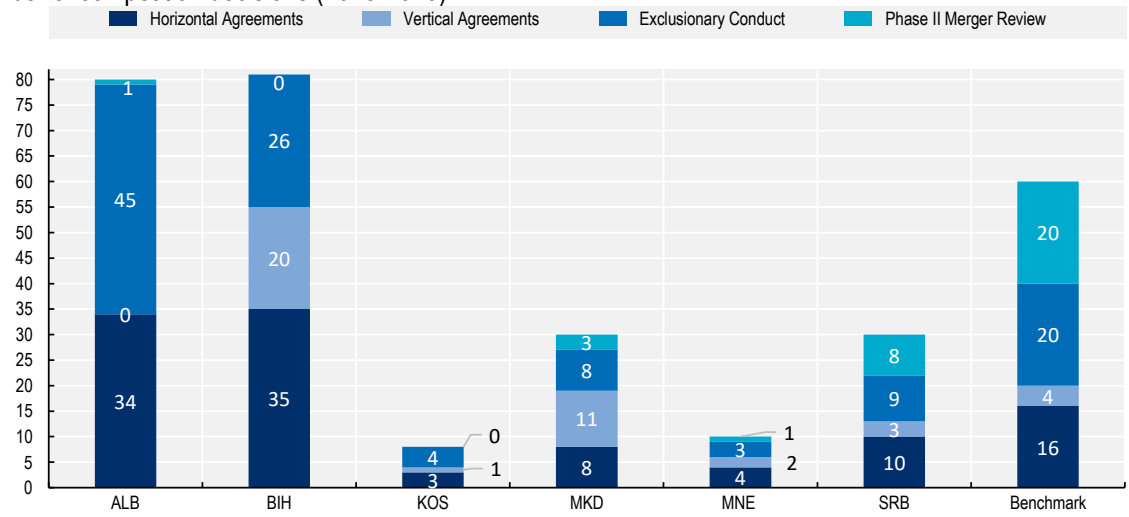
### Figure 8.6. Scores for anti-competitive behaviour (Policy area 5.2)

Number of adopted criteria



## Figure 8.7. Scores for implementation (Policy area 5.5)

Number of competition decisions (2015-2019)




Note: The data for BIH are not immediately comparable with the others because most decisions adopted by the economy's Competition Council have related to the non-opening of formal proceedings, while for other economies decisions have been taken following formal proceedings. The benchmark in the last histogram refers to the average of the 15 competition authorities in small economies that participated in the OECD CompStats database. See the Methodology and assessment process chapter for information on the Competitiveness Outlook assessment process.

### *Enforcement and sanctions for horizontal and vertical agreements and exclusionary conduct are limited*

Despite a comprehensive legal and institutional competition framework in the six economies, the actual implementation of competition rules through enforcement is still limited (Figure 8.7). The number of enforcement decisions adopted by the competition authorities of the WB6 economies between 2015 and 2019 was generally lower than the 15 benchmark competition authorities in the small economies that participate in the OECD CompStat database (Box 8.1). Over the same period, they adopted on average 16 decisions on horizontal agreements, 4 on vertical agreements and 20 on exclusionary conduct. Only Albania stands out, with a higher number of infringement decisions than the benchmark. Bosnia and Herzegovina's figures appear high too, but most of them do not refer to actual competition enforcement, being simple decisions to reject requests by complainants.

The Albanian Competition Authority has an appreciable record of formal proceedings tackling horizontal and vertical agreements, including bid rigging in public procurement. However, the total amount of fines imposed on participants in anti-competitive agreements over the last five years was EUR 2.2 million, vs. EUR 13.5 million levied by the 15 competition authorities in smaller jurisdictions that participated in CompStats in the same period (OECD, 2020[7]).

Regarding Bosnia and Herzegovina, as noted above most decisions adopted by the economy's Competition Council have related to the non-opening of formal proceedings, with the result that the impact of competition enforcement is limited and fines are negligible. No significant fines have been imposed over the last five years for prohibited agreements. One relevant fine was imposed in 2018 for an abuse of dominance in the delivery of heating energy.

Despite a limited number of decisions, the Serbian Commission for the Protection of Competition has performed well over the last few years. It took only one decision concerning horizontal anti-competitive agreements in 2019, but in the previous four years there were nine cartel decisions, which included some cases of bid rigging in public procurement. In 2020 the commission issued five infringement decisions and imposed fines on the parties: one case related to horizontal price fixing, one to bid rigging, two cases

concerned resale price maintenance and one an abuse of dominant position. The total amount of fines imposed on parties involved in anti-competitive agreements reached a peak of EUR 3.8 million in 2018, but decreased to EUR 857 000 in 2019.

In North Macedonia, the number of decisions tackling horizontal agreements has been low, particularly in recent years. The Commission for the Protection of Competition has primarily invested its investigative resources in vertical agreements. Sanctions on cartels were negligible until 2019, when the commission imposed a fine of EUR 1.7 million on two pharmaceutical companies.

In Montenegro, the Agency for Protection of Competition adopted only four cartel decisions between 2015 and 2019, as well as two decisions on vertical agreements and three decisions on abuse of dominance. In 2019, the agency opened two vertical investigations concerning resale price maintenance violations, which is a hardcore restriction in Montenegrin competition law. As said, in Montenegro investigations fall under the remit of the Agency for Protection of Competition and the imposition of fines under the Misdemeanour Courts. The fines imposed by Misdemeanour Courts were particularly low, less than EUR 100 000 per year. The highest fines imposed were not for cartel cases, but for abuse of dominance.

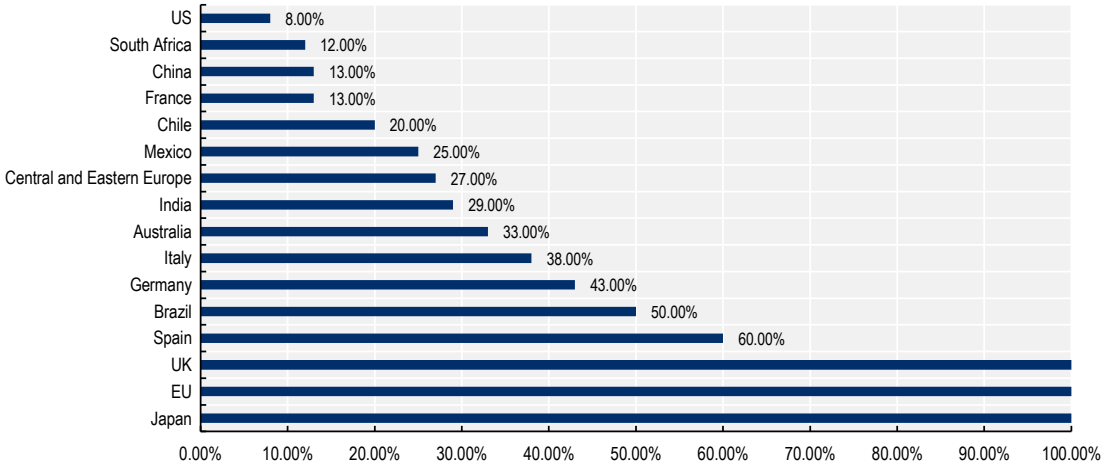
In the same period, the Kosovo Competition Authority investigated a very limited number of cartels, vertical agreements and abuses of dominant position, and imposed no fines. It either found no infringements or accepted commitments and closed the cases, often noting the limited awareness of competition rules in domestic firms. However, in 2020 the authority concluded a major investigation into a horizontal agreement on prices by 13 oil companies and imposed overall sanctions of more than EUR 1 million.

### *The effectiveness of leniency programmes and the use of unannounced inspections should be enhanced*

Several advanced competition authorities around the world use leniency applications as a key way of detecting cartels (Figure 8.8). Leniency programmes have been introduced in all WB6 economies, but have proven ineffective. Only the Serbian Commission for the Protection of Competition has received a leniency application so far, in 2018. This problem is common in most young and even some experienced competition agencies around the world. Nevertheless, the poor performance in the region is not surprising given that a pre-requisite for the effectiveness of a leniency programme is the threat of sanctions that leads cartelists to come forward and report the existence of an agreement to the competition authority. Considering the low sanctions imposed in the WB6 economies, cartelists have no real incentives to submit an application.

**Figure 8.8. Cartel decisions involving an immunity application (2019)**

% of cases involving leniency/immunity applicant



Source: OECD reproduction based on (Allen & Overy, 2020[11]), *Global Cartel Enforcement Report*, https://www.allenovery.com/en-gb/global/news-and-insights/global-cartel-enforcement-control.

The use of unannounced inspections varies across the region. Unannounced inspections (also called dawn raids) of premises are a crucial investigative tool to substantiate allegations so that robust decisions can be adopted, particularly in the case of cartels. Both the Albanian Competition Authority and the Serbian Commission for the Protection of Competition make frequent use of this power. However, the other competition authorities in the region seem to be reluctant to do so, although some have recently begun. For example, the Commission for the Protection of Competition of North Macedonia carried out three dawn raids in 2019, compared to one in the previous years. The Montenegrin Agency for Protection of Competition began performing unannounced inspections for agreement cases in 2019 in the context of anti-trust proceedings on resale price maintenance. The Bosnian Competition Council and the Kosovo Competition Authority have not yet performed any dawn raids.

### *There has been little activity regarding merger reviews across the region*

Regarding mergers, the number of Phase II investigations – i.e. the in depth analysis of a transaction that might raise competition concerns – has been insignificant or non-existent. The exception is Serbia, where the Commission for the Protection of Competition carried out eight Phase II investigations and one "gun jumping" case (failure to notify the competition authority of a merger or the implementation of all/part of the merger during mandatory waiting periods) in 2018 and 2019. The commission did not prohibit any transaction but cleared three cases by imposing remedies. Three additional Phase II merger reviews and two gun-jumping cases were also conducted in 2020. In North Macedonia, one concentration was blocked in 2017 and two were approved with remedies over the last five years. In Albania, only one concentration was investigated in-depth and eventually approved with remedies, in 2019. Another transaction was cleared with conditions and obligations in 2020. In the other jurisdictions, all mergers were unconditionally cleared in Phase I, i.e. without the need for a Phase II in-depth review.

The reason for the low activity on merger reviews in the WB6 economies, which again is not specific to the region, could be the unproblematic nature of most transactions, as many of the notified mergers concerned extra-territorial transactions that had little or no impact on the economy.

### *The way forward for anti-competitive behaviour and implementation*

- **Prioritise boosting cartel enforcement and imposing high fines.** Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. The efforts of the competition authorities of the WB6 economies should be focused on detecting cartels and imposing heavy fines on infringers to deliver a strong message that firms engaging in collusion risk being severely punished. If the amount of fines sufficiently exceeds illicit gains, offences can be deterred even when the probability of paying a fine is low. The concern about fines is also a key driver of leniency applications. Increased cartel sanctions would foster the effectiveness of the leniency programme – which has been unproductive in the region so far – and further boost detection. Consistent with the changes introduced in other jurisdictions in Eastern Europe, the Agency for Protection of Competition of Montenegro could be empowered to impose fines directly. The competition authorities of the WB6 economies should also make full use of their powers to perform unannounced inspections to collect evidence, which are key for the adoption of solid decisions, particularly in the case of cartels.
- **Pay specific attention to public procurement, particularly during the COVID-19 crisis.** The competition authorities of the WB6 economies should expand their detection skills, for example by further strengthening the fight against bid rigging. Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm to the public budget and taxpayers, dampening innovation and creating inefficiencies. The WB6

competition authorities should extend their co-operation with the domestic agencies for public procurement and other procurement bodies to carefully design the procurement process so that it reduces the risks of bid rigging and detects bid-rigging conspiracies. The extensive activities carried out by the OECD in this respect will be helpful (see Box 8.4 and Figure 8.9 below).

- **Continue to participate in the OECD CompStats database.** The new additional questionnaire filled out by the WB6 economies for Policy area 5.5, Implementation, mirrors the data collected by the OECD through the CompStats database (see Box 8.1 above). This has enabled a thorough quantitative analysis of the actual enforcement activity of the WB6 competition authorities, as well as providing a benchmark for the findings against other competition authorities that share similar characteristics. The competition authorities of the WB6 economies would benefit greatly from continuing to participate in the OECD CompStats database and completing future related questionnaires.

### Box 8.4. Initiatives undertaken by the OECD to fight bid rigging

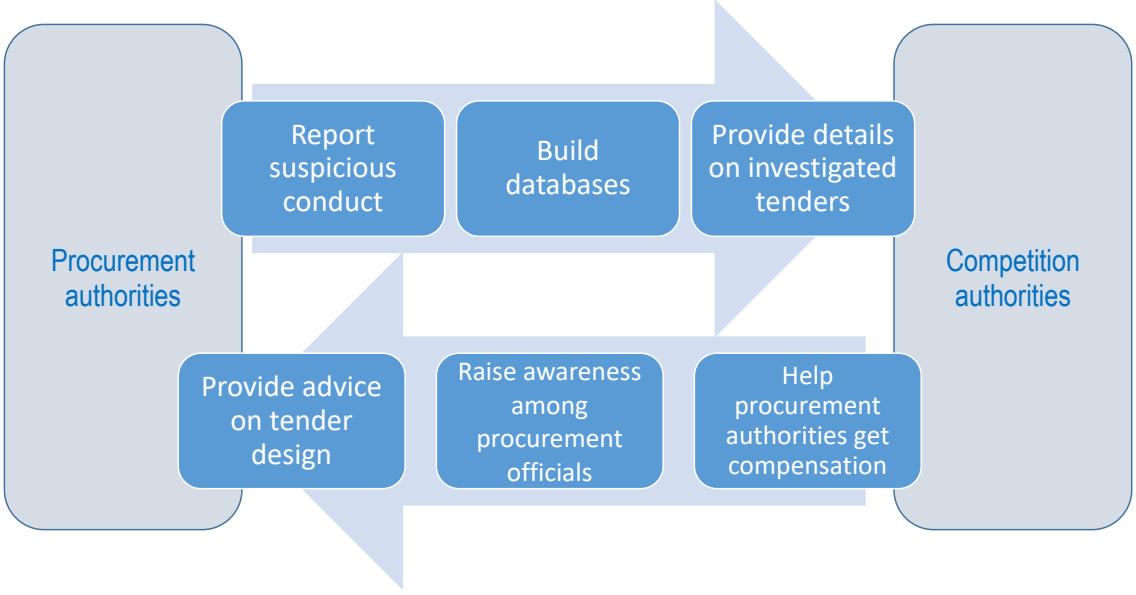
The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement, adopted in 2012, calls for governments to assess their public procurement laws and practices at all levels of government to promote more effective procurement and reduce the risk of bid rigging in public tenders.

The OECD Guidelines on Fighting Bid Rigging in Public Procurement, which have been incorporated into the Recommendation, are designed to reduce the risks of bid rigging and detect bid-rigging conspiracies through the careful design of the procurement process.

The OECD also provides assistance through a project that assesses the main rules governing the procurement of public works and the procurement practices of major public buyers, and provides recommendations to design competitive procurement and fight bid rigging in accordance with international good practice. Training is offered to both competition and public procurement officials based on the Guidelines on Fighting Bid Rigging in Public Procurement.

Note: For more https://www.oecd.org/daf/competition/cartels/42851044.pdf.

### Figure 8.9. Example of co-operation between competition and procurement authorities



## Probity of investigation (Policy area 5.3)

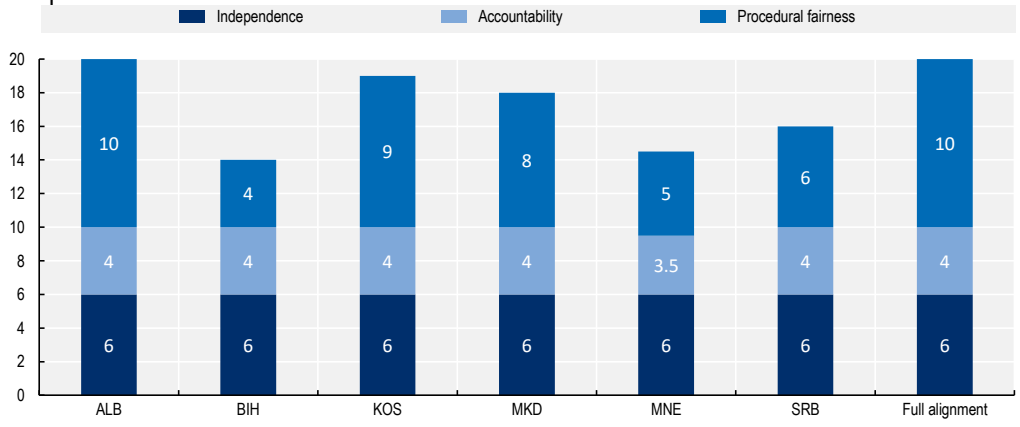
Probity of investigation plays an essential role in fair and effective law enforcement.

Companies must be safe in the knowledge that their practices conform to the applicable laws in the economies where they operate. They must also be able to interpret legal procedures correctly and to know and understand the workings of the statutory authority (or other body) that oversees them. Should they have to mount a defence in court, they need to be fully informed of the allegations against them and in good time (OECD, 2012[12]). Freedom from political influence is a prerequisite for fair and equal competition law enforcement as it helps ensure that cases are brought or dropped only on their merit (OECD, 2016[13]).

The probity of investigation policy area gauges the fairness of competition law enforcement and the degree to which competition authorities are independent and accountable. It involves three qualitative indicators: 1) independence; 2) procedural fairness; and 3) accountability (Figure 8.10). Together, these indicators assess the absence of government interference in investigations or decisions in anti-trust infringements and mergers, the rights of companies under investigation, and the transparency of the authority's actions and activities, as well as its accountability in court.

### Figure 8.10. Scores for probity of investigation (Policy area 5.3)

Number of adopted criteria




### *WB6 competition authorities are independent, but can be subject to political influence*

The competition authorities of the WB6 economies are independent state bodies, which means they are autonomous in their work and decision-making processes within the competencies provided by the competition law. This is consistent with good practices at international level. However, their independence does not exclude possible political influence on their effectiveness.

For example, in Kosovo the competition authority did not function between 2013 and 2016 because the members of the commission, whom are proposed by the government and approved by the parliament, had not been appointed. Kosovo's case shows that political action or lack of action can have a strong impact on competition policy.

In Bosnia and Herzegovina, the appointment and decision-making process of the members of the Competition Council are influenced by ethnic-based procedures, which risks introducing other considerations into decisions that should solely rely on a technical assessment.

### *WB6 competition authorities are accountable before parliament*

The competition authorities must submit an activity report to parliament each year, except the Competition Council of Bosnia and Herzegovina, which submits its annual report to the Council of Ministers. The Agency

for Protection of Competition of Montenegro submits its annual report for approval both to the government and to parliament.

### *Procedural fairness performance is generally good across the region*

The competition authorities of the WB6 economies must give notice of their decision to open formal proceedings and state the purpose of the investigation and the parties concerned, while encouraging interested third parties to come forward if they wish to take part. All final decisions regarding alleged competition infringements and mergers are published.

Prior to the adoption of a final anti-trust decision, the competition authorities must inform the parties of the relevant facts, evidence and other elements on which the decision is based, and enable them to submit a defence. The parties have the right to be heard before the board takes a final decision. At every stage of the proceedings, the parties may consult with the case team.

Likewise, if the competition authorities intend to prohibit a merger transaction, they must inform the merging parties about the evidence and conclusions on which the decision will be based and enable them to submit their remarks and possible remedies. The parties can participate in the process that leads to the determination of conditions and obligations, and can consult with the competition authority during the entire procedure.

The authorities' decisions can be appealed before administrative courts in the first instance and eventually before the high courts. In Bosnia and Herzegovina there is only one level of judicial review.

Most WB6 competition authorities have adopted and published several regulations and guidelines, including on the investigative procedure, the procedure for concentrations of undertakings, the assessment of horizontal and vertical agreements, and the calculation of fines. Bosnia and Herzegovina and Montenegro still have room for improvement.

### *The way forward for probity of investigation*

- **Shelter competition authorities from political influence and preserve their independence.** The OECD Competition Committee has found that ensuring the requisite levels of independence, transparency and appropriate resourcing for competition agencies is an ongoing challenge. Even well-established regimes can deviate from these standards, with detrimental consequences for the quality of competition enforcement, law and policy. It is of the utmost importance that such standards are maintained.

## Advocacy (Policy area 5.4)

Competition may be inhibited by public policies, laws and regulations that create barriers to entry or distort incentives for firms. Some distortions are unnecessary and can be eliminated without affecting public authority policy objectives. The mandate of a competition authority should therefore extend beyond merely enforcing competition law to addressing the additional obstacles to competition. It should also participate in formulating public policies to ensure they do not adversely affect competitive market structures, business conduct or economic performance. Accordingly, the competition authority should be able to advocate for competition and contribute to public policy discussions by assessing policies against barriers to competition and flagging potential threats for competition.

The advocacy policy area considers the capacity of competition authorities to advocate for a more competitive environment at the different government levels. Such advocacy can involve reviewing new and existing regulations to identify any unnecessary distortions to competition and performing market studies

that may lead to policy recommendations on how to foster competition and make the regulatory environment more pro-competition.

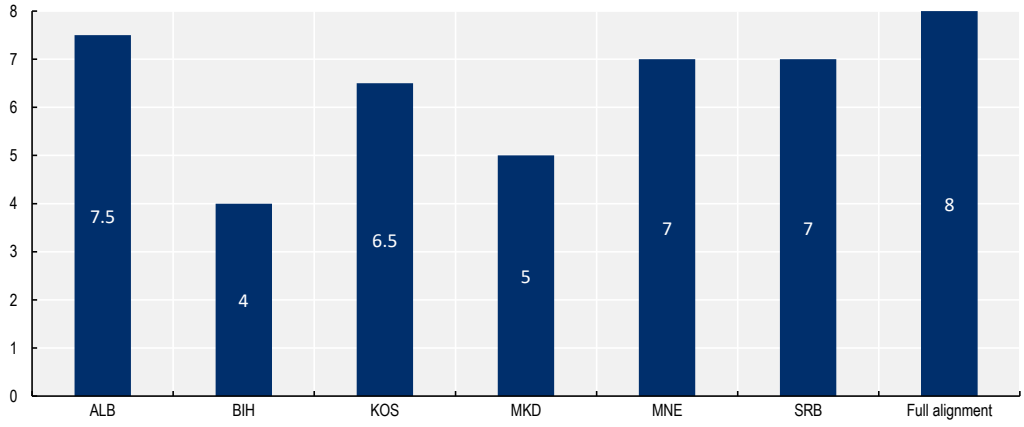
All the competition authorities of the WB6 can formulate opinions and recommendations regarding economy-level or local laws or regulations that affect or may affect competition. They can also assess possible barriers to competition in economic and administrative regulations that are aimed at pursuing general economic interests. In performing this duty, they usually co-operate with the government and regulatory institutions, including public procurement agencies.

The competition authorities can conduct market studies, i.e. general inquiries in any sector of the economy, on their own initiative or following a request by parliament or other regulators, if price patterns or other circumstances suggest that competition might be restricted or distorted. The only exception is the Competition Council of Bosnia and Herzegovina, which does not have the legal power to conduct market studies.

All WB6 economies except Bosnia and Herzegovina and North Macedonia are close to be fully align in the advocacy policy area. With a score of 7.5, Albania is the closest economy followed by Montenegro and Serbia (Figure 8.11).

### Figure 8.11. Scores for advocacy (Policy area 5.4)

Number of adopted criteria




Note: The maximum number of criteria that could be adopted is eight. See the Methodology and assessment process chapter for information on the Competitiveness Outlook assessment process.

### *WB6 competition authorities are engaged in promoting competition*

Competition authorities can help governments eliminate barriers to competition by identifying unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives. Competition advocacy can establish a competition mindset and culture within an economy and strengthen the competition authority's standing and reputation.

Market studies can assess how competition in a sector or industry is functioning, detect the source of any competition problems and identify potential solutions. Competition problems include regulatory barriers to competition and demand-side factors that impair market functioning. Market studies can improve the quality and credibility of advocacy initiatives, while boosting and better orienting competition enforcement. Given that they are a versatile tool that allow the examination of a broader set of issues than simply competition enforcement, their use is growing in most jurisdictions.

The Albanian competition authority issued 25 formal opinions in 2019, which represents a substantial increase from 17 in 2018 and even lower figures in previous years. The sectors addressed by recommendations on draft regulations include water, energy, media and telecommunications. In the period

2015-2019, the Albanian competition authority concluded on average four general inquiries per year, addressing key sectors such as higher education, banking, health care and liberal professions. In 2020, the authority adopted the Competition Advocacy and Communication Strategy, which aims to increase its advocacy role.

The Competition Council of Bosnia and Herzegovina did not issue formal opinions to the government nor parliament on draft or existing laws or regulations in the period 2015-2019. However, it co-operated with public institutions on competition matters and expressed its view on industry practices that may restrict competition. Upon request by the Agency for Public Procurement, it also analysed the rules on public tenders.

The Kosovo Competition Authority has actively engaged in competition advocacy in several sectors, particularly in the last few years. It has issued opinions and recommendations to the Central Bank of Kosovo on insurance companies, to the Ministry of Health on price regulation for medicinal products and equipment, and to the Tax Administration of Kosovo on the provision of cash register equipment. In 2019, it published two market studies, one on the telecommunications sector and one on the energy sector. In 2019, it signed memoranda of understanding with several sector regulators.

The Agency for Protection of Competition of Montenegro has issued a limited number of opinions over the last five years. The main interventions have concerned the Law on Free Access to Information in 2016 and the Draft Law on Audio-visual Services in 2019. The agency signed a co-operation agreement with the Public Procurement Administration in 2015. It did not conduct any market studies.

The Commission for the Protection of Competition of North Macedonia issued seven formal opinions in 2019, including on the Law on Public Procurement and the Law on Misdemeanour. The suggestions made were implemented. In December 2014 the commission issued guidelines for detecting bid rigging in public procurement, in co-operation with the Bureau for Public Procurement. It has not conducted market studies over the last few years.

The Serbian Commission for Protection of Competition has engaged in a wide range of initiatives aimed at promoting compliance with competition principles in laws and regulations, with the number of formal opinions addressed to the government or courts more than doubling over the last few years. The initiatives include an opinion on the regulation of road hailing services and an opinion on regulatory impact assessment, both in 2018. In 2019, the commission signed a memorandum of understanding with the Public Policy Secretariat to improve the competition assessment of legislation, on the basis of the OECD's Competition Assessment Toolkit (OECD, 2019[14]). It has also conducted outreach activities to promote co-operation with other public authorities, including public procurement officials. It has performed at least three market studies per year over the last four years.

It should be highlighted that the state has a dual role as policy maker/sector regulator and supplier or purchaser of goods and services. Consequently, in markets open to competition the state also acts as a market participant and interacts with private businesses, most often indirectly, through SOEs. Governments may be tempted to grant undue advantages to SOEs or to certain domestic companies, such as a privileged market position, soft loans, outright subsidies, regulatory exemptions or tax benefits. Given the importance of SOEs in the WB6 economies, and the increased role of the state in the economy that will likely result from the COVID-19 crisis, competition authorities can make a decisive contribution to promoting competitive neutrality, which occurs when no entity operating in an economic market is subject to undue competitive advantages or disadvantages, irrespective of their ownership (state-owned or privately owned) or nationality (domestic or foreign). WB6 competition authorities have also organised a number of events aimed at developing a competition culture. For example, they have conducted workshops, training initiatives, and events for consumers, companies and public officials. They have also published educational materials through their websites or social media accounts. This activity is important to increase the standing and credibility of competition authorities and to increase awareness about the role and benefit of competition policy.

### *The way forward for advocacy*

- **Continue to advocate against competition restrictions in laws and regulations, using the OECD Competition Assessment Toolkit as a basis**. The OECD's Competition Assessment Toolkit is a practical methodology that supports competition authorities in this task. Where a detrimental impact is discovered, the toolkit helps to develop alternative ways to achieve the same objectives, with minimal harm to competition. The WB6 economies should use this toolkit to support their efforts on competition advocacy.
- **Advocate strongly for competitive neutrality to ensure that all enterprises face the same set of rules, irrespective of their ownership or nationality**. Competition authorities should discourage the government from granting selective aid to SOEs or domestic companies and resist political pressure to adopt a more lenient approach when investigating SOE conduct.
- **Use market studies to gain a better understanding of competition in key sectors and make recommendations more informed and credible. Bosnia and Herzegovina should empower its Competition Council to conduct market studies**. The Competition Council of Bosnia and Herzegovina should have the power to conduct market studies, as is the case in the other WB6 competition authorities and in most competition authorities around the world. OECD country projects can help competition authorities perform key market studies (Box 8.5).
- **Continue to conduct dedicated events to promote a competition culture**. Competition authorities need to strengthen their standing and reputation and inform policy makers and the business community about the key role played by competition in supporting economic growth and consumer welfare. Effective tools to increase competition awareness include tailor-made conferences in co-operation with other public authorities, training events and seminars addressed to the legal and business community or the judiciary, and educational materials for the general public.

#### Box 8.5. Examples of OECD competition assessment support projects

In 2014 the OECD launched a project in **Romania** to review construction, freight transport and food processing, in co-operation with the Romanian Competition Council. The project also provided assistance in building the competition assessment capabilities of the Romania administration, i.e. officials from the line ministries and the relevant authorities.

The OECD worked closely with **Greece** from 2012 to 2016 to assess competition laws and regulations hindering competition in several sectors, including construction, media, wholesale trade, e-commerce, chemicals and pharmaceuticals. Between July 2016 and January 2018, the OECD carried out a policy assessment in **Mexico** in the sectors of medicines and meat. In October 2016, the OECD teamed up with the Portuguese competition authority to carry out a policy assessment in **Portugal** to identify the rules and regulations hindering the efficient functioning of markets in the transportation sector and in 13 professions.

In co-operation with the UK Government, from 2018 to 2021 the OECD has been undertaking ten Competition Assessments of Laws and Regulations in the logistics sector in **Association of Southeast Asian Nations (ASEAN) countries**, based on the OECD Competition Assessment Toolkit.

In **Iceland**, following the arrival of the COVID-19 pandemic, in November 2020 the OECD and the Icelandic Competition Authority made 438 recommendations for a more flexible environment in two key sectors of the economy: construction and tourism.

The OECD has also been asked to contribute to an EU project in **Tunisia** and will conduct a peer review of competition law and policy, as well as a review of laws and regulations, in the tourism and the banking

sectors. The project started in February 2021 and builds on the success of the first OECD Competition Assessment conducted in the country in 2019, which covered wholesale and retail trade, as well as road and maritime freight transport.

## Conclusion

The competition authorities of the WB6 economies can support economic growth and a quick recovery after the COVID-19 crisis. To this end, they must establish themselves as strong, influential entities by tackling anti-trust infringements and advocating for the removal of competition restrictions in laws and regulations.

Competition enforcement is still limited, despite a positive number of infringement decisions in Albania and Serbia, and promising activities in other jurisdictions. Notably, the number of uncovered cartels is still small, and sanctions are not sufficient to ensure deterrence.

WB6 competition authorities are progressing on competition advocacy through urging policy makers and regulators to remove competition restrictions, promoting co-operation with domestic institutions, and engaging in spreading a competition culture in the business community and among the public.

Despite an appropriate competition framework, competition authorities still lack the necessary professional and financial resources to perform all their activities.

Two areas of action seem particularly promising for the near future: 1) co-operation with procurement bodies to enhance the prevention and detection of bid rigging; and 2) market studies to improve the quality and credibility of advocacy initiatives, while boosting and better orienting competition enforcement.

In the face of increasingly complex and supranational competition infringements, regional and international co-operation, as well as constant training, appear necessary to respond effectively to future challenges.

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# Annex 8.A. Competition Questionnaire

| Sub-Dimensions | Policy Indicators |
|---|---|
| **1) Competences framework** | 1.1) Does the competition law apply also to firms located outside your jurisdiction whose behaviour directly affects competition and/or consumers in domestic markets? |
| | 1.2) In your jurisdiction, are state-controlled firms exempt from the application of competition law when conducting commercial activities in competition with private firms? |
| | 1.3) Annual budget of the Competition Authority (as a percentage of total annual state budget) over the last five calendar years (2015-2019)? |
| **2) Independence framework** | 2.1) Have the government/ministers given binding directions to the competition agency on whether it should open an investigation on an alleged antitrust infringement at least once in the last five calendar years (2015-2019)? |
| | 2.2) Have the government/ministers given binding directions to the decision-maker in your jurisdiction on whether it should close an investigation on an alleged antitrust infringement at least once in the last five calendar years (2015-2019)? |
| | 2.3) Have the government/ministers given binding directions to the competition agency on whether it should impose/not impose (or ask a court to impose/not impose) specific remedies when closing an investigation on an alleged antitrust infringement at least once in the last five calendar years (2015-2019)? |
| | 2.4) Have the government/ministers given binding directions to the competition agency (or other public bodies) on whether it should not undertake a market/sectoral study at least once in the last five calendar years (2015-2019)? |
| | 2.5) Have the government/ministers overturned a decision concerning the clearance of a merger at least once in the last five calendar years (2015-2019)? |
| | 2.6) Have the government/ministers overturned a decision concerning the prohibition of a merger at least once in the last five calendar years (2015-2019)? |
| **3) Powers to investigate framework** | 3.1) Can your competition agency compel (or ask a court to compel) firms investigated for a possible antitrust infringement to provide information? |
| | 3.2) Can your competition agency compel (or ask a court to compel) third parties to provide information to help an investigation on an antitrust infringement? |
| | 3.3) Can your competition agency perform unannounced inspections/searches in the premises of firms investigated for a possible antitrust infringement aimed at gathering evidence (with or without a warrant/court authorization)? |
| | 3.4) If yes, has your competition agency performed unannounced inspections in the premises of firms investigated for a possible antitrust infringement at least once in the last five calendar years (2015-2019)? |
| | 3.4.1) If your competition agency has not conducted any unannounced inspections in the last two calendar years (2018-2019), please briefly list the three most important reasons for not having used this instrument and provide a short explanation for each. |
| | 3.5) Can your competition agency compel (or ask a court to compel) merging firms to provide information to help it assess the merger? |
| | 3.6) Can your competition agency compel (or ask a court to compel) third parties to provide information to help it assess the merger? |
| | 3.7) Number of complaints to the Competition Authority over the last five calendar years? |
| **4) Powers to sanction / remedy framework** | 4.1) Can your competition agency impose, or ask a court to impose, remedies or a cease and desist order on firms that have committed an antitrust infringement? |
| | 4.2) If yes, can your competition agency impose, or ask a court to impose sanctions on firms that do not comply with remedies imposed on them with respect to an antitrust infringement they have committed? |
| | 4.3) Can your competition agency impose, or ask a court to impose, sanctions on firms that have committed an antitrust infringement? |
| | 4.4) Can your competition agency, or a court, accept or impose remedies on firms in order to clear a merger? |
| | 4.5) Can your competition agency impose, or ask a court to impose, sanctions on a firm that hinders an investigation on an alleged antitrust infringement? |
| | 4.6) If yes, have sanctions been imposed on a firm and/or individuals for hindering an investigation on an antitrust infringement at least once in the last ten calendar years (2009-2019)? |
| | 4.7) Can your competition agency impose, or ask a court to impose, sanctions on firms and/or individuals that do not comply with a decision concerning a merger? |
| | 4.8) Can your competition agency impose, or ask a court to impose, interim measures while performing an investigation |

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| | of an alleged antitrust infringement because there is a concern that this may lead to irreversible damages? |
| | 4.9) Can your competition agency, or a court, settle voluntarily with the parties investigated for an alleged antitrust infringement and thus close the investigation? |
| | 4.10) Can your competition agency, or a court, clear a merger that raises anticompetitive concerns by negotiating/accepting remedies that address these concerns at an early stage and thus avoid to perform a more in-depth investigation? |
| | 4.11) Number of court cases related to competition |
| **5) Mergers framework** | 5.1) Does the decision-maker conduct an economic analysis of the competitive effects of mergers when investigating them? |
| | 5.2) When assessing a merger can the decision-maker consider whether the merger is likely to generate efficiencies? |
| | 5.3) Has the decision-maker blocked or cleared with remedies at least one merger in the last five calendar years (2015-2019)? |
| **6) Horizontal agreements framework** | 6.1) Are anticompetitive horizontal agreements (including cartels) prohibited in your jurisdiction? |
| | 6.2) Does the decision-maker conduct an economic analysis of the competitive effects of horizontal agreements when investigating them? |
| | 6.3) When investigating an allegedly anticompetitive horizontal agreement can the decision-maker consider any efficiency this may generate? |
| | 6.4) Have sanctions and/or remedies been imposed on at least one cartel in your jurisdiction in the last five calendar years (2015-2019)? |
| | 6.4.1) How many hard core cartel cases (i.e. cases with obvious by object infringements like price fixing or market sharing) have been closed with the finding of an infringement and with fines in the last two calendar years (2018-2019)? |
| | 6.4.2) What was the total amount of the fines (sum of all fines in EUR) imposed in these cases? |
| | 6.5) Have sanctions and/or remedies been imposed on at least one anticompetitive agreement that is not a cartel in your jurisdiction in the last five calendar years (2015-2019)? |
| | 6.6) Does your jurisdiction have a leniency/immunity program for cartel participants (firms and/or individuals)? |
| | 6.7) If yes, has the leniency program generated at least one application in the last five calendar years (2015-2019)? |
| **7) Vertical agreements framework** | 7.1) Are anticompetitive vertical agreements prohibited in your jurisdiction? |
| | 7.2) Does the decision-maker conduct an economic analysis of the competitive effects of vertical agreements when investigating them? |
| | 7.3) When investigating an allegedly anticompetitive vertical agreement can the decision-maker consider any efficiency this may generate? |
| | 7.4) Have sanctions and/or remedies been imposed on at least one anticompetitive vertical agreement in your jurisdiction in the last five calendar years (2015-2019)? |
| **8) Exclusionary conducts framework** | 8.1) Are exclusionary conducts by dominant firms and/or by firms with substantial market power prohibited in your jurisdiction? |
| | 8.2) Does the decision-maker take non-market-share factors (such as conditions of entry, ability of smaller firms to expand, and ability of customers to switch to smaller rivals) into account when determining dominance? |
| | 8.3) Does the decision-maker conduct an economic analysis of the competitive effects of exclusionary conducts when investigating them? |
| | 8.4) When investigating an allegedly exclusionary conduct can the decision-maker consider any efficiency this may generate? |
| | 8.5) Has the decision-maker in your jurisdiction imposed sanctions and/or remedies on at least one firm for exclusionary conduct over the past five calendar years (2015-2019)? |
| **9) Advocacy framework** | 9.1) Does your competition agency (or another public body) advocate competition at central government level? |
| | 9.2) Does your competition agency (or another public body) advocate competition at local or regional government levels? |
| | 9.3) Are all new public policies that may have implications for competition subject to a competition assessment in your jurisdiction? |
| | 9.3.1) In case 9.3 has been answered with "yes", is the competition agency involved in the competition assessment? |
| | 9.3.2) Please briefly describe the competition agency's involvement in the competition assessment:<br>• Does it receive all draft laws and regulations well in advance and is given sufficient time to examine and comment?<br>• Is there a specialised unit/staff member in charge of the competition assessment?<br>• Is there a manual/guidance for conducting the assessment and if so, please briefly describe the major steps or provide a link to the guidance, in case it is public. |
| | 9.3.3) In how many cases has the competition agency issued recommendations for change in the last two calendar years (2018-2019)? Please briefly describe two or three recommendations given. |

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| | 9.3.4) How many of the recommendations led to the recommended changes of the draft laws and regulations? |
| | 9.3.5) If the recommendations were not followed, did the government give reasons for leaving the draft laws and recommendations unchanged? |
| | 9.4) Can market/sectoral studies be performed in your jurisdiction? |
| | 9.5) If yes, has at least one market/sectoral study been performed in your jurisdiction in the last five calendar years (2015-2019)? |
| | 9.6) If a market/sectoral study identifies an obstacle or a restriction to competition caused by an existing public policy, can the study include an opinion/recommendation to the government to remove or reduce such obstacle or restriction? |
| | 9.7) If a market/sectoral study includes an opinion/recommendation to the government concerning an obstacle or restriction to competition caused by an existing public policy, is the government required to publicly respond to this opinion/recommendation? |
| | 9.8?) Please describe if the competition authority is providing information and/or trainings to public procurement officials on the prevention and detection of bid rigging in public procurement procedures. Briefly describe the efforts and materials, i.e. number of trainings or contacts to public procurement bodies within the last two calendar years (2018-2019) and their nature. |
| **10) Accountability framework** | 10.1) Does your competition agency publish regularly a report on its activities? |
| | 10.2) Are decisions that ascertain the existence of an antitrust infringement published by the relevant decision-maker? |
| | 10.3) Are decisions that block a merger or clear a merger with remedies published by the relevant decision-maker? |
| | 10.4) Can decisions on antitrust infringements and mergers (whether taken by a competition agency or a court) be subject to judicial review with respect to their substance? |
| **11) Procedural Fairness framework** | 11.1) Does your competition agency provide the party/parties under investigation for an antitrust infringement with opportunities to consult with your competition agency with regard to significant legal, factual or procedural issues during the course of the investigation? |
| | 11.2) Do parties have the right to be heard and present evidence before the imposition of any sanctions or remedies for having committed an antitrust infringement? |
| | 11.3) Does your competition agency provide the parties under investigation for a merger with opportunities to consult with your competition agency with regard to significant legal, factual or procedural issues during the course of the investigation? |
| | 11.4) Do parties have the right to be heard and present evidence before a decision on a merger is reached? |
| | 11.5) Does your competition agency publish procedural guidelines or public documents explaining its investigative procedures? |
| | 11.6) Does your competition agency publish guidelines that explain how abuses of dominance are assessed? |
| | 11.7) Does your competition agency publish guidelines that explain how horizontal agreements are assessed? |
| | 11.8) Does your competition agency publish guidelines that explain how vertical agreements are assessed? |
| | 11.9) Does your competition agency publish guidelines that explain how mergers are assessed? |
| | 11.10) Are there published administrative guidelines that explain how monetary sanctions for antitrust infringements are set by your competition agency, or recommended by it to the court? |
| **12) Private Enforcement framework** | 12.1) Can individuals bring a legal action to seek damages from firms that have committed an antitrust infringement? |
| | 12.2) Can firms bring a legal action to seek damages from firms that have committed an antitrust infringement? |
| | 12.3) Can a group of consumers (either collectively or through a consumer association) bring a legal action to seek damages from firms that have committed an antitrust infringement? |

# 9 State-owned enterprises (Dimension 6)

State-owned enterprises (SOEs) are an integral part of the Western Balkans' economic architecture. They often operate in vital sectors of the economy and deliver crucial public services, making their efficient operations decisive for broader economic and societal outcomes. Depending on whether they are profitable or loss-making, SOEs can also have significant, and sometimes unexpected, impacts on fiscal budgets. For these reasons, ensuring that SOEs operate efficiently, transparently and on a level playing field with private companies is important. This chapter assesses these aspects through four key sub-dimensions. The first, efficiency and performance through improved governance, summarises available data on the region's SOE landscape, notably sectoral distribution, employment contributions and performance. It then examines state ownership and corporate governance arrangements and how they affect SOEs' efficiency. The second sub-dimension, transparency and accountability practices, discusses SOEs' accountability to the state, the general public and minority shareholders. The third sub-dimension, ensuring a level playing field, explores how the legal treatment and financing conditions for SOEs influence the level playing field with private companies, and how they affect economic efficiency. The final sub-dimension, reforming and privatising SOEs, reviews regional trends concerning SOE reform and privatisation. Each sub-dimension section makes specific recommendations for going forward.

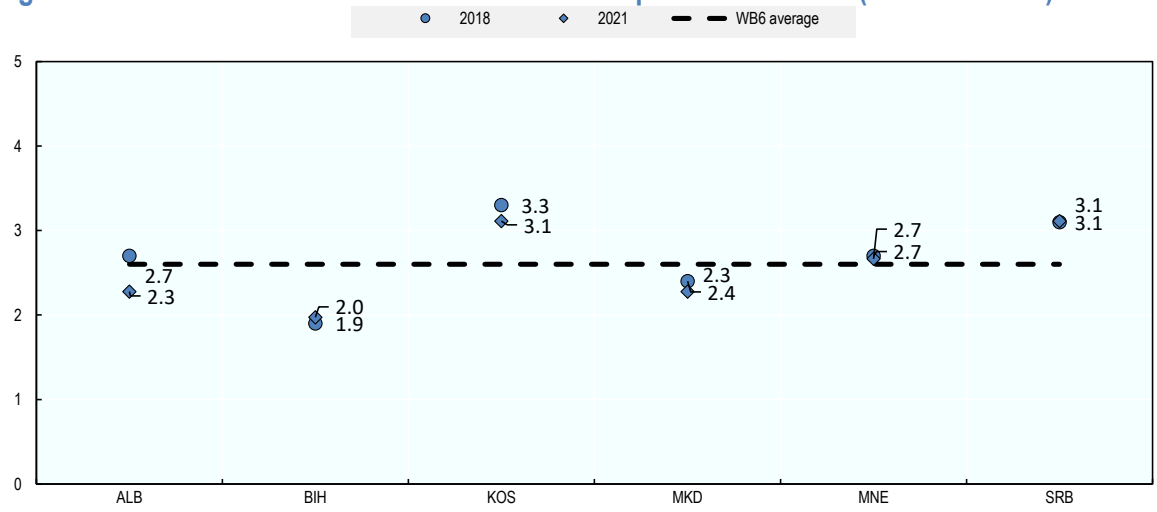
## Key findings

- **The efficiency of SOEs is key for economic development, societal well-being and healthy public finances**. The Western Balkans has over 500 SOEs, which are highly concentrated in sectors that both the general public and companies depend on for their everyday operations, including electricity and gas, water supply and sewage, transportation and telecommunications. Although performance monitoring of central SOEs is limited, external assessments point to their frequent underperformance, which often strains public budgets and contributes to the sub-optimal allocation of economic resources.
- **Most of the region's public authorities have not developed ownership policies** outlining why the state owns companies and what it expects them to achieve, which contributes to SOEs' often unclear or ad hoc performance objectives and limited accountability among state actors for SOE performance.
- **SOE ownership arrangements are predominantly decentralised** across the region, with several line ministries or other public bodies exercising ownership rights over distinct portfolios of SOEs. This can lead to the problematic mixing of roles on the part of state actors (e.g. ownership and regulatory roles), increase the risk for political influence over corporate decision making, and make it difficult to obtain a holistic overview of SOE performance.
- **Small steps have been taken to improve SOE board appointment processes in some of the region's economies.** For example basic qualifications criteria have been introduced in some economies, as well as requirements for independent directors on boards. SOE board positions are nonetheless frequently perceived to be awarded based on political connections rather than purely professional qualifications. Political influence on SOE boards can trickle down to management appointments and increase the risk that corporate decisions are influenced by political factors rather than value creation.
- **SOEs are mostly subject to sound basic requirements for financial reporting, but compliance is not consistent.** In several cases financial audits have uncovered issues with the credibility of SOEs' corporate disclosures. Non-financial reporting, particularly concerning the nature and costs of SOEs' public service obligations (or other non-commercial objectives), is underdeveloped in the region. There is significant scope to strengthen disclosure by the state as shareholder, notably through aggregate reports that analyse the performance of all SOEs.
- **Non-state minority shareholders are an important element of the region's SOE landscape.** This is particularly the case in Bosnia and Herzegovina, Montenegro and Serbia, where a significant number of SOEs have private minority shareholders. Across the region there is scope to improve minority shareholders' legislated rights (applicable to all companies, including SOEs). There is also a need to engage in more targeted efforts to communicate with the minority shareholders of SOEs, be accountable to them and ensure they play an adequate role in corporate decision-making so that SOEs create value for all shareholders.
- **Across the region, the legal and regulatory treatment of most SOEs is broadly aligned with the treatment of private companies**. However, the existence of a separate legal form of "public enterprise" for some SOEs in several economies (Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia) may distort the playing field with private companies. Many SOEs do not earn economically significant rates of return, which can mean that resources are allocated inefficiently (although it can also sometimes reflect public policy obligations financed by commercial revenue). This should be addressed through reforms within individual enterprises.

## Comparison with the 2018 assessment

There have been very limited changes to the scores of the six Western Balkan (WB6) economies for the state-owned enterprise policy dimension since the 2018 assessment, reflecting limited efforts by the economies' authorities to reform state ownership practices (Figure 9.1). For the most part, score changes since 2018 reflect the fact that the current iteration of the assessment has involved more in-depth information gathering at the economy level, allowing for the fine-tuning of individual economy scores.

### Figure 9.1. Overall scores for the state-owned enterprises dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress in implementing the policy recommendations made in the Competitiveness Outlook (CO) 2018 has been limited overall (Table 9.1), although preliminary steps have been taken to professionalise the state shareholding function in three economies (Albania, Bosnia and Herzegovina and Serbia) through proposals to establish dedicated state ownership units. However, the region's authorities have not taken any significant efforts to clarify SOEs' financial and non-financial objectives, or to strengthen accountability to the public and to SOE minority shareholders.

## Table 9.1. Implementation of the Competitiveness Outlook 2018 policy recommendations: State-owned enterprises dimension

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Professionalise the state ownership function as a priority in all WB6 economies** | • There have been no substantial reforms to date, but preliminary proposals have been made to establish central state ownership monitoring or co-ordinating entities in three economies (Albania,[1] Bosnia and Herzegovina and Serbia). | Limited |
| **Foster clarity in financial and non-financial objectives for individual SOEs** | • There is no evidence that any authority has taken steps to clarify SOEs' financial and non-financial objectives for a significant proportion of SOEs.<br>• Reforms of individual SOEs have been undertaken in some economies, often clarifying the sources of underperformance and establishing clearer performance objectives. | None |
| **Ensure governments engage in aggregate reporting on their SOEs** | • No additional authorities have undertaken SOE aggregate reporting since 2018.<br>• Kosovo remains the only economy where aggregate reports are published, with plans to publish the latest edition in 2021. Serbian authorities have undertaken various forms of public reporting on their SOEs. | None |
| **Strengthen the protection of non-state investors further** | • Amendments to the company law in Montenegro increased requirements for independent members of company boards of directors. While not directly related to minority shareholder rights, this development could help ensure that SOE boards of directors are better equipped to make decisions in the interest of all shareholders, including minority investors.<br>• There is no evidence that any targeted efforts have been undertaken in the region's economies to go beyond the basic requirements of the general company law to strengthen accountability to SOEs' minority shareholders. | Limited |

[1]Note: In Albania, a proposal to establish a central state ownership agency was made by the Ministry of Finance but not agreed upon by the government.

## Introduction

Ensuring that state-owned enterprises operate efficiently, transparently and on a level playing field with private companies is key for the economic development and competitiveness of the Western Balkans. SOEs are an integral part of the region's economic architecture, often operating in systemically important sectors, such as electricity and gas, telecommunications, and public transportation, on which other businesses and the general public depend for their everyday operations. Because SOEs frequently operate the public utilities and infrastructure that most other companies rely on for their operations, their efficiency directly impacts the competitiveness of these companies, including notably the producers of tradeables. SOEs can also positively or negatively influence public finances. For example, SOE performance, and whether they provide dividends to the state, affects the capacity of public authorities to finance necessary investments, such as infrastructure and government services. If SOEs are loss-making they can place a significant strain on public finances, which can become a long-term problem if the structural sources of corporate losses are not addressed. If state ownership confers any unwarranted competitive advantages on SOEs compared to private competitors, such as direct financial support or regulatory leniency, then this can distort the level playing field with private companies and ultimately crowd out more productive firms. SOEs can also face unwarranted competitive disadvantages, such as public service obligations that are insufficiently subsidised by the state, jeopardise their commercial viability and even threaten the provision of public services.

This chapter focuses on establishing the appropriate ownership, corporate governance, legal and accountability arrangements to address some of the most prevalent reasons for poor SOE performance

and limited accountability. SOE operations have implications for several other policy areas assessed by the Competitiveness Outlook. Most notably these include:

- **Chapter 4: Investment policy and promotion**. SOEs sometimes operate in sectors of the economy that are deemed strategic or important for national security, and which therefore the authorities wish to maintain under national (non-foreign) and/or state ownership and control, such as energy or telecommunications infrastructure. The maintenance of state ownership and/or control in these sectors is often enshrined in domestic law and can limit the sectors to which inward investment can flow, or the degree of control that can be granted to foreign investors in certain undertakings. More broadly, sound SOE governance and regulation can have far-reaching impacts on an economy's overall investment attractiveness. Foreign investors need to be confident that the state as an owner of structurally important enterprises – and as a regulator of both state-owned and private corporations – will act professionally, predictably and in the interest of a healthy competitive environment.
- **Chapter 8: Competition policy**. Ensuring that SOEs compete on a level playing field with private companies is crucial to establishing a robust competition environment. Even if SOEs are not explicitly exempt from the application of competition rules, the fact that they are owned by the state can result in leniency on the part of competition authorities or courts. SOEs also often operate the network infrastructure (e.g. in the electricity and telecommunications sectors) that private companies depend upon for their operations. In cases where a market has recently been liberalised, state-owned network operators may tend to offer privileged access or conditions to SOEs rather than their private competitors.
- **Chapter 19: Anti-corruption policy**. SOEs can face particularly heightened risks of corruption given their closeness to the public administration – public officials often serve as board members – as well their frequent presence in sectors generally associated with higher corruption risk, such as mining and gas. Ensuring that SOEs are well governed, including through boards of directors that are free of excessive political influence, is crucial to reducing corruption risk. Strong transparency is also important for identifying and addressing illicit or unethical practices. Issues related to corruption risks specifically in the state-owned enterprise sector are not examined in great detail in this publication. Related guidance can be found in the OECD's Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises (OECD, 2019[1]).

## Assessment framework

### *Structure*

This chapter assesses policies to strengthen state-owned enterprise governance in the WB6 by examining practices in four broad sub-dimensions:

1. **Sub-dimension 6.1: Efficiency and governance through improved governance** examines the extent to which state ownership decisions are guided by clear policies and efficient institutional arrangements. It also assesses the extent to which SOE boards of directors are equipped with sufficiently independent and qualified professionals to allow them to effectively oversee corporate management and make decisions in the interests of the enterprises they serve.
2. **Sub-dimension 6.2: Transparency and accountability practices** examines the extent to which SOEs are accountable to the state, to their minority shareholders and to the general public. It analyses SOE corporate disclosure and audit requirements and practices, examines minority shareholder rights and access to information, and reviews the transparency of the state as a shareholder.

3. **Sub-dimension 6.3: Ensuring a level playing field** focuses on the extent to which SOEs' legal and regulatory framework, as well as their financing conditions, impact the competitive landscape with private companies.
4. **Sub-dimension 6.4: Reforming and privatising SOEs** summarises recent SOE governance reforms and privatisation efforts.

Figure 9.2 shows how the sub-dimensions and their indicators make up the SOE dimension assessment framework. The indicators draw on the standards set forth in the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which provides a blueprint for SOEs (OECD, 2015[2]).

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. In particular, data were collected on the number of SOEs, their sectors of operation and their employment contributions to contextualise the qualitative assessment and shed light on the economic importance of SOEs. For more information on the methodology see the Assessment methodology and process chapter.

## Figure 9.2. State-owned enterprise dimension assessment framework

<table>
<tr><th colspan="4">State-owned enterprises dimension</th></tr>
<tr><td colspan="4">Outcome indicators<br>1. Number of central government SOEs per economy<br>2. SOE share of total national employment per economy<br>3. Sectoral distribution of SOEs</td></tr>
<tr><td>Sub-dimension 6.1<br>Efficiency and performance through improved governance</td><td>Sub-dimension 6.2<br>Transparency and accountability practices</td><td>Sub-dimension 6.3<br>Ensuring a level playing field</td><td>Sub-dimension 6.4<br>Reforming and privatising SOEs</td></tr>
<tr><td>Qualitative indicators<br>1. Clarification of ownership policy and rationales<br>2. Professionalising state ownership<br>3. Robust board nomination framework<br>4. Promoting independent and professional boards</td><td>Qualitative indicators<br>5. Financial and non-financial reporting<br>6. Auditing practices<br>7. Protection of minority shareholders</td><td>Qualitative indicators<br>8. Legal and regulatory treatment<br>9. Access to finance</td><td>Qualitative indicators<br>Descriptive Indicators (not scored)<br>10. Recent state ownership reforms<br>11. Privatisation practices</td></tr>
<tr><td>OECD Instruments<br>OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]):<br>• Chapter I: Rationales for state ownership<br>• Chapter II: The state's role as an owner<br>• Chapter VII: The responsibilities of the boards of state-owned enterprises</td><td>OECD Instruments<br>OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]):<br>• Chapter IV: Equitable treatment of shareholders and other investors<br>• Chapter VI: Disclosure and transparency</td><td>OECD Instruments<br>OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]):<br>• Chapter III: State-owned enterprises in the marketplaces</td><td></td></tr>
</table>

| Quantitative indicators | Quantitative indicators | Quantitative indicators | Quantitative indicators |
|---|---|---|---|
| 1. Number of SOEs (majority- and wholly-owned enterprises) and state minority-owned companies<br>2. Sectoral distribution of SOEs and state minority-owned companies<br>3. Number of employees of SOEs and % of total domestic employment | 4. Number of SOEs with non-state shareholders | 5. Proportion of SOEs that are fully corporatised (incorporated under general companies law) | 6. Number of SOEs privatised<br>7. Number of employees of minority-owned entities, and % of total domestic employment |

### *Key methodological changes to the assessment framework*

Since the 2018 edition of the Competitiveness Outlook, a fourth sub-dimension has been added to gather information on recent SOE reforms and privatisation efforts. The indicators under this fourth dimension are not scored. No other methodological changes to the assessment framework have taken place.

## State-owned enterprise performance and context in the WB6

The purpose of improving the ownership, governance, and legal and disclosure arrangements of SOEs is to ensure that they create value for and are accountable to the general public, who are considered their ultimate owners. As well as commercial profitability, SOEs can create value for society through efficient public service delivery or other non-commercial objectives. The state as owner must clearly define how SOEs are expected to create value and allow for robust performance assessments. Value creation also implies that SOE operations should not hinder other firms from creating value, i.e. they should compete on a level playing field.

Sound state ownership and governance arrangements contribute to value creation by clarifying SOE objectives and establishing clear accountability mechanisms to achieve those objectives. A professional state owner should define clear performance objectives for SOEs, strong SOE boards should be sufficiently independent from both political influence and corporate management to ensure that corporate decisions are taken in the interest of the enterprise, and professional management should oversee the day-to-day operations that lead to performance objectives being achieved. Robust corporate disclosure underpins the accountability of boards and management to the state shareholder and the general public, and can be considered an end in itself as it reinforces the state's accountability to citizens. However, when SOEs are not governed effectively they can become vehicles for political patronage by state actors or be used by management for their own personal gain, leading to inefficiencies and low performance. Poor corporate disclosure can then make it difficult to identify and address the sources of efficiency shortcomings.

An overarching concern in the Western Balkans is the fact that most of the region's authorities do not maintain sufficient centralised data on their SOE portfolios to allow for a complete picture of their size, value, or performance. The absence of robust data on SOEs' financial and non-financial performance reflects the overall weak public accountability systems that most public authorities have established for their state portfolios. Albania, Kosovo, and North Macedonia maintain partial online lists of state-owned enterprises, but Kosovo is the only economy in the region where the authorities gather and recurrently publish financial performance data on the central government's main portfolio of SOEs. The Serbian authorities have also undertaken various forms of public reporting on their SOEs. In Albania and North Macedonia, the lists of SOEs provide basic information such as the name of each enterprise and its sector of operation, but no employment or financial performance figures.

Despite the absence of robust performance monitoring frameworks, external assessments (e.g. by international financial institutions) have shed some light on SOE performance in the region. The results of

these assessments will be discussed below, followed by an overview of the available data on the characteristics of SOEs in the region, including their sectoral distribution and employment contributions.

### *External assessments point to the frequent underperformance of SOEs*

External assessments at both the regional and economy levels point to the frequent underperformance of many SOEs in the region. For example, an extensive analysis of firm financial statements published by the International Monetary Fund (IMF) (IMF, 2019[3]) found that surveyed SOEs in the region are consistently less efficient than their private sector peers, producing lower revenues per employee, paying higher wages and posting significantly lower profitability levels.[1] Another study by the European Bank for Reconstruction and Development assessed firm profitability between 2014 and 2016 and found that surveyed SOEs operating in Bosnia and Herzegovina and Serbia posted average losses amounting to approximately 0.5% of gross domestic product (GDP). SOEs in North Macedonia and Montenegro posted profits of below 0.5% of GDP, and Albania and Kosovo were not included in the analysis (EBRD, 2020[4]). The presence of insolvent and/or inactive SOEs is also not uncommon in some of the region's economies.[2]

When SOEs underperform they contribute to the inefficient allocation of resources in the broader economy. Given that SOEs often receive public support, for example in the form of direct subsidies or foregone dividends, their inefficiencies can also lead to additional strains on already depressed public budgets. Even in the absence of formal state guarantees for their debt or other forms of explicit public support, the state is often expected to step in to shore up failing SOEs. While such state support may be economically warranted in some circumstances – for example in the context of the economic downturn associated with the COVID-19 pandemic – in "normal" times it can contribute to inefficiencies by reducing SOEs' incentives to undertake necessary structural improvements, while contributing to an unlevel playing field where SOEs compete in the marketplace.

SOE underperformance can stem from costly public service obligations subsidised from commercial revenue, but there is limited evidence that this is consistently the case in the WB6 economies' SOEs. There is a significant lack of clarity in the region regarding the non-commercial objectives of SOEs, their actual cost and whether they are delivering on their objectives. It is considered good practice, as set out in the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines), to ensure that SOEs' public policy objectives are clearly articulated and transparently financed from the public budget (OECD, 2015[2]). There is therefore a strong need in the region to clarify the commercial and non-commercial objectives of SOEs and to strengthen accountability among responsible public actors and SOEs to achieve these objectives.

### *The efficient operation of SOEs is vital for economic competitiveness in the WB region*

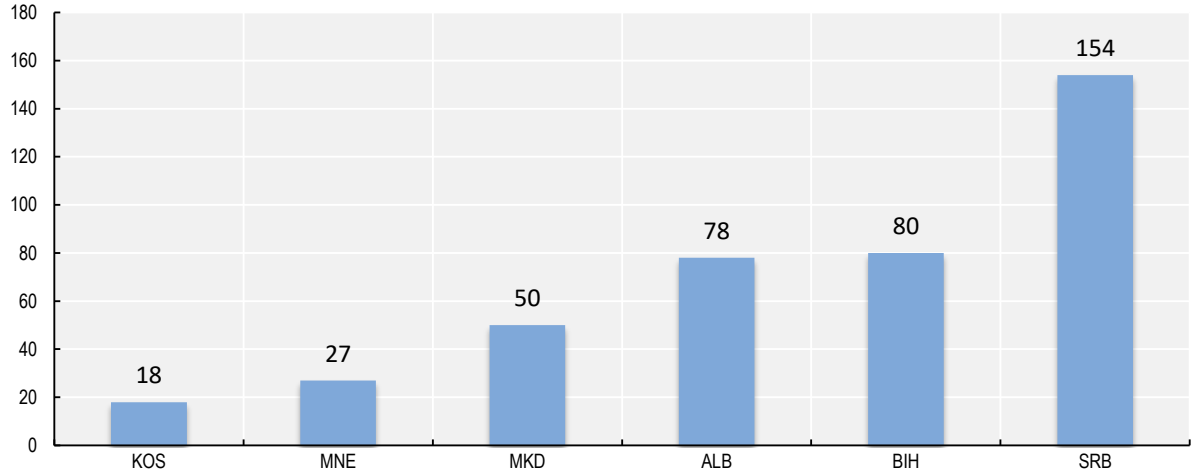
Preliminary data on SOEs gathered in the context of this assessment reveal that SOEs are important economic actors in the WB region, representing a notable proportion of employment and often operating in systemically important sectors. This makes their efficient operations essential for broader economic competitiveness.

While the data gathered for this assessment shed some light on SOEs' economic footprint in the region, the overview that follows can only be considered a preliminary and imperfect mapping of the region's SOE landscape. This is because there were notable differences in the scope of data provided by the public authorities. For example, some authorities provided information on SOEs held only by the central level of government, whereas others included municipality owned companies and did not always distinguish between the two. Limitations in the comparability of data provided by the region's authorities only serves to underscore the need to strengthen economy-level data on SOE portfolios and their performance.

The number of enterprises owned by each central-level government ranges from 18 in Kosovo to just over 150 in Serbia (Figure 9.3).[3] The state's presence in the marketplace is, unsurprisingly, more pronounced

when enterprises owned by other levels of government are included: in Bosnia and Herzegovina an estimated additional 334 enterprises are owned by cantons and municipalities, while in North Macedonia an estimated 265 enterprises are owned by municipalities.[4] Figures on municipal SOEs were not provided for the other four economies in the context of this assessment.

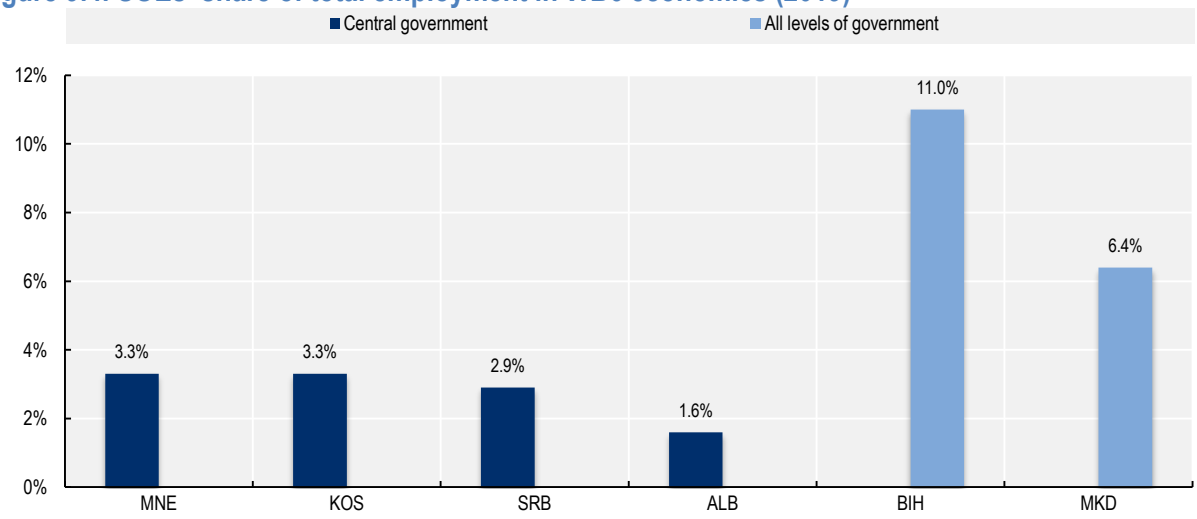
### Figure 9.3. Number of central government SOEs in WB6 economies




Note: For Bosnia and Herzegovina, the estimated number of SOEs reflects the portfolios of both the Federation of Bosnia and Herzegovina (FBiH) (53 SOEs) and Republika Srpska (RS) (24 SOEs). It is based on figures reported in (OECD, 2018[5]) as well as data provided by the Republika Srpska Share Fund in the context of the current assessment. The figure is an estimate because the data provided by the FBiH for the current assessment aggregated SOEs at all levels of government, without distinguishing between the different levels.
Source: Author's calculations based on data provided by the economy or entity authorities; (OECD, 2018[5]), *Competitiveness in Southeast Europe: A Policy Outlook 2018*, https://doi.org/10.1787/9789264298576-en.

Measuring SOEs' share of economic activity is difficult in the absence of comprehensive performance data, for example on SOEs' value added; however, SOEs' share of employment offers a useful measure of their role in the economy. SOEs account for a notable proportion of total employment in all Western Balkan economies, ranging from 1.6% in Albania (limited to central government SOEs) to 11% in Bosnia and Herzegovina (including SOEs at all levels of government) (Figure 9.4).[5] Importantly, in economies where SOE data are limited to central government entities, the employment figures mask the economic importance of public utilities, which are often owned by local governments. SOEs in OECD economies represent between 2% and 3% of total non-agricultural employment, on average (OECD, 2017[6]). However, the comparison with OECD economies is not perfect as the figures are based on different measures of employment (non-agricultural employment in the OECD and total employment in the WB6).[6] Nonetheless, the available data point to the overarching conclusion that SOEs are an important element in all economies of the region and probably account for a higher share of employment than SOEs in OECD economies.

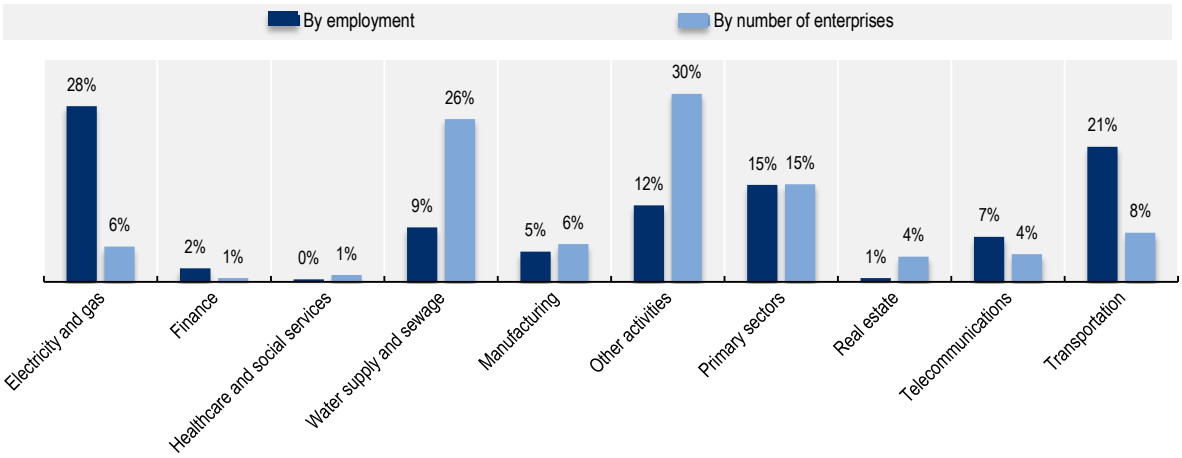
## Figure 9.4. SOEs' share of total employment in WB6 economies (2019)




Note: Data from end-2019 or latest available.
Source: Calculations based on data provided by the economy-level or entity authorities, and employment figures from economies' statistical offices.

SOEs' presence in systemically important sectors further demonstrates their economic and societal importance. SOEs in the Western Balkans are particularly concentrated in transportation (21% of all SOEs by employment), electricity and gas (28%), and water supply and sewage (9%). SOEs are also somewhat concentrated in the primary sectors (e.g. agriculture, forestry and mining) (15%) and, to a lesser extent, in telecommunications (7%). State-owned manufacturing enterprises are also common in SOE portfolios, accounting for 5% of all SOE employees (Figure 9.5). The sectoral distribution of SOEs in the region is broadly similar to their distribution in the 40 economies (mostly OECD but also other large emerging market economies) reviewed in the OECD's recurrent data collection exercise on SOE sectors.[7] Some differences include the near absence of state-owned financial firms in the Western Balkans (2% of SOE employment in the WB vs. 8% in the OECD's sample area) and the higher concentration of SOEs operating in the primary sector (15% of SOE employment in the WB vs. 6% in the OECD's sample economies) (OECD, 2017[6]).

### Figure 9.5. Sectoral distribution of SOEs across the Western Balkans




Note: SOEs' sectoral distribution is based on central government SOEs for Albania, Kosovo, Montenegro and Serbia, and includes sub-national SOEs for Bosnia and Herzegovina and North Macedonia. For Bosnia and Herzegovina, the classification of SOEs according to sector (based on the below-referenced IMF report) has been updated to align with the classification used in this regional overview.
Source: Calculations based on data provided by the authorities in the context of this assessment, except for Bosnia and Herzegovina, for which calculations are based on (IMF, 2019[7]), *State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight*, https://www.imf.org/en/Publications/WP/Issues/2019/09/20/State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight-48621.

## Efficiency and performance through improved governance (Sub-dimension 6.1)

To ensure that SOEs perform well, the state needs to develop clear performance objectives and establish appropriate ownership and governance arrangements to make shareholding entities and SOE boards of directors accountable for achieving those objectives. Good practice calls for the state ownership function to be exercised independently of other functions, including notably market regulation, to avoid unclear or conflicting objectives on the part of economic actors. This can be done through the establishment of a separate ownership agency or, when this is not possible, through a co-ordinating unit that harmonises ownership practices across the public administration. Such units can also help to professionalise and increase the efficiency of the state ownership function by centralising relevant expertise in one body and improving the monitoring of the whole SOE portfolio. To ensure that state ownership is an informed policy decision, the state should develop an ownership policy that outlines why it owns companies and what it expects those companies to achieve. The roles and responsibilities of all state actors involved in implementing the ownership policy should be clearly outlined. The state should ensure that SOE boards of directors are sufficiently qualified and independent to make decisions in the interest of achieving SOEs' clearly defined objectives. More specifically, SOE boards should be independent of any conflicts of interest – for example political or financial connections – that could jeopardise their incentives to act in the best interests of the enterprises they serve.

The Western Balkan economies achieve below-average scores in the efficiency and performance through improved governance sub-dimension (Table 9.2). This reflects the absence of ownership policies in most of the region's economies, together with predominantly decentralised ownership arrangements (albeit with some exceptions where elements of more centralised ownership decisions are in place). Although some steps have been taken to improve the professionalism and independence of SOEs' boards of directors, SOE boards in the region are widely perceived to be subject to political influence, which can undermine corporate efficiency.

### Table 9.2. Scores for Sub-dimension 6.1: Efficiency and performance through improved governance

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Efficiency and performance through improved governance | 1. Clarification of ownership policy and rationales | 1.5 | 1.0 | 3.0 | 1.5 | 2.0 | 3.0 | 2.0 |
| | 2. Professionalising state ownership | 2.0 | 1.3 | 3.5 | 1.5 | 2.0 | 3.0 | 2.2 |
| | 3. Robust board nomination framework | 2.0 | 1.5 | 3.5 | 2.0 | 2.5 | 2.5 | 2.3 |
| | 4. Promoting independent and professional boards | 1.0 | 2.5 | 2.5 | 2.0 | 2.5 | 2.5 | 2.2 |
| **Sub-dimension average score** | | 1.6 | 1.6 | 3.1 | 1.8 | 2.3 | 2.8 | 2.2 |

### *Ownership policies and rationales are still unclear*

There have been limited policy developments to clarify ownership policies and rationales for SOEs in the region. Most WB6 public authorities have not developed a dedicated state ownership policy outlining why the state owns enterprises and what they are expected to achieve. This absence of ownership policies contributes to the often unclear objectives of SOEs and ultimately serves to weaken accountability among public shareholding entities, boards and management regarding the performance and efficiency of SOEs. However, there are small signs of progress in this domain: the Federation of Bosnia and Herzegovina (FBiH) has announced near-term plans to develop an ownership policy, and the Serbian authorities recently developed a state-ownership strategy document concerning future SOE reforms, which notably envisages the greater centralisation of state ownership responsibilities under the Ministry of Economy, as well as the development of an ownership policy.

The rationales for state ownership are also generally not clearly or consistently communicated by public authorities, which have not, for the most part, detailed why state ownership of enterprises should be chosen over private ownership. Clearly outlining the rationales that underpin state ownership is important to ensure that government ownership of commercial enterprises is an informed policy decision and not just a result of historical factors. In cases where the stated rationale(s) for government ownership are no longer present, this can support the decision to privatise or liquidate the concerned enterprises.

According to information provided in the context of this assessment, all WB6 economies identify supporting domestic economic and strategic interests as a rationale for state ownership. Montenegro and North Macedonia also identify supplying public goods and services that the market is not able to supply as a rationale, and Albania, Kosovo, and Serbia identify supporting social objectives. Albania is the only economy to consider the maintenance of enterprises in domestic (non-foreign) ownership as a rationale for state ownership. No public authorities identified the operation of natural monopolies as a rationale for state ownership (Table 9.3).

### Table 9.3. Rationales for economy ownership, as reported by WB6 authorities

| | Supporting domestic economic and strategic interests | Ensuring continued domestic ownership of enterprises | Supply public goods or services that the market cannot provide | Performing business operations in a natural monopoly situation | Supporting social objectives |
|---|---|---|---|---|---|
| Albania | √ | √ | √ | | √ |
| Bosnia and Herzegovina | √ | | | | |
| Kosovo | √ | | | | √ |
| Montenegro | √ | | √ | | |
| North Macedonia | √ | | √ | | |
| Serbia | √ | | √ | | √ |

Note: Responses for Bosnia and Herzegovina reflect both FBiH and RS responses.
Source: Questionnaire responses from economy-level and entity authorities in the context of this assessment.

Although these reported rationales shed some light on the possible justifications for state ownership in the region, it is often not evident how many individual SOEs, particularly those with predominantly commercial activities (e.g. those operating in competitive sectors such as manufacturing), fulfil these rationales. For example, how does maintaining a manufacturing company in state rather than private ownership support economic and strategic interests? This reflects the fact that some of the reported rationales remain very broad in scope, and that the authorities often do not subsequently define the rationales for state ownership at the level of individual enterprises. The rationales for state ownership may in some cases be gleaned from sectoral or enterprise-specific legislation, for example where public service expectations are very clearly defined, but this is generally not consistent across entire economy portfolios. Many public authority portfolios in the region include companies that remain in state ownership owing to stalled or failed privatisations, or that are insolvent, inactive and/or in the process of being liquidated. This points to a disconnect between the reported rationales for maintaining enterprises in state ownership and actual state ownership practices.

### *Efforts to professionalise state ownership are similarly limited in the region*

Most of the region's economies have predominantly decentralised state ownership arrangements, meaning that several line ministries or other state agencies exercise shareholding rights over a distinct portfolio of SOEs. This can be problematic as it risks, among other things, conflicting or unclear objectives among state entities that are simultaneously responsible for ownership, market regulation and/or sectoral policy. A recent trend in economies around the world that are implementing good-practice reforms of state ownership arrangements is to centralise state ownership in a single agency or unit that is either tasked with undertaking the state's shareholding duties or performing a co-ordination and monitoring role among state shareholding entities (OECD, 2020[8]) (see Lithuanian example in Box 9.1).

In the Western Balkans, some elements of domestic practice diverge from the fully decentralised model of ownership, and a degree of professionalisation and co-ordination of ownership decisions has been introduced across the public administration. This is notably the case in Albania, Kosovo, and Montenegro, where a significant proportion of the state's portfolio is subject to some degree of central or co-ordinated ownership, for example through board nomination procedures that involve more than just the responsible line ministry and that are guided by whole-of-government policy documents.[8] In Bosnia and Herzegovina, both the FBiH and RS have announced plans to establish a central state ownership monitoring entity to be housed within each entity's prime minister's office. Similarly, Serbia's new state ownership policy foresees the establishment of a state ownership and co-ordinating body. The region's authorities could build on these preliminary steps to further strengthen central ownership institutions and professionalise the state shareholding function.

### Box 9.1. Creating a state ownership co-ordination entity in Lithuania

Similar to most Western Balkans economies, Lithuania has predominantly decentralised state ownership arrangements, with line ministries exercising shareholding functions in distinct portfolios of SOEs. In the context of these decentralised arrangements, Lithuania has taken several steps to harmonise and professionalise ownership practices across the public administration. These steps notably include the development of a whole-of-government ownership policy and the establishment of a central co-ordination and monitoring unit, the Governance Co-ordination Centre (GCC), to monitor implementation across the SOE portfolio. The GCC is housed in the Monitoring and Forecast Agency, a public institution under the purview of the Ministry of Economy.

Roles undertaken by the GCC to support more professional and accountable ownership practices include:

- Supporting SOE performance improvements by developing three-year rate-of-return targets for SOEs, which are agreed upon by the government.
- Maintaining centralised data on SOEs, including through the collection of SOEs' quarterly and yearly financial reports.
- Participating in an inter-ministerial selection commission, which also involves private recruitment agencies, to choose qualified independent members (those without significant business or personal ties to SOE management) for SOE boards of directors.
- Producing aggregate reports addressed to the public on the activities and performance of the SOE portfolio.

Source: (OECD, 2018[9]), *Corporate Governance in Lithuania*, https://doi.org/10.1787/9789264302617-en; (OECD, 2020[10]), *Note by the OECD Secretariat on Lithuania's implementation of corporate governance accession review recommendations*, http://www.oecd.org/corporate/Lithuania-Corporate-Governance-Progress-Note.pdf.

### *Despite progress on board nomination frameworks, the process is seen as lacking transparency*

Preliminary steps have been taken by some WB6 governments to introduce a more robust SOE board nomination framework and ensure transparent and merit-based procedures for recruiting board members. The authorities of Albania, Kosovo and Serbia have established formal procedures for SOE board nominations that are laid out in dedicated legislative or policy documents. In Bosnia and Herzegovina, related requirements have been formalised but apply to all government appointments rather than being specific to the SOE sector. Overall, even where formal nomination procedures exist, the criteria and process for selecting individual SOE board members are widely perceived to lack transparency. Box 9.2 summarises efforts taken by the authorities of Latvia to strengthen SOE board nomination practices.

### Box 9.2. Establishing professional and independent SOE boards in Latvia

At the time of Latvia's accession to the OECD, several commercially oriented SOEs were not operating under boards of directors and were overseen directly by shareholding ministries. As part of its OECD accession process, Latvia made a pledge to establish professional boards of directors in all large commercially oriented SOEs that did not yet have boards in place. As a result, Latvia established a new SOE board nomination framework to be implemented by shareholding ministries. It undertook the following steps to establish more professional boards in SOEs:

- Adopted requirements that all shareholding ministries establish dedicated SOE board nomination committees to undertake board selection processes and make appointment recommendations to shareholding ministries. All committees were required to include a representative of the state's ownership co-ordination body, the Cross-Sectoral Co-ordination Centre (CSCC), as well as independent experts not employed by shareholding ministries.
- The CSCC developed guidelines on how SOE board candidates should be selected and subsequently assessed.
- Strengthened board member qualifications criteria, for example regarding educational level and professional experience, as well as industry expertise and/or experience managing limited liability companies.
- Introduced requirements that at least half of SOE board members are independent. Clear criteria for establishing independence include the absence of working relationships with the shareholding ministry, not having previously been a board member of the SOE or its subsidiaries, and not having been a representative of the SOE's external audit firm for the previous three years.
- Used an executive search firm to support board recruitment for Latvia's largest SOE, the state-owned electricity company, Latvenergo.

Through the establishment of this new SOE board nomination framework, Latvia was able to successfully establish boards in 12 SOEs that previously had no boards in place. These boards included independent directors, in line with the new requirements.

Source: (OECD, 2017[11]), *Note by the OECD Secretariat on Latvia's implementation of corporate governance accession review recommendations*, https://www.oecd.org/daf/ca/OECD-Note-Latvia-Corporate-Governance-Accession.pdf.

### *There has been limited progress in promoting independent and professional boards*

Establishing independent and professional boards in SOEs is crucial to ensure sufficient outside oversight of corporate management and to shield SOEs from political interference. In practice, SOE boards in the region are often perceived to be operating as extensions of their ownership ministries and subject to political interference. Even in economies where SOE boards must comprise a minimum proportion of "independent" directors – which is the case to some extent in Kosovo, North Macedonia and Serbia, and will soon be the case in Montenegro following recent amendments to the company law – SOE board positions are frequently perceived to be accorded based on political or personal connections rather than purely based on merit. The resulting risk for the politicisation of SOE boards often extends to the senior management members appointed and can mean that corporate decisions, such as those related to procurement or staffing, are politically motivated rather than in the interest of corporate performance. In some cases, the state, rather than SOE boards of directors, is responsible for appointing senior management, further exacerbating the risk of political influence over corporate decisions.

### *The way forward for efficiency and performance through improved governance*

To improve state ownership arrangements and the functioning of SOE boards of directors, WB6 authorities should consider the following steps:

- **Strengthen the institutional and policy arrangements for state ownership**. All Western Balkans economies would benefit from improvements to the institutional arrangements for state ownership and, where applicable, the development of ownership policies that outline why the government owns companies and what it expects them to achieve. Albania and Bosnia and Herzegovina should move forward with implementing proposals to create dedicated state ownership entities or co-ordination units. State ownership units should gather and maintain centralised data on the state-owned enterprise portfolio, including the number of SOEs, their sectors of operation, their employment figures and their financial statement data. Lithuania's experience in establishing a central state ownership monitoring and co-ordination entity (while maintaining predominantly decentralised ownership arrangements) is highlighted in Box 9.1 and may be useful for WB6 economies.
- **Strengthen the professionalism and independence of SOE boards of directors through transparent and merit-based nomination procedures.** Although the authorities of some WB6 economies have established formal procedures for SOE board nominations, there remains the perception across the region that SOE board appointments are often made based on political or personal connections, rather than purely professional experience and merit. The authorities in all WB6 economies should take steps to strengthen SOE board composition requirements and nominating procedures to ensure that SOE boards have sufficient expertise, as well as independence from shareholding ministries and SOE management, to effectively oversee SOE decision making in the interest of achieving well-defined corporate objectives. The authorities could consider using private recruitment agencies to support the process. The experience of Latvia in implementing new SOE board nomination procedures for its large commercial SOEs is outlined in Box 9.2.

## Transparency and accountability practices (Sub-dimension 6.2)

Ensuring that SOEs are accountable to the state shareholder, to other shareholders as relevant, and to the general public (the ultimate "owners" of SOEs) is key for their efficiency and performance. Once the state has established performance objectives for SOEs, the enterprises themselves should produce reliable and high-quality financial and non-financial reports that allow the state to assess how well they have achieved their objectives. SOEs' financial statements should be audited by external audit firms to ensure that these disclosures can be relied upon to present an accurate overview of SOEs' financial situation and help the state and boards identify any structural shortcomings that are holding back SOE performance. SOEs' non-financial reporting should place a particular emphasis on activities undertaken in the public interest. In addition to ensuring that the minority shareholders of SOEs have sound basic rights – such as equitable treatment and access to information – the state should also take steps to regularly communicate with minority shareholders and ensure that SOE corporate decision making considers the needs of all shareholders. The state as shareholder should also be accountable to the general public by being transparent about the enterprises that it owns and reporting to the public on the performance of the state's portfolio.

The Western Balkans region performs relatively well when compared internationally in terms of the financial reporting standards of SOEs, although there is scope for them to strengthen their compliance with applicable requirements (Table 6.4). There is limited information available on non-financial reporting, indicating that efforts should be improved in this domain. Concerning accountability towards minority shareholders and the protection of their rights, there is scope in some WB6 economies to improve basic

legislated minority shareholder rights (applicable to all company shareholders), as well as to undertake more targeted efforts to communicate with minority shareholders and involve them in SOE corporate decision making.

**Table 9.4. Scores for Sub-dimension 6.2: Transparency and accountability practices**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Transparency and accountability practices | 1. Financial and non-financial reporting | 2.5 | 2.0 | 3.5 | 2.5 | 3.0 | 3.5 | 2.8 |
| | 2. Auditing practices | 3.0 | 2.5 | 3.0 | 2.5 | 3.0 | 4.0 | 3.0 |
| | 3. Protection of minority shareholders | 3.0 | 3.0 | 3.0 | 3.5 | 3.0 | 3.0 | 3.1 |
| **Sub-dimension average score** | | 2.8 | 2.5 | 3.2 | 2.8 | 3.0 | 3.5 | 3.0 |

### *Financial reporting standards are sound, but non-financial reporting could be strengthened*

There are legislative provisions in all Wb6 economies that establish basic financial reporting requirements for at least a significant proportion of SOEs, usually involving the mandatory submission of financial statements to a central registry. Financial reporting requirements are often equivalent to those applicable to privately owned companies, and do not always involve reporting in line with internationally recognised standards. In Kosovo, North Macedonia and Serbia, SOEs' financial statements must also be publicly disclosed, either directly by the enterprises or by a government body such as a business registry. While there appear to be sound basic requirements for financial reporting in the region, there is significant scope to strengthen non-financial reporting requirements and practices, particularly concerning activities undertaken in the public interest.

SOEs in the Western Balkans demonstrate weak compliance with applicable reporting requirements, with recent monitoring studies in some individual economies pointing to SOEs' failure to submit required reports and/or delays in submitting them to the authorities.[9] Although this compliance issue may not be a pressing concern in all six economies, no governments in the region (with the exception of Kosovo) appear to undertake the systematic monitoring of SOE compliance with reporting requirements, which is necessary to identify and address any related shortcomings.

### *Financial auditing practices are mostly supported by sound basic legislation*

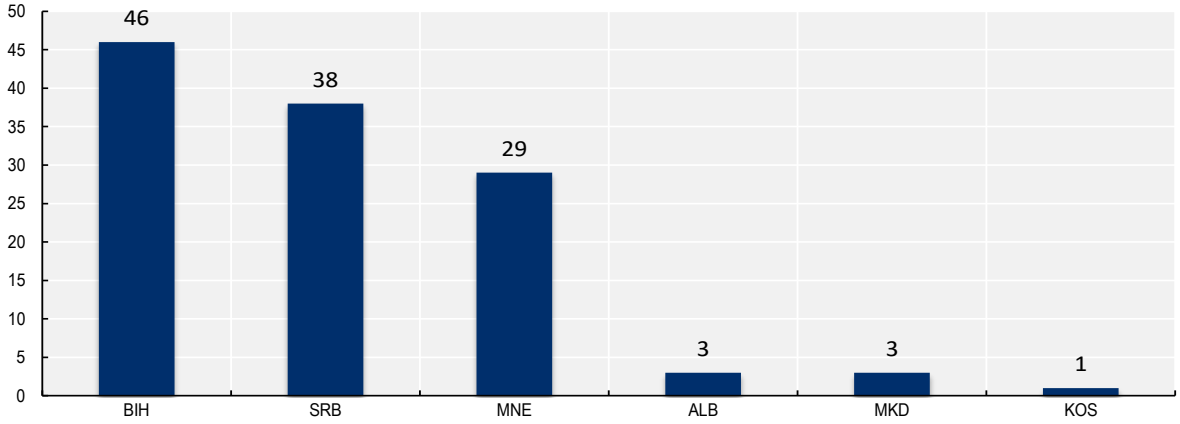
In most WB6 economies, the financial auditing practices of SOEs are supported by sound basic legislation that, for example, requires external audits of financial statements for at least the largest SOEs. In practice, however, some recent external audits of large SOEs in the region have identified significant shortcomings in the soundness of their financial statements, pointing to the need to improve the quality and credibility of SOEs' corporate disclosures.[10] In some cases the state audit office, instead of private firms, conducts SOEs' financial statement audits. This is not considered good practice and could be indicative of broader issues related to the underdevelopment of the audit profession in the region.

### *Protection of SOEs' minority shareholders could be improved*

The protection of SOE minority shareholders is particularly pertinent for economies where a large proportion of SOEs include non-state investors in their shareholding structure, notably Bosnia and Herzegovina, Montenegro and Serbia (Figure 9.6). Bosnia and Herzegovina has the largest absolute number of SOEs with private shareholders (46), although this figure is inflated by the inclusion of municipality-owned enterprises. Albania, Kosovo, and North Macedonia have a very small number of SOEs with private shareholders (fewer than three companies each), which means that protecting minority shareholders, although important for the broader business climate, is less of an immediate priority for state ownership policy reform. In Kosovo, only one SOE, the Trepča Mine, has non-public shareholders. This

mine was expropriated in 2016 and is 20% owned by its employees. For North Macedonia, the three enterprises reflected in Figure 9.6 do not currently have any private shareholders but are nominally listed on the economy's stock exchange.

### Figure 9.6. Estimated number of SOEs with private shareholders in WB6 economies (2019)

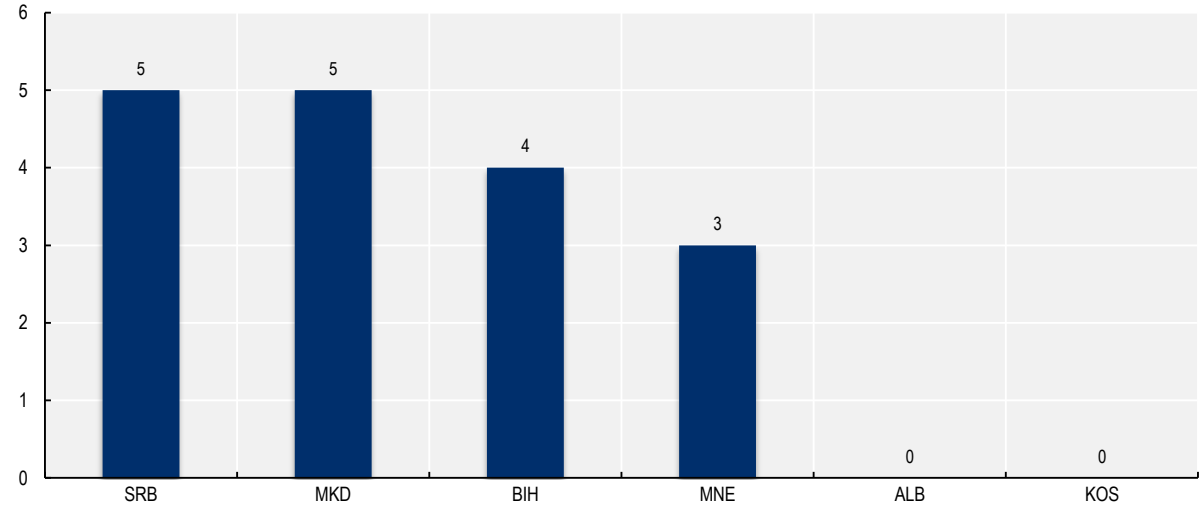



Note: Although three SOEs in North Macedonia are nominally listed on the stock exchange, they currently do not have any private shareholders. For Bosnia and Herzegovina there are an estimated 34 SOEs in FBiH and 12 in RS. Data from end-2019 or latest available.
Source: Information provided by the authorities in the context of this assessment.

Ensuring that minority shareholders are treated equitably is important to ensure that SOEs create value for all shareholders and for attracting private capital to the state-owned enterprise sector. Basic minority shareholder rights, for example the right to access information and to participate in corporate decision making, such as board elections, should be enshrined in law and consistently respected. There should also be a strong degree of transparency from the state towards minority shareholders, particularly in cases where the state encourages corporate decisions that may impact SOE profitability and dividend pay-outs. This is especially relevant when the state expects SOEs to pursue objectives other than profit maximisation. Minority shareholders should be adequately informed of such expectations, both at the time of their investment and on an ongoing basis.

External assessments conducted by the World Bank in the context of its Doing Business reviews point to the presence of sound basic rights in some WB6 economies regarding basic minority shareholder protections, with Serbia the highest performer in the region, followed by North Macedonia and Bosnia and Herzegovina (Figure 9.7) (World Bank, 2020[12]). Among the three economies with the highest number of SOEs with private shareholders, Montenegro receives the lowest score regarding the extent of minority shareholder rights (three out of six). Albania and Kosovo are excluded from the index's scoring as they do not have active stock markets. The ranking presented in Figure 9.7 is based on the economies' scores for the World Bank's Doing Business review's index on the extent of shareholder rights, which examines the extent to which six shareholder rights are enshrined in law for stock-exchange listed companies.[11] These six rights include the right for shareholders to elect and dismiss the company's external audit, and the right for those with at least 10% of equity capital to call for a general shareholders' meeting.[12]

## Figure 9.7. Extent of shareholder rights for stock-exchange listed companies in the WB6 (2019)

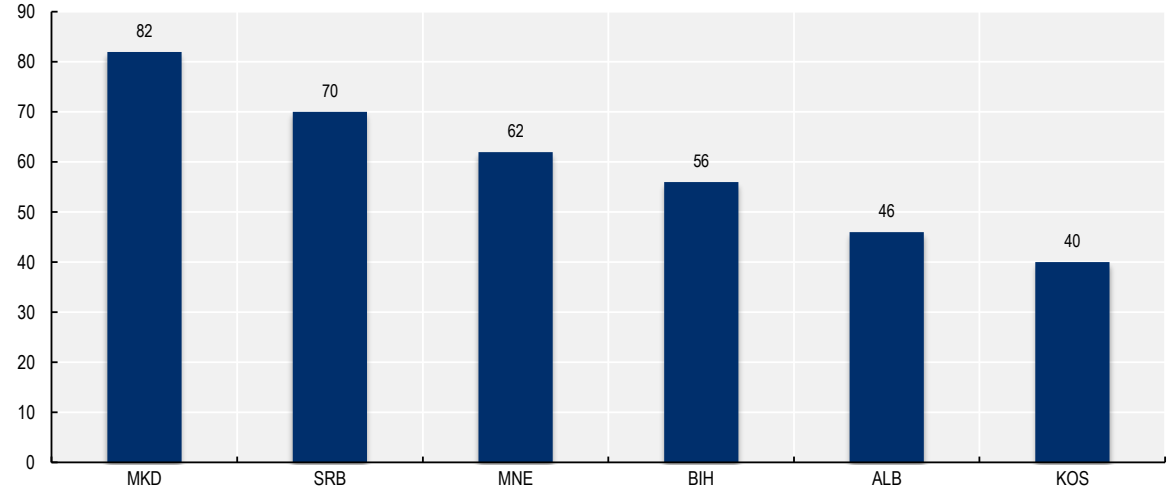



Note: Albania and Kosovo receive scores of 0 on this index owing to the absence of active stock exchanges.
Source: (World Bank, 2020[12]), *Doing Business 2020: Comparing Business Regulation in 190 Economies*, https://openknowledge.worldbank.org/handle/10986/32436.

The Doing Business review's broader index on the extent of shareholder governance, which includes the shareholder rights dimension but also assesses legal safeguards against undue board control as well as corporate transparency towards shareholders, also identifies room for improvement in the six economies, with a similar ranking to the above (Figure 9.8).

## Figure 9.8. Minority investor protections for stock-exchange listed companies in the WB6

(0 worst – 100 best)




Note: Scores for Albania and Kosovo are negatively impacted by the score of 0 accorded for the index on extent of shareholder rights (which is one of the components comprising the index on minority investor protections).
Source: (World Bank, 2020[12]), *Doing Business 2020: Comparing Business Regulation in 190 Economies*, https://openknowledge.worldbank.org/handle/10986/32436.

Although SOEs in the region are not excluded from the applicability of laws intended to accord minority shareholders equal treatment, there are several risks associated with state ownership that call for targeted measures to ensure that minority shareholders are adequately informed and involved in corporate decision making. Based on information gathered for this assessment, there is limited evidence that any of the region's authorities undertake targeted efforts to mitigate these risks and strengthen transparency regarding SOE minority shareholders consistently or as a matter of state shareholding policy.

The risks associated with state ownership include the fact that the state as the dominant shareholder may exclude minority shareholders from key corporate decision making and/or make decisions not in their interest, for example decisions motivated by public policy concerns rather than based on commercial justifications. The presence of politically affiliated individuals on the boards of many SOEs in the region may exacerbate this problem. The state as a shareholder may also have privileged access to corporate information compared to private shareholders, for example through communication channels with the board of directors that omit minority shareholders. Weak rule of law in the region, coupled with the risk that state judicial systems may have a tendency to side with state shareholders, may also make it more difficult for minority shareholders to obtain adequate redress in cases where their legal rights have been violated.

The OECD SOE Guidelines outline several specific efforts that governments should take to ensure that SOE minority shareholders are treated equitably and have equal access to corporate information. These include ensuring that crucial corporate information is shared simultaneously with the state and minority shareholders, facilitating their participation in shareholder meetings, and developing an active policy of communication and consultation with all shareholders (OECD, 2015[2]). Regarding corporate transparency, particular emphasis is placed on ensuring that minority shareholders are aware of any public policy objectives that SOEs are expected to achieve. Given that public policy objectives (especially if ad hoc) are often in conflict with commercial objectives, it is important that minority shareholders are fully informed about their scope and impact on corporate profits. For example, SOEs should be sufficiently clear about public policy objectives (which would normally also be established via clear regulations) in their non-financial disclosures. These avenues for minority shareholder involvement could offer some inspiration for the WB6 authorities as they seek to improve the relationship between the state and minority shareholders.

### *Accountability to the general public could be significantly strengthened*

There have been limited developments in the WB6 economies regarding how the state reports to the public on its activities as a shareholder, and on the performance of the SOE portfolio. Although SOEs are generally required to submit their financial statements to a central registry, very few public authorities use the information collected to undertake or publish an analysis of SOEs' financial performance at the portfolio level. The authorities of only one economy, Kosovo, recurrently publish an aggregate report on the activities and performance of SOEs. Aggregate reports can offer a useful mechanism for increased accountability and help encourage improvements in SOE performance, transparency, and governance practices (Box 9.3).

### Box 9.3. International experience in good-practice aggregate reporting

To strengthen the state shareholder's accountability to the public, many economies around the world produce publicly available aggregate reports that synthesise information about the operations and performance of the state's SOE portfolio. These reports complement SOE-specific disclosures by presenting a more holistic overview of the state's portfolio performance and a summary of the trends in ownership or governance practices, or significant changes in the state's portfolio. The OECD is currently developing a good practice guide on aggregate reporting which will contain useful guidance for policy makers looking to develop such public reports. The following elements are included in aggregate reports worldwide:

- **SOEs' financial performance and value**. This information is often presented both at the sectoral level and at the enterprise-specific level, allowing for a general overview of, for example, SOE revenue, net income and dividends distributed to the state, as well as financial metrics such as leverage ratios and rates of return on debt and equity.
- **SOE employment figures**. This can include information on, and explanations for, any substantial changes in SOE employment levels.
- **Implementation of the state's ownership policy**. This can include information on any recent changes to the state's ownership policy and the institutional roles and responsibilities for its implementation. Many countries also report on SOEs' compliance with applicable governance and disclosure standards.
- **Board composition and/or remuneration in SOEs**. Information on SOEs' board composition can include reporting on the number of board members considered "independent directors" (those without material business or personal connections to enterprise management that could constitute a conflict of interest) and/or information on gender diversity on the boards. Some countries also provide information on individual board member remuneration.
- **Costs and financing of SOEs' public policy activities**. This can include SOE-specific information on how much SOEs' public policy activities cost and how they are paid for (through the state budget or from commercial revenue). Some countries disclose the amount of state subsidies that individual SOEs have received over the preceding year.

Source: (OECD, 2018[13]), *Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices*, http://www.oecd.org/corporate/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf.

### *The way forward for transparency and accountability practices*

To improve SOEs' accountability to the state, minority shareholders (as relevant) and the general public, the following steps are recommended:

- **Review all SOEs' compliance with existing disclosure requirements**. This assessment has revealed that in most of the region's economies, at least the largest SOEs are subject to strong requirements for financial reporting to a central entity. However, there are gaps in compliance in some cases, for example a significant proportion of SOEs are not reporting on time or at all. WB6 authorities are encouraged to undertake more in-depth monitoring of SOE compliance with applicable financial reporting standards to identify and address gaps in compliance. Where monitoring uncovers significant issues with the quality and credibility of SOEs' corporate disclosures (for example as a result of external audits), steps should be taken to address these issues.
- **Strengthen SOEs' non-financial reporting requirements and practices**. Special efforts should be made to ensure that SOEs report to the state shareholder(s) and to the public, in particular on

activities undertaken in the public interest. This implies complementary efforts to better define SOEs' public interest activities and to develop clearer non-financial performance objectives to assess SOEs' success in this regard.

- **Strengthen accountability to SOEs' minority shareholders**. In addition to improving basic minority shareholder rights for all companies, the state should take steps to review and improve communications with SOEs' private minority shareholders. SOEs should be accountable to, and create value for, all shareholders.
- **Produce publicly available aggregate reports on the state ownership portfolio**. In most of the region's economies there is already a mechanism in place to collect SOEs' financial statements, usually involving their submission to a central registry. The authorities could build on this process by collating and analysing SOEs' financial performance data to produce an overview of the performance of the SOE portfolio as a whole. To encourage improvements, aggregate reports could also include information on the number of SOEs that do not comply with financial (and non-financial) reporting requirements. They could also present qualitative information on SOEs' corporate governance practices, their public service activities and other information of relevance to the general public. Box 9.3 presents some elements of international experience in producing aggregate reports and highlights the type of information that such reports can include.

## Ensuring a level playing field (Sub-dimension 6.3)

To ensure a level playing field, SOEs' legal and regulatory treatment and their financial conditions should be similar to those of private enterprises. This means that SOEs should not be exempt from the application of general laws and regulations applicable to private companies, including notably competition rules and other market regulations. Concerning their financing conditions, SOEs should not benefit from any direct or indirect state support – including implicit or explicit guarantees on commercial debt – that may confer a competitive advantage over private enterprises. At the same time, SOEs should not face competitive disadvantages owing to, for example, under-compensated non-commercial objectives (e.g., providing local employment) that can jeopardise their commercial viability or otherwise lead to structural inefficiencies.

The WB6 region achieves average performance on SOEs' legal and regulatory treatment (Table 9.5), reflecting the fact that most SOEs are incorporated subject to general company law and do not benefit from many of the explicit exemptions to the laws and regulations applicable to private companies. The region underperforms on SOEs' financing conditions, reflecting the fact that many SOEs do not achieve economically significant rates of return, which amounts to below-market costs of equity capital (provided by the state).

### Table 9.5. Scores for Sub-Dimension 6.3: Ensuring a level playing field

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Ensuring a level playing field | 1. Legal and regulatory treatment | 3.5 | 2.0 | 4.0 | 3.0 | 3.5 | 3.5 | 3.3 |
| | 2. Access to finance | 2.0 | 2.0 | 2.0 | 2.0 | 2.5 | 3.0 | 2.3 |
| **Sub-dimension average score** | | 2.8 | 2.0 | 3.0 | 2.5 | 3.0 | 3.3 | 2.8 |

### *Most SOEs in WB6 economies are incorporated under company law*

Concerning SOEs' legal and regulatory treatment, a significant proportion of SOEs in WB6 economies – in many cases a majority – are incorporated as joint-stock or limited liability companies, and thus subject to the general company law that is also applicable to privately owned corporations. This establishes a sound foundation for ensuring that SOEs face similar legal and regulatory treatment to private companies, which is important for maintaining a level playing field between state and privately owned companies.

Nevertheless, in four of the six economies (all except for Albania and Kosovo, according to authorities involved in this assessment) at least some SOEs are incorporated under the distinct legal form of "public enterprise" and subject primarily to SOE-specific legislation. Maintaining SOEs under such a separate legal form introduces material operational differences between SOEs and private companies that can distort the level playing field (for example by exempting SOEs from the possibility of bankruptcy) and is not considered good practice. In general, maintaining SOEs under a separate legal regime often results in different transparency and accountability requirements, particularly compared to stock-exchange listed corporations, which are usually the "gold standard" for corporate reporting and governance practices. For example, the boards of directors of SOEs with special legal status are often not subject to corporate liability, which can greatly weaken their incentive to act purely in the interest of corporate performance. In some cases, SOEs with a separate legal status are effectively operated as arms of the public administration, increasing the risk of political interference in corporate decision making. SOEs with special legal status may also face different accounting requirements, which can, among other things, make it difficult to benchmark their performance against industry peers. The maintenance of some SOEs under a separate legal form is undertaken in Bosnia and Herzegovina, North Macedonia and Serbia, all of which have developed separate laws on public enterprises. Montenegro also maintains some SOEs under the separate legal form of public enterprise, all of which reportedly undertake public service activities, but the authorities report that most of these enterprises are owned by municipalities. In every WB6 economy there are some nuances related to this overarching trend; for example, in North Macedonia, the Law on Public Enterprises stipulates that all SOEs undertaking public interest activities must be incorporated as limited liability or joint-stock companies, but in practice several SOEs are still incorporated under the separate legal form of public enterprise. Only in Albania and Kosovo are all SOEs reportedly incorporated as joint-stock or limited liability companies operating primarily under general company law.

Concerning SOEs' regulatory treatment, the authorities of most countries report very few explicit regulatory exemptions granted to SOEs, and generally maintain that SOEs face the same treatment as private companies in terms of taxation, competition rules, and environmental and zoning regulations. However, this assessment has found that in practice SOEs face some apparent regulatory leniency from public authorities, resulting in, for example, tax payment arrears or barriers to free competition in sectors where the state previously held a monopoly position.[13] External assessments confirm the existence of operational advantages granted to SOEs in some cases; for example, in a recent IMF study the authorities of Albania, Bosnia and Herzegovina and North Macedonia reported that they grant some legal preferences to SOEs (IMF, 2019[3]).

### *Most SOEs access at least some financing on the commercial marketplace*

Many SOEs in the WB region benefit from explicit state guarantees on debt, which constitutes an operational advantage that may distort the level playing field with private companies. This being said, explicit state guarantees that distort competition are prohibited in economies subject to EU state aid rules. Even in cases where no explicit guarantees are provided, it is likely that many commercial banks perceive an implicit state guarantee – i.e. that the state will step in if an SOE is unable to service its debt – and may price their financing accordingly. Such financing conditions are by no means unique to the Western Balkan economies, with the authorities of many OECD economies considering that SOEs are likely to benefit from advantageous commercial lending conditions owing to implicit state guarantees. Few economies have established mechanisms to offset such operational privileges to maintain "competitive neutrality" (the absence of differences in the competitive landscape that stem from state ownership, regulation or activity in the market) between state-owned and private firms (OECD, 2014[14]). Other problematic financing arrangements include state recapitalisations that are not undertaken on market terms, leading to competitive distortions.

Many SOEs in the WB6 economies do not earn economically significant rates of return. It is not uncommon for SOEs to be outright loss-making, which places a significant burden on public budgets and often

channels economic resources to less efficient economic actors. Although some of the corporate inefficiencies of SOEs may stem from under-compensated public service obligations, there is no evidence that this is consistently the case, particularly given that most of the region's authorities have not clearly defined or disclosed the costs of SOEs' public service obligations or other activities undertaken "in the public interest". The OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) recommend that any public policy objectives that SOEs are expected to achieve should be clearly articulated and their costs transparently accounted for and funded directly from the public budget (OECD, 2015[2]).

### *The way forward for ensuring a level playing field*

To further level the playing field with private enterprises, WB6 authorities are encouraged to consider the following measures:

- **Fully corporatise SOEs that engage in commercial activities**. While the majority of SOEs in the region are incorporated as limited liability or joint-stock companies, in most of the region's economies there remains a subset of SOEs incorporated according to separate enterprise-specific (or SOE-specific) legislation. SOEs engaged in commercial activities should, wherever possible, be incorporated according to the general company law and not face regulatory exemptions that could distort the level playing field with private companies. In cases where the authorities deem it more efficient to maintain certain SOEs under a separate legal form, the rationales for doing so should be clearly and transparently defined.
- **Improve SOEs' efficiency so that they achieve economically significant rates of return on their commercial activities**. A fundamental issue in many of the region's economies is that many SOEs do not earn economically significant rates of return, in some cases posting persistent losses. Efforts should be made to ensure that SOEs achieve minimum profitability levels on their commercial activities. This may require the clarification of SOEs' commercial and non-commercial activities, as well as structural changes within individual enterprises to improve efficiency.

## Reforming and privatising state-owned enterprises (Sub-dimension 6.4)

The frequent underperformance of the Western Balkans' SOEs, together with underdeveloped policy and institutional frameworks for state ownership in most WB6 economies, point to the need for substantial state ownership reforms. The presence of many SOEs for which the rationales for state ownership are not clear, or which have become insolvent, indicate the need to optimise state ownership portfolios through enterprise liquidation, restructuring and/or privatisation. This section summarises recent domestic SOE reform initiatives and sheds light on the privatisation landscape in the region. This sub-dimension is purely descriptive and is not scored.

### *SOE reforms have been limited in the region*

No WB6 government has reported any significant state ownership reforms since the 2018 Competitiveness Outlook. Recent state ownership reforms have mostly been limited to restructuring individual SOEs that were suffering persistent losses and/or were insolvent, for example through organisational changes and/or corporate mergers. In Albania and Bosnia and Herzegovina, proposals to strengthen institutional arrangements for state ownership have been discussed by the authorities, but formal steps have not been taken to follow through on preliminary discussions. The largest legislative reform effort affecting SOEs could be considered to have taken place in Montenegro through recent amendments to the general company law, which notably introduces independence requirements for certain company boards of

directors that will apply to fully corporatised SOEs. However, no WB6 government has recently undertaken any significant policy, institutional or legislative reforms specific to state ownership.

### *Small-scale privatisation efforts are continuing in some WB6 economies*

Small-scale privatisation efforts often involve the sale of remaining state equity in companies that had been partially privatised in earlier years. Most of the recent privatisations in the region have not involved large or systemically important SOEs. The authorities of Kosovo, and North Macedonia have had preliminary discussions about potential future privatisations of the state-owned telecommunications (Kosovo[14]) and railway (North Macedonia) enterprises, but no further progress has been made. The region's economies can be divided into two main groups in terms of privatisation programmes: in Albania, Bosnia and Herzegovina, Montenegro, and Serbia, privatisations have taken place with some regularity over the past decade, and in Kosovo and North Macedonia, privatisation programmes have been considerably less active.[15] This assessment has also uncovered individual cases of recent "failed" privatisations, for example where the authorities have been unable to identify interested or suitable investors. This underscores that many elements must be in place for a privatisation to be successful, including the political will and agreement to privatise, the presence of interested investors with sufficient capital for the purchase, and sufficiently strong corporate performance to attract purchase offers that justify relinquishing ownership.

Almost all public authorities in the region maintain state minority shareholdings (ownership shares of between 10% and 50%) in a notable number of companies. These minority shareholdings often reflect privatisation processes already initiated (through partial sales) that have either stalled or been cancelled. Based on available data, Albania, Bosnia and Herzegovina, Montenegro, and Serbia all hold state minority shareholdings in a large number of companies, ranging from 17 to 38 (see Table 9.6). In some cases, the maintenance of state minority shareholdings seems to reflect general policy inertia regarding their eventual privatisation, rather than the result of an informed decision on the part of the public authorities to maintain strategic shares in such companies. However, state minority shareholdings can also reflect temporary capital injections made to shore up private companies, or efforts to maintain some degree of strategic influence (without full control) over certain companies or within certain sectors of the economy.

**Table 9.6. Companies with state minority shareholdings in WB6 economies (2019)**
State minority shareholdings of 10-50%

| | ALB | BIH | | KOS | MKD | MNE | SRB |
|---|---|---|---|---|---|---|---|
| | | FBiH | RS | | | | |
| Estimated number of companies with state minority shareholdings | 28 | 4 | 13 | n.a | n.a | 21 | 38 |

Source: Data provided by economy-level or entity authorities for this assessment.

### *The way forward for reforming and privatising SOEs*

- **Make state ownership reform a policy priority**. In most of the region's economies, state ownership reforms have been particularly limited in recent years, even though SOEs are often loss-making and represent substantial fiscal liabilities for the authorities. The authorities of all WB6 economies should make state ownership reforms, in line with this assessment's recommendations, a policy priority.
- **Review the rationales for maintaining state ownership in commercially oriented enterprises**. The rationales for state ownership should be clearly defined and regularly reviewed. This is particularly relevant for state majority shareholdings but can also be applied to state minority shareholdings. Limited information is available on why several governments in the region maintain minority state shareholdings in a large number of companies, which also reflects the broader issue

of limited state ownership policy development in the region. Going forward, governments in the region should review the benefits that existing shareholdings bring to the state and, where those benefits are not evident, reconsider their maintenance in state ownership. Such a review could complement the development of economy-level ownership policies that outline the rationales for state ownership, as recommended earlier in this assessment. Policy makers considering privatisation may find the OECD's recent guidance on privatisation practices useful (OECD, 2019[15]).

## Conclusion

Strengthening state ownership and governance arrangements in WB6 economies could significantly improve the efficiency of the region's SOEs and help ensure that they create value alongside private companies. Improving the efficiency of state portfolios – including through operational changes that increase productivity and winding down insolvent or inactive SOEs – can also have significant fiscal impact by reducing the need for excessive state support of SOEs and by ultimately increasing the level of dividends that SOEs are able to return to the state budget. Strengthening the transparency of SOEs' operations can help make those responsible for their oversight, notably state shareholding entities and SOE boards of directors, more accountable to SOEs' ultimate shareholders, the general public.

Because SOEs operate at the nexus of the public and private sectors, improving their operations often requires reforms in multiple policy areas that cannot be tackled all at once. These include public governance reforms that impact institutional arrangements for state ownership and company law reforms that relate to how boards of directors oversee management decisions. The OECD SOE Guidelines provide an aspirational standard across seven policy areas that can guide the region's authorities in implementing the state ownership reforms they consider the most pressing and relevant to their context (OECD, 2015[2]).

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## Notes

[1] Albania and Kosovo were excluded from the IMF analysis of SOE performance owing to insufficient data availability. The IMF analysis used firm financial statements from 2014-16 where available and considered all firms with at least 25% state ownership to be SOEs, whereas OECD definitions use majority share ownership (or other means of exercising an equivalent degree of control) as the threshold to consider an enterprise an SOE. The number of SOEs included in the analysis for each economy is as follows: 8 in Bosnia and Herzegovina, 9 in Montenegro, 59 in North Macedonia and 370 in Serbia.

[2] For example, in Albania eight insolvent SOEs were recently merged with other SOEs, reportedly to avoid costly and lengthy insolvency procedures.

[3] Figures for Kosovo exclude the estimated 500+ companies in the portfolio of the Kosovo Privatisation Agency.

[4] In Bosnia and Herzegovina, responsibilities for state ownership policy are exercised separately by the Federation of Bosnia and Herzegovina and Republika Srpska. In the FBiH, state ownership rights are shared between the Federation, the ten cantons and municipalities.

[5] For Bosnia and Herzegovina, SOEs' estimated share of domestic employment is based on IMF (2019[3]). For Montenegro, North Macedonia, Kosovo and Serbia, SOEs' share of domestic employment is based on SOE employment data provided by the public authorities in the context of this assessment and total domestic employment figures reported by economies' statistical offices.

[6] This comparison with OECD economies' SOE sectors is only an approximation owing to differences in methodology. For example, OECD figures on SOE employment relate to their share of total non-agriculture employment, whereas figures for the Western Balkans relate to total employment. Using total non-agricultural employment would inflate SOEs' employment share in the Western Balkan economies.

[7] The OECD's recurrent data collection exercise on national SOE sectors has been undertaken three times since 2011, the latest edition being published in 2017 (OECD, 2017[6]). It is based on self-reporting by authorities and carried out by the OECD Working Party on State Ownership and Privatisation Practices. The dataset includes information on the number of SOEs held by the central level of government, their sectors of operation and their employment contributions.

[8] In Albania, for example, SOE board nominations are jointly decided by the Ministry of Finance and responsible line ministries, which mitigates the degree of decentralised decision making involving SOEs. Kosovo has centralised ownership rights over its main portfolio of 17 SOEs under the Ministry of Economy

and Finance, while many of Montenegro's SOEs are overseen by several state funds that do not exercise regulatory functions.

[9] For example, in Montenegro, according to monitoring by the Securities Commission, only an estimated 50% of state-owned joint-stock companies respect applicable disclosure requirements (OECD, 2018[5]). Similarly, a recent IMF assessment of SOEs in Bosnia and Herzegovina found that a significant proportion of SOEs do not make their financial statements available in a timely manner (IMF, 2019[7]).

[10] For example, recent state audits of Kosovo Telecom found that their financial statements did not present a fair view of their financial situation.

[11] The six shareholder rights examined in the Doing Business index are: 1) shareholder approval requirements for the sale of 51% of company assets; 2) the right of shareholders holding 10% of shares to call a meeting of shareholders; 3) the requirement to obtain shareholder approval for new share issuance; 4) whether existing shareholders have pre-emptive rights to purchase newly issued shares; 5) the right of shareholders to select and dismiss the external auditor; and 6) whether shareholders that hold a separate class of shares must approve any changes to the rights attached to such shares.

[12] Although the World Bank's extent of shareholder rights index explicitly excludes state-owned companies from its assessment, the findings are still considered relevant in the case of SOEs, as usually SOEs are not, at least explicitly, excluded from the provisions of domestic company law or listing rules applicable to corporations owned by non-state investors. For the broader "extent of shareholder governance" index, which comprises scores for "extent of shareholder rights", the World Bank does not assign a score for economies where the stock exchange does not have at least 10 listings that are not state-owned.

[13] An example is the case of Kosovo Telecom, which was involved in a dispute with the private mobile services operator Z-Mobile. Z-Mobile alleged that the state-owned Kosovo Telecom was not respecting its contractual responsibilities to provide access to network infrastructure. The dispute went to international arbitration, which concluded in favour of the private operator. More information on the Kosovo Telecom dispute is available here: https://www.reuters.com/article/kosovo-telecom-court/state-owned-kosovo-telecom-may-face-bankruptcy-after-court-ruling-says-ceo-idUSL5N1EG23Y.

[14] The public authority previously announced its intention to privatise Kosovo Telecom in 2019, but the privatisation has not taken place and the authorities report that the enterprise's performance will need to improve prior to privatisation to increase the company's attractiveness to potential investors.

[15] The Privatisation Agency of Kosovo holds administrative rights in an estimated 500+ formerly "socially-owned enterprises" for which the mandate to eventually privatise remains in place, but the authority does not currently have any announced plans to privatise any the state's "main" portfolio of 18 SOEs. The Macedonian authorities reported that they do not currently have an active privatisation programme in place and that the Macedonian Privatisation Agency was disbanded in 2005, with responsibilities for its remaining portfolio of enterprises divided among other public institutions and ministries.

# 10 Education policy (Dimension 7)

This chapter assesses the education policy settings, strategies, processes, and institutions in the six Western Balkan economies (WB6). After a brief overview of progress since the last Competitiveness Outlook (CO) assessment in 2018, the chapter focuses on four sub-dimensions. The first, early childhood and school education, considers the quality of pre-university education from preschool upwards. The second, teachers, looks at the selection, initial training and ongoing development and management of the teaching workforce. The third, vocational education, and training (VET) considers how this key sector is governed, and the roll out of work-based learning across the region. The final sub-dimension, tertiary education, considers the equity of access to higher education and how relevant it is to the labour market for those who do attain it. A cross-cutting sub-dimension on system governance focuses on how the WB6 economies govern and manage their education systems across the board, including strategies and policies for the improvement of their overall performance. Each of these sub-dimensions includes suggestions to improve performance in education policy and in turn foster greater labour productivity and social inclusion, key long-term drivers of competitiveness.

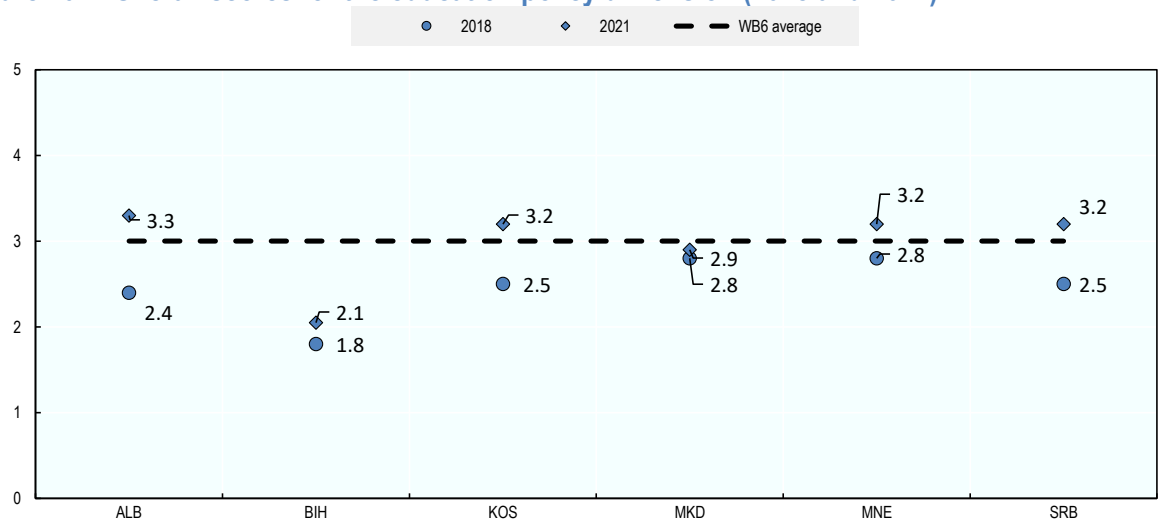
## Key findings

- **All of the WB6 economies have seen increasing coverage of early childhood education (ECE)**, with significant increases recorded in Kosovo, Montenegro, North Macedonia and Serbia. However, despite this positive trend and various efforts to increase coverage, enrolment rates in pre-primary education in the WB6 economies remain below the EU and OECD averages.
- **Most of the WB6 economies have strategies to address the quality of pre-university education.** However, they vary in the comprehensiveness, implementation and monitoring of their policy frameworks. All the WB6 economies have developed or are developing competency-based curricula and learning standards, which many are using to facilitate the examination and comparability of students' achievements.
- **The WB6 economies have made significant progress in reducing the rate of early school leaving**. However, the percentage of pupils who leave education early is still very high in Albania and Kosovo, around 10-20 percentage points (p.p.) higher than the EU and OECD averages. It is however, encouraging that these economies have seen the most significant decline in early school leavers in the region since the last Competitiveness Outlook assessment.
- **In most WB6 economies, teachers' educational attainment is lower than the EU and OECD average** as, except in Albania and Serbia, the overwhelming majority of teachers only have bachelor's degrees. Despite efforts to encourage and improve teachers' participation in professional development and important reforms, participation in professional development remains below the EU and OECD averages.
- **The WB6 economies have made progress in strengthening vocational education and training (VET) governance and work-based learning (WBL).** However, performance disparities in core literacy and numeracy skills remain high between students in VET and general programmes, and data collection and reporting on VET sectors could be improved. A significant achievement by most economies has been the introduction of dual-education systems, which has helped promote WBL opportunities.
- **Improving equity in access to higher education and the labour market relevance of higher education continue to be challenges**. Despite efforts made and policies in place, employment rates among recent graduates remain below the EU and OECD average and policies to reduce inequity have so far had mixed results.
- **All the WB6 economies, except for Bosnia and Herzegovina, have developed an education management information system (EMIS)** to centralise and facilitate the collection and management of data for various indicators across the education system. Nevertheless, data collection remains a key challenge in several areas (such as in VET and tertiary education). Furthermore, the WB6 economies do not systemically exploit the data they do collect, to analyse education policies or comprehensively report on overall progress to inform policy making.

## Comparison with the 2018 assessment

All the WB6 economies have improved their scores for the education policy dimension since the last assessment (Figure 10.1). The regional average score increased from 2.5 in 2018 to 3 in 2021. The strongest improvements were registered in Albania, Kosovo and Serbia.

### Figure 10.1. Overall scores for the education policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators and re-structuring of sub-dimensions. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Since the last Competitiveness Outlook assessment, the WB6 economies have made progress in introducing dual education models into their education systems, thereby promoting and strengthening work-based learning schemes. More moderate progress has been made regarding the promotion of participation in ECE and regarding efforts to increase the attractiveness of the teaching profession and incentivise the professional development of teachers (Table 10.1).

### Table 10.1. Implementation of the CO 2018 policy recommendations: Education policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| Increase expenditure on primary and secondary education | • Public spending on education in general in the WB6 economies remains below the EU and OECD average, and there has been no internationally recorded consistent increase in public spending on education (relative to GDP) since the last assessment. | Limited |
| Stimulate participation in ECE, for example by improving provision and affordability | • Despite strong measures in some WB6 economies (particularly Kosovo and Montenegro) to develop ECE and encourage participation, enrolment rates in pre-primary education, while increasing, remain below the EU and OECD averages. | Moderate |
| Invest more in improving the attractiveness of the teaching profession and the participation of teachers in professional development programmes | • The WB6 economies have made moderate progress in improving the attractiveness of the teaching profession. Most economies have made efforts to improve working conditions of teachers, all have raised salaries,[1] and some have also strengthened recruitment standards.<br>• All the WB6 economies have made efforts to incentivise professional development of teachers, but the average participation of teachers in professional development remains below the EU and OECD average | Moderate |

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| | (although this is not the case in all WB6 economies). | |
| Promote and strengthen work-based learning schemes like apprenticeships or internships | • Most WB6 economies (Albania, Kosovo, Montenegro, North Macedonia, and Serbia) have introduced, or are in the process of piloting, models for dual education, allowing students to undergo professional practices in parallel with their in-school education. This is a significant development as it systematises work-based learning in certain education programmes. | Advanced |
| Make efforts to reduce skills mismatches | • Limited progress has been made in this area: The labour market relevance of higher education remains a significant challenge and employment rates of recent graduates are below the EU and OECD average. | Limited |

1: Data not available for Kosovo.

## Introduction

Education is foundational for an economy's competitiveness as it forms the basis of its human capital and allows individuals to develop the skills needed to adapt to changes in the labour market. Theories of economic growth have pointed to education and human capital as key determinants of long-term growth (OECD, 2010[1]). This is particularly relevant in the context of the COVID-19 pandemic, as a well-educated and skilled workforce is a key pillar of an economy's resilience (OECD, 2020[2]).

Strong and inclusive education systems are essential for the development of the WB6 economies. A qualified workforce is indispensable for an economy's integration into global value chains and production processes, and is a boost to labour productivity and therefore overall competitiveness. As a vector of social inclusion, education is also essential for ensuring social cohesion. This is particularly important in the WB6 economies, which see differences in performance among students based on criteria such as gender, ethnic minority origin and geography (OECD, 2020[3]). The 2018 Programme for International Student Assessment (PISA) suggests that the WB6 economies also continue to have a large share of students who complete school without achieving the minimum levels of literacy and numeracy needed to succeed in work and life. However, the region is making efforts to align with EU education standards, which is helping drive reforms that promise to improve learning outcomes and better equip individuals with the skills and competencies needed to succeed in the changing world of work.

This chapter looks at the policies and strategies the WB6 economies have adopted to improve their education systems, assesses their progress in implementing the previous Competitiveness Outlook recommendations and provides policy advice based on the new education policy assessment framework. Education policy is closely related to other policy areas addressed in this publication, in particular:

- **Chapter 4. Investment policy and promotion.** Domestic and foreign direct investment (FDI), depends on a skilled local workforce in the key sectors attracting investment.
- **Chapter 5. Trade policy.** Integrating the WB6 economies with dynamic global value chains generates both opportunities and risks for education systems.
- **Chapter 11. Employment policy.** Employment is influenced by the quality of the labour force, which is largely determined by the education system. Employment rates are very closely related to education levels and unemployment predominantly affects the poorly educated. Higher levels of educational attainment, on the other hand, bring substantial returns, such as higher employment rates and relative earnings (OECD, 2020[2]).
- **Chapter 12. Science, technology and innovation.** Research and innovation are key to improving the allocation of scarce resources and identifying new solutions to social and economic challenges. These sectors need highly educated and trained professionals to act as scientists, technicians and

innovators. An education system that allows individuals to develop their talents and skills is a pre-requisite for a highly qualified workforce of science, technology, and innovation professionals.

- **Chapter 13. Digital society.** Information and communication technology is profoundly and rapidly transforming the world of work and society more broadly. Education must play a key role in allowing individuals to adapt to a rapidly evolving labour market and world around them. Digital technologies have also become the bedrock of many education systems as a result of the COVID-19 pandemic, and their use will certainly be more widespread and integrated in the future.
- **Chapter 18. Tourism policy.** An economy's cultural, historical and natural resources can all attract foreign and domestic visitors and support economic activity. A qualified workforce is a cornerstone of an effective tourism policy, as many of the sectors that benefit from and support tourism (such as hospitality, culture and overall tourism management) are dependent on vocational education and training to provide specialised and well-trained workers.

## Assessment framework

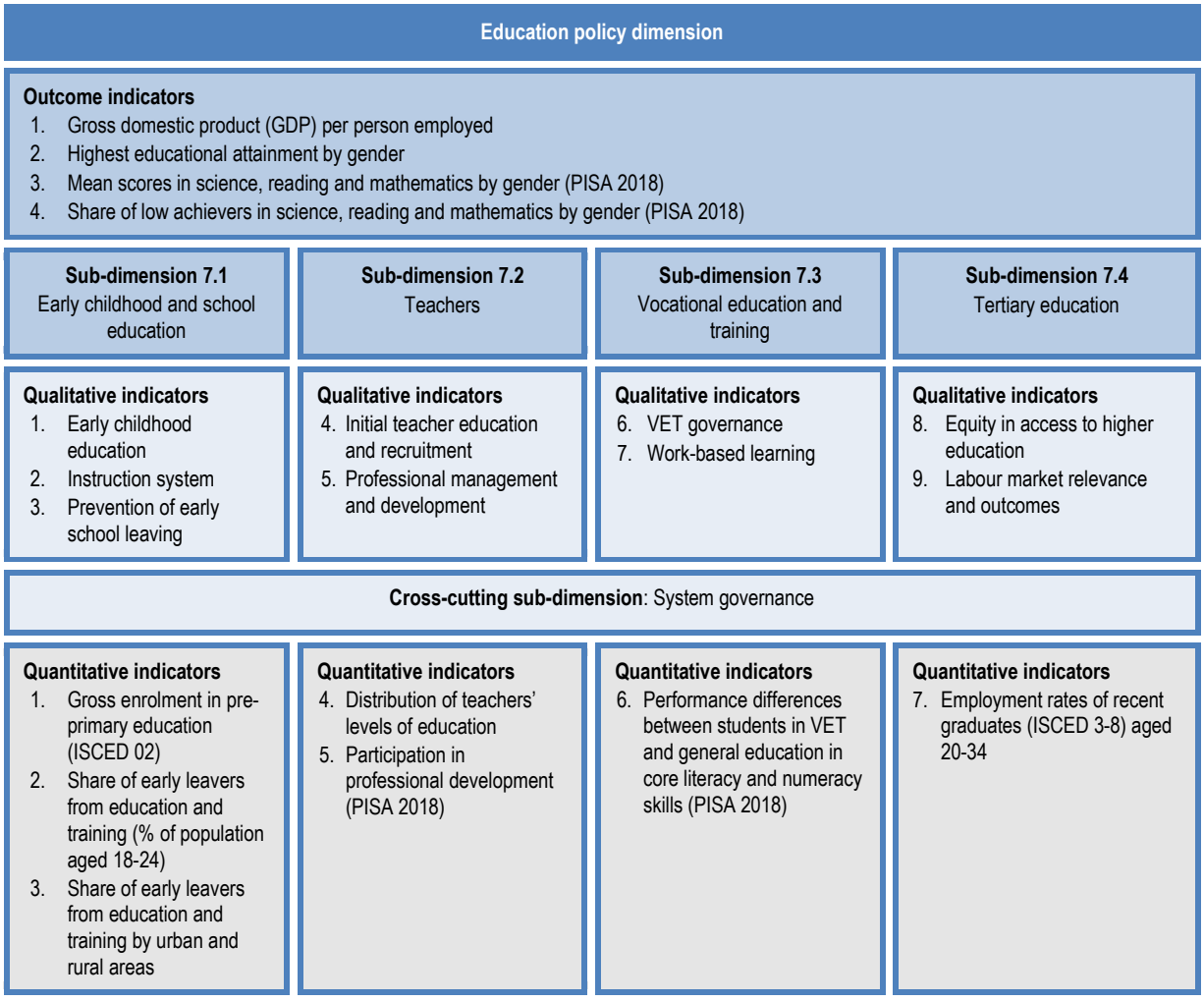
### *Structure*

This chapter assesses policies to improve education in the WB6 by assessing four broad sub-dimensions:

1. **Sub-dimension 7.1: Early childhood and school education**[1] assesses the access and availability of early childhood education (ISCED level 0 under the international standardised classification of education), as a foundation for early development of key competencies for lifelong learning. It also assesses the instruction systems and quality assurance mechanisms of schools in the WB6 economies. Finally, it assesses efforts to tackle early school leaving.
2. **Sub-dimension 7.2: Teachers** assesses the teaching workforce of the WB6 economies, by looking at progress made in strengthening initial teacher education (ITE) accreditation criteria and selection processes, as well as efforts to improve continuing professional development of teachers.
3. **Sub-dimension 7.3: Vocational education and training** looks at efforts to make improvements to the governance systems for VET in the WB6 economies, as well as the promotion and strengthening of work-based learning as a key driver of students' skill development.
4. **Sub-dimension 7.4: Tertiary education** assesses the WB6 economies' progress in ensuring greater equity in access to tertiary education for students coming from disadvantaged groups or backgrounds. It also assesses efforts to improve labour market relevance and outcomes of tertiary education in the WB6 economies through making higher education more competitive and ensuring its quality and synchronisation with labour market needs.
5. **Cross-cutting sub-dimension: System governance** assesses the WB6 economies' efforts to improve the overall holistic management of their education systems, through the introduction and development of data management systems and strengthening of policy monitoring, as well as the development of qualifications frameworks.

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. Figure 10.2 shows how these sub-dimensions and indicators make up the assessment framework. For more information, see the Methodology and assessment process chapter.

## Figure 10.2. Education policy dimension assessment framework




The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan (AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The Action Plan is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area.

In the regional trade area, the WB6 economies commit to closely align rules and regulations with the core principles governing the EU Internal Market based on the "four freedoms", enabling goods, services, capital and people to move more freely across the region. Mobility of students and researchers is a key component of the free movement of people. The findings in the tertiary education sub-dimension can inform the implementation of the actions under this component (see Box 10.4).

### *Key methodological changes to the assessment framework*

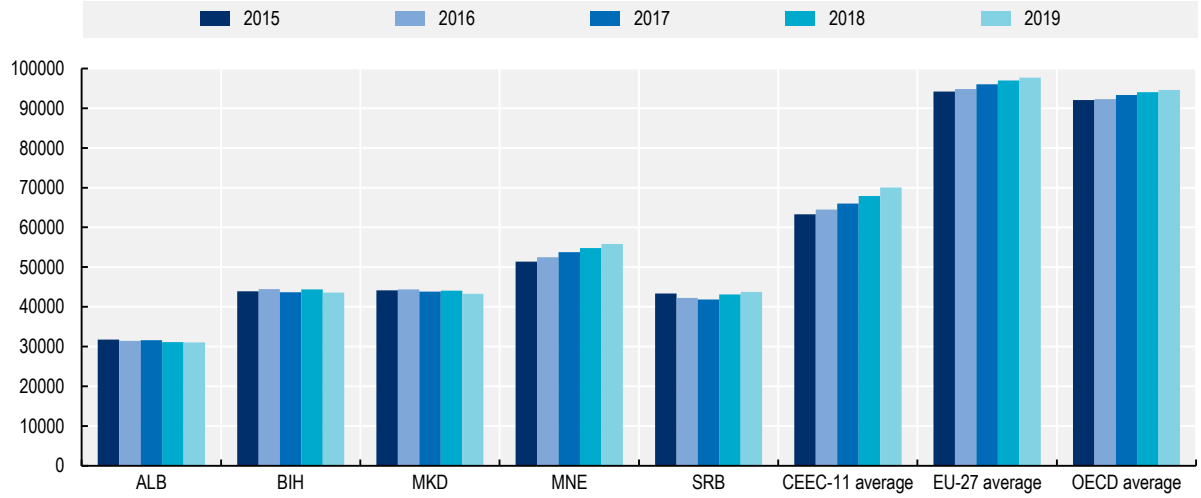
The assessment framework for the education policy dimension has changed slightly from the previous assessment cycle. The framework was re-arranged to include four sub-dimensions instead of three. The previous assessment cycle's first sub-dimension, access to and participation in high quality education, was divided into two sub-dimensions (early childhood and school education, and teachers) in order to better cover and expand on these key policy areas. A cross-cutting sub-dimension on system governance has also been added.

## Education performance and context in the WB6

High standards of education and competencies have many benefits for an economy and society. While education is not the only factor determining productivity, it plays an important role in skill formation and the availability of skills in the labour market. (OECD, 2019[4]). Growth in an economy or sector can come either from increased employment or more efficient work, i.e. improved labour productivity. Figure 10.3 shows that labour productivity, as measured by GDP per person employed, was lower in the WB6 economies than the CEEC-11,[2] EU or OECD averages between 2015 and 2019. On average, the Western Balkan economies' GDP per person employed was only 46% of the OECD average in 2019.

### Figure 10.3. GDP per person employed (2015-19)

Constant 2017 PPP USD



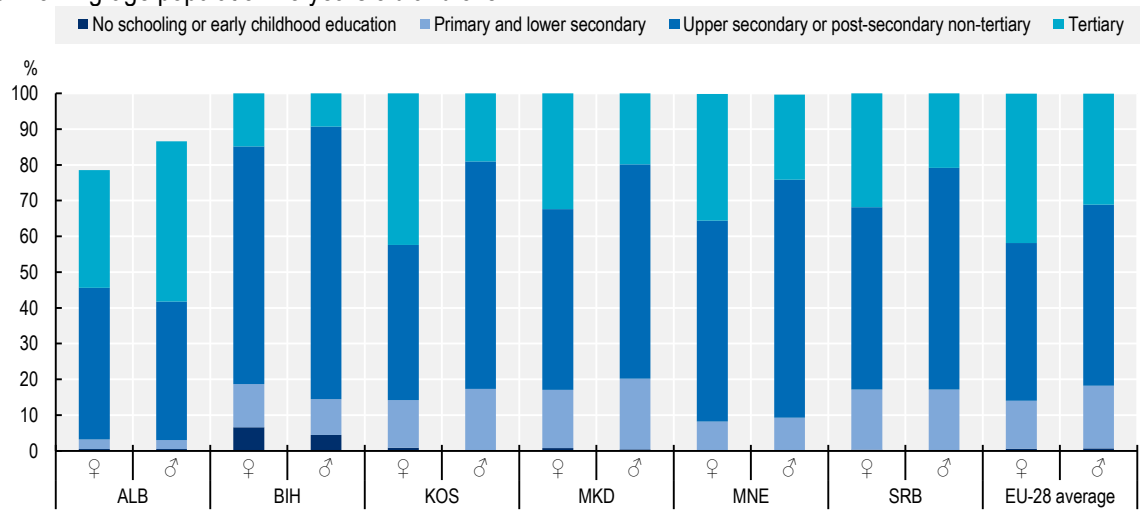

Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia. All WB6 and CEEC-11 averages in this chapter have been calculated as simple averages.
Source: (ILO, 2020[5]), *ILOSTAT* database, ilostat.ilo.org.

StatLink https://doi.org/10.1787/888934253917

Educational attainment is frequently used as a measure of human capital and thus as a proxy for the skills available in the labour force. Figure 10.4 shows levels of educational attainment in the working-age population (aged 15 and over) by gender. The share of tertiary-educated individuals in the WB6 economies is 9 percentage points (p.p.) below the EU average. However, except in Albania, women in the WB6 economies, as in the EU, are more likely to have a tertiary degree than their male peers. This gender gap is most pronounced in Kosovo, where 42.4% of women had a tertiary education, but only 19% of men.

## Figure 10.4. Highest educational attainment by gender (2019)

% of working-age population 15 years old and over




Note: Data based on labour force surveys. In Albania, 21.4%/13.3% of female/male respondents did not specify their level of education. EU average calculated as a simple average by the author. On average across the EU, 0.46% of respondents did not specify their level of education. Level of education refers to the highest level completed, classified according to the 2011 International Standard Classification of Education (ISCED). Primary and lower secondary education refers to ISCED levels 1-2; upper secondary or post-secondary non-tertiary education to ISCED levels 3-4; and tertiary education to ISCED levels 5-8.

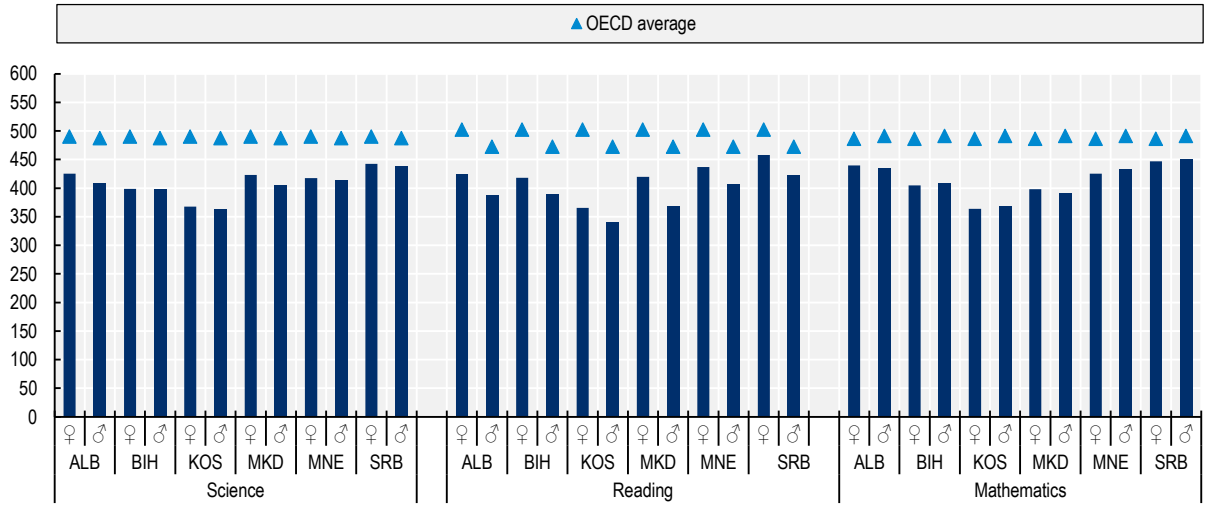
Source: (ILO, 2020[5]), *ILOSTAT* database, ilostat.ilo.org.

StatLink https://doi.org/10.1787/888934253936

All the WB6 economies participated in the 2018 PISA. The results found that they all have room to improve the quality of their education as the mean scores of 15-year-old students were well below the OECD averages (Figure 10.5). The results also revealed important disparities in learning outcomes. Across the WB6 economies, the differences in science, reading and mathematics performance between girls and boys are more pronounced than in the average OECD country. For example, in reading, girls in the WB6 economies outperformed boys by 35.1 score points on average, compared with a gap of only 29.7 score points on average in OECD countries. Most strikingly, in North Macedonia girls outperformed boys in reading by 51.6 points, the fourth highest gender gap across all the 77 countries and economies with available data that participated in the 2018 PISA.

## Figure 10.5. PISA 2018 performance in science, reading and mathematics by gender

Mean scores



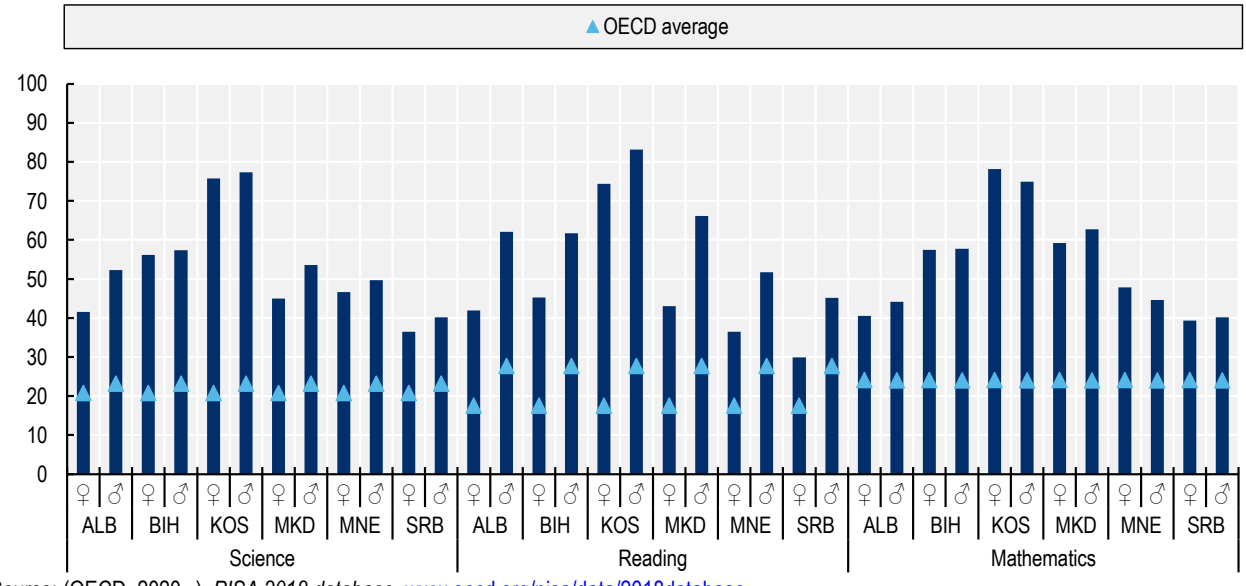

Source: (OECD, 2020[6]), *PISA 2018 database*, www.oecd.org/pisa/data/2018database.

StatLink https://doi.org/10.1787/888934253955

The PISA assessment has a scale of proficiency levels for the different subject domains. All students should be expected to attain Level 2 by the time they leave compulsory education, as this is considered the baseline level of proficiency required to participate fully in society. Students who score below Level 2 are defined by PISA as "low performers". Figure 10.6 shows that the WB6 economies have a larger share of such low performing students than the OECD average. On average across the WB6 economies in 2018, around one in two students did not attain Level 2 in each of the three domains (science, reading and mathematics) – a much higher share than the average for OECD countries, of about one in five students.

## Figure 10.6. PISA 2018 low achievers in science, reading and mathematics by gender

% of students scoring below Level 2




Source: (OECD, 2020[6]), *PISA 2018 database*, www.oecd.org/pisa/data/2018database.

StatLink https://doi.org/10.1787/888934253974

## Early childhood and school education (Sub-dimension 7.1)

Early childhood education (ECE) spans a critical window for a child's development which sets the foundation for later success in school, career, and life (UNICEF, 2019[7]; European Commission, 2013[8]). The benefits of ECE for individual children depends on the quality of provision but high-quality services have been shown to support children's social and emotional well-being, reduce their risks of dropping out of school and even contribute to better learning and employment outcomes later in life (UNICEF, 2019[7]; OECD, 2017[9]). Children from disadvantaged families stand to benefit the most from high-quality ECE and the return on investment from interventions during the early years are more significant than those that occur later on (OECD, 2017[9]). Moreover, children's participation in ECE offer greater opportunities for mothers and other caregivers to participate in the workforce, increasing household earnings and breaking cycles of intergenerational poverty (UNICEF, 2019[7]; OECD, 2017[9]).

Strong instructional systems hold schools accountable for educational quality and provided feedback to help improve teaching and learning practices (OECD, 2013[10]). Achieving this requires identifying areas of poor performance and providing additional resources to support the most disadvantaged schools and students. To improve overall learning outcomes, instructional systems should be highly coherent, with the curriculum, learning standards and student assessments all clearly aligned (Tucker, 2016[11]).

Preventing early school leaving is also key to ensuring the good functioning of the education system as individuals who leave education and training before completing upper secondary school, and who no longer participate in formal learning processes, face increased risks of unemployment, social exclusion, poverty and poor health (European Commission, 2019[12]).

The WB6 economies scored an average of 3 for this sub-dimension. Overall, Bosnia and Herzegovina and North Macedonia scored lower than the other economies in the region. However, all the WB6 economies could make more effort to strengthen their instructional systems (where Kosovo and Montenegro also have significant room for improvement) and ECE policies (Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework).

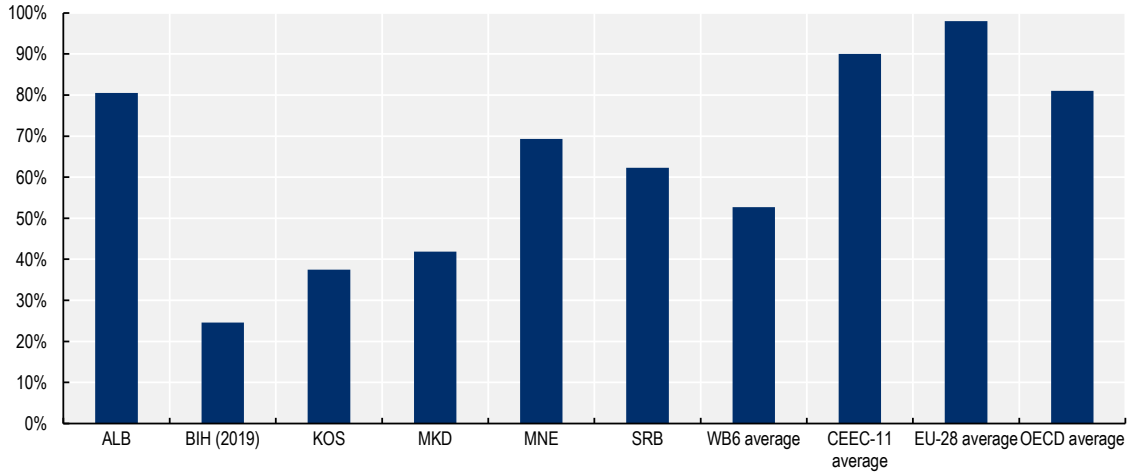
### Table 10.2. Scores for Sub-dimension 7.1: Early childhood and school education

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 7.1: Early childhood and school education | Early childhood education | 3.0 | 2.0 | 3.5 | 2.5 | 3.5 | 2.5 | 2.8 |
| | Instructional system | 4.0 | 2.5 | 2.5 | 2.5 | 2.0 | 4.0 | 2.9 |
| | Prevention of early school leaving | 3.0 | 2.0 | 4.5 | 2.0 | 4.0 | 4.0 | 3.3 |
| **Sub-dimension average score** | | 3.3 | 2.2 | 3.7 | 2.3 | 3.2 | 3.5 | 3.0 |

### *The WB6 economies have strengthened their early childhood education policies*

Although enrolment in pre-primary education (ISCED 02) has increased in the six Western Balkan economies, it remains on average around 40 percentage points below the EU and OECD averages, ranging from 25% in Bosnia and Herzegovina to 76% in Albania (Figure 10.7).

## Figure 10.7. Gross enrolment ratio, pre-primary (ISCED 02), both sexes (2018)




Note: Data for Bosnia and Herzegovina as of 2019 due to unavailability of 2018 data. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (UIS, 2020[13]), *Education statistics*, http://data.uis.unesco.org; For Kosovo: data received from Kosovo Agency of Statistics for this assessment.

StatLink https://doi.org/10.1787/888934253993

Implementing ECE policies, such as increasing coverage and reducing reliance on donor funding, remain key challenges for the sector. On average, the WB6 economies achieved a score of 2.8 for the early childhood education indicator, ranging from 2.0 (Bosnia and Herzegovina) to 3.5 (Kosovo and Montenegro). The WB6 economies scoring over 3.0 for this indicator (Kosovo and Montenegro) have distinguished themselves by having more ambitious policies for improving access to ECE via strong financial support for covering participation costs for parents in general, and socio-economically vulnerable groups in particular. However, as in all other WB6 economies, donor-funded initiatives continue to play a very important role in delivering ECE in both these economies.

All the economies have a strategic and legal framework in place addressing ECE and since the last Competitiveness Outlook assessment, several have also introduced ECE curriculum frameworks, promising to help improve the quality of ECE provision. In 2018, Albania introduced a new competency-based pre-school curriculum framework, which aligns with contemporary child development theories and practice, and Bosnia and Herzegovina introduced curriculum guidelines based on learning outcomes to help ensure continuity in children's transition from ECE to primary education. Also in 2018, Serbia introduced a new preschool curriculum framework that aims to support the well-being of young children and promote continuity between pre-school and primary education, while the government in North Macedonia adopted the Education Strategy 2018-25 and its corresponding action plan, which sets out activities to improve the quality and equity of ECE (although it does not connect the goals and curricula of ECE with those at primary school level). Montenegro has general curriculum guidelines in place to ensure continuity in children's transition from ECE to primary education. Curriculum frameworks in Kosovo are more specific, as the Early Childhood Education and Development and Early Childhood Development and Learning Standards describe clear expectations for child behaviour and performance in different areas of development and early learning. All the economies also have professional requirements and standards for ECE staff, which aim to ensure the quality of service delivery. ECE participation in Bosnia and Herzegovina is particularly low for the region, and is hampered by a number of factors, such as challenges with municipal financing and low parental awareness about the importance of ECE. The inconsistent design and implementation of ECE policies across the different entities and cantons further exacerbates these challenges, despite efforts to harmonise ECE quality and delivery (notably through the 2007 Framework Law on Preschool Care and Education in Bosnia and Herzegovina, and the state-level Platform for the Development of Preschool Education for 2017-22).

Despite the potential benefits of lowering the starting age of compulsory education to include one year of ECE, pre-primary education (ISCED 02) is still not compulsory in Albania, Bosnia and Herzegovina,[3] Montenegro and North Macedonia. Kosovo aims to make pre-primary education compulsory through the adoption of a new law on early childhood education, which is expected by the end of the year.

### *Policies and measures to improve instructional systems vary widely across the region*

On average, the WB6 economies achieve a score of 2.9 for the instructional system indicator, with most WB6 economies scoring between 2.0 (Montenegro) and 2.5 (Bosnia and Herzegovina, Kosovo, and North Macedonia). Albania and Serbia score far higher, lifting the regional average for this indicator, mainly thanks to a more comprehensive strategic vision for the education sector and better-developed school performance monitoring, with targeted supports to schools and school leaders.

All the WB6 economies have strategies which set out a vision for improving the quality of pre-university education, but they differ in their scope, accompanying action plans and the monitoring of their implementation. For example the recently expired strategies of Albania and Serbia (both ended in 2020) comprehensively covered all sectors of pre-university education. Their implementation plans included clear goals and implementation timelines for measurable and budgeted actions, while also allocating responsibilities between the different actors involved. In both economies, the implementation of the strategies has also benefitted from monitoring and evaluation, in Albania by an external expert organisation (UNICEF), and both economies are preparing new comprehensive long-term education strategies at the time of writing.

While Kosovo's Quality Assurance Strategy for Pre-University Education 2016-20 possesses similar characteristics (clear and measurable targets, allocations of responsibilities, a budget and timeline for proposed activities), neither its implementation, nor Kosovo's instructional system as a whole, has been evaluated comprehensively. North Macedonia's Comprehensive Education Strategy 2018-25 and its action plan set out objectives and activities for improving educational quality and inclusion, but they do not define clear budgets or monitoring processes (OECD, 2019[14]).

In Bosnia and Herzegovina and Montenegro, approaches to improving the quality of education have been more fragmented. Montenegro lacks an overarching strategy that establishes a coherent vision for the school system and instead has multiple strategies, which cover different time periods, topics and levels of education.[4] However, despite this rather fragmented approach, its administrative laws establish clear regulations around the curriculum, assessment, and evaluations. In Bosnia and Herzegovina, significant differences among education authorities contribute to fragmented education policies and resource inefficiencies. There is a Framework Law for Primary and Secondary Education, which requires the various education authorities to co-ordinate and align policies with EU standards and principles but there is no comprehensive state-level education strategy for the school sector. Instead, the Federation of Bosnia and Herzegovina (FBiH) and some individual cantons have policies regarding instructional quality and equity but only the Republika Srpska (RS) has prepared a comprehensive strategic document focused specifically on education.[5]

To improve the quality of education and their instructional systems, Albania and Kosovo have developed and rolled out a competency-based curriculum and corresponding learning standards to all grade levels, while Montenegro, North Macedonia and Serbia are in the process of doing so. In Bosnia and Herzegovina, an important achievement since the last Competitiveness Outlook assessment has been the introduction of the Common Core Curriculum based on learning outcomes, which sets out a model for competent education authorities to modernise their own curricula. However, the extent to which the education authorities have aligned and implemented their curricula to the Common Core varies.

External assessments of student learning, at the state or international level, yield results that can help evaluate the performance of education systems on a regular basis. In addition to growing participation in

international assessments, most WB6 education systems also implement or are developing external assessments or examinations to help determine the extent to which students in their economy are achieving core competencies and learning standards.

Comprehensive school evaluations, engaging school leaders and providing additional resources to support the most disadvantaged schools and students, can strengthen the overall quality of instructional systems and improve educational equity. All the WB6 economies have legal frameworks regulating school evaluations based on defined set of performance indicators, but they differ in the scope of indicators used, the methods used to evaluate schools externally and how the results of evaluations are used, including for additional support to low-performing schools (see the Competitiveness Outlook 2021 profiles of the different economies for more information).

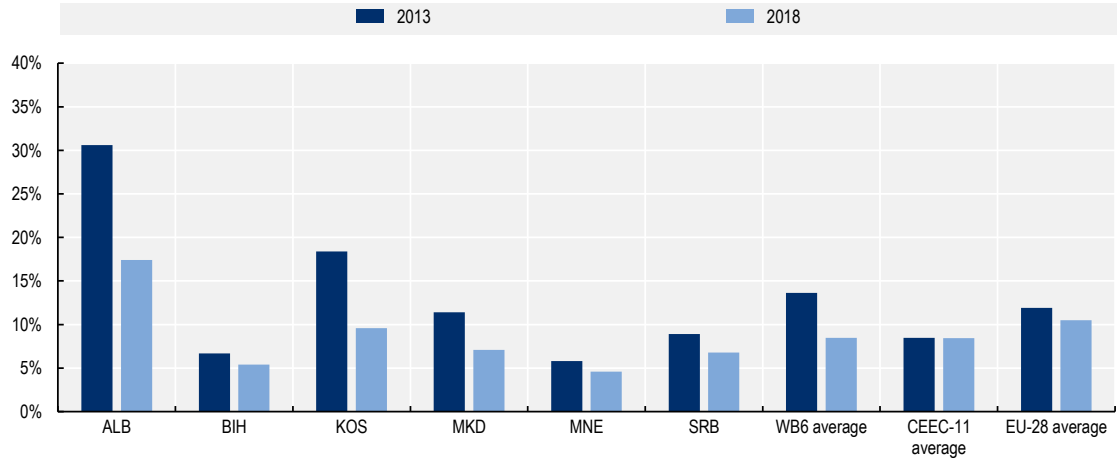
Since the last assessment, Albania and Serbia have undertaken significant reforms to their school quality evaluations. In Albania, the education ministry's Quality Assurance Agency is now reviewing the School Performance Card (a set of indicators used to rank individual schools) to ensure this data reflects contextual factors and is relevant to instructional quality. Albania has also established the Centre for School Leadership, which aims to support the preparation and professional development of school leaders. In Serbia, school quality standards were revised in 2017-18 to ensure that all students receive a good quality education. These standards are supported by a strong school evaluation framework that includes both self-evaluation and external evaluations, modelled on inspection systems found in other European countries. Serbia also has policies to provide additional support to low-performing schools (e.g. through expert assistance or small grants), although they remain in the pilot phase due to resource limitations.

### *Early school leaving rates have fallen across the region*

All the WB6 economies have taken measures to reduce early school leaving, leading to an average score of 3.3 for the prevention of early school leaving indicator. Between 2013 and 2018, the share of students leaving school without an upper secondary education has declined in all WB6 economies (Figure 10.8). The greatest reductions have been observed in Albania (13.2 p.p.), Kosovo (8.8 p.p.), and North Macedonia (4.3 p.p.), but despite this, their early school leaver rates still stood above the WB6 average of 8.5% in 2018. In contrast, the shares of early school leavers in Montenegro (4.6%), Bosnia and Herzegovina (5.4%) and Serbia (6.8) are below the CEEC-11 (8.4%) and EU (10.5%) averages.

## Figure 10.8. Percentage of early school leavers (2013 and 2018)

% of 18-24 year-olds with at most lower secondary education (ISCED 2) who were not in further education or training




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (Eurostat, n.d.[15]), *Candidate countries and potential candidates' database*, https://ec.europa.eu/eurostat/web/enlargement-countries/data/database; (Eurostat, n.d.[16]), *Education and training database*, https://ec.europa.eu/eurostat/web/education-and-training/data/database.

StatLink https://doi.org/10.1787/888934254012

Data for North Macedonia and Serbia show significant differences in the extent of early school leaving in cities and rural areas, unlike in EU countries on average (Table 10.3). However, while the early school leaving rate in Serbia was much higher in rural areas than in cities, as with the CEEC average, the opposite is the case in North Macedonia.

## Table 10.3. Early school leavers by degree of urbanisation (2019)

% of 18-24 year-olds with at most lower secondary education (ISCED 2) who were not in further education or training

| | Total | Cities | Towns and suburbs | Rural areas |
|---|---|---|---|---|
| MKD | 7.1 | 9.2 | 6.1 | 6.3 |
| SRB | 6.6 | 3.2 | 7.3 | 9.3 |
| CEEC-11 average | 8.3 | 4.5 | 9.9 | 11.2 |
| EU average | 10.3 | 9.4 | 11.3 | 10.6 |

Note: Data for Albania, Bosnia and Herzegovina, Kosovo, and Montenegro are not available. The CEEC-11 are the 11 Central and Eastern European countries joining the EU: Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia. EU includes all EU Member States in 2019. The degree of urbanisation is based on the share of local population living in urban clusters and in urban centres and classifies Local Administrative Units into three types of area: 1) cities (densely populated areas where at least 50% of the population lives in urban centres); 2) towns and suburbs (intermediate density with less than 50% of the population living in rural grid cells and less than 50% of the population in urban centres); and 3) rural areas (thinly populated areas where more than 50% of the population lives in rural grid cells).

Source: (Eurostat, n.d.[15]), *Candidate countries and potential candidates' database*, https://ec.europa.eu/eurostat/web/enlargement-countries/data/database; (Eurostat, n.d.[16]), *Education and training database*, https://ec.europa.eu/eurostat/web/education-and-training/data/database.

All the WB6 economies address early school leaving in their education strategies and have legal requirements aimed at keeping students in formal education and training pathways. However, there are differences in the extent to which measures to prevent early school leaving are budgeted and implemented, as well as how the relevant data are collected and analysed to identify the specific factors that contribute to early school leaving in each economy.

Kosovo, Montenegro and Serbia have performed particularly well in policies addressing early school leaving, as they all have budgeted activities to reduce and prevent early school leaving in a high-level strategic document, and implement measures that target at-risk learners to help keep them in school. Moreover, these three economies have recently improved their monitoring systems to better identify students at risk of early school leaving, with partial support from international donors. In 2017, Kosovo introduced an Early Warning System of Abandonment in its education management information system (EMIS), while Montenegro refined its indicators to more closely monitor student attendance and eventual abandonment. Serbia has recently developed indicators for monitoring the accessibility of institutions and identifying children who need additional support. All three economies also provide career guidance activities at both primary and secondary level, to help connect students with education and training programmes that align with their skills and interests.

Albania, which scores slightly below the regional average for this indicator, also implements some measures to prevent early school leaving. In 2017, the Ministry of Education, Sports and Youth conducted a study and identified several factors that contributed to Albania's high rates of school abandonment. Donor agencies have supported Albania to develop indicators and collect data to better monitor students at risk of early school leaving and in July 2019, Albania published a manual for monitoring children outside education institutions and at risk of dropping out of school, with support from UNICEF. However, career guidance activities in Albania only seem to be offered by higher education institutions, although there are efforts under way to introduce them at the secondary school level.

Bosnia and Herzegovina and North Macedonia achieve a score of 2 for this indicator. North Macedonia's Comprehensive Education Strategy and the Inclusion of Out-of-School Children project propose measures that could help reduce early school leaving and allocate responsibilities for implementation. However, these efforts appear to be largely supported by donor funding, with no evaluations of their implementation and effectiveness, or whether implementation is taking place within the planned timeline. North Macedonia collects only a limited range of data to monitor this issue and better understand the factors contributing to young people leaving education or training early. Bosnia and Herzegovina has no state-level strategy or policy that explicitly addresses early school leaving, as the entities and cantons have sole responsibility for such policies. However, the Ministry of Civil Affairs adopted the Recommendations for Inclusive Education in Bosnia and Herzegovina in 2019, which calls for measures and activities aimed at retaining students in the education system. The individual authorities collect their own data to monitor early school leaving and the FBiH has studied this issue in depth, finding that Roma children are especially vulnerable to leaving school early. However, the data available are limited and collected using inconsistent definitions across jurisdictions, making it difficult to accurately report on this issue, understand the contributing factors, and implement early interventions at the student and school level. North Macedonia has also made efforts to reduce the early school leaving rate of Roma children, who are particularly vulnerable, by engaging mediators to help bring students back to school or prevent them from leaving school.

### *The way forward for early childhood and school education*

- **Continue efforts to increase ECE coverage by making it more affordable and accessible**. Albania, Bosnia and Herzegovina, Montenegro, and North Macedonia could aim to make pre-primary education compulsory, as Serbia has done, and Kosovo aims to do.
- **Improve the affordability of ECE by linking prices to household income**. The WB6 economies could follow the example of Norway (Box 10.1) and limit the price of ECE to a percentage of the family's income, with the government financing costs that exceed this threshold.
- **Reduce dependence on donor assistance for financing ECE infrastructure and accessibility**. This could be achieved through making ECE funding a regular part of public spending on education, as well as by engaging the private sector.

### Box 10.1. Early childhood education funding in Norway

Norway has two types of ECE settings: kindergartens (*barnehage*) and family child care (*familiebarnehage*), which can be managed publicly or privately. More than 98% of children enrolled in ECE attend kindergartens and less than 2% are in family child care. Kindergartens in Norway are integrated pedagogical settings providing ECE for children aged 0-5.

Both publicly and privately managed ECE settings in Norway are mostly funded by public sources. Only 15% of Norway's total expenditure on early childhood education and care (ECEC) comes from private sources, including fees paid by parents/guardians. Both national and municipal governments in Norway have made efforts to expand access and support equality of participation, particularly for low-income and minority-language families through fee reductions and legal entitlements, as part of the kindergarten reform 2004-09. This was achieved through increased public funding, which reduced parental contributions to operating costs. Nationally, there is a maximum price (for all children) of NOK 3 040 (EUR 304) monthly (adjusted in August 2019).

To better target low-income families, a regulation was introduced in 2015 stating that the maximum annual fee shall not exceed 6% of the family income. If the fee does exceeds this, the excess is covered by the state rather than by municipalities (as used to be the case). The national regulations also stipulate lower fees for siblings with reductions of 30% of the annual fee for the second child and 50% for the third child.

Municipalities are responsible for ensuring that these regulations are applied by all kindergartens (both public and private) and for compensating private providers for the reduced fees. Although participation among minority-language children continues to be lower than for all children, the gap is closing. In 2018, according to national authorities, 83% of minority-language children aged 1-5 attended ECEC, an increase of 2.5 percentage points compared to 2017. For all children, the participation rate was 92%.

Source: Extracted from (OECD, 2019[17]), *Providing Quality Early Childhood Education and Care: Results from the Starting Strong Survey 2018*, https://doi.org/10.1787/301005d1-en; (Statistics Norway, 2018[18]), *Minoritetsspråklige barn i barnehage 1-5 år (K) 2015 - 2018*, www.ssb.no/statbank/table/12272/.

- **Ensure that policy frameworks for improving pre-university education have measurable and budgeted objectives**, **and that they are regularly monitored**. Some good practice examples can be taken from the strategies of Albania and Serbia, and also from Ireland's Action Plan for Education (Box 10.2). Recent OECD education policy reviews provide insights into how the economies' education systems could improve the focus and effectiveness of strategic documents. Kosovo should pay particular attention to these criteria as it develops its new education strategy post 2021 and Montenegro could consider developing an overarching education strategy to synchronise the objectives of various policy documents that exist for different levels of education. Bosnia and Herzegovina could also consider drafting a state-level framework strategy for pre-university education, with the goal of aligning education policies with EU standards and principles.

### Box 10.2. Ireland's indicator framework for the Action Plan for Education 2018

Ireland's Action Plan for Education 2018 accompanies the economy's national education strategy for 2016-19, setting out priorities and actions that the Department of Education and Skills and its technical agencies should undertake during the year. The action plan clearly aligns each action and sub-action to the economy's five main goals for improving the quality of its education system. Each goal is associated with a list of actions and a set of indicators that are used to measure progress. For example, the first goal – "improve the learning experience and the success of learners" – identifies six objectives, followed by indicators, as in the table below.

| Objectives | Indicators |
|---|---|
| 1.2 Deliver a "step change" in the development of critical skills, knowledge and competencies to provide the foundations for participation in work and society | Increase the percentage of students taking higher-level maths at the end of Junior Cycle: 60% by 2020 |
| | Increase the proportion of students performing at Level 5 or above for reading in PISA: 12% by 2020 |
| | Decrease the proportion of students performing below Level 2 for science in PISA: < 10 by 2025 |
| | Increase the proportion of students performing at Level 5 or above for mathematics in PISA: 13% by 2020 |
| 1.6 Enable learners to communicate effectively and improve their standards of competency in languages | Percentage of candidates presenting a foreign language at the Junior Certificate/ Cycle Examination: 100% by 2026, 92% by 2022 |
| | Students studying a foreign language as part of their HE course: Support 20% of all HE students to study a foreign language as part of their course (2026) |
| | Students doing Erasmus +: 4 100 HE students (2018/19) |

Source: extracted from (Maghnouj et al., 2019[19]) *OECD Reviews of Evaluation and Assessment in Education: Serbia,* https://doi.org/10.1787/225350d9-en; (Government of Ireland, 2018[20]), *Action Plan for Education 2018*, www.gov.ie/en/collection/d3b2f1-action-plan-for-education-2018/.

## Teachers (Sub-dimension 7.2)

Coherent and comprehensive systems of initial teacher education (ITE) can better prepare teachers to deliver high-quality instruction and help all students reach their full potential (OECD, 2019[21]). Such systems aim to attract and select the best candidates into teacher education, helping to raise the profession's status and contributing to a high-quality teaching workforce. While initial education provides an important foundation for new teachers, continuous staff development helps to improve the quality of the workforce and retain effective staff over time. Professional development must enable teachers to refresh and broaden their knowledge and practice throughout their careers. To this end, many OECD and EU countries have used teacher standards to develop management systems that provide teachers with clear feedback on their performance and connect them with relevant training and support (OECD, 2019[21]; OECD, 2013[10]). When combined with a differentiated career structure, this can create incentives for teachers to develop their skills and help accelerate system-wide improvement by directing the most experienced teachers towards mentorship and leadership roles.

The WB6 economies scored an average of 2.7 for this sub-dimension, with Albania, Montenegro and Serbia scoring above the regional average. However, performances remain uneven with Serbia scoring

the regional average for the ITE indicator but well above it in the professional management and development of teachers indicator, showing it has room to strengthen its ITE policies (Table 10.4).

### Table 10.4. Scores for Sub-dimension 7.2: Teachers

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 7.2: Teachers | Initial teacher education and selection | 3.5 | 1.5 | 2.0 | 2.5 | 3.0 | 2.5 | 2.5 |
| | Professional management and development | 3.5 | 1.5 | 2.5 | 2.5 | 3.5 | 4.0 | 2.9 |
| **Sub-dimension average score** | | 3.5 | 1.5 | 2.3 | 2.5 | 3.3 | 3.3 | 2.7 |

### *Entry and accreditation standards for initial teacher education could be strengthened*

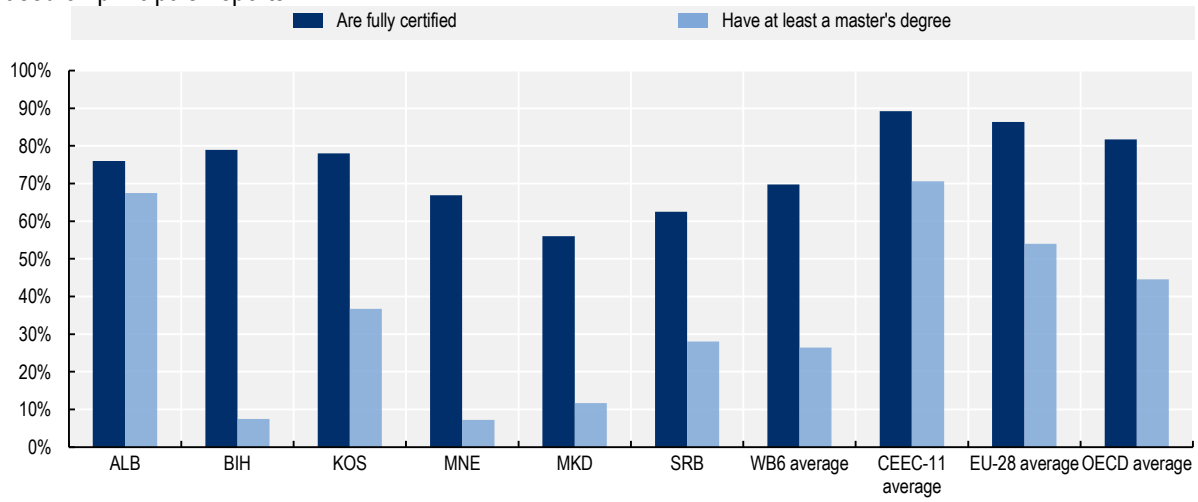
On average the WB6 economies achieved a score of 2.5 for the initial teacher education indicator, ranging from 3.5 for Albania to 1.5 for Bosnia and Herzegovina. Across the region, only Albania and North Macedonia have minimum entry requirements for selecting ITE candidates. All ITE candidates in Albania must have a minimum grade point average of 7.5 out of 10. In North Macedonia, the Law on Higher Educational Institutions for Teaching Education Staff in Preschool Education, Primary and Secondary Education, sets minimum entry requirements (based on State Matura results), but its policies have not been implemented because of insufficient human and financial resources. Placement quotas (a common feature of all tertiary programmes in North Macedonia) are very large for ITE, meaning nearly everyone who applies for a place is accepted (OECD, 2019[14]). In the four other WB6 economies, higher education institutions (HEIs) have full autonomy over entry requirements for ITE candidates.

In Albania and Serbia, all primary and secondary school teachers are required to have a master's degree (ISCED 7), while in North Macedonia and Montenegro they are required to have achieved at least a bachelor's degree (ISCED 6). In Bosnia and Herzegovina specific qualification requirements for teachers vary across entities and cantons, but all future teachers must have at least a bachelor's degree and attend study programmes to gain pedagogical knowledge and teaching qualifications. In Kosovo, by-laws establish minimum educational requirements for teachers in each level of education and subject area.

The OECD's 2018 PISA assessment asked school principals how many of the teachers in their school were fully certified by an appropriate authority and had attained at least a master's degree. Figure 10.9 shows that that on average, 26.4% of surveyed school principals in the Western Balkans reported that teachers in their school had at least a master's degree, a much lower share than the CEEC (70.6%), EU (54%) and OECD averages (44.6%).[6]

## Figure 10.9. Teacher qualifications (PISA 2018)

Based on principals' reports

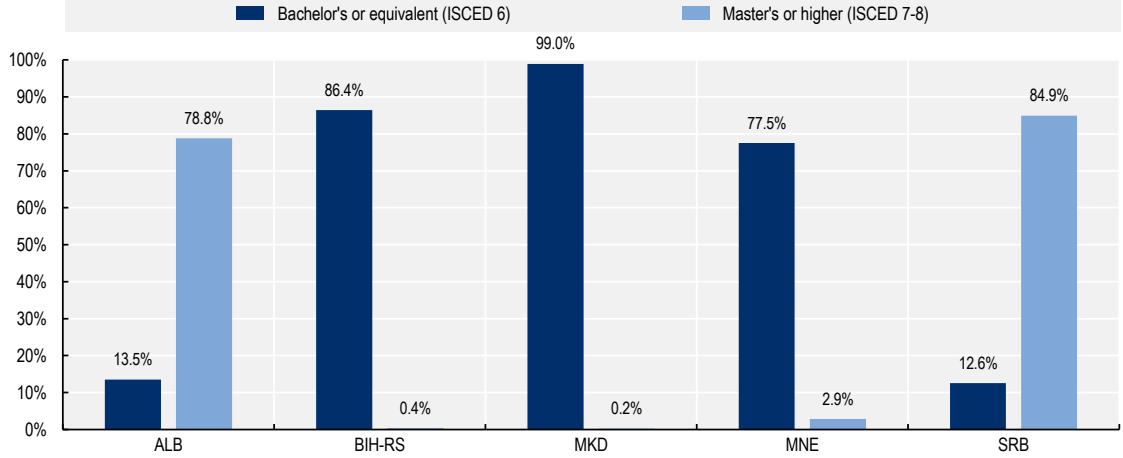



Note: Certified teachers are those licensed to teach in a school based on the standards defined by national or local institutions. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (OECD, 2020[6]), *PISA 2018 database*, www.oecd.org/pisa/data/2018database.

StatLink https://doi.org/10.1787/888934254031

Statistical data provided by Western Balkan education ministries and/or statistical offices for this Competitiveness Outlook assessment show that, in 2019, the share of teachers with at least a master's degree was much higher (i.e. teachers had higher qualification levels), in Albania and Serbia (since, as mentioned above, this is a requirement in these economies) than in the other Western Balkan economies with available data (Figure 10.10).[7]

## Figure 10.10. Teachers with a bachelor's or master's or higher degree (2019)




Note: For Bosnia and Herzegovina, data only available for Republika Srpska (BIH-RS). Data for Kosovo not available.
Source: Data provided by WB6 statistical offices for this assessment.

The quality of ITE programmes and minimum entry requirements typically vary by individual institutions across most WB6 economies. Accreditation processes that set specific requirements for ITE programmes can ensure that all new teachers receive adequate preparation for their job. Of the WB6 economies, only Kosovo and Montenegro accredit ITE programmes based on professional teacher standards, which provide a common reference point for what "good" teaching is and how it is demonstrated. In Albania, Bosnia and Herzegovina, and North Macedonia, there are no programme-specific accreditation criteria for ITE programmes so ITE providers do not have to demonstrate how their programmes help candidates

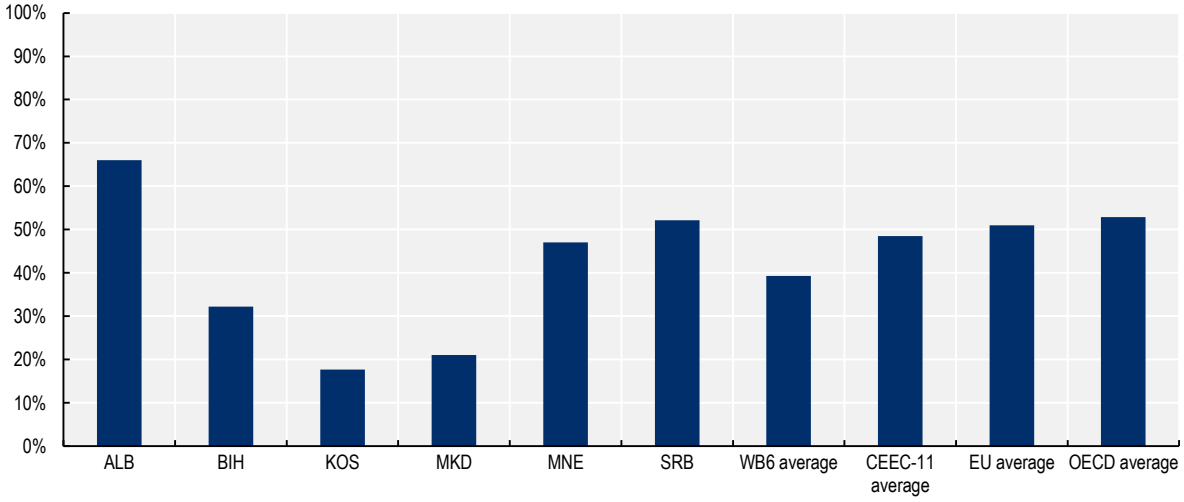
develop the specific competencies needed to teach. One positive development in Serbia has been the revision of its national accreditation standards in 2019, establishing a minimum duration for the initial practicum component[8] of ITE programmes. Regardless of accreditation requirements, teacher candidates in all WB6 economies have to complete some form of practical classroom experience under the supervision of a mentor teacher and pass a professional examination before being able to teach as fully certified teachers.

### *Almost all the WB6 economies have made strong progress in improving professional development opportunities for teachers*

While improvements to ITE can help improve the quality of future teachers, governments must also ensure that practising teachers are supported and encouraged to develop throughout their careers. According to data from the 2018 PISA assessment, teacher participation in professional development programmes in the WB6 economies is around 10% lower on average than the EU, OECD and CEEC averages. However, it varies widely across the region, with teachers in some economies (Albania, Montenegro and Serbia) having participation equal to or even higher than the EU, OECD and CEEC average (Figure 10.11).

**Figure 10.11. Participation of teaching staff in professional development (PISA 2018)**

Teaching staff who attended a programme of professional development during the last three months




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (OECD, 2020[6]), *PISA 2018 database*, www.oecd.org/pisa/data/2018database.

StatLink https://doi.org/10.1787/888934254050

The WB6 economies scored an average of 2.9 for the professional management and development of teachers indicator, ranging from 1.5 (Bosnia and Herzegovina) to 4.0 (Serbia). All the WB6 economies except Bosnia and Herzegovina made moderate to strong progress in implementing the previous assessment's recommendations on improving professional development opportunities and structures for teachers. In particular, North Macedonia created a model for the career development and promotion of teachers in primary and secondary education with its Law on Teachers and Professional Associates in Primary and Secondary Schools, adopted in 2019.

The improvement of teachers' professional development is a recognised policy objective in all the WB6 economies. Albania and North Macedonia have included this objective in their respective education strategies, while Kosovo, Montenegro and Serbia have dedicated strategies or regulations for the improvement of teacher professional development and management frameworks. To encourage participation in professional development, all WB6 economies have models for teacher career

advancement. These models often include different professional categories and promotions that are based on years of experience and rewarded with salary increases. However, only some of the WB6 economies (Kosovo, Montenegro, North Macedonia and Serbia) have aligned teachers' career structures with differentiated professional standards and offer incentives that encourage teachers to develop higher levels of competency and take on more advanced teaching roles.

All the WB6 economies legally require teachers to participate in training and professional development activities. They all regularly assess teachers' professional development needs, often based on survey results or government priorities. However, decisions about the types of professional development offered are not systematically informed by the results of teacher appraisal processes. Most WB6 economies have some form of accreditation process for professional development providers, except Bosnia and Herzegovina.[9] Kosovo and Montenegro are the only economies which require teachers to regularly renew their teaching licences and certificates (every five years), which can be a significant motivator for participation in professional development as it is valued in the renewal process.

### *The way forward for teachers*

- **Build strong accreditation criteria for initial teacher education (ITE) programmes**, tailored specifically to ITE and the requirements of the teaching profession. The economies that lack such criteria (Albania, Bosnia and Herzegovina, and North Macedonia) should develop criteria that are tailored to the teaching profession and demonstrate how programmes prepare candidates to work in schools.
- **Ensure that teachers have clear, progressive career structures**, with differentiated competencies based on categories or ranks that are associated with appropriate rewards to incentive teachers to advance up the career ladder. Currently, only Kosovo, North Macedonia and Serbia have such frameworks. Albania and Bosnia and Herzegovina should develop criteria to help guide teachers' professional development, while Montenegro should align its standards with the existing categories and ranks of teachers in its education system.
- **Provide adequate support and incentives for teachers' continuing professional development**. Such support might include increasing funding for professional development activities, while incentives might include making professional development an integral and mandatory part of the career advancement process or leading to salary increases (see Box 10.3 for examples from Georgia and Italy). Introducing a regular renewal of licences, as is the case in Kosovo and Montenegro, can also motivate teachers to participate in professional development.

### Box 10.3. Encouraging and funding teachers' professional development in Georgia and Italy

The Teacher Professional Development Scheme in Georgia is a key component of the overarching Teacher Recruitment, Evaluation, Professional Development, and Career Advancement Scheme (2015). The scheme offers Georgian teachers career advancement opportunities through differentiation of teacher status: practitioner, senior teacher, leading teacher and mentor. All in-service and new teachers are expected to pass a certifying examination to gain the status of a senior teacher. Teachers are required to participate in a number of mandatory and optional professional development activities to earn credits and thus maintain or enhance their status.

One main constituent of the scheme, introduced in 2016, is an increased number of optional activities replacing mandatory activities for teachers. This gives teachers more flexibility to tailor their professional development based on their needs and interests. Teachers also have a financial incentive to improve their status through participation in professional development activities, as they receive higher salaries based on their status advancement. The programme also stands out by offering teachers the opportunity for self-reflection through self-evaluation, including designing an individual work plan, self-assessment of performance and identifying their professional development needs.

The Italian government is focusing on school-level autonomy as a key lever for educational improvement. Reflecting this orientation, in-service professional development provisions at the school level, and chosen by teachers, are a key feature of the Good School reform (*La Buona Scuola*), introduced in 2015. The reform has made in-service training mandatory, permanent and structural.

These provisions were designed in response to the low participation of Italian teachers in professional development activities. First, the Italian government made a large financial investment (EUR 1.5 billion) exclusively for training in areas of system skills (school autonomy, evaluation and innovative teaching) and 21st century skills (such as digital skills, schoolwork schemes) and skills for inclusive education. Second, the programme stands out for its tailored approach and the scope it offers teachers to participate in professional development according to their needs. This is done by providing teachers a sum of EUR 500 per year on their "Teachers Card" to participate in training activities or purchase resources (books, conference tickets, etc.). It also offers a matching processes to align training offers with training demands using a digital platform.

Source: Extracted from (OECD, 2019[21]), *A Flying Start: Improving Initial Teacher Preparation Systems*, https://dx.doi.org/10.1787/cf74e549-en; (Government of Georgia, 2015[22]), Decree of the Government of Georgia no. 68: Initiating teacher activities, approving professional development and career progression scheme, Chapter V, https://matsne.gov.ge/document/view/2739007?publication=0 (accessed 8 April 2019); (OECD, 2017[23]), *Education Policy Outlook: Italy*, www.oecd.org/education/Education-Policy-Outlook-Country-Profile-Italy.pdf.

## Vocational education and training (Sub-dimension 7.3)

In addition to the basic competencies learnt in general education programmes, vocational education and training systems play a major role in supplying occupation-specific skills in both quickly expanding economic fields, and in traditional trades – and are therefore fundamental to improving competitiveness. However, the governance of VET is inherently complex, as it covers a range of programmes offered at either upper secondary or post-secondary levels of education (ISCED 3-5) and involves co-ordinating tasks and responsibilities both horizontally across governance levels and vertically between national and local authorities (Bergseng, 2019[24]). Effective VET governance also demands strong engagement with social partners and reliable data to develop programmes and determine the number of study and/or training places to balance the supply and demand for skills.

Work-based learning is a key component of VET systems, as it provides a powerful way for learners to acquire professional skills and the key competencies needed for working life. Its effectiveness in easing school-to-work transitions and meeting labour market demand is increasingly recognised internationally (OECD, 2018[25]; UNESCO, 2018[26]). However, engaging students, employers, social partners and education and training systems in these learning processes remains a significant challenge for many economies around the world, and especially in the Western Balkans, where the transition from centrally planned economies means private sector partnership with state education systems are a relatively new tradition. Such partnerships between VET providers and businesses are critical to the success of WBL models.

Overall, the WB6 economies scored an average of 3.1 for the VET sub-dimension, an improvement over the previous assessment score of 2.2, and reflecting substantial progress in nearly all of them.. Performance across both indicators in this edition of the CO is similar for all WB6 economies, with the notable exception of Montenegro and North Macedonia, which perform slightly better in the VET governance indicator (Table 10.5).

### Table 10.5. Scores for Sub-dimension 7.3: Vocational education and training

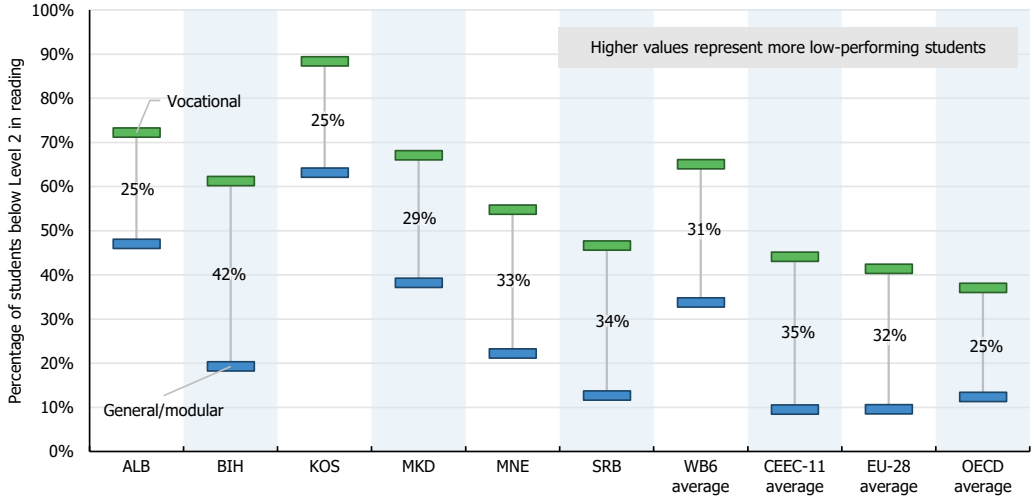
| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 7.3: Vocational education and training | VET governance | 3.5 | 2.0 | 3.0 | 4.0 | 4.0 | 3.5 | 3.3 |
| | Work-based learning | 3.0 | 2.0 | 3.5 | 3.0 | 3.0 | 3.0 | 2.9 |
| **Sub-dimension average score** | | 3.3 | 2.0 | 3.3 | 3.5 | 3.5 | 3.3 | 3.1 |

### *The WB6 economies have strengthened their VET policy frameworks but inequalities with general education remain high*

Students in the WB6 economies have a higher average enrolment rate in VET programmes than the OECD and EU averages. Data from PISA 2018 finds that students enrolled in VET programmes in the WB6 economies, as is common in many countries, tend to have lower average performance in core literacy and numeracy skills than those in general programmes (Figure 10.12). Strengthening VET governance and improving VET curricula is thus key to reducing disparities in learning outcomes between VET and general students. Such measures can also help ensure that VET students are equipped with the core knowledge and skills needed for success in work and life.

## Figure 10.12. PISA 2018 low achieving students and education programmes

Differences in performance between students in upper-secondary education




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (OECD, 2020[6]), *PISA 2018 database*, www.oecd.org/pisa/data/2018database.

StatLink https://doi.org/10.1787/888934254069

On average, the WB6 economies scored 3.3 for the VET governance indicator. Nearly all the WB6 economies have strategic frameworks for the development of VET, as well as bodies responsible for the development, management and evaluation of VET programmes. In Bosnia and Herzegovina, a new state-level strategic document on improving VET has been adopted in January 2021. This is an important development, as there has been no state-level VET strategy since the previous one expired in 2013. Legal and regulatory frameworks in all the WB6 economies ensure that responsibilities between the different bodies responsible for VET (ministries, VET agencies, VET providers, etc.) are well defined. Furthermore, these frameworks typically establish quality standards and regulations for VET programmes in nearly all the WB6 economies (except for FBiH in Bosnia and Herzegovina).

While all the economies have bodies responsible for accrediting education programmes, Bosnia and Herzegovina lacks a formal accreditation process for VET programmes in both entities. Nevertheless, Bosnia and Herzegovina has some measure of programme quality control, as new VET providers must undergo an approval process and are subject to regular inspections in both entities (the RS also has quality standards and regulations for VET providers in place), as in the other WB6 economies. The competent authorities (i.e. VET agencies, education ministries and education providers) in Albania, Kosovo, Montenegro, North Macedonia and Serbia involve social partners, and most notably employers, in the elaboration of VET-related policy and curriculum materials, but in Bosnia and Herzegovina, their involvement varies across entities and cantons, being most developed in the RS.[10]

Data collection on completion rates of VET courses and employment rates of recent graduates remains very variable across the WB6 economies, but no economy collects robust data on all relevant indicators for VET development.[11] For example, North Macedonia is the only economy to report on the earnings of VET graduates, an important indicator for measuring socio-economic outcomes and to help students make informed decisions about their future pathways. Data collection in Bosnia and Herzegovina is uneven, with very limited data at the state level on the number of VET schools, students and programmes. However, some entities and cantons do collect information on the completion and employment rates of VET graduates. The economies that did best in this indicator (Montenegro and North Macedonia), not only collect such data but also ensure it is analysed and used to shape VET policy and career guidance.

### *All of the WB6 economies are developing work-based learning policies*

The WB6 economies scored an average of 2.9 in the work-based learning indicator, with scores ranging from 2 (Bosnia and Herzegovina) to 3.5 (Kosovo). While all WB6 economies see the development of WBL as an important part of their education policy frameworks, there are differences in the level of support, in terms of promotion, stakeholder engagement and monitoring. Several WB6 economies (Albania, Kosovo, Montenegro and North Macedonia) are rolling out pilot projects to develop dual education, and Serbia has created a legal framework for dual education through the adoption of a dedicated law allowing students in secondary education to undertake their studies in parallel with gaining professional experience.

All the WB6 economies run broad public awareness campaigns to promote WBL to social partners and students. Social partners are involved in the selection of candidates and there are systems for matchmaking, ensuring that students are allocated to WBL experiences based on established criteria. However, these systems differ in their scope across the economies. Albania, Kosovo and Serbia have dedicated career placement services that help match students with WBL experiences, and some economies have online portals listing WBL opportunities (Kosovo and the RS in Bosnia and Herzegovina), while others rely on public awareness campaigns to match students with WBL providers. Incentives to employers to offer WBL places is one area for improvement, as only Montenegro and North Macedonia currently provide or plan to provide some form of financial incentive to employers who engage in WBL.

All the WB6 economies would benefit from improving their data collection on WBL programmes to support their development, by expanding their range of monitoring indicators and using relevant data to inform policy making. Bosnia and Herzegovina (except for the RS) and North Macedonia do not yet have a data collection system in place to report on key WBL indicators,[12] while Serbia is planning to deploy one. None of the economies that do collect these data report on all the key indicators that are usually used by OECD countries with mature WBL systems. Kosovo aims to establish a central office for collecting data on WBL, which would help improve monitoring of the sector and inform policy decisions.

### *The way forward for vocational education and training*

- **Ensure that students in VET develop core literacy and numeracy skills by supporting strong VET accreditation standards** including these core skills. This would reduce the gap with students enrolled in general education and ensure that VET students can adapt to changes in the labour market. Bosnia and Herzegovina should work to create a VET accreditation authority, either at the state level, to ensure harmonisation between standards in the entities, or at the entity level. The other WB6 economies should continue to support their accreditation authorities and ensure they have the resources they need.
- **Continue efforts to incorporate WBL into VET programmes**, as this can provide learners with valuable on-the-job experience and opportunities to develop the competencies needed for success in further studies or work. Attention should also be paid to ensuring that vocational teachers are aware of recent developments in the professional practice of their respective fields.
- **Collect comprehensive data on the VET sector** and use this information to align programmes with labour market needs and strengthen career guidance.

## Tertiary education (Sub-dimension 7.4)

Higher education contributes to competitiveness and inclusive growth by strengthening human capital, research and development and innovation. In most economies, individuals with a tertiary education (ISCED 5-8) often have better labour market outcomes than those with lower levels of education. To align the supply and demand for higher education graduates, economies need reliable labour market information and must be able to communicate this information to learners and adapt flexibly to changing needs. This

is especially important for the WB6 economies as they suffer from "brain drain", where skilled young people seek opportunities abroad, in part due to mismatches between tertiary education programmes and labour market needs, presenting a risk to economic competitiveness.

Around the world, educational attainment and access to tertiary education have greatly improved over the past half-century. Disparities in the participation and completion of tertiary education have consequences for competitiveness since fewer individuals are able to benefit from the economic and social mobility often associated with having a tertiary education degree. Equitable higher education systems thus ensure that access to tertiary education depends on individuals' abilities, efforts and interests – rather than their personal and social circumstances, such as socio-economic status, gender, ethnicity, age or disability (OECD, 2019[27]).

The WB6 economies scored an average of 2.8 for this sub-dimension, showing that, although there are examples of good practice, there is still room for improvement in addressing these key areas for the competitiveness of the WB6 education systems (Table 10.6).

**Table 10.6. Scores for Sub-dimension 7.4: Tertiary education**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 7.4: Tertiary education | Equity in access to higher education | 2.5 | 2.5 | 2.5 | 2.5 | 2.0 | 2.5 | 2.4 |
| | Labour market relevance and outcomes | 3.5 | 3.0 | 3.0 | 3.5 | 3.5 | 2.5 | 3.2 |
| **Sub-dimension average score** | | 3.0 | 2.8 | 2.8 | 3.0 | 2.8 | 2.5 | 2.8 |

### *Access to higher education remains highly inequitable in the WB6 economies*

The WB6 economies scored an average of 2.4 in the equity in access to higher education indicator, with all the economies scoring 2.5, except Montenegro, which scored 2. This shows that the whole region has room for improvement in ensuring equitable access to higher education, mainly by developing more effective support measures and ensuring more comprehensive data collection to better understand the root causes of this inequality.

All the WB6 economies have enshrined equitable access to higher education in their legal frameworks and ensuring it is a key objective of all the higher education strategies in the region. All the economies have some measures in place, such as scholarships, tuition fee exemptions, quotas for students meeting certain criteria and other support measures. However, their effectiveness in helping students from socio-economically disadvantaged groups to access and complete higher education is debatable. For instance, some scholarships are awarded based solely on academic merit, and do not always take into account difficulties that students from disadvantaged or marginalised backgrounds may face. In Montenegro, scholarships are awarded to the winners of academic competitions, which may benefit students who were already on track to access higher education, rather than those who may need additional support. Albania is the only WB6 economy that has put in place a quota system for students facing economic and social difficulties to access higher education, providing them a 50% reduction in tuition fees. The RS is drafting legislation that would allow the government to directly allocate tuition fees to HEIs for each student enrolled. The change aims to encourage them to adjust admission policies and increase the number of students from lower socio-economic background in order to obtain more funding. Apart from this planned initiative, no WB6 economy has created incentives to encourage HEIs to enrol students from disadvantaged backgrounds to improve equity.

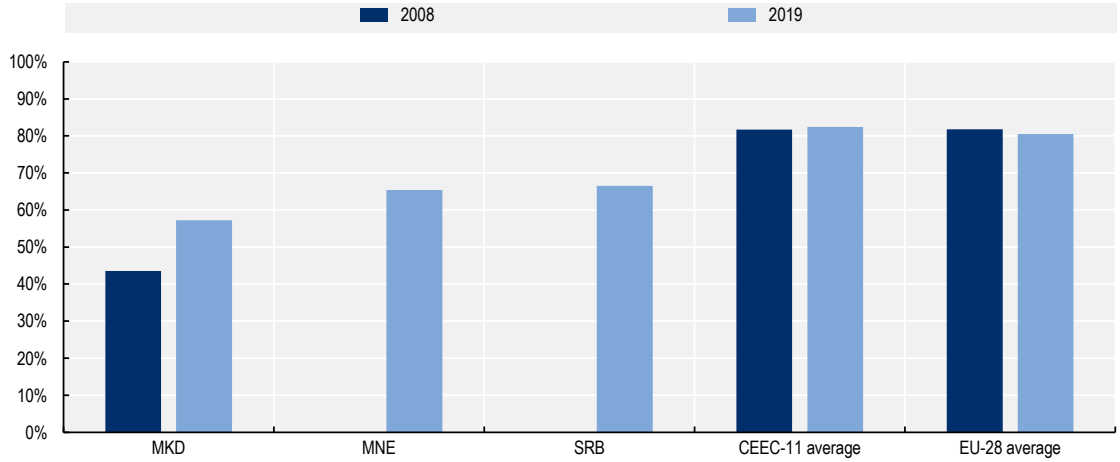
The collection and analysis of data to help understand the causes of inequality in access to higher education is another area where all the WB6 economies could improve. Although they all collect some form of data such as enrolment and completion rates based on gender or ethnic background, none have analysed this data to identify associations between individual factors and participation in higher education.

### *All the WB6 economies have taken steps to improve the market relevance of their tertiary education systems*

Another key challenge for the WB6 economies is in improving the labour market relevance of tertiary education. The employment rates of young people and young graduates in the region remains significantly below the EU and CEEC-11 averages (Figure 10.13), showing the need to reinforce policies to better connect higher education with the labour market and improve the employability of graduates.

**Figure 10.13. Employment rates of recent graduates in the EU and WB6 economies (2008 and 2019)**

Employment rates of recent graduates (aged 20-34) not in education and training (%)




Note: Recent graduates refers to those with an upper secondary, post-secondary non-tertiary or tertiary education (ISCED 3-8) who have graduated within 1-3 years. Data for Albania, Bosnia and Herzegovina, and Kosovo are not available. CEEC-11 average calculated based on individual statistics for Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (Eurostat, 2020[28]), *Employment rates of young people not in education and training by sex, educational attainment level and years since completion of highest level of education*, https://ec.europa.eu/eurostat/web/products-datasets/-/edat_lfse_24.

StatLink https://doi.org/10.1787/888934254088

The WB6 economies scored an average of 3.2 in the labour market relevance and outcomes indicator, with scores ranging from 2.5 (Serbia) to 3.5 (Albania, Montenegro and North Macedonia). All the WB6 economies see improving the employability of graduates by increasing the labour market relevance of their tertiary education as a priority, and have integrated this objective into their policy frameworks.

The WB6 economies have all also taken steps to promote the internationalisation of tertiary education, through mechanisms such as funding and promoting mobility and participation in the EU's Erasmus+ programme, either as members (Serbia and North Macedonia) or partners (the other WB6 economies). To improve the quality assurance of higher education, they have all established independent quality assurance agencies to certify and review higher education curricula and adapt them to labour market needs.

All the WB6 economies collect some form of data relevant to assessing the labour market relevance of education. However, as with the other indicators in this dimension, data collection remains uneven and could benefit from broadening the range of information collected. For example, Albania and Kosovo do not collect data on labour market outcomes by field of study, a key indicator for measuring labour market relevance.

### *The way forward for tertiary education*

- **Analyse data related to inequity in access to higher education** in order to better identify and understand the root causes of inequity, such as socio-economic or ethnic minority background, gender and other factors and how they relate to students' chances at accessing and succeeding in higher education.
- **Create incentives for higher education institutions to improve equity** in higher education through support measures such as scholarships or tuition fee exemptions. Inspiration could be taken from the planned initiative in the RS to give HEIs an incentive to increase the number of students from lower socio-economic backgrounds.
- **Broaden the range of data collection related to labour market outcomes** to help understand the extent and causes of skills mismatches between education and the labour market. The WB6 economies should also undertake regular analysis and monitoring of these data to inform policy making.

#### Box 10.4. Student and researcher mobility in the Common Regional Market

The regional trade area part of the Common Regional Market (2021-24) Action Plan (CRM AP) includes five components: 1) cross-cutting trade measures; 2) goods; 3) services; 4) capital; and 5) people. The following key findings of the CO2021 tertiary education sub-dimension can inform the implementation of the actions related to the people component:

- Encouraging mobility of students and researchers (regional actions 1 and 2 of priority area 5.1 of the CRM AP) depends on aligning qualifications frameworks between the WB6 education systems. An important step towards this is the alignment and referencing of qualifications frameworks to the EQF, which only four of the WB6 economies (Kosovo, Montenegro, North Macedonia and Serbia) have completed fully.
- The Action Plan aims to guarantee the right to study across the WB6 economies through a Framework Agreement on Access to Study. A good practice example can be taken from the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden), who signed an Agreement on Admission to Higher Education in 1996. This agreement guarantees applicants domiciled in one of the parties the right to apply to public higher education courses in the other parties and be considered as though they were a domestic applicant (European Commission, 2018[29]). To facilitate intelligibility of qualifications and education systems, the Nordic-Baltic manual, developed in 2016, can also serve as an example. It features a table which facilitates the comparison of qualifications in the Nordic countries mentioned, as well as in Estonia, Latvia and Lithuania (NORRIC, n.d.[30]).
- According to the Action Plan, regional integration of education systems is expected to be driven by deeper integration into the European Higher Education Area, namely the membership of all WB6 quality assurance agencies in the European Association for Quality Assurance in Higher Education (ENQA) and registration with the European Quality Assurance Register for Higher Education (EQAR). Currently, none of the WB6 economies' accreditation agencies are members of the ENQA[1] nor registered with the EQAR. However, except for Kosovo and Serbia, all are governmental members of the EQAR. It will be essential to further integrate higher education accreditation agencies into these institutions by improving their governance practices and alignment with ENQA requirements in order to harmonise regional qualifications standards.
- None of the tertiary education systems in the WB6 economies, except Montenegro, allow for portability of public study grants for studies conducted abroad (Eurostat, 2020[28]), which provides a significant financing challenge for students wishing to undertake their studies within

the European Higher Education Area. This also poses an equity challenge, as the students who will find this barrier most significant will be those from socio-economically disadvantaged backgrounds. Along with creating new incentives for encouraging equity, as suggested in the tertiary education sub-dimension, the WB6 economies should ensure the portability of financial support measures within the European Higher Education Area, both for short term (credit mobility) and long-term (degree mobility) studies abroad.

1: From 2014 to 2019 the Kosovo Accreditation Agency had the status of member, but it was suspended due to lack of compliance with ENQA's governance standards (ESG) following a review by ENQA in 2019. Serbia's National Entity for Accreditation and Quality Assurance had the status of member since 2013 (through a predecessor institution), but was downgraded to an affiliate in 2020 due to insufficient compliance with the ESG following ENQA's review.
Source: (European Commission, 2021[31]), *Common Regional Market*, https://ec.europa.eu/neighbourhood-enlargement/policy/common-regional-market_en; (Regional Cooperation Council, n.d.[32]), *Common Regional Market*, www.rcc.int/pages/143/common-regional-market (Eurostat, 2020[28]), *The European Higher Education Area in 2020: Bologna Process Implementation Report*, https://op.europa.eu/en/publication-detail/-/publication/c90aaf32-4fce-11eb-b59f-01aa75ed71a1/language-en/format-PDF/source-183354043; (European Commission, 2018[29]), "Council Recommendation on promoting automatic mutual recognition of higher education and upper secondary education diplomas", https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018SC0170; (NORRIC, n.d.[30]), Overview of Qualifications, https://norric.org/nordbalt/overview/.

## System governance (cross-cutting sub-dimension)

Governing complex and multi-level education systems requires governance models that balance responsiveness to local diversity with the ability to ensure key objectives at the system level (Burns, 2016[33]). Governments set the overall framework that determines the organisation and structure of their education system (e.g. years of compulsory education, students' age of entry in school, grade levels, courses offered, teachers' qualifications, etc.), who is allowed to provide compulsory education (public and/or private actors), and what mechanisms are in place to finance education. Governments also set goals for the overall system, as well as the standards by which providers are held accountable.

The WB6 economies scored an average of 3.3 for this cross-cutting dimension on system governance, ranging from 1.5 (Bosnia and Herzegovina) to 4 (Kosovo and North Macedonia). Except for Bosnia and Herzegovina,[13] all the WB6 economies have strategies and legal frameworks in place to improve the governance of the education system – for more information, see Early childhood and school education (Sub-dimension 7.1). The differences in scoring arise mainly from differences in data collection systems to support monitoring of the education system's performance and the implementation and evaluation of policies within individual economies, as well as the internationalisation of qualification frameworks. Bosnia and Herzegovina's low score in this dimension is mainly a result of challenges to policy co-ordination, fragmentation of responsibilities and a lack of overall vision for education system governance (Table 10.7).

### Table 10.7. Scores for cross-cutting sub-dimension: System governance

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|
| Cross-cutting sub-dimension: System governance | 3.5 | 1.5 | 4.0 | 4.0 | 3.5 | 3.5 | 3.3 |

In terms of data collection, with the exception of Bosnia and Herzegovina,[14] all the WB6 economies have developed an education management information system (EMIS) to centralise data collection and report on the performance, in line with international data definitions and methods. Albania is currently developing a new EMIS and Kosovo and Serbia are making efforts to improve and modernise their existing systems. So far, Albania is the only WB6 economy to have developed an economy-wide external assessment system to measure student achievement. This tool provides valuable information about the quality of teaching and learning for system monitoring. North Macedonia and Serbia have plans to develop such systems as well.

The WB6 economies also differ in the adaptation of their education qualification frameworks to recognised international frameworks This is important for international comparability and relevance of education systems, which can boost worker and learner mobility and thus competitiveness. While Kosovo, Montenegro, North Macedonia and Serbia have aligned their frameworks with the EU's European Qualifications Framework (EQF), Albania and Bosnia and Herzegovina have yet to finalise this process.

### *The way forward for system governance*

- **Develop system-wide standardised assessments** with the primary purpose of measuring student performance. Currently, only Albania has fully developed such an assessment, although Serbia has piloted one. Those economies which are not in the process of developing one (Bosnia and Herzegovina, Kosovo, and Montenegro) should consider this policy measure as a means to increase the reliability of student assessments and collect information about learning processes within their economy-specific contexts. Unlike standardised examinations, these assessments would not have stakes for students, but serve exclusively as a monitoring and evaluation tool.
- **Develop a well-functioning, modern and comprehensive data collection system, facilitated by an EMIS**. This would facilitate reporting to the EU and allow the region to benchmark performance against international peers. Those economies which do not yet have plans to modernise their EMIS (Montenegro and North Macedonia) should look to broaden the range of data collection and indicator monitoring in order to cover all key indicators related to tackling the policy challenges mentioned in this chapter. Bosnia and Herzegovina should look to implement a harmonised EMIS. While not necessarily state-wide or centralised system, it should enable data interoperability between the systems used by entities and cantons, in order to give an idea of state-level performance.
- **Encourage analytical research to identify the root causes of key education challenges** (such as inequity, skills mismatches with the labour market, etc.) based on regular monitoring of educational data. The results of this research should be used to inform policy making and to propose potential solutions to identified issues.

## Conclusion

Since the last Competitiveness Outlook assessment, all the WB6 economies have made progress in creating more inclusive and competitive education systems, especially prior to the COVID-19 pandemic. Significant achievements include the reduction in early school leavers and the implementation of more work-based practical experience and the development of VET programmes. The region nevertheless faces key challenges, chief among them being the labour market relevance of education systems, especially at the higher education level, and data collection and management. The recommendations included in this chapter should serve as guidance to help tackle these key challenges, among others, and help the WB6 economies on their path to creating high-quality education systems that contribute to a more qualified workforce and more competitive economies.

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## Notes

[1] ECE (ISCED level 0) covers all forms of early childhood programmes that have an intentional education component - such as preschools, kindergartens and day-care centres – designed to foster learning and emotional and social development in children. Pre-primary programmes (ISCED 02) are generally offered to children from the age of three until the age of primary school entry. However, in some economies it is not always easy to establish the boundaries between pre-primary and ISCED 01 provision (early childhood educational development) that is more focused on basic childcare, health and nutrition and can be less structured.

[2] The 11 Central and Eastern European countries (CEEC-11) joining the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[3] The Framework Law on Preschool Education in Bosnia and Herzegovina made the year prior to primary school compulsory. Most cantons in the Federation of Bosnia and Herzegovina (FBIH) and BD have implemented a compulsory year of pre-primary and it is optional in the Republika Srpska (RS).

[4] For example, there are separate strategies for general and vocational education at the secondary level, both of which cover 2015-20, in addition to strategies on inclusive education (2019-25) and supporting talented students (2020-22).

[5] The Strategy of Education Development for Pre-university Education 2016-2021.

[6] The PISA data cover schools with 15-year-old students so this may include VET schools where the rules about teacher education requirements could be slightly different from general primary and secondary education.

[7] In Serbia, the law does stipulate that teachers must have a master's degree. However, the difference in numbers could be explained by the fact that when school principals filled in the PISA questionnaire, they may not have taken into account the fact that the law recognises that a 4-year degree obtained before 2005 is the equivalent of a master's degree, and hence reported a lower number of teachers with such a degree.

[8] Under the 2019 revised accreditation standards, the teacher practicum must be at least 90 hours per year in the second, third and fourth years of the programme. In the fifth year of the programme, the teaching practicum is at least 180 hours and 6 ECTS.

[9] Although not universally present in BiH, the RS and some cantons do have processes for accreditation of professional development providers.

[10] In the RS, the Chamber of Commerce, the Union of Employers' Associations and the Employment Bureau are engaged in VET policy within the entity and surveys are conducted annually to understand skills demand, whereas the level of engagement in FBiH varies depending on the different cantons. The Framework Law on VET requires the formation of tripartite advisory councils, comprising representatives of employers, trade unions and competent education authorities at the levels of cantons, entities, the District of Brcko and at state level. Not all FBiH cantons have formed such councils but they are expected to do so.

[11] The CO 2021 assessment framework defines the following as key indicators for monitoring VET and WBL performance and outcomes: completion rates of VET programmes, employment rates of recent VET graduates, number of learners who are hired after completing a WBL opportunity or apprenticeship, earnings of VET graduates.

[12] Apart from the WBL-related indicators mentioned above, other relevant indicators include the type, location and duration of WBL opportunities, attendance rates, resulting skill gains, demographics of participants, and academic credits / wages earned.

[13] The RS has an education strategy setting out the entity’s education policy from 2016 to 2021, but there are no strategies for the FBiH, its cantons, or at the state level.

[14] The RS and some cantons have their own data systems that serve the same function as an EMIS but there is no state-level EMIS.

# 11 Employment policy (Dimension 8)

Employment is central for economic development and social inclusion. This chapter aims to assess the employment regulatory framework and policies, and the institutional capacity to implement them, in the six Western Balkan economies (WB6). It explores whether they are likely to enhance the quantity and quality of employment, promote skills development, and allow labour market participation for all, including vulnerable groups and minorities. It considers four sub-dimensions. The first considers the labour market governance system, including the resourcing of inspectorates and efforts to reduce informal employment. The second, skills, looks at mismatches between the supply and demand for skills and the policies in place to identify and address mismatches. The job quality sub-dimension assesses the quality of earnings and policies to ensure men and women have equal access to high-quality jobs. The final sub-dimension considers activation policies, and the work of public employment services to implement the mutual obligation framework and active labour market programmes aimed at reducing unemployment and inactivity. Each sub-dimension provides recommendations for the way forward across the region.

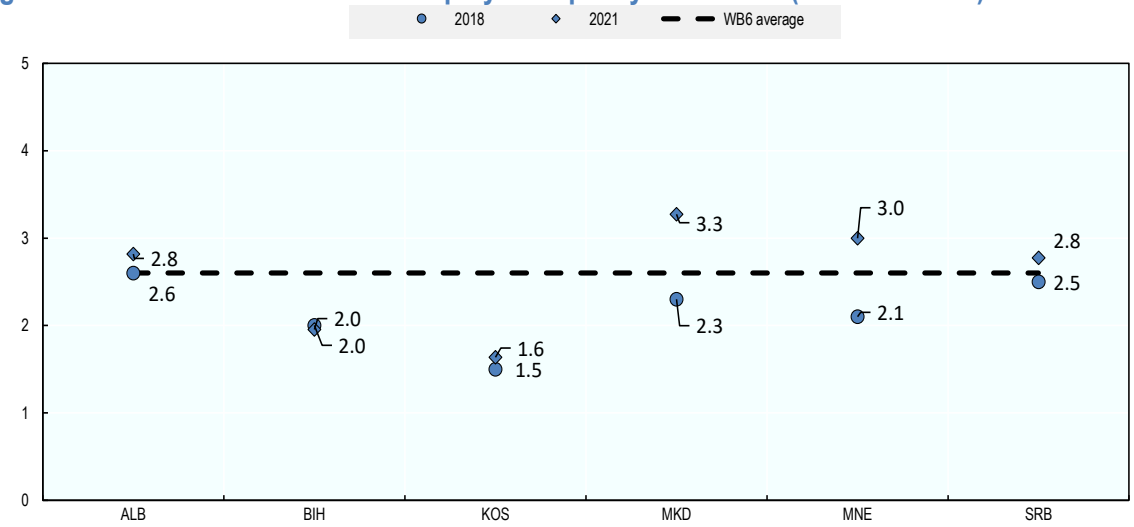
## Key findings

- **Employment rates have risen but are still below the averages for the European Union (EU), Central and Eastern European (CEEC) and OECD economies**. Rates of temporary employment, self-employment and informal employment are comparatively high, and unemployment rates are very high, well above the EU, CEEC and OECD averages. Job retention schemes have limited the impact of the COVID-19 pandemic on employment in many of the WB6 economies, but the informally employed have been negatively affected.
- **Economies vary in the alignment of their employment frameworks with the EU *acquis***. Some economies have increased labour market flexibility and improved regulatory frameworks for non-standard forms of work. The regulatory frameworks for occupational health and safety have been improved, although they still have a long way to go. Implementing the frameworks has proven to be the most challenging aspect. Labour inspectorates still generally have limited capacity, and tackling informal employment remains a key challenge. Some economies have started to improve inter-agency co-operation and work methods.
- **Workplace representation and collective bargaining remain weak**, with some variation across economies. Tripartism plays a more important role in regulating employment-related issues, with the economic and social councils consulted about key issues, such as the minimum wage. However, tripartite social dialogue could be improved, and the capacity of the economic and social councils strengthened. No assessments have been done of the impact of the minimum wage level on either informal employment or poverty reduction.
- **High unemployment rates are combined with skills shortages**. Most economies have made significant progress in analysing skills mismatches and have started to set up strategies to reduce them. Recent improvements have been made to help young people gain work experience. Nevertheless, overall, the education system is failing to produce the skills employers need, school-to-work transition mechanisms are poor, participation in upskilling and skills adaptation activities among both the employed and unemployed is low, and emigration exacerbates skills shortages and skills gaps.
- **Participation of adults in job-related learning activities is below the EU average.** The low skill levels of older adults will hinder their employment opportunities when conditions improve. Adult learning initiatives consist mainly of systems to recognise and validate prior learning and some small-scale measures for the low-skilled and unemployed.
- **Women's employment and activity rates have risen significantly** but remain below the EU and OECD averages. Female employment is particularly low in Bosnia and Herzegovina and Kosovo. Low activity rates significantly increase the numbers at risk of poverty.
- **The capacities of the region's public employment services (PESs) have improved**, with the introduction of tools to profile the unemployed and individual job seekers' action plans. Improvements have also been made in targeted active labour market programmes (ALMPs), although vulnerable groups and minority groups are still less well covered. Co-operation with local social services has improved but social services have limited capacity. Unemployment benefits and means-tested minimum income schemes are not very generous and job-search requirements are not well implemented. Low PES budgets for staff and ALMPs limit the effectiveness of activation policies.

## Comparison with the 2018 assessment

On average, the WB6 economies have achieved higher scores for this dimension in the 2021 assessment than they did in 2018 (Figure 11.1). However, progress has been uneven. While North Macedonia and Montenegro have made the most noticeable improvement, Kosovo and Bosnia and Herzegovina have made no progress. These two economies recorded the lowest scores in the 2021 assessment.

### Figure 11.1. Overall scores for the employment policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress on implementing the policy recommendations made in the CO 2018 has been moderate overall (Table 11.1). The main advances have been in improving the regulatory framework and applied methods, while improvements to institutional capacities in terms of staffing and sustainable budgets have been limited. There are wide differences in implementation across the economies.

## Table 11.1. Implementation of the CO 2018 policy recommendations: Employment policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Fully implement measures set out in strategies and action plans** | Implementation of strategies and action plans varies considerably among economies in the region and across policy fields. Significant improvements have been made in promoting female employment and reducing youth unemployment and rates of those not in employment, education, and training (NEET). Low female employment and very high youth unemployment remain key challenges in Bosnia and Herzegovina and Kosovo. There was limited improvement in implementing action plans for labour market inclusion of vulnerable groups and minorities. | Moderate to advanced |
| **Strengthen the capacities of social partners, in particular workers' organisations** | There is no or little evidence of much improvement. | None to limited |
| **Continue to tackle informal employment** | There is no evidence of significant improvement yet, although some economies have started to set up dedicated and encompassing strategies (e.g., Kosovo). Implementation of these strategies remains challenging. Some economies have improved the transparency and working methods of labour inspectorates (e.g., Albania, Montenegro and Serbia). However, the overall capacities of labour inspectorates have not improved much. | Limited |
| **Improve activation policies and create an effective institutional setup** | Important progress has been made in the design and targeting of ALMPs. However, budgets spent on ALMPs remain very low (particularly in Kosovo) given the level of unemployment and long-term unemployment. PES staff's caseloads are still too high when dealing with vulnerable groups, especially in Bosnia and Herzegovina, Kosovo, and Serbia. Some vulnerable groups are not well represented among participants. There has been no (significant) progress in terms of budgets and little to moderate progress in linking social and employment policies. | Moderate |
| **Strengthen the capacity and infrastructure of public employment services (PES)** | Significant progress has been made in strengthening PES's working methods. Labour market information systems have been improved. No or little progress has been made to increase the number of PES staff or to reduce counsellors' caseloads. Little improvement has been made to employer services. | Moderate |
| **Improve skills matching and ensure that training measures are effective** | Important improvements have been made in the design of tracer studies in some economies (Albania and Serbia) and the conduct of skills needs surveys. The measuring of skills mismatches has been improved (in Albania, Montenegro, North Macedonia and Serbia) or is underway. Workplace-based training modules have been introduced into vocational education and training (VET) curricula and the promotion of internships improved in some economies (e.g. Montenegro, North Macedonia and Serbia). | Moderate |
| **Improve job quality by targeting the factors that affect earnings, job security and the quality of the working environment** | There have been few improvements to labour productivity except in Bosnia and Herzegovina. There has also been little improvement in monitoring working conditions and accidents at work. However, progress has been made in developing and implementing occupational health and safety at work frameworks. | Limited |

## Introduction

The quality and inclusiveness of employment should be central policy priorities, as much as job creation, while resilience and adaptability are important for good economic and labour market performance in a changing world of work (OECD, 2018[1]). This calls for policies and institutions that protect workers and foster inclusiveness but also allow workers and firms to adapt to technological change, increase productivity, and reach good and sustainable outcomes. The key outcomes targeted by the employment policy dimension are an increase in the employment rate and a reduction in unemployment. Skilled workers

are a key asset for competitiveness and technological development and are essential to attracting investment into the region (OECD, 2019[2]).

Other policy areas also have an important impact on employment. Policies geared toward improving competitiveness and modernising economies increase labour productivity and are thus the basis for increasing wages and purchasing power. This links the employment chapter to some of the following chapters in this publication:

- **Chapter 7. Tax policy.** Tax policies and the social protection system can create incentives for people to work in the formal economy and move from informal to formal employment and can also encourage investment in lifelong learning, which benefits the economy as a whole.
- **Chapter 9. State-owned enterprises.** Differences between wages in state-owned enterprises and the private sector have an impact on labour allocation and potential skills shortages in the private sector.
- **Chapter 10. Education policy.** Education is central to providing the workforce with the skills in demand in the labour market as well as allowing economies to modernise and advance digitalisation, innovate and grow. In turn, well-educated workers have better employment and working conditions. There is a danger that skilled workers will move abroad if they cannot find attractive employment opportunities and career prospects in the region. Conversely, ties with the diaspora in the areas of research, investment and entrepreneurship have the potential for valuable knowledge transfer.
- **Chapter 14. Transport policy.** Transport investment has the potential to reduce employment barriers, particularly for women in rural areas.
- **Chapters 15 and 16. Energy policy and environment policy.** These policies, and policies for greening the economy, require the development and adaptation of relevant technical and cross-cutting skills.
- **Chapter 18. Tourism policy.** The tourism sector is labour-intensive so tourism strategies have an impact on employment.
- **Chapter 19. Anti-corruption policy.** Anti-corruption measures may help to reduce informal employment.

From an employment perspective, sector policies need to strike a balance between tapping into the potential for additional employment opportunities (e.g., in rural areas), and addressing employment conditions. The efficient provision of social and health services and the close co-operation between employment and social policy actors is key for bringing vulnerable groups into the labour market. The provision of childcare and elderly care services is a precondition for promoting female employment.

## Assessment framework

### *Structure*

This chapter assesses policies related to employment in the WB6 in four broad sub-dimensions:

1. **Sub-dimension 8.1: Labour market governance** measures whether there is a co-ordinated, strategic government approach to labour standards, and to what extent it has been implemented. It considers the range of policies, norms, laws, regulations, institutions, and processes that influence the demand and supply of labour as well as employment quality, covering the regulatory framework, labour inspectorates, employment policy framework, and social dialogue and tripartism.
2. **Sub-dimension 8.2: Skills** assesses whether there is a co-ordinated, strategic government approach to skills development, and to what extent it has been implemented so that the incentives

are in place to reduce skills gaps and encourage upskilling and skills adaptation, focusing on reducing skills mismatches and adult learning.

3. **Sub-dimension 8.3: Job quality** assesses the policy approach to quality earnings, including wage setting mechanisms, and social security contributions and taxes. It looks at whether they strike a balance between providing decent pay, social protection, and incentives for formal employment (OECD, 2018[1]). It also considers whether there are policy mechanisms to promote female employment and how effective they are.
4. **Sub-dimension 8.4: Activation policies** looks at the policy, legal and institutional arrangements for activation policies, which aim to bring more people into the labour force and into jobs (OECD, n.d.[3]). It considers the economies' public employment services, mutual obligation frameworks, and active labour market programmes.
5. **Two crosscutting sub-dimensions: Informality and brain drain** have been included as separate indicators in the questionnaire, and are being dealt with in this chapter across the sub-dimensions where relevant. **Informal employment** may take various forms. It generally includes employment in unregistered enterprises, and employment in registered enterprises but which is not registered or only partly declared for the purposes of income tax and social security contributions, and thus contributes less to state revenues than it should. Informal workplaces may be unsafe and unhealthy, employment conditions may be below legal or collectively agreed minimum standards, workers may participate less in lifelong learning, and may be badly protected against illness, unemployment, and old age (pensions). **Brain drain** may be a result of high net emigration of skilled labour causing skill shortages and hindering economic development. While it is important to understand which factors push workers to work abroad it is equally important to know who returned, how return migration is managed and more generally how the transmission of skills is organised and what policies are in place to reap benefits from emigration (Moon and Shin, 2018[4]).

Figure 11.2 shows how the sub-dimensions, and their indicators, make up the employment policy dimension assessment framework. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as virtual interviews undertaken with relevant non-government stakeholders for this sub-dimension. Alongside these qualitative inputs, quantitative data on relevant indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information, see the Assessment methodology and process chapter.

## Figure 11.2. Employment policy dimension assessment framework

**Employment policy dimension**

**Outcome indicators**
1. Employment rate (of 15-year-olds and over), by age, gender, education
2. Unemployment rate (of 15-year-olds and over), by age, gender, education
3. Inactivity rates (of 15-year-olds and over), by age, gender, education
4. Employment growth, by age gender, education
5. Unemployment growth, by age, gender, education
6. Real average wages / productivity growth

| **Sub-dimension 8.1** Labour market governance | **Sub-dimension 8.2** Skills | **Sub-dimension 8.3** Job quality | **Sub-dimension 8.4** Activation policies |
|---|---|---|---|
| **Qualitative indicators**<br>1. Regulatory framework<br>2. Labour inspectorates<br>3. Employment policy framework<br>4. Tripartism and social dialogue | **Qualitative indicators**<br>5. Skills mismatch<br>6. Adult learning | **Qualitative indicators**<br>7. Quality earnings<br>8. Policies to promote female employment | **Qualitative indicators**<br>9. Public employment services (PES)<br>10. Mutual obligations framework<br>11. Active labour market programmes |

**Cross-cutting sub-dimension**
12. Informality
13. Brain drain

| | | | |
|---|---|---|---|
| **Quantitative indicators**<br>1. Share of self-employed among all employed<br>2. Share of temporary employment<br>3. Number of staff of labour inspectorates<br>4. Trade union density (number of trade union members as a share of all workers)<br>5. Company with health and safety delegates<br>6. Long working hours<br>7. Physical health risk factors | **Quantitative indicators**<br>8. Participation of workers in training | **Quantitative indicators**<br>9. Average wages (changes, PPP)<br>10. Net minimum wage / net average wage<br>11. Share of women in management | **Quantitative indicators**<br>12. Ratio of staff in public employment service to number of registered unemployed<br>13. Public expenditure active labour market policies by category 1-7 (ALMP) (% of GDP)<br>14. Ratio of passive measures / spending on ALMP<br>15. Ratio number of registered unemployed at the PES to registered vacancies at the PES as off 30 June of a given year; December of a given year<br>16. Number of benefit recipients, differentiated by unemployment benefit, social assistance, disability benefits |

**Cross-cutting quantitative indicators**
17. Informal employment (% of total non-agricultural employment)
18. Stock of nationals living abroad

The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan (AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The action plan is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area.

In the regional trade area, the WB6 economies commit to closely align rules and regulations with the core principles governing the EU Internal Market, based on the "four freedoms": enabling goods, services, capital and people to move more freely across the region. The action plan includes measures to 1) enable mobility for students, researchers and professors; 2) introduce freedom of movement on the basis of IDs within the WB6 economies; 3) to remove work permits for intracompany transfers and contractual service providers; and 4) enable the portability of social rights. These measures have also been central for the EU since the Treaty of Rome in 1958. The findings of this employment policy assessment can inform the implementation of the actions in this plan. Box 11.2 assesses the current regional migration situation, while Box 11.6 looks at progress in human capital development and fighting brain drain, another objective of the action plan.

### *Key methodological changes to the assessment framework*

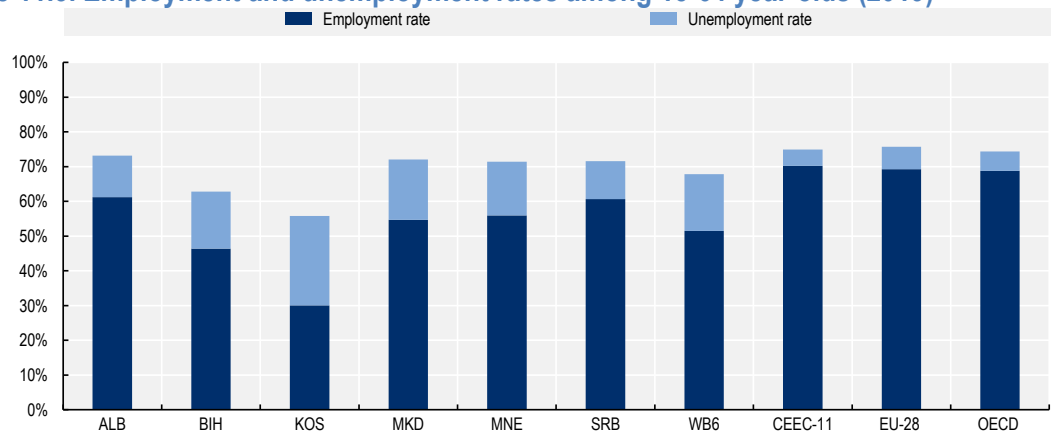
There have been some major changes to the assessment framework since the 2018 assessment. Two cross-cutting policy areas have been introduced: informal employment and brain drain. The social economy sub-dimension has been removed due to unavailability of data. To better align with the 2018 OECD Jobs Strategy, a new skills sub-dimension has been added. The adult learning qualitative indicator now includes the old employee trainings indicator and the continuing education and training indicator of the 2018 education dimension. The qualitative indicators in the former activation policies sub-dimension have changed focus and been renamed to align better with the OECD Activation Policy Framework (OECD, 2015[5]). The old employment framework indicator has been changed to regulatory framework. The former skills gap analysis indicator has been integrated into the skills mismatch indicator.

## Employment performance and context in the WB6

Employment has generally risen between 2015 and 2019; average employment rates for the region rose by 4.6 percentage points (p.p.) and unemployment fell by -7.9 p.p. before the COVID-19 pandemic.[1] Nevertheless, the employment rate remains markedly below the EU, CEEC-11[2] and OECD averages and unemployment was still very high in the WB6 compared to EU and OECD economies in 2019 (Figure 11.3). The inactivity rate is also high in the region (32%) and is worryingly high in Bosnia and Herzegovina and Kosovo.

The impact of the COVID-19 pandemic on employment, unemployment and inactivity varied quite significantly across WB6 economies. Figure 11.4 shows how employment rates changed between the third quarter of 2019 and the third quarter of 2020 for five WB economies for which data are available, and the EU. In Albania, North Macedonia, and Serbia, the impact of COVID-19 was similar to the EU average.

## Figure 11.3. Employment and unemployment rates among 15-64 year-olds (2019)

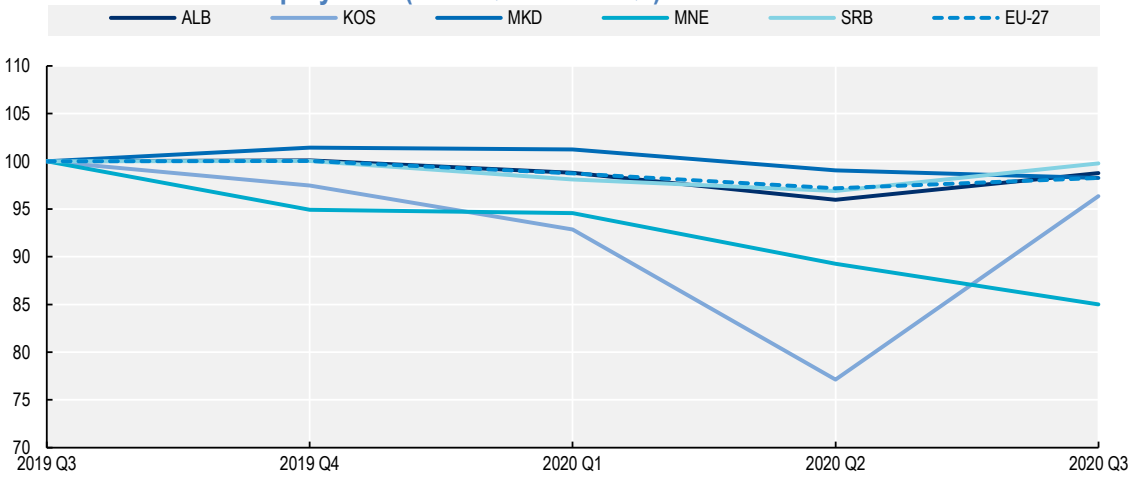



Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (Eurostat, n.d.[6]), *Labour Force Survey* for EU, Montenegro, North Macedonia, Serbia; (Instat, 2020[7]), *Women and Men in 2020* for Albania, (ASK, 2020[8]), *Labour Force Survey 2019* for Kosovo; (BHAS, 2019[9]), *Labour Force Survey 2019* for Bosnia and Herzegovina; OECD average: (OECD, n.d.[10]), *Labour Force Survey*.

StatLink https://doi.org/10.1787/888934254107

## Figure 11.4. Evolution of employment (2019 Q3 to 2020 Q3)




Note: 2019 Q3=100. Data for Bosnia and Herzegovina are unavailable.

Source: (Eurostat, n.d.[6]), *Labour Force Survey* for EU, Montenegro, North Macedonia, Serbia; Instat for Albania; ASK for Kosovo.

StatLink https://doi.org/10.1787/888934254126

The WB6 economies have introduced job retention schemes, employment incentives and access to more generous welfare benefits in order to mitigate the labour market impact of the pandemic Box 11.1. Job retention schemes have been widely used in the EU to contain unemployment. In most EU economies face-to-face services were suspended during the first lockdown and taken up thereafter and as a consequence digitalisation has been accelerated (Duell, 2020[11]).

### Box 11.1. Action by the WB6 economies to reduce the impact of COVID-19 on the labour market

In **Albania**, registered unemployment rose by 30% between March and September 2020. About 32% of registered jobseekers applied for unemployment benefits over this period and the number of benefit recipients increased by 50%. Unemployment risks have been significantly higher for the low-skilled; those performing trade, services and elementary occupations; and the informally employed. This led to an increase in the number of economic aid recipients by 19% between March and September 2020.

In **Bosnia and Herzegovina**, registered employment fell by 2.2% in 2020 Q2 compared to 2019 Q2. In July 2020, registered unemployment had risen by 4.7% compared to the previous year. The International Labour Organization (ILO) estimates that the pandemic constitutes an employment risk for 88% of informal workers (ILO, 2020[12]). Job retention measures were put in place to mitigate the impact of the crisis on workers.

In **Kosovo,** employment rates fell significantly between the first and second quarters of 2020 but bounced back in the third quarter. Changes in the employment rate had a bigger impact on inactivity than on unemployment according to the Labour Force Survey (LFS) (ASK, 2021[13]). However, the number of registered jobseekers increased by over 50%, due to expected unemployment and welfare benefits linked to COVID-19. Support was also provided to private sector companies for each employee on their payroll for March and April 2020. Firms also received a subsidy for each new employee hired on a minimum one-year contract during the crisis. A scheme for regularising informal employed has been set up.

In **Montenegro**, the number of registered unemployed in September 2020 was 28.8% higher than in September 2019, while the number of unemployed increased by 10.7% over the same period according to LFS data (MONSTAT, 2021[14]). Between January and September 2020, the number of registered vacancies fell by 32.2%.

In **North Macedonia**, the number of unemployed fell by 5.5% between the third quarter 2019 and the third quarter 2020 but inactivity increased. A short-time work scheme has been set up with the support of the World Bank to cope with the labour market impact of the pandemic.

In **Serbia**, the COVID-19 pandemic has had only limited effects on the labour market so far. The crisis mainly hit the informally employed. Among the formally employed a rise in unemployment was avoided and the number of LFS unemployed even continued to fall (by 5.3% between the third quarter of 2019 and the third quarter 2020), although the decrease was slower than the previous year. The introduction of a job preservation scheme by the Ministry of Finance has had a positive impact. It takes the form of a wage subsidy scheme (at the level of minimum wages from March to May, and half the minimum wage thereafter) for micro and small and medium-sized enterprises (MSMEs) affected by the pandemic.[1] Take up of this measure was very high, covering roughly half of the employed, although workers on non-standard forms of employment have mostly not been covered by this measure.

1: The only criterion was that companies did not cut employment by more than 10% (CEVES / World Bank, 2020[15]; Government of Serbia, 2021[16]).

Source: Information from WB6 governments and (OECD, 2021[17]), *The OECD and South East Europe: Covid-19 Response*, www.oecd.org/south-east-europe/; (Eurostat, 2020[18]), *European Union Labour Force Survey: 2019 dataset*, https://ec.europa.eu/eurostat/documents/203647/1004071/EU+LFS+DOI+2020v1.pdf.

## Labour market governance (Sub-dimension 8.1)

Effective labour market governance is paramount to ensuring high-quality jobs as well as developing flexible, socially inclusive, and proactive labour markets. Strong governance, clear directions, and independent regulation and enforcement help ensure labour markets are responsive and also give strong signals to investors. The scores for the four qualitative indicators under this sub-dimension vary quite substantially from one economy to the other, with scores ranging between 1.8 and 3.3 (Table 11.2). North Macedonia and Montenegro have achieved the highest scores, both scoring above average across the board for the sub-dimension. Kosovo and Bosnia and Herzegovina have the lowest scores for all indicators, particularly for regulatory frameworks and tripartism and social dialogue in Kosovo, and for employment policy frameworks in Bosnia and Herzegovina.

### Table 11.2. Scores for Sub-dimension 8.1: Labour market governance

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 8.1: Labour market governance | Regulatory framework | 3.0 | 2.0 | 1.5 | 3.0 | 3.0 | 2.5 | 2.5 |
| | Labour inspectorates | 3.0 | 2.0 | 2.0 | 3.0 | 3.5 | 3.0 | 2.8 |
| | Employment policy framework | 2.5 | 1.8 | 2.0 | 3.5 | 3.0 | 3.5 | 2.7 |
| | Tripartism and social dialogue | 2.5 | 2.5 | 1.5 | 3.5 | 2.5 | 2.5 | 2.5 |
| **Sub-dimension average score** | | 2.8 | 2.1 | 1.8 | 3.3 | 3.0 | 2.9 | 2.6 |

### *Regulatory frameworks have improved but full implementation is challenging*

Regulating employment and working conditions is key to ensuring high-quality jobs, which in turn protects workers, reduces incentives to work abroad and helps economies move up the value chain. Improving the quality of the work environment also helps people to prolong their working lives, which is particularly important where populations are rapidly ageing. Employment regulations encompass regulations on health and safety at work, working time, paid holidays, formal labour contracts and non-standard forms of employment.

The WB6 economies have started to adapt their regulatory frameworks to the EU *acquis*, although progress has been uneven. The economies have mostly advanced in some thematic areas but not all, with further progress planned.[3] In Serbia, most of the legislative framework governing the labour market has been aligned with the *acquis.* The Law on Safety and Health at Work is, for the most part, harmonised with EU directives, with recent amendments made on temporary agency work and posting of workers to align with EU legislation. Progress has also been significant in Montenegro and North Macedonia. In Montenegro, the latest changes have increased labour market flexibility and improved labour standards for workers in certain areas, temporary agency work, working time, protection of pregnant workers and parental leave, and regulations of collective dismissals. In North Macedonia recent changes have addressed dismissal rules to allow companies flexibility to adapt employment to the market situation, protect workers from unfair dismissal and increased the re-employment chances of dismissed workers.

Bosnia and Herzegovina does not have a state-level programme for the adoption of the *acquis*, nor has it established adequate horizontal and vertical mechanisms to ensure alignment with EU directives is done properly (EC, 2019[19]). The two entities – the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS) – have started to harmonise their labour laws with the EU *acquis*.[4] Progress has been slow in Kosovo (where the relevant draft laws had not been adopted at the time of writing). All the WB6 economies need to identify and address the remaining gaps in their employment regulatory frameworks.

Improving working conditions is a key challenge. For example, the sixth Eurofound survey on working conditions, conducted in 2015, found that 44% of respondents in Albania, 32% in North Macedonia, 30% in Serbia and 23% in Montenegro were not very or not at all satisfied with their working conditions,

compared to only 12% of respondents in the EU (Eurofound, 2016[20]). Posture-related health risks were particularly high in Albania and North Macedonia, well above the risk in EU economies (Eurofound, 2017[21]).[5] The results of the seventh survey, which was still in progress at the time of writing, will shed light on recent improvements. Long working hours and weekend working feature in some of the economies, according to Eurostat LFS data. Some economies have progressed in the area of working time regulation: Montenegro has made improvements to its transparent working conditions, part-time work, work-life balance (i.e., working from home), aligning overtime hours with EU standards, take-up of annual leave, and protection for pregnant workers and workers on parental leave (Karanovic and Partners, 2020[22]).

Accidents at work mainly occur in the mining, manufacturing and construction industries. The WB6 economies have generally made progress in the area of occupational health and safety. Most of Serbia's health and safety regulation is aligned with the EU *acquis*, Albania has made significant progress, and the FBiH adopted a new law on occupational health and safety in 2020. Kosovo has also made some progress in this area. In addition to the regulatory framework, healthy working environments can be promoted through policies to prevent and address work-related health and safety risks (OECD, 2018[1]). The WB6 economies need to make significant efforts in this area.

Adequate employment protection for regular workers can promote labour market resilience by preserving job matches that are at risk of being suppressed. However, excessively strict protection risks becoming counterproductive by increasing incentives for the use of temporary contracts. The challenge for public policy is to design employment protection that strikes the right balance between preserving viable jobs and avoiding labour market segmentation (OECD, 2018[1]). While short-term or casual employment contracts and platform work may bring advantages, including flexibility for both employers and workers, they raise concerns around job quality, improper use of such contracts, fair competition among firms and the sustainability of social protection systems.

Since the last Competitiveness Outlook assessment, for which data was collected in 2017, Montenegro and North Macedonia have made significant progress in increasing labour market flexibility, while protecting specific categories of workers, protecting workers from unfair dismissal (in North Macedonia) and improving working conditions in specific areas. In the FBiH, amendments to the labour law in 2016 reduced rigidities in hiring procedures and have eased dismissals. In contrast, no progress was made in Kosovo, which in 2016 had the least employment protection for fixed-term contracts in the region and a wide gap to the protection level of permanent contracts (OECD, 2016[23]). Some workers in non-standard forms of work are not fully protected by labour regulations, e.g., they are not entitled to annual leave,[6] increasing the incentive to employ workers on non-standard contracts. As a result, more than half of workers in Kosovo are on temporary contracts and more than one-fifth are self-employed (the vast majority being solo self-employed or helping family members). On average across the WB6 economies, the self-employed accounted for 23.1% of workers in Q2 2019, much higher than the EU average of 15.3% (in 2018). Those on temporary contracts accounted for 21.9% compared with the OECD average of 11.8% and the EU average of 13.6% in 2019.[7] There are no specific regulations for employment conditions and social security coverage for gig workers in the region.

### *Little progress has been made in reducing informal employment*

As the self-employed are not registered, self-employment contributes to the informal economy. Informal employment can also occur through not declaring employees, or by declaring only part of their hours worked and wages (envelope wages). Informal employment fosters inequalities and increases the risk of poverty both in work and after workers exit the labour market as they are less well covered by the social protection system. A high share of informal employment also contributes to persistent low productivity and poor investment in people. Informal employment weakens the tax base and the social protection system, threatening public finances. Combatting informal employment calls for tax and social security contribution

policies that reduce incentives for informal employment and support the transition from informal to formal employment.

Survey results and assessments in the WB6 economies suggest that informal employment rates range from 18% (Serbia) to 37% (Albania). These data need to be compared with caution, as the informal economy and informal employment are by definition difficult to assess and the economies use different data sources and surveys. Some economies have carried out ad hoc surveys on informal employment (e.g., in Montenegro in 2014), and most have included a question in their labour force survey (not available in Kosovo). Nevertheless, a look into the structure of informal employment gives interesting insights. Across the region, informality is particularly high in the agricultural and construction sectors and some service sectors (e.g., household services, social services, and hospitality). In Kosovo, informal employment is also prevalent in the manufacturing sector, according to a previous study.[8] The largest share of informal workers in the region is the solo self-employed. Women also often work as unpaid family members. Informal work is often more widespread among young workers who have found the school-to-work transition difficult as well as among older workers. Informal workers are typically low-skilled (for details see economy profiles) (ILO, 2020[12]).[9]

The WB6 economies overall have made little progress in tackling informal employment, although some relevant measures have recently been introduced. The FBiH has introduced a requirement for employers to keep daily records of workers and people engaged at work to help detect envelope wages. Serbia implemented a law in 2019 to simplify the employment of seasonal workers in certain activities (e.g., agriculture) and introducing a new type of contract, which makes it easier to register these workers for social insurance and taxes. The objective is to reduce informal employment and the initial results from the labour inspectorates seem promising. In order to raise awareness among employers, Serbia uses a name and shame approach; each week the ministry publishes two lists on its website: one naming employers which have employed informal workers and another naming workers who have engaged in informal activity.

To make significant progress in fighting informality, the WB6 will need to grow and generate demand for workers in the formal labour market. Studies across EU Member States have shown that informal employment is higher in those economies with lower levels of GDP per capita and fewer modern institutions, higher levels of public sector corruption and low trust in authorities, and less effective social transfer systems (EC, 2020[24]).

### *Labour inspectorates lack the resources needed to regulate effectively*

A well-functioning labour inspectorate is required to ensure effective compliance with the law and is thus an essential part of labour regulation and the fight against informal employment. Labour inspection is a labour-intensive task, and, although not expensive, does require many well-trained inspectors in order to function optimally. Labour inspectorates are often plagued by internal problems including too few inspectors, poorly paid staff, lack of training and capacity, lack of resources, and vulnerability to corruption (ILO, 2013[25]).

Labour inspectorates in the region still have insufficient staff in light of the high levels of informality, the large number of small companies, and the fact that company mechanisms to ensure compliance with occupational health and safety (OHS) rules are often weakly implemented. For example, although required by law, OHS councils at company level are often not established or operational. In Albania and Serbia, the number of workers per labour inspector exceeds the ILO maximum recommendation for industrial market economies (10 000 workers, compared to 12 600 in Albania, and around 12 000 in Serbia in 2019). In contrast, inspectors in Germany have a caseload of around 6 000 workers and they are concerned only with the detection of informal and illegal employment, as there are dedicated inspectorates dealing with OHS issues (General Customs Directorate of Germany, n.d.[26]). In addition to high caseloads in the WB6, guidelines are often not clear and inspectors not well trained. Although improvements have been made to training (e.g., in Albania with the support of the ILO, and Montenegro), there are no curricula or certification

procedures. To reduce corruption, some economies have implemented a rotating system of labour inspectors (e.g., across cities in Montenegro or for on-the-spot visits in Serbia). Inspectorates also suffer from out-of-date equipment.

Good inter-agency co-operation, with IT systems that allow effective information sharing between institutions, increases the effectiveness of labour inspectorates. The WB6 economies have started to improve their inter-institutional co-ordination, although implementation varies across the region. Montenegro has a horizontal co-ordination mechanism, bringing together other units from the administration for inspection affairs, the tax authority, police administration (border police and the sector for foreigners) and local municipality institutions (communal inspection and police). In contrast, in North Macedonia, a lack of inter-agency co-operation is limiting the effectiveness of its inspectorates. File and information sharing between agencies may be challenging and require a unified IT system. For instance, in Serbia, labour inspectors have access to some data which were entered into the unified IT system e-Inspector from other inspections but reporting through this system is not yet available or adjusted to the needs of the labour inspectorate.

Transparency and monitoring of the work of labour inspectorates also increase trust and efficiency. Some economies have made improvements to processes: in North Macedonia, a new Law on Inspection Supervision, enacted in early 2019, created a new legal basis for risk-based inspections and introduced good practices (e.g., warnings and grace periods for infractions, use of checklists, and risk criteria) to increase transparency.

Child labour remains a challenge in the WB6 economies. All, except Bosnia and Herzegovina, have a legal framework to set the minimum working age but progress in detecting, fining and preventing child labour has been poor. Nevertheless, some economies have made some progress. For instance, Albania issued a new practical guide for labour inspectors in 2020 on identifying and controlling forms of child labour and responding appropriately.[10] Serbia has also developed guidelines through participation in the project Engagement and Support at the National Level to Reduce Appearance of Child Labour, which started in 2016, while 70% of inspectors have received related training.

### *Employment policy frameworks are becoming more comprehensive*

Labour market segmentation, high inequalities, high unemployment, and high inactivity rates in the WB6 economies call for a comprehensive employment policy framework (OECD, 2018[1]; OECD, 2019[2]). The economies have made some progress in employment policy, with a focus on improving frameworks for public employment services (PES) and active labour market policies (ALMPs) – see Activation policies (Sub-dimension 8.4). They have adopted employment strategies and related action plans, except in in the FBiH where the employment strategy for 2018-21 had not been adopted by the parliament at the time of writing.

Employment strategies may include a few measures for minority groups such as Roma, Ashkali and Egyptian communities and other vulnerable groups (e.g., women in rural areas, as is the case in Kosovo). In many cases, activities to improve the labour market integration of vulnerable groups come through projects financed by international donors or organisations. Rendering these policy approaches sustainable by introducing them into mainstream policy and scaling them up remains a challenge. The implementation of related strategies on poverty reduction and integration of Roma and other minorities has generally been slow.

Little progress has been made to integrate people with disabilities, and the number of participants in targeted measures are generally low. Albania has recently made progress in this area, however. Its Employment Promotion Law of 1995 introduced quotas and levies for the employment of people with disabilities by public and private employers, but the levies have never been enforced. In December 2018 Albania adopted the Employment Promotion Law which set up an employment fund for the employment

and skills development of people with disabilities. Some progress has also been made in the use of a management information system for disabled beneficiaries, which is still in the pilot phase (EC, 2019[27]).

Employment strategies have become more comprehensive by including skills development, for example in Montenegro. Other policy areas affecting employment include those targeting the informal economy and youth employment. To improve their comprehensiveness further, they should strengthen links to policies on tax, social protection systems (including pension reforms), promoting entrepreneurship and innovation, and digital skills, and support to companies to make productivity and efficiency improvements. All these policy areas directly affect employment and working conditions. Improvements have been made in monitoring the implementation of employment policies although monitoring reports are often not publicly available, administrative, and labour force survey data not fully exploited, and rigorous programme evaluations often missing.

### *The frameworks are in place for tripartism and social dialogue but partners lack capacity*

Tripartism and social dialogue are part of the mechanisms for setting labour standards in modern economies and are the pillars of industrial democracy (Eurofound, 2020[28]). Well-designed collective bargaining systems can promote labour market stability by facilitating adjustments in wages and working time. This can be achieved through the effective co-ordination of bargaining outcomes across firms and industries and by allowing firms enough flexibility to align wages with productivity (OECD, 2017[29]; OECD, 2018[30]). Labour relations should be sufficiently well developed to adapt to emerging challenges, including non-standard forms of work, economic restructuring and challenges related to the future of work (OECD, 2017[29]; OECD, 2018[30]; OECD, 2019[31]; OECD, 2018[1]).

The WB6 economies generally have frameworks for collective bargaining, but social partners often lack the capacity to regulate this important part of the economy. Union density is low in most WB6 economies and few companies are affiliated to employers' organisations. Sectoral collective bargaining is not well developed among private sector employers, with collective agreements more common in the public sector. Company-level agreements are often not recorded by domestic institutions. The share of employees covered by collective agreements was 25% in Albania (in 2017), 24-29% in North Macedonia and 30% in Serbia, compared to the OECD average of 33% in 2014 and the EU average of 60% (Ladjevac, 2017[32]; Danaj, 2019[33]; OECD, 2019[31]). There is little information on other labour standards fixed in collective agreements as compared to the average of the economy. According to the Albanian Government, most collective bargaining agreements are concluded in the public sector, often without agreeing higher labour standards than those set by law.[11] In Kosovo, trade union presence in the private sector is mainly limited to former public/socially owned enterprises (Shaipi, 2017[34]). Although most economies have a legal framework for workplace representation, implementation seems to be weak. In general, there is little information available on labour relations at the workplace.

All the WB6 economies have a framework for tripartite social dialogue and have established tripartite economic and social councils composed of representatives of the government and social partners. The main role of a tripartite council should be to link the government's agenda with those of economic actors on the ground (employers and workers) and so facilitate participatory policy making (ILO, n.d.[35]). Tripartite social dialogue is particularly important in a context where collective bargaining is weak. Councils may agree on general collective agreements (although negotiations have often failed in recent years) and they are generally consulted over minimum wages. They may also be consulted when setting taxes and social security contributions (e.g., in the FBiH) and on amendments to regulatory frameworks.

While there is evidence that consultation happens, procedures are not systematically implemented in all cases. Many working groups on different themes have been set up but may only meet on an ad hoc basis. Even where they meet regularly (as in Kosovo), their influence often remains limited. In some economies, such as Kosovo, local level tripartite consultation structures have been set up. One reason for their lack of

influence is the fact that the councils do not generally have a dedicated budget for analyses and studies and get no technical support (ILO, 2019[36]; Ladjevac, 2017[32]). Progress on strengthening bilateral and tripartite social dialogue structures has been slow, but strategies have been set up and support is being received from the ILO (e.g., in North Macedonia).

The regulatory framework for the labour market also includes the migration policy framework. The assessment of the regulatory and policy framework in CO2021 included emigration addressed through the cross-cutting sub-dimension of brain drain – see e.g., Skills (Sub-dimension 8.2). Easing labour migration within the region (Box 11.2) and regulating conditions for commuters would certainly help to reduce labour market imbalances and skills mismatches within the region and to bundle resources in the area of higher education and research. In other regions setting up a framework for free movement of labour has been on the agenda for many years.

### Box 11.2. Easing migration in the Common Regional Market

The following key findings of the CO2021 labour market and governance sub-dimension can inform progress on the actions under the CRM Action Plan component on the movement of people.

- Migration within the region is difficult to measure, especially if short-term stays and commuting are considered. In 2015, around 23% of emigrants had chosen to move to another economy in the region (Oruč, 2021[37]). Intra-region migration was lowest for emigrants from Albania, Serbia, and North Macedonia (5-12% of emigrants) but ranged between 50% and 66% for Bosnia and Herzegovina and Montenegro (intra-region migration could not be measured for Kosovo). Serbia has attracted the most migrants from the region.
- Intra-regional migration patterns have been shaped by historical ties, differences in labour market prospects, typical rural-urban migration, and economic structure (e.g., demand for seasonal workers in the tourism industry). Another importance driver has been universities and study; in particular, Serbian universities have attracted students from Bosnia and Herzegovina and Montenegro (Leitner, 2021[38]).
- Intra-regional migration is still hindered by existing rules, such as continuing visa requirements for movement between Bosnia and Herzegovina and Kosovo, and no progress has been made. Some economies, such as Serbia, have started to align labour legislation on the posting of workers with EU legislation, although the EU directive has not yet been fully achieved (Djuric and Tiodorovic, 2019[39]). Some economies have set up agreements on the portability of social rights, e.g., between Albania and North Macedonia and Albania and Kosovo (signed in 2015) (Government of Albania, 2019[40]). Albania's National Strategy on Migration and Action Plan 2019-22 envisions designing and implementing skills transfer programmes on the basis of sectoral skills.

#### *The way forward for labour market governance*

- **Continue to align labour laws and occupation health and safety regulations with EU directives.** Identify the remaining gaps with regard to the EU legislative framework. In those economies which do not yet have a strategy for implementing OHS measures, they will need to develop a strategy document, implement preventive measures, and strengthen worker representation for OHS related issues at company level.
- **Develop the regulatory framework for non-standard forms of employment** for which no regulation is in place or amend existing regulations to strike a balance between flexibility and protection of the employed as well as coverage by the social protection system (including self-employment, temporary agency work, platform work, etc.).

- **Reduce incentives for informal employment** and ease the transition from informal to formal employment. One approach could be to ease registration for seasonal workers, as Serbia is already doing, or to subsidise social security contributions for some workers, such as household and care workers employed by private households. Taxes could be adapted to make the transition from informal to formal employment easier, reducing non-wage labour costs, especially for low-wage earners. Awareness-raising activities among employers and workers are also important, as in the example from the Netherlands (Box 11.4). The OECD and ILO (2019[36]) recommend supporting the transition to formal employment and the formalisation of enterprises through subsidising social security contributions. More specific measures could include support for social security contributions for some employees. For instance, France has a voucher system supporting social security contributions for household and care workers (Box 11.3). Social security contributions for workers from vulnerable groups who are otherwise likely to be informally employed could also be subsidised for a fixed period, as is done in Portugal (Düll et al., 2018[41]). The OECD Jobs Strategy also recommends reducing non-wage labour costs, especially for low earners (OECD, 2018[1]).

### Box 11.3. The Universal Service Employment Voucher (Chèque emploi service universel - CESU) in France

One major objective of this voucher is to assist in the fight against undeclared work in these services. The CESU was launched in 2006 as part of a plan for the development of personal services and replaces the service employment voucher (CES) set up in 1994 (which was limited to traditional personal services e.g., housework, childcare in the home or care for the elderly). It includes simplified registration procedures as well as a pre-financed CESU voucher, which is totally or partially prepaid by a company, local authority etc., and used by the service user/employer to pay a personal household service worker.

The CESU also enables users to receive a tax benefit, which was extended to non-taxable active persons from 2007 and to the inactive from 2017. The list of services eligible for tax reduction has also broadened to include small maintenance tasks, garden work, study help and ICT or administrative assistance.

The Court of Auditors estimated in 2014 that 153 000 full-time equivalent jobs were created between 2003 and 2012. Another study by the Ministry of Labour shows an increase in employment in personal and household services by 250 000 between 2005 and 2015. The CESU contributed to this increase, although there has been no dedicated impact assessment of the measure. As a job creation measure, the instrument is expensive but its impact on undeclared work is significant. According to different assessments undeclared work declined by 30% between 1996 and 2015.

Source: (Cour des Comptes, 2014[42]), *Le développement des services à la personne et le maintien à domicile des personnes âgées en perte d'autonomie*: www.ccomptes.fr/fr/publications/le-developpement-des-services-la-personne-et-le-maintien-domicile-des-personnes-agees; (DARES, 2017[43]), *Les services à la personne en 2015. Une baisse continue de l'emploi par les particuliers employeurs,* http://dares.travail-emploi.gouv.fr/IMG/pdf/2017-011.pdf; (CREDOC, 2017[44]), *Une première enquête pilote en France sur le travail dissimulé*, www.credoc.fr/pdf/Sou/Enquete_%20pilote_travail_dissimule.pdf; (EC, n.d.[45]), *Universal Service Employment Voucher (CESU), France*, https://ec.europa.eu/social/ajax/BlobServlet?docId=20385&langId=en.

### Box 11.4. Combating undeclared work in the cleaning sector in the Netherlands

The Netherlands is estimated to have around 14 000 cleaning companies, with the sector growing each year. This has led to increased competition, and recent evidence has shown increased fraud and exploitation (e.g., workers being paid less than the minimum wage and working unpaid hours) within the sector. The labour inspectorate decided to tackle this issue by raising awareness among hiring companies of their responsibility to hire cleaning companies who behave ethically towards their employees, and thereby put pressure on cleaning companies within the sector to change their behaviour.

The Chain Approach initiative began in 2013 and is ongoing. It involves a two-fold strategy: awareness raising among businesses who hire cleaning companies and a prevention strategy focused on changing attitudes to undeclared work in the sector. The inspectorate communicates through regular consultations with companies (e.g., with directors of fast-food chains), press releases and social media. Companies are told that cleaning companies need to fulfil a 10-item checklist, available on the web (with items such as paying tax and complying with minimum labour standards). Companies are also told about fines. The inspectorate also conducts on-the-spot visits and if infringements are found, they maintain contact with the companies to discuss how to progress.

As a result, more workplace inspections in relevant companies have been carried out, and companies are using the checklist. Companies have tightened their internal hiring conditions and adapted contracts, for instance allowing termination if exploitation is discovered). Following 398 site inspections, 32 cleaning companies in 144 locations have been banned, 22 companies in 69 locations have been replaced and 76 of the sites inspected have changed their cleaning to in-house.

Source: (EC, 2020[24]), *What works when tackling undeclared work? Realities in Member States*, https://ec.europa.eu/social/main.jsp?langId=en&catId=1298&furtherNews=yes&newsId=9740.

- **Continue to exchange practices to combat undeclared work** with other economies in the region. The European Platform tackling undeclared work could serve as an example. The platform enhances co-operation between EU economies. It brings together relevant authorities and actors involved in fighting undeclared work (EC, n.d.[46]).
- **Strengthen the institutional capacities of labour inspectorates**. This involves increasing the number of inspectors, providing clear guidelines, improving work organisation, increasing transparency to avoid corruption, providing training (including on child labour), and increasing resources for onsite visits. It would also be advisable to modernise their equipment, including hardware and software. Economies should also improve the monitoring of labour inspectorates and increase transparency (e.g., through databases recording all inspections, infringements, and fines); implement preventive measures (e.g., awareness-raising activities, information on risk prevention in the workplace, training OHS councils as well as managers, line managers and staff); and impose effective fines where there are clear infringements of the law.
- **Continue to strengthen social dialogue at branch and company level** and increase the capacity of the social and economic councils, so that they have technical support, can carry out their own analysis and meet regularly. Economic councils should be equipped with basic resources to conduct labour market and sector analysis, as happens in France, for example (Arkwright et al., 2020[47]), and a number of other European economies.
- **Facilitate the free movement of labour among the Western Balkan economies**. Implement the measures set out in the Action Plan for creating a Common Regional Market. See Box 11.5 for examples of how this has been achieved in other regions.

### Box 11.5. Examples of free movement of labour in regional common markets

- The EU has established a comprehensive free movement of labour regime. No residence permit is required for intra-EU migrants, although they may need to prove they have enough resources and do not become a burden on member states during the first five years of stay. The Bologna Process seeks to create a transparent and harmonised higher education framework, removing regulatory barriers to the movement of students (EC, n.d.[48]). Programmes have also been introduced to support mobility among students, researchers and professors (e.g., Erasmus, Leonardo da Vinci programmes). Although social protection systems are not harmonised within the EU, migration barriers have been removed over time by the increasing portability of social rights. Regulating social contributions to social security schemes and taxation for cross-border commuters received specific attention early in the EU integration process.
- Another example of regional labour migration management comes from the Southern American Common Market (MERCOSUR)[12] created in 1991. MERCOSUR citizens, as well as nationals of Bolivia and Chile, get an automatic visa and the freedom to work and live within the territory of the state parties. The Mercosur Residence Agreement, adopted in 2002, was an important step towards addressing intra-regional migration. There are essentially no conditions on a temporary stay, but a means-of-livelihood requirement for a permanent stay (OECD, 2016[49]). A Multilateral Social Security Agreement was signed in 2005.
- Since 1989, the Caribbean Community and Common Market (CARICOM)[13] has gradually extended intra-regional freedom of movement to various categories of persons, and free movement of community nationals is permitted. A CARICOM Agreement on Social Security has been signed.
- More recently, the Pacific Alliance of four South American states (Chile, Colombia, Mexico, and Peru), was established through the Lima Declaration of 2011 to promote a common market and free movement of people (Alianza del Pacífico, n.d.[50]). Visa requirements for members of the Pacific Alliance were removed. Working groups have been established addressing the issues of youth employment, child labour, labour migration and social security systems.

## Skills (Sub-dimension 8.2)

Skills governance is concerned with providing the skills needed by the labour market while also permitting individuals to pursue their aspirations, exploit their potential and help them progress their careers. Reducing skills mismatches can make the economy more productive by overcoming skills shortages and gaps and can also make labour markets more inclusive by reducing unemployment and offering good-quality jobs. Key challenges are managing the school-to-work transition and enabling skills development throughout people's working lives.

The WB6 economies have achieved quite varied scores in the skills sub-dimension (Table 11.3). While Albania, Montenegro, North Macedonia and Serbia have made significant progress in measuring skills mismatches and designing measures to reduce them, Bosnia and Herzegovina and Kosovo have made limited progress. Likewise, the first group of economies have made greater advances in setting up and implementing adult learning strategies compared to the second group.

### Table 11.3. Scores for Sub-dimension 8.2

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 8.2: Skills | Skills mismatch | 3.0 | 1.3 | 1.0 | 3.0 | 3.5 | 3.5 | 2.6 |
| | Adult learning | 2.5 | 0.8 | 1.0 | 2.5 | 2.5 | 2.0 | 1.9 |
| **Sub-dimension average score** | | 2.8 | 1.1 | 1.0 | 2.8 | 3.0 | 2.8 | 2.2 |

#### *Skills gaps and mismatches are being identified but more efforts are needed to resolve them*

Greater skills increase employment rates quite significantly and reduce the risk of being unemployed in the Western Balkans (Table 11.4). Across the WB6 economies, a low skills level is associated with poor employment conditions and in-work poverty (EC, 2019[51]). Low-educated individuals are also more likely to be inactive, compared to those who are medium or highly educated.

### Table 11.4. Average regional employment and unemployment rate by educational level (2015 and 2019 Q2)

| Education level | Employment rate (%) | | Unemployment rate (%) | |
|---|---|---|---|---|
| | 2015 | 2019 (Q2) | 2015 | 2019 (Q2) |
| Low | 31.8 | 37.1 | 19.8 | 12.6 |
| Medium | 49.5 | 57.0 | 23.3 | 14.5 |
| High | 68.8 | 76.7 | 17.1 | 11.2 |

Note: Unemployment rates for 2019 Q2 are preliminary. Low educated refer to ISCED level 0-2, medium educated to ISCED level 3-4 and high educated to ISCED level 5-8.
Source: (WIIW / World Bank, 2020[52]) *Western Balkans Labor Market Trends 2020*, https://wiiw.ac.at/western-balkans-labor-market-trends-2020-dlp-5300.pdf.

Skills mismatches refer to situations in which the skills offered by workers and job seekers do not match the skills employers need. Mismatches reduce the potential productivity of individual workers and of companies as a whole. The WB6 labour markets are marked by significant skills mismatches, with high unemployment rates coexisting with skill shortages. Emigration is aggravating the situation, as skilled labour leaves the economies (Box 11.6).

Skills shortages and skills gaps[14] are also the result of poor quality training and education, using curricula that are not adapted to employers' needs. It has become evident that regional curricula are not sufficiently developing workplace-related skills. Insufficient adaptation of curricula to changing economic structures and technological development is another reason for skills gaps.

### Box 11.6. Tackling brain drain in the Common Regional Market

Human capital development and fighting brain drain is one of the objectives of the Common Regional Market Action Plan 2021-24. The plan foresees the creation of a Regional Diaspora Knowledge Transfer Initiative to tap into the potential of the region's diaspora and encourage brain circulation. The following key findings of the CO 2021 skills sub-dimension can inform actions under this component.

Some economies have started to develop policies to mitigate the negative effects of emigration on the labour market in terms of skills shortages and foregone development potential.

- The Serbian Government has adopted the Strategy on Economic Migration of the Republic of Serbia 2021-27. Its aims are to improve the economic and social environment to slow down the departure of the working-age population, strengthen ties with the diaspora, encourage returning and circular migration, and attract foreigners with a range of educational attainment.
- In North Macedonia, the government adopted a national strategy for co-operation with the diaspora in 2019 (Government of North Macedonia, 2019[53]).
- Albania has adopted a new law and a National Strategy for Diaspora (2018-20). The strategy focuses on boosting the diaspora's engagement in its development and facilitating investments.

Source: Government responses to OECD questionnaire; Also see Albania profile, North Macedonia profile and Serbia profile.

The results of the World Bank's STEP skills measurement employer survey in Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, and Serbia between 2015 and 2017 point to significant skills gaps and skills shortages (World Bank, 2018[54]). On average, 69% of employers in these five economies stated that they faced difficulties in recruiting workers for non-routine jobs due to lack of skills or experience, with employers in North Macedonia and Kosovo reporting the greatest difficulties. Overall, 57% of employers reported difficulties in hiring workers for routine jobs.[15] Deficits in the education system and an underperforming continuing training system in the Western Balkan economies are reducing the employability of the working age population and creating these skills shortages, which are preventing companies from growing. In addition, a horizontal skills mismatch, meaning that people tend to choose study fields that are not high in demand instead of enrolling in study fields for which there is demand, is leading to both unemployment and skill shortages.

The WB6 economies have made progress in measuring skills mismatches, using Labour Force Survey (LFS) data to calculate indicators for over- and under-qualification, with support from the European Training Foundation (ETF). This is an important knowledge basis for effective skills governance. While good practices are being implemented (Box 11.7), more needs to be done to develop regular monitoring of education outcomes. This should include information on graduate employment, use of skills in the workplace, difficulties encountered by job seekers, and strategies used to find employment.

### Box 11.7. Measuring skills gaps in WB6 economies

Some Western Balkan economies have introduced tools to measure skills gaps and mismatches, have carried out studies into short and long-term skills needs and have improved their labour market monitoring system. Examples include:

1. **Employability tracer studies**: Since 2017, Albania has traced the employability of all vocational education and training (VET) graduates (both secondary VET students and trainees) through an annual tracer study conducted by the National Agency for Employment and Skills ( NAES).[1] North Macedonia conducted its first trader study of VET and higher education graduates in 2014/15 (Mojsoska-Blazevski, 2017[55]).[2] Serbia ran a pilot graduate tracer study in 2018 (ETF, 2019[56]). Montenegro plans to introduce a tracer study.
2. **Skills needs surveys**: Some economies have made progress implementing skills surveys among employers. North Macedonia uses its survey of employers' skills needs for one-year forecasting at occupational level.
3. **Labour market information system**: Montenegro's employment agency conducts detailed annual supply and demand analysis, covering all levels, sectors, and municipalities. This is one of the elements needed to create enrolment policies for secondary and tertiary education institutions. Relevant data include vacancies by qualification, the length of time of seeking employment, persons without work experience by sector, the number of pupils and students completing secondary and tertiary education, the number of registered unemployed with no qualifications, the duration of unemployment etc.
4. **Skills needs and foresight studies**: Chambers of commerce and social partners, particularly employer associations, conduct various analyses (e.g., in Montenegro and North Macedonia) and provide the education sector with recommendations on future qualification needs.
5. **Labour market forecasts** are carried out by labour ministries in some economies (e.g., North Macedonia).

1: The results indicate that, in 2019, 52% of 2018 graduates were employed and 12% were concurrently working and studying, for a total employment rate of 64%. (Jorgoni, 2019[57]).
2: Less than half of all employed VET graduates (45%) reported that the knowledge and skills they acquired during the education process are well utilised in their current job.
Source: Government responses to OECD questionnaire.

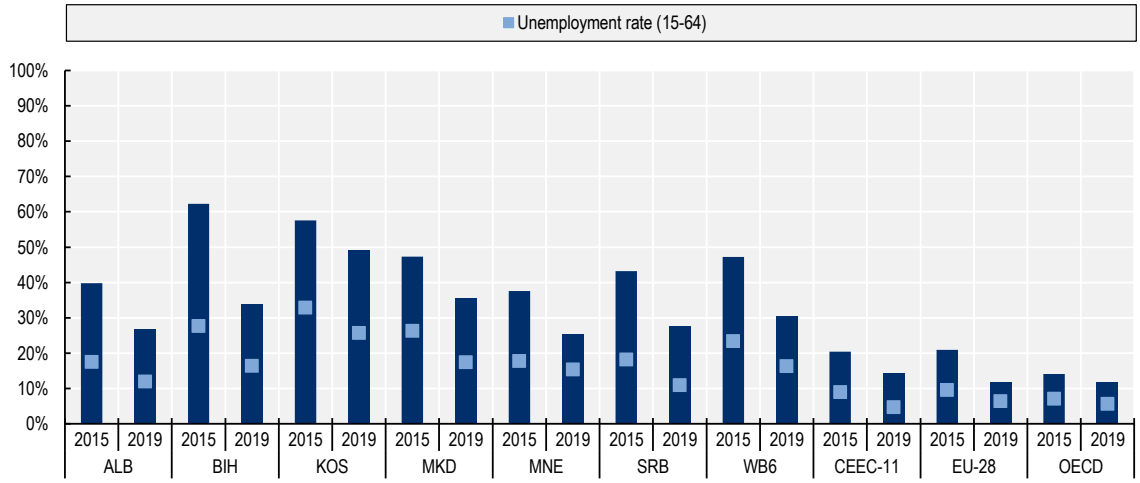
Labour market information and skills anticipation need to be used effectively by the relevant institutions, such as VET actors, PESs, education ministries and higher education institutions. There is much room for improvement in this regard. Some economies are taking steps to improve skills governance – for instance, the RS in Bosnia and Herzegovina adopted a new law in 2020 to include employers in the management board of public universities. The Republika Srpska, Serbia and North Macedonia, which has created an Occupational Outlook, are improving vocational and career counselling (ILO, 2018[58]). In parts of the region, structures to bring together relevant institutions have been set up, such as local councils for education and employment in the RS, and sector commissions and councils in Montenegro and Serbia.

The transition from education to work still poses a major challenge in the region. According to the STEP survey, 35% of firms in the five participating economies reported that insufficient workers' experience was a major or severe obstacle for business expansion (WIIW / World Bank, 2020[52]). On the supply side, unemployment rates reflect young people's difficulties in finding stable employment. Although youth unemployment (among 15-24 year-olds) fell by 36% between 2015 and the second quarter of 2019 across the region, it remains tremendously high, and well above the OECD, EU and CEEC-11 averages (Figure 11.5). Pathways to employment are often marked by unstable employment conditions. For

example, in Kosovo, entering the labour market through informal employment is widespread, with more than half (54.8%) of employed young people having a temporary employment contract (Government of Kosovo, 2017[59]).

## Figure 11.5. Youth unemployment rates in the WB6 (2015 and 2019)

15-24 year-olds




Note: Youth unemployment rate data for Albania, Bosnia and Herzegovina and Kosovo as well as WB6 average refer to the second quarter of 2019, as these are the latest available data. The unemployment rate data for Bosnia and Herzegovina in 2015 refer to the 15+ age group. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: Youth unemployment rates: (Eurostat, n.d.[60]), *Labour Force Survey* for EU, Montenegro, North Macedonia, Serbia; (WIIW / World Bank, 2020[52]), *Western Balkans Labor Market Trends 2020* for Albania, Bosnia and Herzegovina and Kosovo; (OECD, n.d.[10]), *Labour Force Statistics* for OECD average. Unemployment rates (15-64): (Eurostat, n.d.[60]), *Labour Force Survey* for EU, Montenegro, North Macedonia, Serbia; (Instat, 2020[7]), *Women and Men in Albania 2020* for Albania; (ASK, 2020[8]), *Labor Force Survey in Kosovo, 2019*; (BHAS, 2019[9]), *Labour Force Survey 2019*.

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Most worryingly, the share of young people not in employment, education, or training (NEET) in the region is still well above the EU and OECD average (Figure 11.6).

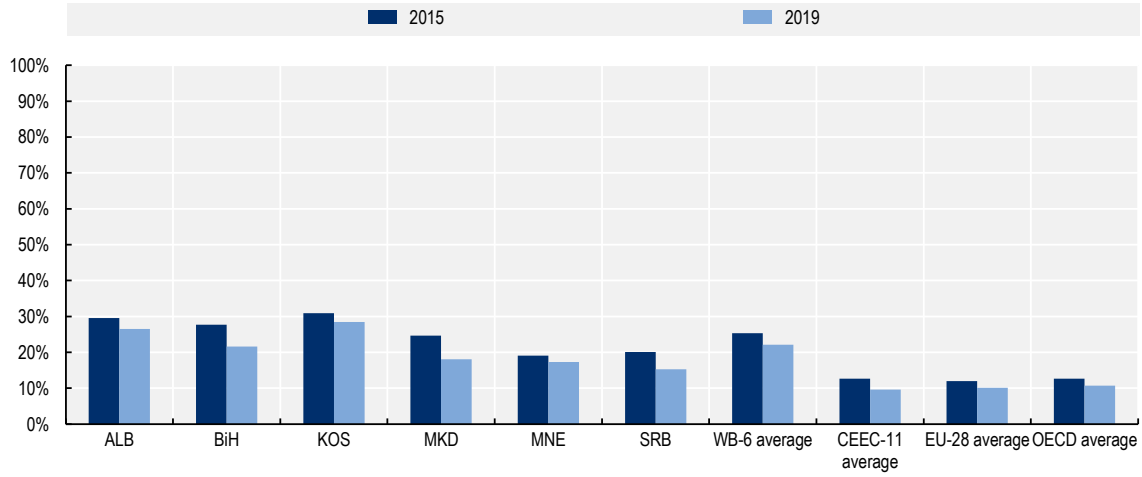
WB6 economies succeeded in reducing the NEET rate between 2015 and 2018 or 2019, as did EU and OECD economies on average. Bosnia and Herzegovina, North Macedonia, and Serbia made the most progress in reducing the NEET rate. Discouragement among young men and women, high drop-out rates and an unsupportive learning environment, poor job-search skills, and childcare roles among young women may explain the high NEET rates.

The WB6 economies have continued their efforts to reduce youth unemployment and NEET rates and smooth the school-to-work transition. For instance, North Macedonia has been implementing the Youth Guarantee scheme, in line with EU practice (EC, n.d.[61]).

Inexperience and skills gaps do not just lead to youth unemployment but also to vertical skills mismatches, i.e., individuals' first work experience may be in jobs requiring much lower educational attainment than they have. Serbia has made progress in this area: its National Employment Service set up a new programme called My First Salary, which began in the second half of 2020. Private sector employers, and especially those from disadvantaged municipalities are given priority for inclusion in the programme. Under the programme, the National Employment Service pays a monthly cash benefit of RSD 20 000 (EUR 170) to young people with secondary education, and RSD 24 000 to those with higher education, and also pays a contribution in the case of injuries at work and occupational diseases for people included in this

programme. It plans to include 10 000 young people during 2020 and 2021 (Government of Serbia, 2020[62]).

**Figure 11.6. Young people not in employment, education or training (2015 and 2019)**
Share of 15-24 year-old age group




Note: Data for Albania, Bosnia and Herzegovina, and Kosovo as well as WB6 average refer to 2018 instead of 2019, as these are the latest available data. Data for OECD average refers to the unweighted average of age groups 15-19 and age group 20-24. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, n.d.[6]), *Labour Force Survey* for EU, Montenegro, North Macedonia, Serbia; (WIIW / World Bank, 2020[52]), *Western Balkans Labor Market Trends 2020* for Albania, Bosnia and Herzegovina, and Kosovo; (OECD, 2021[63]), *Youth not in employment, education, or training (NEET) (indicator)*, doi: 10.1787/72d1033a-en (accessed on 03 March 2021).

StatLink https://doi.org/10.1787/888934254164

Over-education among high-skilled and university graduates may result from the unattractiveness of the VET system for young people and their parents and the greater attractiveness of the higher education system. Work-based learning, such as apprenticeships and internships, is a key approach pursued in OECD economies to tackle skills mismatch (OECD, n.d.[64]; OECD, 2018[1]). Albania, Montenegro, North Macedonia and Serbia have recently introduced workplace-based training modules into their VET and tertiary education curricula. However, students cannot always complete their workplace-based professional practice modules; for example, it was reported that in Albania it was not possible to find enough work-based training opportunities in companies.

### *Adult learning will be key to closing skills gaps and increasing competitiveness*

As companies respond to more volatile markets and shorter product cycles, individuals will need to adapt their skills and change jobs more frequently during their working lives. Adult learning is therefore central to a lifelong learning approach. It involves not just formal classes in training institutions or universities, but also non-formal and informal learning in workplaces (OECD, 2019[2]). Employee training helps to foster the competitiveness of businesses and enhance labour productivity, as well as improving individuals' experience of work (ETF, 2014[65]).

Participation of workers in continuing training in the region is below the EU average. According to data from the Adult Education Survey, last conducted in 2016, the share of adults participating in job-related non-formal education and training was only 5.0% in Bosnia and Herzegovina, 6.1% in Albania, 9.9% in North Macedonia and 14.1% in Serbia – all far below the EU average of 35.3% (Eurostat, 2021[66]). Younger adults and highly educated workers tend to participate more often.

Developing an efficient and quality adult education system remains a key challenge. The WB6 economies have started to set up or strengthen their adult learning frameworks. Although strategies for adult education have been adopted, implementation seems to be weak in some economies or they are outdated (for example in Kosovo). Although there are small budgets for training measures for the unemployed, education ministries may lack a targeted budget for adult education (as in Montenegro). Measures to provide financial incentives for participating in continuing training are lacking. Measures in some OECD economies might offer inspiration. Some have introduced individual learning accounts (OECD, 2019[67]), put in place infrastructure to guide adults as they upgrade their skills (such as Portugal's Qualifica Centres), or implemented programmes to increase the skills of low-skilled adults and supported companies to do so (OECD, 2019[68]).

One important approach is the validation and recognition of prior non-formal learning. Some economies have started to set up validation and certification processes for adult learning (e.g., Albania and the RS in Bosnia and Herzegovina, while in North Macedonia a system is being set up). Evidence from some EU economies, such as Portugal, shows that linking upskilling measures to validation and recognition of prior learning increases their effectiveness (Düll et al., 2018[41]). In the RS, the law also foresees that employers may organise various forms of training and additional training for the employed to adjust to the market demands and changes, and to the new technological and work processes.

Some economies, such as Montenegro and North Macedonia, have made progress in awareness-raising activities. For instance, Montenegro organises the Adult Education and Learning Day Conference and publishes relevant material, including flyers and a guide to the non-formal education system. One challenge is to better connect all parties involved: the policy makers, other ministries, local governments, social partners, employers, media representatives and non-government organisations (NGOs).[16] North Macedonia has also made progress in increasing transparency about adult education providers. In October 2017, the Adult Education Centre in North Macedonia officially launched a newly developed web platform of certified adult education providers and training programmes (Eurydice, n.d.[69]).

Reaching low-educated and older workers is a particular challenge, since they have often not developed their learning skills over their lifetimes. These workers are also more likely to be employed in companies with low productivity and in small enterprises, which are less likely to offer continuing training. More efforts are needed to increase participation among prime age and older workers, as well those who are low educated, vulnerable groups and the self-employed. A range of OECD economies have developed programmes exclusively targeting these groups, e.g. the Chèque Formation in Wallonia, Belgium; Profi!Lehre and Weiter!Bilden in Austria; the Consortium for HRD Ability Magnified Program (CHAMP) in Korea, the Industry Skills Fund in Australia and the Formação-Ação in Portugal (OECD, 2019[2]).

Remedial education aims to make labour markets more inclusive and open up employment opportunities for low-skilled adults. Kosovo is developing some learning programmes for remedial education (Grades 6-9) and adult education programmes within the VET schools, supported by international donors (Haxhikadrija, Mustafa and Loxha, 2019[70]). It is offering programmes like "Literacy for women and girls" for women from Romani, Ashkali and Egyptian (RAE) communities. One challenge is to scale up these types of programmes and to ensure sustainable financing.

### *The way forward for skills*

- **Provide adequate financial incentives to employers to offer continuing education** to help companies adapt to technological change. These could target low-skilled, prime age and older workers and SMEs (Box 11.8). This should be combined with awareness-raising activities targeted at employees and employers to pursue continuing training.
- **Include internships in university curricula** to continue to develop and implement dual vocational training formats.

- **Improve vocational guidance for both young people and adults**. Plans could also include counselling activities for employers as well as employees, in particular for SMEs. A good example to follow would be France, where every individual has the right to information, advice and career guidance support. To put this right into action, the government launched the Advice for Professional Evolution *(Conseil en Évolution Professionnelle)* in 2014, offering free and personalised services (OECD, 2019[31]).
- **Develop a framework for the recognition of prior learning combined with activities to increase skills**. The economies which already have such a system in place should link recognition processes to upskilling measures.
- **Scale up remedial education measures for low-educated adults.** In Kosovo, the whole education and training infrastructure should be used, including VET institutions, in order to provide remedial education and vocational skills to adults, as also recommended by ETF (2019[71]).
- **Use the skills anticipation system to guide young people, adult workers and the unemployed** in retraining and upskilling activities. Skills anticipation and labour market information systems should provide information about the current labour market and expected changes, for instance with implementation of the Green Agenda, particularly for coal-related work. The information on skills in demand and tracer studies can also be used to adapt the curricula of VET, university, and adult education programmes. Trainers can be trained in adult education and vocational rehabilitation on skills in demand and on adult learning pedagogy.
- **Monitor the employability of VET and university graduates** (as some WB6 economies already do through tracer studies) and adapt curricula and teaching methods accordingly. Offer modular training courses to close skills gaps.

### Box 11.8. Financial incentives for workplace training

In **Belgium (Flanders)**, the SME Wallet (*KMO-portefeuille*) programme offers specific incentives to encourage SMEs to train their employees. It targets SMEs exclusively and is designed to help them grow and become more competitive through investment in skills. The SME Wallet covers 30-40% of training costs, depending on the size of the enterprise. SMEs can apply for subsidies online. Employers determine their own training needs, and there is no targeting element. A recent impact assessment determined that participating firms achieved higher growth than a control group.

**Finland** has a financial incentive that goes hand-in-hand with building the capacity of companies to identify their training needs and deliver training. The Joint Purchase Training *(Yhteishankintakoulutus)* supports employers who want to retrain existing staff or set up training programmes for newly recruited staff. Offered by the PES, it supports employers to define their training needs, select candidates for training and find an education provider to deliver the tailored training. The PES also part-finances the training.

In **Ireland**, in 2017, Springboard+ (a programme originally conceived for the unemployed population which offers free courses leading to qualification) was extended to the self-employed who want to increase their skills in certain sectors.

Source: (OECD, 2017[29]), *Financial Incentives for Steering Education and Training*,, https://dx.doi.org/10.1787/9789264272415-en, (OECD, 2019[2]), *OECD Skills Strategy 2019: Skills to Shape a Better Future*, https://doi.org/10.1787/9789264313835; (OECD, 2019[72]), Employment Outlook: The Future of Work, https://dx.doi.org/10.1787/9ee00155-en.

## Job quality (Sub-dimension 8.3)

The focus of this sub-dimension is on earnings quality, including non-wage elements that offer protection from labour market risks. Earnings are one of the three key dimensions of job quality (OECD, 2014[73]; Cazes, Hijzen and Saint-Martin, 2015[74]), with the other two being labour market security and the quality of the working environment – see Labour market governance (Sub-dimension 8.1). Good jobs should be equally available for men and women. Therefore, this sub-dimension also looks at gender inequality and policies to promote female employment.

Most WB6 economies receive only low scores for quality earnings (Table 11.5). In general, the WB6 economies score better for their policies to promote female employment, particularly North Macedonia.

### Table 11.5. Scores for Sub-dimension 8.3

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 8.3: Job quality | Quality earnings | 2.0 | 1.0 | 1.0 | 3.0 | 2.0 | 2.0 | 1.8 |
| | Policies to promote female employment | 3.5 | 2.8 | 2.0 | 4.0 | 3.0 | 2.5 | 3.0 |
| **Sub-dimension average score** | | 2.8 | 1.9 | 1.5 | 3.5 | 2.5 | 2.3 | 2.4 |

### *Despite mechanisms to set minimum wages, average wages and low labour productivity remain key challenges*

Quality of earnings relate to competitive wages, which set the right incentives to formally employ workers so that they are covered by social protection and set incentives for increasing productivity and workforce development. Very low wage levels are associated with a risk of the economy becoming trapped in a low wage-low productivity vicious circle (OECD, 2018[1]). Low wage levels and poor career perspectives also increase the incentives for skilled workers to leave the country and work abroad, which in turn creates skills shortages. Widespread informality implies that large parts of the workforce are effectively beyond the reach of government policies and do not have access to social insurance or regulatory protection. Good quality earnings are associated with a more productive economy and make it more attractive for employers to invest in human capital. Policy options include setting the statutory minimum wage at a moderate level in order to raise wages at the bottom of the ladder, while avoiding pricing low-skilled workers out of jobs (OECD, 2018[1]).

Although economic and social councils should be involved in fixing the minimum wage, in the WB6 economies their role is mostly limited to consultation and the decision is often taken unilaterally by the government. Sometimes they may not even be consulted, as happened with the increase in the minimum wage in 2020 in Albania. In Serbia, the government only steps in when the social economic council cannot agree the level of the minimum wage (this happened in 2018, 2019 and 2020). In 2018, Albania, North Macedonia and Serbia had the highest ratio of monthly minimum wage to monthly average gross wage; the ratio was higher than in Bulgaria and Croatia, for which comparable information was available. The ratio was lower in Montenegro and Kosovo (Table 11.6). Measured in purchasing power parity (PPP) terms, the minimum wage was lowest in Albania and Kosovo in 2018.

## Table 11.6. Minimum and gross average wages in the Western Balkans, Bulgaria and Croatia (2018)

| | Monthly gross minimum wages, EUR (ER) | Monthly gross minimum wages, EUR (PPP) | Average monthly gross wage (EUR) | Ratio of minimum wage: average gross wage (2018) | Change in minimum: average gross wage ratio since 2015 (p.p.) |
|---|---|---|---|---|---|
| ALB | 181 | 358 | 397 | 0.46 | 0.00 |
| BIH | - | - | 724 | - | - |
| KOS | 170 | 334 | 558 | 0.30 | -0.11 |
| MKD | 279 | 576 | 579 | 0.48 | 0.06 |
| MNE | 288 | 514 | 766 | 0.38 | -0.02 |
| SRB | 285 | 530 | 580 | 0.49 | 0.03 |
| BGR | 261 | 517 | 586 | 0.45 | 0.04 |
| HRV | 462 | 681 | 1139 | 0.41 | 0.03 |

Note: Data for Bosnia and Herzegovina refer to 2017 Q2. p.p. = percentage points; PPP = purchasing power parity;
Source: (wiiw Databases, 2021[75]) The Jobs Gateway in South East Europe, https://data.wiiw.ac.at/seejobsgateway.html; based on data provided by statistical offices and Eurostat.

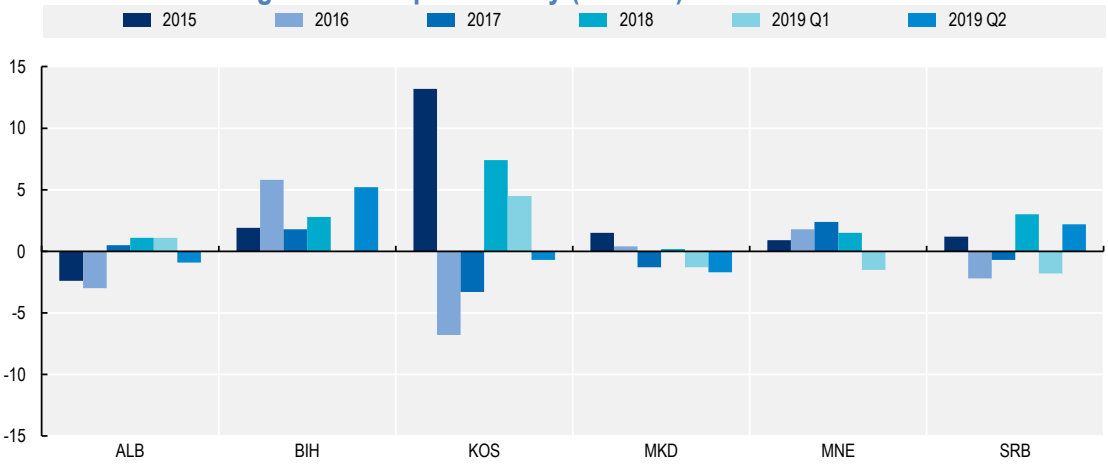
No comparable data for 2019 and 2020 are available. In 2019, Albania increased the minimum wage to EUR 213 (48% of the average gross monthly wage).[17] In 2020 the minimum wage in the RS in Bosnia and Herzegovina was fixed at EUR 266. A comparison of the ratio of minimum wages to mean monthly gross earnings found that in 2019 the ratio was highest in Albania, followed by Serbia and Montenegro (Eurostat, 2021[76]).[18]

In-work poverty is caused by low wages as well as low work intensity, in particular among vulnerable groups. The self-employed are often more likely to be at risk of poverty.[19] There are no policies and measures in place to reduce taxes or social security contributions for low wage earners.

It would be advisable for WB6 economies to carry out a study of the potential impact of the minimum wage on informality on the one hand, and its potential to prevent poverty in low-wage sectors and occupations on the other.

One main challenge is to increase productivity. Between 2015 and Q2 of 2019 (the latest quarter for which comparative data are available), labour productivity has been rather volatile with no or limited improvements over time, except in Bosnia and Herzegovina (Figure 11.7).

## Figure 11.7. Annual change in labour productivity (2015-19)




Note: Labour productivity is defined as the ratio of labour to GDP at 2010 reference prices per person employed (LFS), growth in %.
Source: (wiiw Databases, 2021[75]) The Jobs Gateway in South East Europe, https://data.wiiw.ac.at/seejobsgateway.html; based on data provided by statistical offices and Eurostat; WIIW / World Bank (2020[52]), *Western Balkans Labor Market Trends 2020.*

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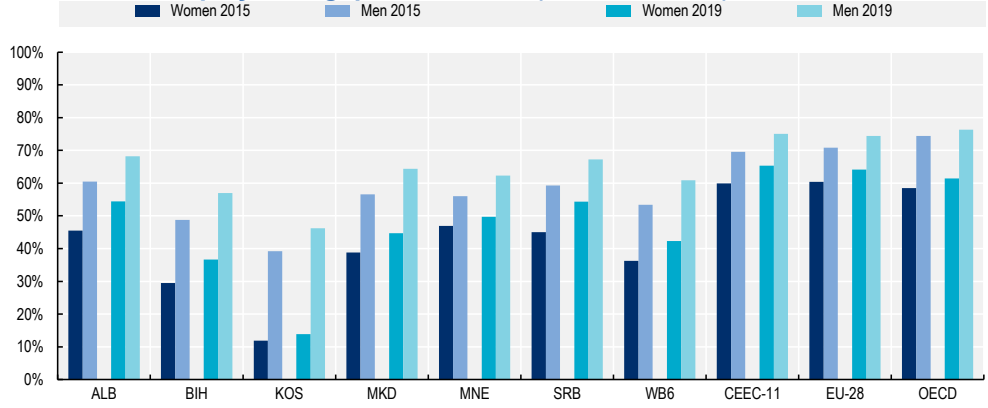
Another issue is the wage difference between the public and the private sector in some of the Western Balkan economies. For example, in Bosnia and Herzegovina, the public sector offers higher wages and better working conditions than the private sector. Likewise, in Kosovo, the highest wages were paid by publicly owned enterprises, while the lowest wages were in the private sector.[20] This makes it harder for the private sector to attract workers. The average gender wage gap was 16% in the region in 2014.[21] The largest wage gap was in craft and related occupations (Suta et al., 2021[77]).

### *Women's economic activity has increased substantially, but the gender employment gap remains wide*

Gender inequality is not only bad for labour market inclusiveness but also harms economic performance. Conversely, there is evidence that greater gender equality increases economic growth (EIGE, 2017[78]). Policies to promote female employment are therefore crucial. Enhanced educational outcomes for women, increased female labour force participation, and improved career development opportunities contribute to better economic performance and higher living standards. A recent study commissioned by the Regional Cooperation Council (RCC) as part of a wider Women Economic Empowerment agenda, based on the European Institute for Gender Equality (EIGE) methodology, showed that continuing to increase employment among women and narrowing the employment gap would increase GDP (Suta et al., 2021[77]).[22]

Despite rising in all WB6 economies since 2015, the average employment rate among women was still 21.8 percentage points below the EU average, 23 p.p. below the CEEC-11 average, and 19.1 p.p. below the OECD average in 2019 (Figure 11.8). The gender employment gap – the percentage-point difference between men and women's employment rates – was higher on average for the WB6 economies (18.6 p.p.) than the EU average (10.3 p.p.), the CEEC-11 average (9.8 p.p.) and the OECD average (14.9 p.p.). On average, the gender employment gap widened in the WB6 economies between 2015 and 2019, driven mainly by increased gaps in Kosovo and Montenegro. Over that period, the gender employment gap only narrowed in Albania and Serbia, where employment among women rose faster than among men. More recently, between 2019 Q2 and 2020 Q2, the gender employment gap among 20-65 year-olds has narrowed across both the WB region and the EU. Between the first and second quarter of 2020, employment rates in the WB6 economies fell by 3.3 p.p. for men on average and 0.9 p.p. for women (Suta et al., 2021[77]).

**Figure 11.8. Gender employment gaps in the WB6 (2015 and 2019)**




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: (Eurostat, 2020[18]), *European Union Labour Force Survey: 2019 dataset* for EU, Montenegro, North Macedonia and Serbia; Instat (Instat, 2020[7]), *Women and Men in Albania 2020* for Albania; (ASK, 2020[8]), *Labor Force Survey in Kosovo, 2019* for Kosovo; (BHAS, 2019[9]), *Labour Force Survey 2019* for Bosnia and Herzegovina; (WIIW / World Bank, 2020[52]), *Western Balkans Labor Market Trends 2020* for Bosnia and Herzegovina and Kosovo (for 2015); (OECD, n.d.[10]), *Labour Force Statistics* for OECD average.

StatLink https://doi.org/10.1787/888934254202

Women's employment rates in 2019 were highest in Albania and Serbia, and lowest in Kosovo. The women empowerment index (WEI) provides a more nuanced picture of gender inequality in the labour market. In addition to the gender employment gap, this indicator includes the share of women in middle and senior management, the female labour force participation rate, the female unemployment rate, and the share of female employees in full-time employment. In 2019, the average WEI score for the WB6 economies was 52.4 out of 100 while the EU average was 80. In the region, the highest scores were achieved by Albania (outperforming several Southern European economies) and Montenegro. Bosnia and Herzegovina (45.9) and Kosovo (27.4) scored the lowest among the WB6 and EU economies (Suta et al., 2021). Four of the WB6 economies have calculated their gender equality index following the EIGE methodology, which also includes other dimensions, such as money, knowledge, time spent in care activities, power and access to services. North Macedonia received the highest score (62) in the region, followed by Albania (60.4), Serbia (55.8) and Montenegro (55). Bosnia and Herzegovina and Kosovo did not take part. The 2019 EU average is 67.4.

There are a number of reasons for women's comparatively low employment , including gender stereotypes, a lack of affordable and high-quality child care and elderly care, and inflexible working time arrangements (World Bank, 2017[79]; Haxhikadrija, Mustafa and Loxha, 2019[70]; Centre for Equality and Gender Equality, 2016[80]; NALED, 2019[81]).[23] Differences in labour market outcomes are also related to occupational segregation, lack of access to finance and entrepreneurship support, discrimination in recruitment and career progression, and lower retirement ages in several WB6 economies. In Kosovo, generous maternity leave regulations may discourage employers from employing women. Educational attainment is also decisive for women's labour market participation and gender employment gaps are smallest among the well-educated (WIIW / World Bank, 2020[52]). Conversely, the gaps are largest among the low educated, while low-educated women also work more often as unpaid family members than their male peers.

WB6 economies have set up co-ordination mechanisms to tackle gender inequality in a comprehensive way and have strategies for gender equality in place. Women make up an increasing share of university graduates, and women even outnumber men among recent university graduates, for example in Albania (Instat, 2020[7]). Young women already account for a larger share of students and graduates in science, technology, engineering, and mathematics (STEM) subjects than in many EU economies (including in engineering and computer sciences), but computer sciences and engineering remain more typical choices for young men (RCC, 2020[82]). Some WB6 economies have made progress in providing gender-sensitive vocational guidance. North Macedonia has made progress in the gender-sensitive revision of schoolbooks and the Ministry of Education and Science awards scholarships to female university students studying bio-technical, technical-technological, natural-mathematical, IT, chemistry, physics, mathematics and medical sciences. Some WB6 economies, such as North Macedonia, have made progress in revising legislation to avoid gender discrimination, but there is a general lack of transparency about the implementation of the regulatory framework.

The main targeted measures to promote female employment have been in the area of active labour market programmes, although they are mostly small in scale. Specific programmes include promoting employment among single mothers in Albania, self-employment and female entrepreneurship schemes in Bosnia and Herzegovina, measures targeted at women aged 40 and older in FBiH, and measures for women with three or more children and other hard-to-place women in Kosovo. Women are in general well represented among participants of mainstream ALMPs, except for start-up support measures. Progress has been made in training labour office staff on gender equality issues in Albania.[24] Another area where recent, but generally limited, progress has been made is in entrepreneurship programmes, implemented by the public employment services and other institutions. However, programmes have been small in scale; for instance, in Albania, little progress has been observed (OECD et al., 2019[83]).

### *The way forward for quality jobs*

- **Conduct regular analyses of earnings structures** covering earnings by gender, sectors, educational level and occupation; non-wage labour costs (like social security contributions); the share of recipients of minimum wages; and the development of the low-wage sector by gender. Monitoring of labour market data should be improved and include data on in-work poverty. Increasing the quality of earnings will mean raising the productivity of companies so wider monitoring should also include labour productivity.
- **Assess the impact of the minimum wage on both poverty reduction and informal employment.** One example to follow could be Germany's Minimum Wage Commission which is composed of two members from the scientific community in a consultative role, as well as three representatives of the trade unions and three representatives of employers who have voting rights, and a chair appointed by the government on the basis of suggestions made by the social partners. Its mandate is to constantly evaluate the impact of the minimum wage on the protection of workers, conditions of competition, employment in certain industries and regions, and on productivity. The commission presents the results of its evaluation to the Federal Government in a report together with its resolution every other year on the level of the minimum wage (Mindestlohn Kommission, n.d.[84]).
- **Increase access to affordable and high-quality childcare as well as support for elderly care**. International experience shows that labour market participation rates of women depend on availability of childcare and after-school care (OECD, 2016[85]).
- **Take steps to reduce gender stereotypes in education and the workplace**, including implementing the regulatory framework on non-discrimination, conducting awareness-raising activities, and adapting vocational guidance to attract more women into ICT and engineering and more men into occupations like education and care. Kosovo should make its maternity leave law less generous so as to reduce barriers to employment of young women. All the economies should promote entrepreneurship among women, including access to training, counselling and follow-up, and financing.

## Activation policies (Sub-dimension 8.4)

The goal of an effective activation policy for jobseekers and other disadvantaged groups is to bring more people into the labour force and into jobs. This requires in particular ensuring that people have the motivation and incentives to seek employment; increasing people's employability and helping them to find suitable employment; expanding employment opportunities for jobseekers and people outside the labour force; and managing the implementation of activation policy through efficient labour market institutions (OECD, n.d.[3]). Activation policies need to balance and combine different types of activities, including counselling jobseekers and employers; implementing active labour market programmes (ALMPs); and designing welfare benefits so that they increase matching efficiency, provide protection against poverty, while setting work incentives in the mutual obligations framework, which induces setting job-search requirements, rules for accepting suitable work, obligation to participate in ALMPs if needed and rules on sanctions.

WB6 economies score better for their public employment services (PESs) and ALMPs than for their mutual obligations frameworks (Table 11.7).

### Table 11.7. Scores for Sub-dimension 8.4

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 8.4: Activation policies | Public employment services | 3.5 | 2.5 | 2.5 | 3.5 | 3.5 | 3.5 | 3.2 |
| | Mutual obligations framework | 2.0 | 2.5 | 1.5 | 3.5 | 3.0 | 2.5 | 2.5 |
| | Active labour market programmes | 3.5 | 2.3 | 2.0 | 3.5 | 3.5 | 3.0 | 3.0 |
| **Sub-dimension average score** | | 3.0 | 2.4 | 2.0 | 3.5 | 3.3 | 3.0 | 2.9 |

### *The governance and service delivery of public employment services have improved, but they remain under-resourced*

Public employment services are the main institutions involved in activation policies. PES staff capacity in the WB6 economies has improved in recent years, but staff caseloads, i.e., the number of registered unemployed people per counsellor, are still high or very high (Table 11.8). In France and Germany, by comparison, counsellors' caseloads of hard-to-place jobseekers are much lower, at around 70 jobseekers per employment counsellor, while overall caseloads may range between 100 and 350, depending on the degree to which jobseekers need individual guidance and how autonomous they are at using self-help guidance tools (OECD, 2015[5]; Manoudi et al., 2014[86]; Pôle emploi France, n.d.[87]). In the WB6, PES staff are receiving training on implementing new work methods, ALMPs and dealing with specific target groups. However, high caseloads may hinder them from effectively implementing counselling and job placement services.

### Table 11.8. Caseloads for PES counsellors (2019)

Number of registered jobseekers per counsellor

| | ALB | BIH-RS | KOS | MKD | MNE | SRB |
|---|---|---|---|---|---|---|
| Caseload | 300 | > 1000 | 769 | 400 | 556 | 827 |

Source: Assessment on the basis of administrative data received by the PES in the economies; no data are available for FBiH.

Following EU and OECD good practice, PESs in the WB6 economies have introduced or are in the process of developing profiling tools to categorise jobseekers into three main groups: 1) autonomous and easy-to-place jobseekers; 2) jobseekers with a medium level of employment barriers; and 3) hard-to-place jobseekers. The last category are quite likely to be predominant, since many registered jobseekers have low skills and/or are long-term unemployed. The WB6 PESs have also introduced the creation of individual action plans and follow-ups; however, very high caseloads in the majority of PESs limit their effectiveness, as counsellors are unlikely to have sufficient time for in-depth interviews, counselling and timely and regular follow-up activities. PESs have also modernised their IT systems to make their labour intermediation and case handling more effective or have at least started to do so.

Despite recent improvements in the WB6 economies, the high rate of long-term unemployment remains a key challenge for labour market policies (Table 11.9). Rates are well above the EU and CEEC-11 averages.

### Table 11.9. Incidence of long-term unemployment (2015 and 2019)

Long-term unemployed as % of all unemployed

| | ALB | BIH | KOS | MKD | MNE | SRB | WB6 | EU-28 | CEEC-11 |
|---|---|---|---|---|---|---|---|---|---|
| 2015 | 66 | 81.7 | 72.1 | 81.6 | 76.8 | 59.7 | 72 | 48.2 | 43.6 |
| 2019 | 64.3 | 76 | 69.1 | 71.7 | 79 | 50.3 | 66.3 | 40.1 | 37.1 |

Note: Table shows the share who have been unemployed for more than one year as a percentage of all unemployed (15–74-year-olds). Data are for 2019 Q2 for ALB, BIH, KOS and the WB6 average. The CEEC-11 are the 11 Central and Eastern European countries joining the EU: Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: Eurostat (n.d.[6]), *Labour Force Survey*, https://ec.europa.eu/eurostat/web/main/data/database; WIIW / World Bank (2020[52]), *Western Balkans Labor Market Trends 2020* for Albania, Bosnia and Herzegovina, and Kosovo.

Collecting vacancies and building trust with employers is challenging, particularly as the region's PESs have many hard-to-place jobseekers on their registries. They need to increase their active efforts to collect vacancies and to provide services to employers. A common approach in European economies is to identify growth sectors at the national or regional level and to contact employers active in these sectors (ILO, 2016[88]). Other PESs explicitly target their individualised services at SMEs (Oberholzner, 2018[89]). In Slovenia, small and micro-enterprises that lack human resources (HR) management professionals and experience can get personal assistance from advisors, while companies with HR management resources and experience are asked to use the portal for employers.

### *Jobseekers have mutual obligations for receiving benefits although monitoring is limited*

Moderately generous and comprehensive social benefits strengthen the effectiveness of activation policies. Effective social safety nets alleviate concerns about job security among the employed, with important consequences for worker well-being. Adequate unemployment insurance and other social benefits – including sickness, disability, lone parent, and social assistance benefits – enhance job quality by effectively insuring workers against losing their jobs and giving them time to find a new one. However, unemployment and other social benefits can also create disincentives to finding work in the shortest possible timeframe. Therefore, a well-designed mutual obligation framework is decisive in preventing benefits from creating disincentives to work (OECD, 2018[1]). Mutual obligation principles link the generosity of unemployment benefits and social assistance with requirements on beneficiaries to look for work and accept suitable offers, while imposing sanctions on those who do not comply (Langenbucher, 2015[90]).

Unemployment benefits in the WB6 economies do not provide generous income replacements. Some economies do not link the level of unemployment benefits to previous earnings (e.g., in Albania the unemployment benefit is set at 50% of the minimum wage), which contradicts good practice in OECD and EU economies. This may facilitate processes at the PES, but it does not create a strong incentive to engage in formal employment and limits matching efficiency. On the other hand, older unemployed people with a long work history are able to receive benefits for a long period and there is a risk of unemployment benefits being misused as a route to early retirement. This contradicts OECD recommendations on reducing incentives for early retirement and eliminating early retirement elements in unemployment benefit schemes (OECD, n.d.[91]).

In general, able-bodied social assistance recipients have to register at the PES and actively search for work, otherwise they get sanctioned, as is the case in Kosovo, for instance. Electronic data management and information exchange systems have been established but monitoring and follow-up on job-search activities may be weak. In the Federation of Bosnia and Herzegovina and Serbia, there is still an incentive to register at the PES in order to be covered by health insurance. While this may represent an opportunity to reach out to the inactive population, often no such follow-up is made. Overall, WB6 economies have improved co-operation with social services at the local level (e.g., in Serbia and North Macedonia, see Box 11.9), however, poor institutional capacity for providing encompassing social services limits the effectiveness of co-operation.

### Box 11.9. Co-operation between social services and employment services to integrate vulnerable groups into the labour market in North Macedonia

Since 2019, the Centre for Social Work and the Employment Centre have co-operated to put together individual employment plans to map out beneficiaries' participation in active employment measures and job seeking. Counsellors from the two centres communicate regularly on the outcomes of activities and meet as needed, at least once a month. They perform joint assessment of the needs and the employability level of all registered unemployed persons or beneficiaries from one household, with the aim of identifying the most employable person and including that person in the active employment measures and services, taking into account their age, educational attainment, previous work experience, professional qualifications, acquired skills, the job demand in the labour market, and whether there are no obstacles to participation in the active employment measures and other circumstances.

Source: (Government of North Macedonia, 2019[92]), *Economic Reform Programme 2019-2021*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/north_macedonia_erp_2019-2021.pdf; (EC, 2019[93]), "Economic Reform Programme of North Macedonia (2019-2021): Commission assessment", https://data.consilium.europa.eu/doc/document/ST-8545-2019-INIT/en/pdf; information received from the government.

Well-targeted, permanent in-work benefits can be effective at making work pay. In-work benefits supplement low wages with welfare benefits. If well designed they create an incentive to take up low-paid work (OECD, 2018[1]). In-work benefits are only implemented in Albania among the WB6 economies. Supported by the World Bank, a reform of social assistance (economic aid) was rolled out across Albania at the beginning of 2018, introducing in-work benefits, by extending social assistance eligibility to people in low-paid employment, receiving a modest income from household agricultural activity in rural areas, or in receipt of other forms of social protection benefits (such as pensions or disability benefits). While the introduction of in-work benefits corresponds to international good practice (Immervoll and Scarpetta, 2012[94]), the level of social assistance, currently less than one-third of the minimum wage, remains low (Jorgoni, 2019[57]).

#### *Active labour market programmes are very under-resourced*

Active labour market programmes can play a constructive role in finding people employment when used judiciously. Thorough evaluations of ALMPs across OECD economies indicate that the record is mixed, but also that well-designed and targeted measures can increase the employability of jobseekers and their employment opportunities in a cost-effective manner (OECD, 2015[5]).

The WB6 economies have improved the design of their measures and introduced targeted programmes but the most vulnerable groups are still under-served. Expenditures on ALMPs as a percentage of GDP have been low, limiting their potential impact on the region's very high unemployment rates: 0.27% in the RS, 0.08% in Kosovo and 0.19% in North Macedonia in 2019; 0.08% in Serbia in 2017. Considering that unemployment rates are nearly three times the OECD average, these expenditures are not adequate. In 2017, about 5.5% of unemployed people participated in an ALMP in Albania, around 6% in Bosnia and Herzegovina, 10.2% in Kosovo.

In comparison, on average in 2018, OECD economies spent 0.36% of GDP on ALMPs (including employment incentives, training measures, job creation measures/public works, start-up incentives, vocational rehabilitation and sheltered workshops). This rises to 0.46% if placement services, counselling and PES administration are included (OECD, n.d.[10]). In the EU, expenditure on ALMPs (without counselling) ranged from 0.03% of GDP in Romania to 1.39% in Denmark (EC, 2020[95]).

### *The way forward for activation policies*

- **Continue to strengthen the capacities of PESs** by enhancing the number of employment counsellors, and offering digital and self-help services for those who are ready to help place themselves. Train staff so that they become gender sensitive, have a deep understanding of the employment barriers faced by hard-to-place jobseekers, and identify the work capacity of people with disabilities in co-operation with relevant institutions and occupational doctors.
- **Regularly monitor PES activities and outcomes** and publish the results, systematically differentiating outcomes (i.e., employment) by degree of disadvantage. Thorough evaluations of ALMPs and their impact on different target groups should be conducted by an external evaluator.
- **Continue to develop services for employers** and to proactively collect vacancies. These services could include organising job fairs, meeting regularly with local employers, cold calling employers, and following up with employers who recruited hard-to-place jobseekers.
- **Continue efforts to increase the employment of vulnerable groups**, by developing integrated approaches for the delivery of social and employment services and allocating relevant budgets to improve the labour market integration of the most vulnerable groups (e.g. Roma communities, women in rural areas). This requires close co-operation with other key stakeholders at central and local levels in order to reach those who have become inactive and support those in informal work to transition to formal employment.
- **Continue to strengthen the role of PESs in increasing skills among jobseekers and workers threatened by industrial restructuring.** Scale up training programmes leading to certification and increase the budget for ALMPs accordingly. Develop adult vocational guidance for adults. This could be done by PESs in co-operation with other relevant institutions.
- **Revise the design of unemployment benefits (where relevant)** to link them to previous earnings and avoid them being used as a pathway to early retirement. Where relevant reform health insurance schemes to avoid people only registering with the PES to get health care coverage. Where relevant, reform social assistance schemes to improve targeting and create incentives to take up work.
- **Co-operate with other PESs within the region in the area of labour intermediation**. Within the EU, the European Network of Employment Services (EURES) provides placement services.
- **Support skilled workers who gained experience abroad and are returning** to find good work conditions and living conditions. Co-operate with relevant actors to facilitate labour market integration of returning emigrants.
- **Intensify the exchange of experience and benchmarking of PESs within the region**. In the EU the European PES Network, supported by the European Commission, is very active and produces reports and survey-based studies on work methods, strategies and measures of PESs, and working groups and webinars are organised on pressing issues. It organises bench learning and mutual learning events and peer reviews with the support of the European Commission (EC, n.d.[96]). These are key activities enshrined in the open co-ordination among EU Member States in the area of employment.

## Conclusion

Labour market outcomes have improved with increased employment and reduced unemployment among both men and women. However, employment rates in the region are still below OECD and EU averages and unemployment rates are significantly higher. Job quality has not improved significantly: informality remains high and duality still characterises some labour markets, while working conditions are improving only slowly. Limited progress has been made in including the most vulnerable groups and minorities in the

labour market. Labour laws, occupational health and safety regulatory frameworks and the design of employment policy strategies have improved. However, major efforts are needed to improve implementation and to strengthen the institutional capacities of relevant actors. The capacity of social partners to regulate employment and working conditions remains weak. Employment policies would benefit from being more encompassing and better linked to competitiveness strategies, tax policies, social policies, and education policies. Tackling skills gaps and skills shortages will be paramount for economic development. This calls for further improvements in the education system as well as progress in the school-to-work transition and adult learning.

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## Notes

[1] (WIIW / World Bank, 2020[52]) for 2015 employment rate data, and for unemployment rate (population aged 15+, 2015, 2019Q2).

[2] The 11 Central and Eastern European countries (CEECs) which have joined the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[3] These include issues such as working time, pregnant women, workers' rights in case of mergers and acquisitions, and some health and safety issues in Federation of Bosnia and Herzegovina and the preparation of a draft law on maternity and parental leave in Kosovo.

[4] E.g. the Federation of Bosnia and Herzegovina has started harmonising domestic legislation with EU directives, mainly in the area of working time, pregnant women, workers' rights in case of mergers and acquisitions, and some health and safety issues.

[5] Except for Romania which was between Albania and North Macedonia.

[6] According to Article 10 of the Labour Law, a contract for a specified task may not be longer than 120 days within a year.

[7] The latest available comparative data for the WB6 are from (WIIW / World Bank, 2020[52]); OECD and EU average are from the LFS database (OECD, n.d.[97]).

[8] According to a MLSW Report, developed within the EU-funded project "Support to Labour Inspectorate for fighting against undeclared work". Information provided by the government.

[9] According to the Statistical Office of the Republic of Serbia (2021), informal employed includes the employed in unregistered companies, the employed in registered companies but without formal contract and without paying social and pension contributions, as well as unpaid family workers, (Statistical Office of the Republic of Serbia, 2021[99])

[10] The related framework of the project Measures to Protect Children from Trafficking, Exploitation for Work and Unsafe Migration is funded by the governments of Italy, Germany and France.

[11] Government response to the questionnaire.

[12] Argentina, Brazil, Paraguay, Uruguay and the Bolivarian Republic of Venezuela. Associate members are Bolivia, Chile, Colombia, Ecuador and Peru.

[13] Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. Associate members are Anguilla, Bermuda, British Virgin Islands, Cayman Islands, and the Turks and Caicos Islands.

[14] Skills shortages occur when the demand for a particular skill or set of skills exceeds the supply of those available with that skill. Skills gaps occur when workers do not have the right skills required for competent job performance.

[15] Non-routine jobs refer to managers, professionals and higher-level technicians, whose job descriptions usually contain non-routine cognitive and socio-emotional tasks. This corresponds to Type A occupations in the STEP methodology. Routine jobs refer to all other occupations, which are Type B occupations in the STEP methodology. This methodology was slightly adapted.

[16] Information provided by Montenegro.

[17] SEE Jobs Gateway, based on data provided by statistical offices and Eurostat. (WIIW / World Bank, 2020[52])

[18] In 2019, among the 17 EU countries which have a minimum wage, the average ratio of minimum to mean monthly gross earnings in the business economy was 45.1%, while it was 55.5% in Albania. This was higher than in any of the EU countries, where the highest ratio was 52.5%, in Slovenia. It was 48.8% in Serbia and 45.2% in Montenegro. There were no data for North Macedonia, Kosovo and Bosnia and Herzegovina. In the industry, construction and services sectors, the ratio in the three WB economies is lower, but it remains markedly above the EU average in Albania (Eurostat, 2021[76]).

[19] As shown in the profiles of the WB6 economies prepared by the European Social Policy Network of the European Commission (EC, 2019[100]).

[20] The highest average gross wages in 2018 were: EUR 843 in the electricity, gas, steam and air conditioning supply sector; EUR 717 in information and communication; and EUR 639 in mining and quarrying. The lowest was in agriculture, forestry and fishing (EUR 256) (ASK, 2019[98]).

[21] There are no comparable updated data on gender wage gaps, although there is more recent evidence for some WB6 economies; see economy profiles for details.

[22] According to an earlier study, the EU is expected to improve its GDP per capita over 2015-30 by between 0.8% (slow scenario, by reducing the gap by up to 13 p.p.) and 1.5% (rapid scenario; reducing the gap by 20 p.p.) (EIGE, 2017[78]).

[23] Information on the RS provided by the RS authorities.

[24] Government response to questionnaire.

# 12 Science, technology and innovation (Dimension 9)

An effective institutional and policy context for science, technology and innovation (STI) is essential to boost the knowledge economy. For the small open economies of the Western Balkans, STI activities play an important role in the region's path to EU accession and are viewed as key for regional integration. This chapter assesses the STI policy framework and support structure in the six Western Balkan (WB6) economies. After a brief analysis of overall STI trends and performance in the region, the chapter explores three sub-dimensions considered instrumental to the development of sustainable and impactful STI policies and processes. The first, governance of domestic STI systems, reviews the strategic and regulatory framework for STI, including key strategies, institutional set-up and co-ordination, as well as international collaboration and alignment with EU good practice. The second sub-dimension, public research systems, analyses the governance of the public scientific research sector, funding approaches and human resource capacity to foster academic research excellence. The third sub-dimension, business-academia collaboration, assesses the policy framework that supports integration between scientific research and the private sector, which is critical for technology transfer, successful commercialisation, and the economic impact of STI. The chapter concludes with a set of recommendations to further enhance STI policy development and implementation.

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## Key findings

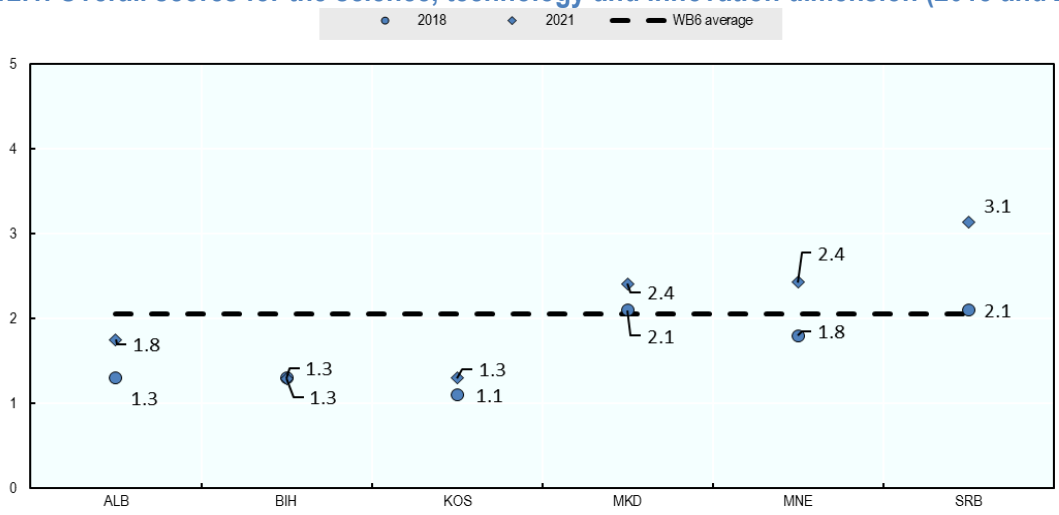
- **Most WB6 economies have a comprehensive STI strategic framework in place** or are in the process of renewing their framework. However, effective implementation is sometimes hindered by limited co-ordination and a lack of policy prioritisation and impact evaluation. Smart specialisation strategies have been adopted in Montenegro, North Macedonia and Serbia, and are being prepared in the other economies.
- **Overall research and development (R&D) expenditure in WB6 economies remains well below regional peers and the EU target**. Although domestic funding is increasing, many critical policy initiatives and programmes continue to rely heavily on international donor support.
- **Some economies operate or are setting up an innovation fund** as a key vehicle for implementing STI policy. The funds in North Macedonia and Serbia are the largest in scope and size and implement STI financial schemes in line with international best practice.
- **A weak track record of enforcing intellectual property protection (IPP),** coupled with low awareness of intellectual property (IP) rights and use, impedes STI development.
- **All economies are embedded in and connected to European and international research networks**; however, these linkages do not always produce the desired scientific outputs. International research collaboration is growing, albeit from low levels. Regional integration of STI, however, remains limited and lacks a systematic approach.
- **Public research remains systemically underfunded**, while the available funds are not used optimally, resulting in subdued research outputs and outcomes. Some economies, notably Serbia, have taken steps to reform the funding model for research by introducing a stronger focus on performance and competitive project-based funding.
- **Human capital remains below potential** amid weak funding, limited development opportunities and few incentives to seek the commercialisation of research. Some economies are increasingly promoting young researchers and linkages with their diaspora to tackle falling numbers of researchers and accelerating brain drain.
- **Linkages between academic research and industry remain nascent**, and a clear strategic policy approach is lacking. As a result, private sector investment in R&D has remained low. All economies have experimented with financial incentives for business-academia collaboration, but non-financial incentives are virtually non-existent. Where voucher schemes are available, they are underfunded, while sophisticated competitive co-operative grants are only available in Serbia and are being introduced in North Macedonia. All economies have expanded institutional support for collaboration; however, the support infrastructure is often provided in the form of incubators for start-ups.

### Comparison with the 2018 assessment

The WB6 region has made some progress in the science, technology and innovation dimension, albeit mostly from a relatively low base (Figure 12.1). While the economies that already had an emerging STI framework and policies in place in the 2018 assessment (Montenegro, North Macedonia, and Serbia) have further consolidated and expanded policy measures, the gap has widened for those positioned at the lower end of the performance review. This suggests an increasing tendency towards a two-speed development of STI policy within the Western Balkans, which – unless effectively addressed in the short to medium term – will intensify disparities across the region.

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## Figure 12.1. Overall scores for the science, technology and innovation dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Assessment methodology and process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress on implementing the policy recommendations made in the Competitiveness Outlook (CO) 2018 has been moderate overall (Table 12.1), although some economies have pursued STI policy reform more proactively than others. At a regional level, moderate progress has been made in areas such as making available financial STI support schemes, creating better linkages between academia and industry, introducing technology diffusion and absorption policies, integrating the diaspora and improving statistical data collection in STI, whilst only limited progress has been made in reforming procurement policies to incentivise STI.

### Table 12.1. Implementation of the CO 2018 policy recommendations: Science, technology and innovation dimension

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| Increase and consolidate financial support for research and development | • All economies have increased the budget for STI; however, gross domestic expenditure on research and development (GERD) remains significantly lower than peer economies.<br>• Some economies, notably Montenegro and Serbia, have reformed their financing approaches for scientific research and have announced a significant increase in funding for STI in the coming years.<br>• Serbia established a dedicated Science Fund in 2019 that provides financial support to foster research activities.<br>• In North Macedonia and Serbia, the activities of the respective innovation funds are increasingly funded though domestic budget allocations. | Moderate |
| Place more emphasis on technology diffusion and absorption policies | • Serbia has put in place a Technology Extension Facility and North Macedonia launched a grant scheme to support technology extension in 2018. | Moderate |
| Use procurement to encourage innovation | • Serbia has introduced an element of support for innovation in its 2019 Public Procurement Law. | Limited |
| Develop a structured approach to creating links between business and | • The Serbian Innovation Fund offers a variety of financial support schemes to support collaboration. | Moderate |

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| | | |
|---|---|---|
| academia | • Institutional support structures, primarily in the form of science and technology parks and centres of excellence, have advanced in most economies. | |
| Make better use of the WB economies' highly educated diaspora and tackle brain drain | • The STI framework in most economies makes reference to leveraging connections with diaspora communities.<br>• Only Serbia has implemented a dedicated finance scheme to foster such linkages through the Science Fund, while Albania is exploring a digital platform for ideas exchange. | Moderate |
| Improve the creation of STI-related statistics to enable the development of evidence-based policies | • In 2020, Montenegro participated in the European Innovation Scoreboard for the first time, joining North Macedonia and Serbia.<br>• In other economies, STI-related statistics remain highly limited. | Moderate |

## Introduction

Effective STI policies, processes and organisations, which define the institutional and policy context for science, technology and innovation, are essential aspects of the toolbox available to policy makers to boost the knowledge economy. STI policy spans the entire innovation value chain, ranging from the creation of fundamental knowledge in basic and applied sciences and technology to the transfer of knowledge to the economic sphere to foster product, process and organisational innovation. STI policies, if designed well, provide the strategic framework for embracing the knowledge economy, embed targeted financial and human capacity-building measures for research and innovation, and incentivise the exchange of knowledge between the public and the private sector, thereby ultimately facilitating the commercialisation of innovation and increasing productivity.

The outbreak of COVID-19 has highlighted another benefit of a well-functioning and modern STI system. Science, technology and innovation have proven essential in the global response to the pandemic and will be vital to support recovery and strengthen economic resilience and competitiveness in the long term.

STI policy is closely intertwined with other policy dimensions covered by the Competitiveness Outlook 2021. Most notably these include:

- **Chapter 4. Investment policy and promotion** aims to facilitate foreign direct investment (FDI), which can generate significant and instrumental grassroots investment and investment in knowledge-intensive sectors. Economies demonstrating strong STI-enabling ecosystems are more attractive to international investors, who can leverage their investment with existing local infrastructure and skills.
- **Chapter 5. Trade policy** and STI reinforce each other, as STI increases local productivity and provides a competitive edge.
- **Chapter 6. Access to finance** remains a key obstacle to private sector innovation. Conventional funding is often ill suited for innovative firms, but alternative finance instruments such as venture capital or business angel investments remain at an early stage of development.
- **Chapter 10. Education policy** is essential for building a knowledge economy as successful STI systems rely heavily on human capital.
- **Chapter 8. Employment policy** can support and attract human resources for research and innovation, strongly affected by brain drain in the region.
- **Chapter 13. Digital society** is important as effective digital communication and information infrastructure are the main enabling tools for fostering "open science", while e-commerce and e-business facilitate firm innovation.

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## Assessment framework

### *Structure*

This chapter assesses policies to develop science, technology and innovation in the WB6 through three broad sub-dimensions:

1. **Sub-dimension 9.1: STI system** focuses on the overarching strategic framework for STI. It assesses the comprehensiveness and relevance of STI strategies and how they are implemented.
2. **Sub-dimension 9.2: Public research system** focuses on the governance of public scientific research and how well policies ensure academic excellence. It examines how public research is funded and assesses policy approaches to foster human resource capacity.
3. **Sub-dimension 9.3: Business-academia collaboration** focuses on the collaboration framework and analyses how policies encourage technology transfer, commercialisation and co-operation between academia and the business community. It also examines the support mechanisms, both financial and others, available to encourage science-industry collaboration, and how the institutional support infrastructure encourages such linkages.

Figure 12.2 shows how the sub-dimensions and their indicators make up the STI dimension assessment framework. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information on the methodology see the Assessment methodology and process chapter.

### Figure 12.2. Science, technology and innovation dimension assessment framework

| Science, technology and innovation dimension | | |
|---|---|---|
| **Sub-dimension 9.1**<br>STI system | **Sub-dimension 9.2**<br>Public research system | **Sub-dimension 9.3**<br>Business-academia collaboration |
| **Qualitative indicators**<br>1. STI strategy<br>2. Institutional framework<br>3. Regulatory framework<br>4. International collaboration<br>5. Alignment with EU STI policies | **Qualitative indicators**<br>6. Institutional structure of the public research system<br>7. Public research funding<br>8. Human resources for research and innovation | **Qualitative indicators**<br>9. Collaboration promotion framework<br>10. Financial incentives for collaboration<br>11. Non-financial incentives for collaboration<br>12. Institutional support for collaboration |
| **Quantitative Indicators**<br>1. Gross domestic expenditure on R&D (% of GDP)<br>2. Gross domestic expenditure on R&D by source of funds (% of GDP)<br>3. Volume of international competitive research grants (e.g., Horizon 2020, Eureka, WBEDIF)<br>4. Number of projects receiving international competitive research grants | **Quantitative Indicators**<br>5. Number of researchers, per million population<br>6. Government budget appropriations or outlays on R&D (% of GDP) | **Quantitative Indicators**<br>7. Total amount of financial support for business-academia collaboration<br>8. Charges for use of IP receipts |

Note: GDP = gross domestic product; IP=intellectual property.

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For the small open economies of the Western Balkans, the opportunities of STI activities go beyond just economic impact; research and innovation play an important role in the region's path to EU accession and are viewed as key for regional integration. Against this background, the leaders of the WB6 endorsed the Common Regional Market 2021-2024 Action Plan (AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The AP sets out a roadmap towards deeper regional and European integration. It is made up of targeted actions in four key areas: (1) a regional trade area; (2) a regional investment area; (3) a regional digital area; and (4) a regional industrial and innovation area. The findings of this CO assessment can inform the implementation of the actions under the "regional innovation area" (Box 12.3).

### *Key methodological changes to the assessment framework*

The methodology for this dimension has changed substantially since the last Competitiveness Outlook, with the number of sub-dimensions reduced from five to three. Most notably, the sub-dimension on innovation in firms has been removed, reflecting the strong focus on policies that enable research excellence as a prerequisite for the knowledge economy, and the shift away from a focus on start-up innovation. Firm innovation continues to feature strongly in the OECD SME Policy Index (OECD, 2019[1]).

Several aspects of the previous CO assessment framework have been consolidated in the new methodology. Sub-dimensions 9.1 and 9.3 remain largely unchanged, whereas sub-dimension 9.2 now also includes all aspects related to human resource capacity, which had previously been covered in a separate sub-dimension.

In this edition, the qualitative data collected through the assessment framework has also facilitated the WB6 economies' participation in the EC-OECD STIP Compass database (Box 12.1).

#### Box 12.1. STIP Compass: International database on science, technology, and innovation policy

The Science, Technology and Innovation Policy (STIP) Compass is a joint initiative of the European Commission (EC) and the OECD that aims to bring together quantitative and qualitative data on domestic trends in STI policy in one place. The STIP Compass portal supports the continuous monitoring and analysis of economies' STI policies and provides a platform for policy research and advice to support government officials, analysts and scholars.

STIP Compass data are gathered through responses to the EC-OECD STI Policy survey, sent every two years to government officials working on STI policies. The CO 2021 STI dimension's assessment framework and indicators include several policy areas that feature in the 2019 edition of the survey:

**Sub-dimension 9.1: STI system** includes a number of policy themes from the EC-OECD survey, including part of the "Governance" area, such as an STI plan or strategy, horizontal policy co-ordination and international STI governance policy. It also partially reflects the survey's "Emerging trends in STI policy" module.

**Sub-dimension 9.2: Public research system** incorporates indicators based on different policy themes from two areas of the survey: "Public research system", which focuses on research infrastructure, financing, and structural changes; and "Human resources for research and innovation", which includes themes of research careers and international mobility.

**Sub-dimension 9.3: Business-academia collaboration** partially reflects the policy area "Science-industry knowledge transfer and sharing", including collaborative research and innovation and intersectoral mobility themes.

Source: (EC and OECD, n.d.[2]), *STIP Compass*, https://stip.oecd.org/stip.html.

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## Science, technology and innovation performance and context in the WB6

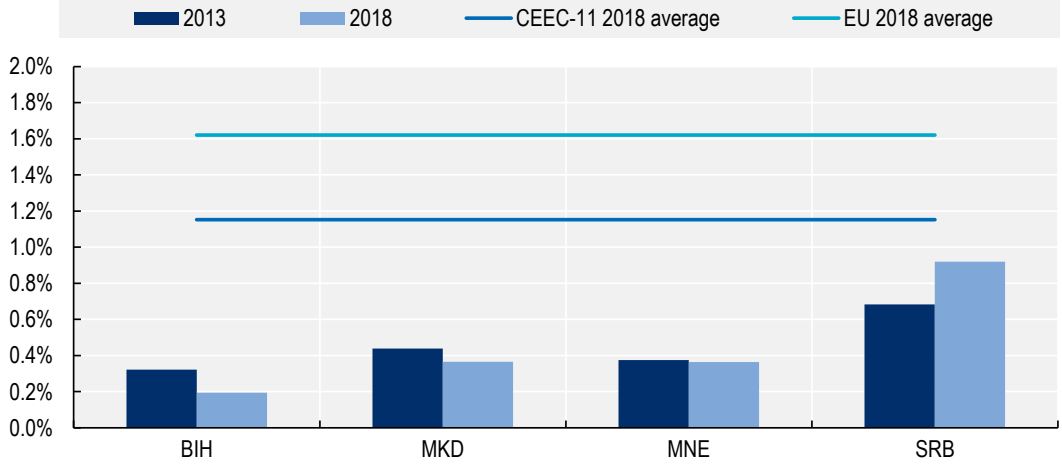
Reliable statistical data on key areas of STI are still scarce in some WB6 economies, which limits a comprehensive analysis of the state of play of science, technology and innovation across the region. Only North Macedonia and Serbia regularly participate in the European Innovation Scoreboard, with Montenegro having joined for the first time in 2020.

The latest scoreboard assessment for the participating WB6 economies is not particularly positive. All three economies rank near the bottom, with Montenegro and North Macedonia categorised as "modest innovators" (ahead of Romania and Ukraine), which means that their performance is less than 50% of the EU average. Serbia is categorised as a "moderate innovator", with its relative performance between 50 and 95% of the EU average. Although there are significant gaps with the European average, the 2020 edition of the innovation scoreboard also emphasises that significant improvements have been made since the previous annual assessment, suggesting that capacity for innovation is gradually increasing in the three economies (EC, 2020[3]).

Spending on R&D as a percentage of GDP (GERD) remains low in all six economies (Figure 12.3) and is well below the EU target of 3%. Even when compared with the CEEC,[1] gaps remain significant. Despite a stronger focus on STI in recent years, an increase in spending is only evident in Serbia. In 2018, average R&D investment was only 0.5% of GDP in the region, compared to 1.15% in the CEEC and 1.62% in the EU.

### Figure 12.3. Gross domestic expenditure on R&D (GERD) (2013 and 2018)

% of GDP




Note: Data for Albania and Kosovo are unavailable. EU and CEEC-11 averages are calculated as simple averages. EU average includes 27 EU Member States. CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

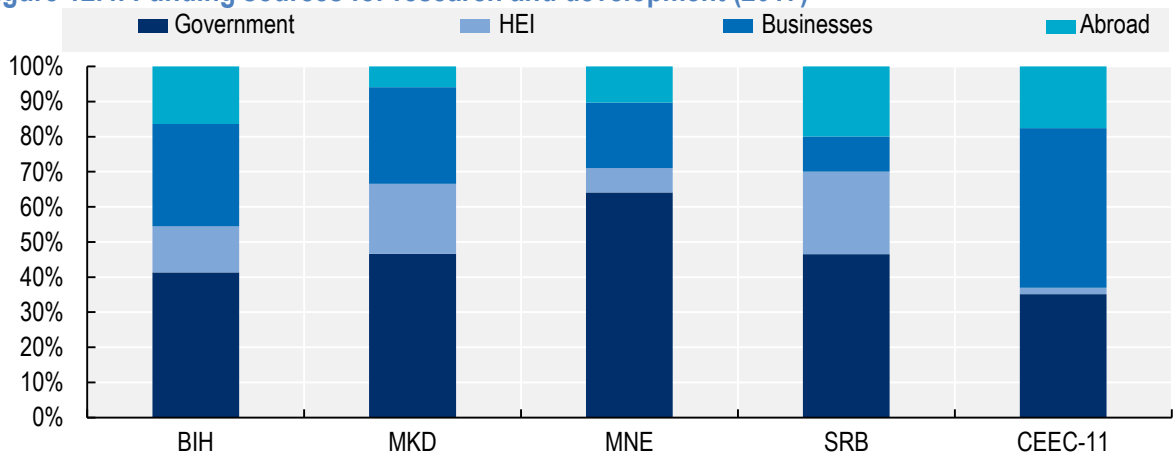
Source: (UIS, 2021[4]), *Science Technology and Innovation Database*, http://data.uis.unesco.org/; (Eurostat, 2020[5]), "Gross domestic expenditure on R&D (GERD) at national and regional level", https://ec.europa.eu/eurostat/data/database.

StatLink https://doi.org/10.1787/888934254221

R&D investment in the Western Balkans continues to be driven by the public sector, with activities concentrated in public centres and institutes, higher education institutions (HEIs), and government agencies. Company investment in research is only slowly gaining pace. Across the region, public sector investment (government and HEI) accounted for around two-thirds (65%) of overall GERD in 2017, compared to around one-third (37%) in the CEEC region. In contrast, private sector investment in R&D was around 20% on average across the region, which is less than half the CEEC average (Figure 12.4). This suggests an overall low capacity of firms in the Western Balkans to innovate, and limited appetite to invest in risky R&D.

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## Figure 12.4. Funding sources for research and development (2017)




Note: Data for Albania and Kosovo are unavailable. CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. HEI=higher education institutions.
Source: (UIS, 2021[4]), *Science Technology and Innovation Database*, http://data.uis.unesco.org/.

StatLink https://doi.org/10.1787/888934254240

Research output and quality remain subdued in the WB region, with the six economies significantly lagging behind CEEC peers for patent applications. Very few patents granted by the European Patent Office (EPO) or the United States Patent and Trademark Office (USTPO) originate in any of the WB6 (Table 12.2). Of the patent applications made to the EPO from the region (just over 100 between 2010 and 2019), fewer than half were granted, which suggests substantial shortcomings in the quality of research (EPO, n.d.[6]).

## Table 12.2. Patents granted, WB region and CEEC averages (2019)

| Number of patents | EPO | USPTO | CEEC-11 average EPO | CEEC-11 average USPTO |
|---|---|---|---|---|
| ALB | 0 | 1 | 61 | 121.9 |
| BIH | 0 | 3 | 61 | 121.9 |
| MKD | 1 | 0 | 61 | 121.9 |
| MNE | 0 | 1 | 61 | 121.9 |
| SRB | 6 | 27 | 61 | 121.9 |

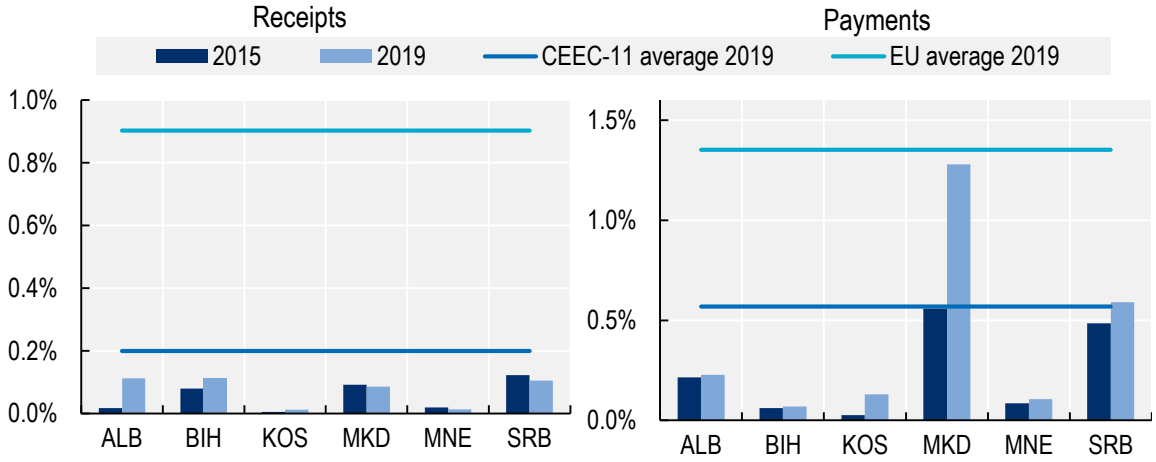
Note: Data for Kosovo are unavailable. CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. EPO: European Patent Office; USPTO: United States Patent and Trademark Office
Source: (EPO, n.d.[6]), *Patent statistics*, https://www.epo.org/about-us/annual-reports-statistics/statistics.html#data; (USTPO, 2019[7]), *Patent count by country of origin and type 2019*, https://www.uspto.gov/web/offices/ac/ido/oeip/taf/st_co_19.htm.

Figure 12.5 suggests that monetary returns on patents remain negligible. Receipts for the foreign use of domestic IP are less than half the CEEC average and significantly below the EU average. The gap in payments for foreign IP is also substantial, suggesting a low technology absorption and diffusion capacity of the Western Balkan economies compared to the EU. However, the gap with the CEEC region is narrowing.

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## Figure 12.5. Charges for the use of intellectual property, receipts and payments (2015 and 2019)

% of GDP



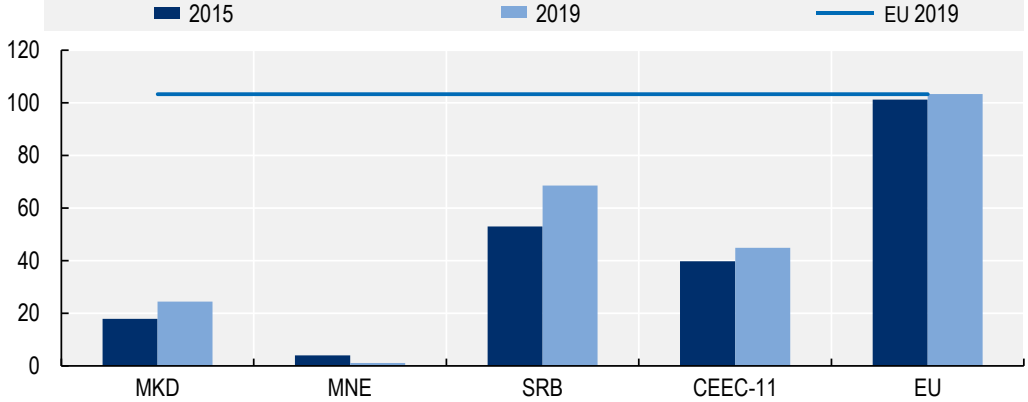

Note: Receipts include domestic inventions owed to foreign clients, payments include use of foreign inventions. EU average includes 27 EU Member States . CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (World Bank, n.d.[8]), *World Bank Development Indicators*, https://data.worldbank.org/.

StatLink https://doi.org/10.1787/888934254259

The WB economies are predominately service-oriented, and the limited ability of the region to innovate and leverage its innovation potential is evident when looking at high value-added exports. The share of knowledge-intensive service exports can be a robust indication of an economy's capacity to export services with a high level of value added, notably resulting from innovation, and to successfully take part in knowledge-intensive global value chains. Data for the economies participating in the European Innovation Scoreboard suggest that the WB region is catching up with, or exceeds in the case of Serbia, the performance of the CEEC region (Figure 12.6). This is mainly linked to the increasing importance of the information and communication technology (ICT) sector in the Serbian economy, with ICT service exports accounting for over 17% of total service exports in 2017, compared to 12.7% in the EU (World Bank, n.d.[8]). However, comparing the region's performance to the European average highlights the overall relatively weak performance in STI.

## Figure 12.6. Knowledge-intensive service exports, European Innovation Scoreboard (2020)




Note: Data indicate normalised performance of economies in 2019 relative to that of the EU in 2012. Data are unavailable for Albania, Bosnia and Herzegovina and Kosovo. EU average includes 27 EU Member States. CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (EC, 2020[3]), *European Innovation Scoreboard 2020*, https://ec.europa.eu/docsroom/documents/42981.

StatLink https://doi.org/10.1787/888934254278

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The following sections analyse in more detail the policy tools available to the Western Balkan economies to unlock their innovation potential and move towards a knowledge economy.

## STI system (Sub-dimension 9.1)

Science, technology and innovation is an inherently interdisciplinary area that covers a broad set of policy areas, including science and education, economic development, industrial policy and entrepreneurship. This makes the governance of STI complex as it requires a comprehensive strategic framework, clearly mandated implementation bodies, and attentive and consensus-driven cross-cutting co-ordination to ensure effective and impactful implementation. If poorly designed, the policy framework may create overlapping, insufficiently financed or even contradicting support measures, and leave gaps where support may be most needed. In the STI system sub-dimension, these aspects are assessed by looking at domestic STI strategies, including the overall strategic framework, its scope and implementation status, as well as the presence of a smart specialisation strategy. In addition, the sub-dimension includes a review of institutional frameworks, including implementation mechanisms such as innovation or science and technology agencies, the mandate and operational capacity of such bodies, and horizontal policy co-ordination efforts. The regulatory framework in which the STI system is embedded, including regulations on intellectual property protection, is also assessed.

Taking into account the increasingly important international dimension of STI, the analysis also includes policies and initiatives that support international collaboration, and further reflects on economies' capacity to implement effective STI policies by looking at the alignment of domestic STI priorities with EU STI policies. It also explores ways of incorporating EU good practice into domestic policies.

Across the STI dimension, the WB6 achieves the highest average score (2.4) for the STI system sub-dimension (Table 12.3). This score, however, remains relatively low, since relevant policies and mechanisms are formally in place in Serbia, Montenegro and North Macedonia, but remain nascent in the remaining three economies. Implementation of these policies in most WB6 economies is still at an early stage, and the full impact of the policy frameworks will only become evident in the years to come.

### Table 12.3. Scores for Sub-dimension 9.1: STI system

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| STI system | STI strategy | 2.8 | 1.3 | 1.3 | 2.5 | 3.5 | 3.5 | 2.5 |
| | Institutional framework | 1.8 | 1.2 | 1.5 | 2.8 | 2.5 | 4.0 | 2.3 |
| | Regulatory framework | 2.0 | 1.3 | 2.0 | 2.0 | 2.0 | 3.0 | 2.1 |
| | International collaboration | 1.8 | 2.0 | 2.0 | 2.5 | 2.8 | 3.0 | 2.3 |
| | Alignment with EU STI policies | 2.5 | 2.5 | 2.0 | 3.3 | 3.5 | 3.5 | 2.9 |
| **Sub-dimension average score** | | 2.2 | 1.7 | 1.8 | 2.6 | 2.9 | 3.4 | 2.4 |

### *STI policy frameworks are comprehensive and strategic in most economies, but implementation varies*

Innovation is a key driver of productivity, growth and well-being, and plays an important role in helping address core public policy challenges (OECD, 2015[9]). However, seizing the full potential of innovation remains a challenge for many economies. Therefore, an economy-level STI strategy that covers areas such as fostering academic excellence in basic and applied science, technology transfer, commercialisation, firm innovation and business-academia collaboration is essential for policy makers to harness innovation.

The need for a comprehensive domestic STI strategy has been increasingly recognised by most WB6 economies. Albania, Montenegro and Serbia have approved STI strategies that include clear objectives,

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action plans, key performance indicators and some level of monitoring and evaluation mechanisms. The strategies were designed following public consultations and reflect, to varying extents, feedback from relevant stakeholders. Since the last assessment, Albania also adopted the National Strategy of Scientific Research, Technology, and Innovation (2017-2022). The STI policy frameworks in Albania, Montenegro and Serbia include strategic cross-cutting themes related to brain drain, although key policy measures to tackle this increasingly evident trend are scarce. Some strategies also address elements of digitalisation, climate change and artificial intelligence, but only Serbia has adopted a dedicated strategy (in 2019) to address and develop artificial intelligence more comprehensively. For the other three WB economies, North Macedonia's strategic framework expired in 2020 and a renewed strategy is still under preparation. In Bosnia and Herzegovina, the complex governance structure means that STI policy making predominately falls under the responsibility of the entities and/or cantons, which results in an incomplete and fragmented policy framework. In Kosovo, where STI is governed through numerous high-level strategic frameworks, no progress has been made in developing a clearly defined STI strategy.

Good progress has been made by some economies in developing smart specialisation strategies (Box 12.2). Montenegro adopted such a strategy in 2019, followed by Serbia in 2020. Similar strategies are expected to be adopted in Albania and North Macedonia in 2021, which will further boost the STI framework in these economies. All economies have received support from the European Commission's Joint Research Centre to prepare their smart specialisation strategies and have greatly benefitted from its experience.

### Box 12.2. Smart specialisation in the Western Balkans

Smart specialisation considers the assets and resources available in economies, as well as their specific socio-economic challenges, and aims to identify competitive advantages and opportunities for growth. Smart specialisation leverages industrial, education and innovation policies to address a small number of priority sectors and technologies relevant for knowledge-based investment.

The concept of smart specialisation is still relatively new to economic development theory and was first initiated by the European Union. The smart specialisation process includes an in-depth feasibility assessment to identify and target the most competitive industries with innovation potential to accelerate economic growth.

Despite its huge potential, smart specialisation cannot be an alternative to a broader STI framework, but rather complements robust, holistic and impactful innovation policy actions.

Smart specialisation strategies as a tool in the EU accession process

The EU's strategy for the Western Balkans defines how smart specialisation can be used to boost entrepreneurship and innovation across the region. In 2017, the heads of government of all WB6 economies endorsed the Multi-annual Action Plan for a Regional Economic Area in WB. This encompasses economic development strategies based on knowledge and innovation and builds on EU experiences of smart specialisation.

Smart specialisation remains at an early stage in the region. However, with support from the European Commission's Joint Research Centre, which provides policy advice, methodological guidance, and implementation support, it is increasingly becoming a priority in the STI frameworks of the WB6.

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Montenegro was the first non-EU economy to adopt a smart specialisation strategy. Key areas identified include energy and sustainable environment, agriculture and food value chains, and sustainable and health tourism, with ICT as a horizontal priority. Serbia adopted its smart specialisation strategy in February 2020, with priority sectors including computer programming and ICT, agriculture (including high tech agriculture and agri-food production), machines and manufacturing systems (including Industry 4.0) and creative industries (including audio-visual production and smart packaging).

The smart specialisation process in both economies has mobilised over 1 600 stakeholders, including 450 representatives of the private sector involved in the entrepreneurial discovery process. In addition, 80 public administration representatives have been trained to build capacity and engagement.

Source: (EC, n.d.[10]), *Smart Specialisation Platform*, https://s3platform.jrc.ec.europa.eu/; (OECD, 2019[1]), *SME Policy Index: Western Balkans and Turkey 2019: Assessing the Implementation of the Small Business Act for Europe*, https://doi.org/10.1787/g2g9fa9a-en.

### *The institutional framework for STI policy implementation varies significantly across the region*

Inter-ministerial co-ordination remains weak in most economies, with significant impact on outcomes and efficiency of policy implementation. Serbia remains the top performer in this regard, with its Innovation Fund, operational since 2011, continuing to be a key vehicle for innovation policy implementation. It also established a Science Fund in 2019. In North Macedonia, support for the Fund for Innovation and Technological Development has increased substantially in recent years, but operational capacity remains below potential. In Montenegro, the Council for Innovation and Smart Specialisation, established in 2019, oversees the implementation of innovation policies, and the creation of a dedicated Innovation Fund is in the final planning stage. Albania lacks a clear co-ordination and implementation body, and its budget is insufficient. As a result, the Albanian SME Agency and the National Research Agency have been slow to implement comprehensive STI-related policy measures. Kosovo and Bosnia and Herzegovina have no dedicated agencies in place to support the implementation of STI policy. The Scientific Innovation Council of Kosovo oversees some aspects of STI policy, and there are plans in Republika Srpska to establish an Innovation and Science Fund.

### *Legal and regulatory frameworks are mostly in place, but could be better enforced*

STI is embedded in a solid legal and regulatory framework in all economies except Bosnia and Herzegovina, where only Republika Srpska and three cantons within the Federation of Bosnia and Herzegovina (FBiH) have adopted a legal framework (the FBiH science law has been pending adoption for several years). Montenegro and Serbia have put forward dedicated laws regulating the public financing of scientific or innovation activities, which provide the legal foundation for the Serbian Science Fund and forthcoming Innovation Fund in Montenegro, as well as a modern STI-enabling legal framework. However, despite some ambitious measures outlined in these laws, legal frameworks have not always been fully implemented.

Regarding intellectual property protection (IPP), nearly all economies have implemented reforms to align their IPP framework with the EU *acquis* since the last assessment. The European Commission's annual progress reports for the WB6 economies identified significant shortcomings in enforcing IPP, which has led the economies to raise awareness of the importance of patenting. Some economies, such as Kosovo, have strengthened the capacity of their IPP enforcement offices. However, further action will be needed to educate the research and business community about IP rights, build capacity and fully enforce international standards and practices.

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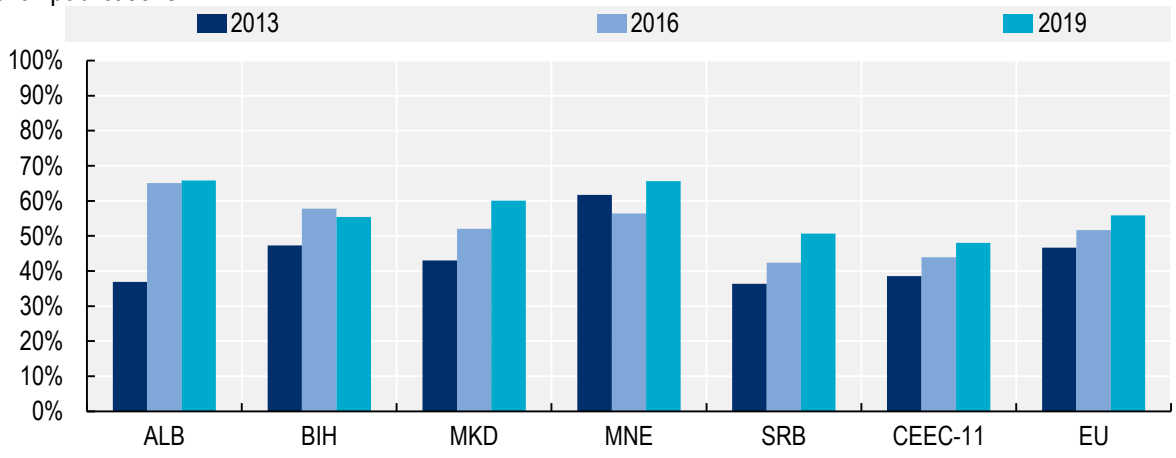
### *The region is well connected with international networks, and regional integration is gaining momentum*

International collaboration is recognised in most domestic STI strategic frameworks. Most economies provide financial support for participation in international conferences and fairs, as well as scholarships to mobilise international research co-operation, although these remain at a low level and are often not focused on identified priority areas. In addition, the region benefits from access to a diverse set of European and global research networks, including EURAXESS[2] (except Kosovo) and Eureka,[3] which Serbia, Montenegro and North Macedonia have joined as full members, while Albania and Bosnia and Herzegovina continue to maintain national information points. In line with their strategic frameworks, some economies, such as Albania and Serbia, are also increasingly focusing on outreach and collaboration with their diaspora (Box 12.5).

As a result, the number of international co-publications has grown substantially in the last decade, even outperforming some European peers (Figure 12.7). While this is encouraging, it remains unclear whether collaboration is predominately intra-regional or based on European or global co-operation.

**Figure 12.7. International co-publications originating from the WB6 (2013-2019)**

% of all publications




Note: Data for Kosovo are unavailable. Document ratio whose affiliation includes more than one economy address. EU average includes 27 EU Member States. CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (SCImago, 2020[11]), *SCImago Journal and Country Rank*, https://www.scimagojr.com/countryrank.php?region=Eastern%20Europe&year=2019.

StatLink https://doi.org/10.1787/888934254297

All six Western Balkan economies participate in and have received financial support from the EU's Horizon 2020 Programme.[4] However, the scope of activities under the framework varies significantly. Overall, the region has participated in over 706 research projects as part of Horizon 2020, receiving total funding of more than EUR 146.9 million. Serbia continues to attract the most projects (413) and overall funding (EUR 116.2 million in total); however, other economies, notably Kosovo and Montenegro, have picked up in recent years amid targeted measures to raise awareness about the programme and help with project applications (EC, n.d.[12]).

The need for deeper regional integration and research collaboration has been recognised in the economies and has gained traction in recent years. In 2017, the Montenegrin Government launched an initiative to establish the South East European International Institute for Sustainable Technologies (SEEIIST), which provides an important opportunity for intensified regional research integration. The need for a more regional approach to STI also prominently featured in the joint Action Plan for a Common Regional Market (Box 12.3).

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### *Alignment with EU STI policies remains a priority for all six economies*

The WB6 economies have committed to the priorities of the European Research Area:[5] 1) effective national research systems; 2) transnational co-operation and competition; 3) an open labour market for researchers; 4) gender equality in research; 5) circulation of scientific knowledge; and 6) international collaboration (EC, n.d.[13]). All economies except Kosovo participate in the European Strategy Forum on Research Infrastructures (EFSRI). Serbia adopted a national ESFRI Research Infrastructure Roadmap in 2018, and Montenegro revised its current roadmap in 2019. The research infrastructure roadmap in North Macedonia remains at the drafting stage, and in Bosnia and Herzegovina, only Republika Srpska has adopted a roadmap, while Albania has not started the preparation of a roadmap to date.

All economies are committed to open science, and open access initiatives are underway across the region. In 2019, nearly half of all publications were provided as open access resources (in line with the EU average), and up from less than one-third in 2010 (SCImago, 2020[11]).

#### Box 12.3. Towards regional innovation in the Common Regional Market

The following key findings of the CO 2021 STI system sub-dimension can inform implementation of the "regional innovation area" in the Common Regional Market (CRM) 2021-2024 Action Plan:

- There is no strategic approach in place to increase the regional integration of domestic STI systems, although some best-practice sharing exists, especially in areas related to STI implementation bodies such as innovation funds.
- As the design and implementation of smart specialisation strategies progresses, opportunities are increasing for knowledge exchange and the sharing of lessons learnt, particularly through collaboration with the EC's Joint Research Centre.
- Despite the potential opportunities, economies' research infrastructure roadmaps continue to focus on domestic levels or European Strategy Forum on Research Infrastructures initiatives, without considering a regional approach to research infrastructure.

### *The way forward for the STI system*

STI systems have advanced in most economies, but further efforts are needed to consolidate policy measures and ensure effective implementation. Policy makers should consider the following:

- **Complete the strategic framework.** In the economies with an advanced STI framework (Montenegro, Serbia, and to a lesser extent Albania and North Macedonia), the focus should be on enhancing implementation and monitoring and evaluating relevant policy measures. These economies should also prioritise the full adoption of smart specialisation strategies and ensure that they are well embedded in the broader STI framework. Bosnia and Herzegovina and Kosovo should focus on completing their strategic frameworks for STI.
- **Increase implementation capacity and co-ordination**. Increased ministerial co-ordination will ensure the smooth implementation of STI policies and the consolidation of financial support (see Box 12.4 for an example from Japan). Implementation agencies should be given clearly defined mandates to avoid overlap, and capacity building should be secured to ensure the mirroring of international best practice. Increasing the state budget allocation is positive but not sufficient, as it is important to first design efficient and effective policies.
- **Integrate STI policy development regionally, in line with the CRM action plan**. Regional integration is key to the long-term economic success of the region. Economies should identify further scope for collaboration, for example by creating cross-regional research infrastructure,

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through the cross-fertilisation of policy design and implementation, and by strengthening regional co-operation in international platforms.

- **Strengthen IPP enforcement**. The weak enforcement of intellectual property remains a major obstacle to STI development across the region. Efforts are needed to raise awareness of IPP, provide technical and financial support to facilitate patent applications, and build the capacity of enforcement agencies.

### Box 12.4. Co-ordinating innovation policy in Japan

Innovation has been a core driver of Japan's economic resurgence and sustainable growth. Under the auspice of the Prime Minister and Ministry of State for Science and Technology, Japan's Council for Science, Technology and Innovation oversees the planning and co-ordination of comprehensive basic science, technology and innovation policies, taking a bird's eye view of Japan's entire science and technology landscape. As a result, Japan's STI policy framework is based on three overarching pillars: 1) strategic formulation of overall governmental science and technology budget; 2) the Cross-ministerial Strategic Innovation Promotion Program (SIP); and 3) the programme on Impulsing Paradigm Change through Disruptive Technologies (ImPACT).

The Japanese government established the Cross-ministerial Strategic Innovation Promotion Programme (SIP) in 2014, spearheaded by the Council for Science, Technology and Innovation. Its aim was for the council to lead science, technology and innovation beyond the framework of government ministries and traditional disciplines. The SIP identified 11 themes addressing the most important social problems facing Japan, as well as contributing to the resurgence of the Japanese economy. Each research project is led by an experienced team who are responsible for end-to-end focused research and development, facilitating co-ordination among government, industry and academic entities, supporting their projects from basic research to practical application and commercialisation, and ultimately to a clear exit strategy.

The key features of the SIP programme include:

- projects selected by the Council for Science, Technology and Innovation based on competitive advantage and potential to address critical social needs
- cross-ministerial, multidisciplinary initiatives
- promotion of focused, end-to-end research and development, from basic research to practical application and commercialisation
- intellectual property management system facilitating strategic corporate use of research results.

The SIP programme has selected programme directors (PDs) to be responsible for each of the 11 individual programmes making up this government initiative. This strong, centralised implementation structure of the SIP has been vital for effective co-ordination between ministries and among industry, academia and government agencies.

Source: (Science Council of Japan, n.d.[14]), *About SCJ*, http://www.scj.go.jp/en/; (Government of Japan, 2017[15]) *What is Cross-ministerial Strategic Innovation Promotion Program (SIP)*, https://www8.cao.go.jp/cstp/panhu/sip_english/4-6.pdf.

## Public research system (Sub-dimension 9.2)

Research excellence provides the basis for knowledge creation and is fundamental for economies transitioning to a knowledge economy. Research and development can occur both in the public and private sector; however, typically public HEIs and public sector research and development institutes (RDIs) account for the overwhelming majority of R&D capacity in emerging economies. The management and

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performance assessment approach of HEIs and RDIs, and the mode of financing scientific research, are therefore critical aspects of the STI policy framework. Targeted measures to attract and retain academic researchers, particularly in areas of strategic importance, are also essential to strengthen human capital in research to produce high-quality scientific output.[6]

The public research system sub-dimension assesses these aspects based on the institutional structure for public research and through an analysis of the governance of HEIs and RDIs, including quality assurance and performance assessment. It assesses the impact of public research funding on research excellence and analyses approaches to funding scientific research. It also explores the available policy initiatives to strengthen human resources for research and innovation.

Overall performance in this sub-dimension is low, with an average score of 2.0. Serbia leads the way, followed by North Macedonia. Bosnia and Herzegovina and Kosovo continue to rank very low, with an average score of just above 1.0. This reflects the limited overall availability of funding for public sector research and the level of scientific output (Table 12.4).

### Table 12.4. Scores for Sub-dimension 9.2: Public research system

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Public research system | Institutional structure of the public research system | 1.5 | 1.3 | 1.5 | 2.3 | 2.5 | 2.5 | 1.9 |
| | Public research funding | 2.0 | 1.3 | 1.5 | 1.8 | 1.8 | 3.3 | 2.0 |
| | Human resources for research and innovation | 2.3 | 1.0 | 1.0 | 3.3 | 2.5 | 3.0 | 2.2 |
| **Sub-dimension average score** | | 1.9 | 1.2 | 1.3 | 2.5 | 2.3 | 2.9 | 2.0 |

### *Institutional structures are moving towards public research quality assurance*

The volume and quality of academic research in the Western Balkans remain low. Although scientific output has increased in the past decade in all economies, the productivity of researchers still underperforms many European peers. Efforts have been made to increase the quality and integrity of research outputs, although overall support for research excellence remains limited.

HEIs and RDIs in the WB6 are typically governed by a law on higher education or on research activities and are subject to regular reporting that is usually strongly focused on teaching. Independent evaluation is starting to be introduced in some economies, but overall remains ad hoc and without clear evidence of having a substantive impact on performance or approaches to research. In Bosnia and Herzegovina, research activities are further constrained amid fragmented competences within the institutional structure, while there is no comprehensive cross-entity accreditation system in place. Nevertheless, an increasing focus on creating quality assurance by fostering academic integrity in scientific research has become evident across the region. For instance, Montenegro's participation in the World Bank's Higher Education and Research for Innovation and Competitiveness (HERIC) project has led to reforms of the quality assurance system and the adoption of the Law on Academic Integrity in 2019. Similar efforts have been made in Albania and North Macedonia, where new agencies have been created to monitor quality in higher education. In all WB6 economies, HEI and RDIs benefit from a fair level of autonomy, with governments holding a minority representation (if any) in public universities. While this approach aims to ensure independent and transparent research, it limits governments' ability to introduce a strategic approach to public research in line with a domestic STI framework.

As mentioned above, all economies except Kosovo participate in EURAXESS, with HEIs and RDIs across the region having adopted its human resource strategy for researchers, which aims to harmonise human resource policies with the principles of the EURAXESS Charter and Code of Conduct.

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### *Public research remains chronically underfunded*

In most developed economies, public research funding consists of a combination of institutional "block" funding and competitive research grants. While block funding ensures funding security and long-term planning, competitive research grants can be used as a strategic policy tool to encourage impact-oriented research and prioritisation of areas of strategic importance (OECD, 2016[16]).

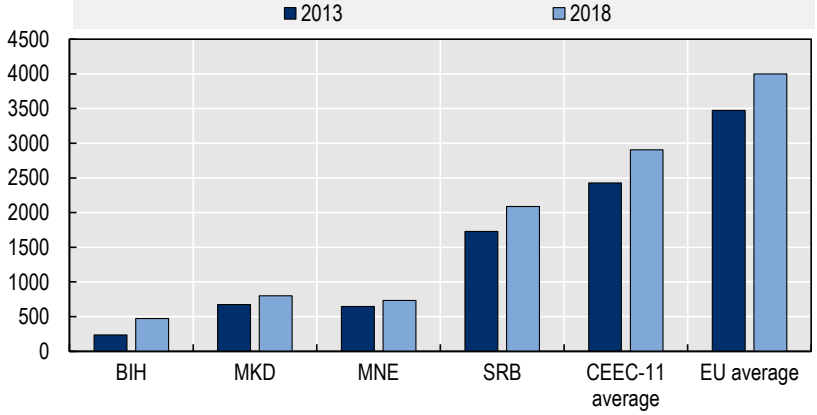
As discussed above, investment in R&D remains very low in the WB6 economies. However, an increased focus of public spending on scientific research has become evident in recent years, albeit often from very low levels, underlining the growing importance of this sector for governments across the region. In all economies except Serbia, where public research funding has traditionally been project-based, research is predominantly dependent on institutional block funding, with small-scale competitive research grants available for research-associated activities. In most economies, R&D is mainly performed in HEIs. These receive most of their public funding for teaching, with often extremely low levels of funding specifically allocated for R&D activities. Funding for teaching is typically based on numbers of enrolled students, but the methodology for awarding funding for R&D is not always clear.

Montenegro and Serbia have taken significant steps to reform their funding models for public research in recent years. In line with its revised legal framework and conclusions from the HERIC project, Montenegro adopted a new performance-based financing model for the University of Montenegro in 2018, which introduced more competitive funding schemes. In Serbia, the new legal framework envisages a clear shift towards performance-based institutional funding combined with targeted competitive grants available through the Science Fund. In North Macedonia, similar efforts to reform public research funding are under consideration following a feasibility study conducted during the previous CO assessment cycle.

### *Human resources in R&D are increasingly lost through brain drain*

The number of researchers (per 1 million inhabitants) steadily increased across all WB6 economies between 2013 and 2018, doubling in Bosnia and Herzegovina and growing at 18% on average in Montenegro, North Macedonia and Serbia. Nevertheless, significant discrepancies remain within the region, with the number of researchers (proportionally) the highest in Serbia and by far the lowest in Bosnia and Herzegovina (UIS, 2021[4]). All are well below the EU and CEEC-11 average (Figure 12.8). In addition, numbers have recently stagnated or even declined in some economies, suggesting increasing brain drain from the scientific research sector, which is becoming particularly evident in key areas such as medical and health (EC, 2020[17]).

**Figure 12.8. Number of researchers per million population (2013-18)**




Note: CEEC-11=Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia. EU average includes all EU Member States in 2013-20 period. Data for Albania and Kosovo are unavailable.
Source: (UIS, 2021[4]), *Science Technology and Innovation Database*, http://data.uis.unesco.org/.

StatLink https://doi.org/10.1787/888934254316

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All economies provide some level of support for research mobility, participation in conferences and research networks, and scholarships; however, these measures are often scattered and limited in scope and scale due to funding constraints. In addition, the focus of postgraduate programmes continues to be on teaching. Some economies offer technical support to help researchers complete patent applications and write proposals, as well as improve other technical skills, although these are often untargeted. All economies also participate in the Marie Skłodowska-Curie Actions (MSCA),[7] but with mixed results. As outlined in Table 12.5, Serbian researchers have benefitted most from the MSCA, having been awarded over EUR 7.7 million since 2014. In contrast, only three researchers from Kosovo have participated.

### Table 12.5. WB6 participation in the Marie Skłodowska-Curie Actions (2014-2020)

| | ALB | BIH | KOS | MKD | MNE | SRB |
|---|---|---|---|---|---|---|
| Number of researchers funded by MSCA | 32 | 41 | 3 | 30 | 12 | 246 |
| EU budget awarded (EUR million) | 0.08 | 0.98 | n.a. | 0.28 | 0.08 | 7.76 |

Source: (EC, n.d.[18]), *Marie Skłodowska-Curie Actions*, https://ec.europa.eu/research/mariecurieactions/msca-numbers_en.

Fostering research excellence is embedded as a strategic focus in the STI frameworks in Montenegro, North Macedonia and Serbia, which have taken steps to increase the attractiveness of research as a profession in recent years. Montenegro implemented a dedicated reform programme to increase human capital between 2018 and 2020, while North Macedonia has launched an initiative to support gender mainstreaming in the sector and is championing young researchers. In Serbia, the newly established Science Fund provides dedicated programmes to foster research excellence. Increasingly, economies are exploring opportunities to leverage their diaspora by facilitating exchange or joint research collaboration. For instance, in Albania there are plans to set up a digital platform to circulate research ideas, whereas in Serbia the Science Fund has launched a dedicated programme to facilitate collaboration with the diaspora (Box 12.5).

### Box 12.5. Integrating the diaspora into domestic scientific research activities

The international migration of skilled labour has long been considered an obstacle to economic development and building innovation capacity in the economies of origin. However, more recently the concept of turning “brain drain” into “brain gain” through more pro-active engagement with the skilled diaspora has gained momentum.

The resources that diaspora communities have are multi-dimensional, typically ranging from skills, knowledge and ideas to cultural capital, finance, and trade opportunities, and are therefore considered as important vehicles for development, particularly in transferring human capital and increasing innovation.

**The diaspora as a tool for the Western Balkans’ long-term economic prosperity**

For the Western Balkans, integrating its wide diaspora community can help unleash the region’s potential in STI. A good example is the Serbian Diaspora Collaboration Programme, launched by the recently established Science Fund in 2019. The programme provides financing to local RDIs to develop research collaborations with the Serbian diaspora and build their human resource capacity through short-term visits of researchers from Serbia to diaspora experts.

The aim of the programme is to establish scientific co-operation and knowledge exchange and widen the collaborative network between researchers from Serbia and their counterparts abroad. The programme supports basic and applied research in all research areas, without pre-defined priority topics. Within this framework, a pilot programme, Vouchers for Knowledge Exchange, was launched in

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2020. As part of this programme, 92 projects were awarded almost EUR 800 000 (up to EUR 10 000 per project). The programme involved the Serbian diaspora across 22 countries, ranging from EU Member States to Australia, The People's Republic of China and the United States. The vast majority of approved projects were submitted by Serbian HEIs and covered areas such as natural science, technology, engineering and medical science.

Source: (Agunias and Newland, 2012[19]), *Developing a Road Map for Engaging Diasporas in Development*, https://publications.iom.int/system/files/pdf/diaspora_handbook_en_for_web_28may2013.pdf; (Science Fund of the Republic of Serbia, n.d.[20]), *Science Fund of the Republic of Serbia homepage,* http://fondzanauku.gov.rs/?lang=en.

### *The way forward for the public research system*

Public research requires significantly more and better funding to fully exploit the region's potential for research excellence. Policy makers should consider the following:

- **Introduce a more balanced and strategic approach for public sector research funding, with a stronger emphasis on research outputs**. Economies should consider performance-based institutional funding coupled with regular self-assessments and external evaluations of public research institutions. Governments can encourage research in areas of strategic importance linked to business needs if they combine performance-based institutional funding with competitive project-based funding designed in line with international best practices (in particular regarding international peer review and independent expert selection bodies).
- **Promote scientific research as an attractive profession to develop human capital and counteract brain drain**. Public research systems across all WB6 economies require significant investment to create an attractive environment that fosters research excellence. Efforts are needed to increase the reputation of research and recognise it as an important profession, including through creating more opportunities for mobility.
- **Leverage diaspora linkages**. All WB6 economies have diaspora communities across the globe. The economies could leverage the expertise of these communities, including at the regional level, and encourage the transfer of knowledge through targeted internationalisation policies and financial support schemes (Box 12.5).

## Business-academia collaboration (Sub-dimension 9.3)

A strong partnership between the private sector and academia helps accelerate the value creation of innovation. Knowledge is created by researchers and adapted by industry, which develops practical applications in the shape of products and services. To optimise this process, research is ideally demand-driven and under constant review by the business community, which provides feedback on its viability for commercialisation. However, in reality, this approach implies several challenges. For example, academics may not have the time or knowledge to engage effectively with the business community, or they may not be sufficiently encouraged by their organisations to collaborate. Equally, while a researcher's priority may be to publish, businesses may be more focused on protecting IP as this enables commercialisation. Academics may further want to focus on meaningful research with societal benefits, while the business community may prioritise financial returns over the impact on society. For these reasons, the co-creation of innovations between business and academia is often subdued and requires involvement from policy makers. Through a "triple helix" approach, governments can gain valuable insights into the obstacles preventing full collaboration, which will help them design supportive measures to incentivise the transfer of knowledge and commercialisation (OECD, 2013[21]).

The business-academia collaboration sub-dimension analyses collaboration promotion frameworks and the availability and scope of incentives for business-academia collaboration. These incentives include

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innovation vouchers, competitive co-operative grants, tax, and procurement incentives; and non-financial incentives such as opportunities for professional exchanges with the business community, and evaluation of research and legislative incentives for commercialisation. This sub-dimension also assesses institutional support for business-academia collaboration by looking at the support infrastructure for business innovation and partnerships. Beyond incubators and accelerators, which typically cater to the needs of start-ups, this assessment includes science and technology parks (STPs), technology transfer offices and centres of excellence, which provide space and services for both researchers and the business community.

Overall, performance in this sub-dimension remains below potential for all WB6 economies due to the lack of targeted policies in this area. The average score shown in the Table 12.6. is just 1.6, which is the lowest for the entire STI dimension. As elsewhere, Serbia ranks the highest in this sub-dimension due to its comprehensive set of financial incentives and solid institutional support structure. It is followed by North Macedonia and Montenegro, with the remaining economies ranking at the lower end of the scoring.

**Table 12.6. Scores for Sub-dimension 9.3: Business-academia collaboration**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Business-academia collaboration | Collaboration promotion framework | 1.3 | 0.8 | 0.0 | 2.8 | 3.0 | 3.0 | 1.8 |
| | Financial incentives for business-academia collaboration | 1.0 | 1.0 | 1.0 | 2.8 | 2.0 | 3.3 | 1.9 |
| | Non-financial incentives for business-academia collaboration | 0.5 | 0.0 | 0.5 | 1.0 | 1.0 | 2.0 | 0.8 |
| | Institutional support for business-academia collaboration | 1.5 | 1.8 | 1.3 | 1.8 | 2.0 | 3.5 | 2.0 |
| **Sub-dimension average score** | | 1.1 | 0.9 | 0.7 | 2.1 | 2.0 | 3.0 | 1.6 |

### *The collaboration framework is weak, and academic research is rarely linked to business needs*

Support for business-academia partnerships must be carefully structured and implemented to overcome the barriers identified above. It should also aim to facilitate communication and co-operation and combine the market knowledge of entrepreneurs with the technology from academia.

Increasing ties between academia and the business community is recognised as a strategic priority for STI development across the region, but the overall collaboration promotion framework remains weak in most economies and is largely limited to awareness-raising activities. As a result, joint research by academia and the business community remains limited, as evidenced, for instance, by the low level of public-private co-publications in Montenegro and Serbia, which remains well below the EU average, according to the EU's Innovation Scoreboard (EC, 2020[3]).[8] Going forward, and aligned with the objectives of the respective STI frameworks, efforts are likely to focus on increasing financial measures to encourage collaboration and commercialisation, as well as strengthening the institutional support structure.

### *Financial incentives for collaboration are mostly limited in scope, size and predictability*

Many economies have been experimenting with financial incentives to foster innovation, although these often do not have a specific focus on collaboration between academia and industry. Small-scale innovation voucher schemes may support businesses to undertake initial exploratory projects with RDIs and test collaboration at a minimal risk. In contrast, co-operative grants provide more substantial support and usually require a rigorous selection process based on technological merit and commercialisation potential.

Among the WB6 economies, Serbia has the most comprehensive financing scheme to support business-academia collaboration. Its Innovation Fund has provided collaborative grants for joint technological projects since 2016, complemented by an innovation voucher scheme in 2017. Previously, in 2015 a technology transfer facility was established. In North Macedonia, the Fund for Innovation and

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Technological Development plans to develop a dedicated co-operative grant instrument. In Montenegro, a programme for funding innovative projects was successfully implemented between 2018 and 2020. In Republika Srpska, a small-scale programme is currently being piloted for promoting technology transfer and absorption and raising awareness of the potential of business-academia collaboration. In Albania and Kosovo, financial support has at times been made available through small-scale voucher schemes, although these predominately supported firm innovation. Many of these schemes in the WB6 economies have been dependent on donor funding, although the Serbian Innovation Fund and to a lesser extent North Macedonia's fund are increasingly co-financed domestically.

No economy implements specific procurement practices to encourage joint business-academia activities; however, the new Procurement Law in Serbia, adopted in 2019, introduces some elements of support for innovation. Tax incentives, where available, focus on ICT and other equipment to stimulate innovation. Only in Montenegro and Serbia do the governments offer tax breaks for businesses that employ qualified researchers.

### *Non-financial incentives for collaboration remain scattered*

The aforementioned support to provide scholarships and mobility schemes does not usually focus on fostering exchange with the private sector, and measures such as entrepreneurial leave of absence are non-existent. There is also no evidence of a systemic approach to evaluate researchers' performance based on private sector collaboration, which provides few incentives to actively seek partnerships. Finally, IP legislation does not favour collaboration or the commercialisation of research, as royalty splits and IP ownership between the individual researcher and the organisation obtaining a patent are not sufficiently nuanced.

### *An institutional support structure is emerging, but focuses on start-ups*

Some progress has been made in expanding institutional support for businesses-academia collaboration. However, there is often no systemic approach and efforts collide with broader policy measures to create an innovation ecosystem focusing on start-ups. Further efforts are needed to leverage the existing infrastructure to stimulate joint collaboration.

Serbia has the most advanced infrastructure in place among WB6 economies, notably through a strong network of science and technology parks (STPs). The number of centres of excellence has also expanded in recent years. In Montenegro, construction of its flagship STP in Podgorica is expected to be completed in 2021, and in North Macedonia a feasibility study for STP construction has been finalised. A number of STPs operate or are planned throughout Bosnia and Herzegovina, but these serve predominately as start-up incubators. However, the establishment of a competence centre for quality assurance in Mostar in 2019, with support from private investment from Slovenia, is a welcome step. In Kosovo, the support infrastructure is limited to a number of innovation centres. Among these, the Innovation Centre Kosovo has been instrumental in building the local start-up ecosystem. Increasing attention is also being given to the establishment of technology transfer offices, although their operational capacity remains limited. In Albania, efforts are underway to create a technology transfer office with EU support, while North Macedonia established such an office in 2018. In Montenegro, a technology transfer office was established as part of the new Centre of Excellence for Research and Innovation at the University of Montenegro.

### *The way forward for business-academia collaboration*

A more strategic approach is needed to encourage business-academia collaboration. Policy makers should consider the following:

- **Identify bottlenecks in the framework for business-academia collaboration.** A thorough analysis of the key obstacles, including financial support, the IP framework, evaluation criteria for

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researcher mobility schemes and the tax regime, should result in an action plan to systematically address shortcomings in the promotion framework for business-academia collaboration.

- **Raise awareness and communicate more about the opportunities of business-academia collaboration**. For instance, a platform could be provided through STPs for exchange and communication between researchers and the business community. This would help all parties to better understand different needs and requirements and identify opportunities for more collaboration.
- **Develop more focused and well-funded financial incentives.** Voucher schemes are under-used across most economies in the region and often focus more on broader innovation than specifically on collaboration between researchers and the industry. If coupled with awareness raising, targeted voucher schemes could serve as an effective tool to encourage firms to seek co-operation with academic researchers, as long as they are implemented consistently (not just as one-off events) and in line with international good practice.
- **Introduce collaborative grants in economies where voucher schemes have been tested.** As a follow-up, economies could consider introducing higher value co-operative grants (see Box 12.6 for an example from Israel). These should be implemented in line with international practice and follow clear assessment criteria that include international peer review and independent selection bodies. This will require significant operational capacity. In economies where such collaborative grants are already available, the focus should be on monitoring and evaluation, with adjustments made, when applicable, to maximise impact.
- **Leverage the increasing support infrastructure.** Governments should rationalise investments in large-scale infrastructure such as STPs and ensure that they serve as an effective platform to create linkages between research and businesses, rather than just incubators. Small-scale competency centres and well-staffed and experienced technology transfer offices, or a more regional approach to STPs, may be more cost efficient.

### Box 12.6. Enabling business-academia collaboration through Israel's Magnet programme

With the objective of stimulating greater co-operation between public sector research and the business community, Israel launched the large-scale Magnet programme to support pre-competitive R&D. The goal of the programme is to assist the development of generic technologies in areas in which Israeli industries may have a competitive advantage.

The programme is aimed at Israeli companies that are interested in developing innovative technologies which can be the basis for the advanced generation of products, and Israeli academic scientific or technological research groups seeking to promote applied research as part of a consortium with industry and to study market needs.

Magnet provides grants for R&D collaboration, thereby providing opportunities for businesses to collaborate either with peers or with academia. Magnet also specifically supports infrastructure technologies which enable the distribution of knowledge and co-operation between companies operating in the same field which otherwise may be difficult to achieve. Grants are provided for up to two-thirds of the costs of enterprises and up to 80% of the costs of scientific research contribution over a period of three years. The average funding per project is about USD 5-6 million.

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In order to apply for funding under the programme, members of the consortia have to sign an agreement, part of which promises all parties the rights to the intellectual property created by the consortium, and create a legal entity. Funding decisions are made by the Magnet Committee, taking into consideration criteria such as the level of co-operation between academia and industry, level of innovation of the proposed technology, market size and benefits to the local economy, amongst others. The simplicity of management and a competitive approach, as well as emphasis on co-operation, make this programme a very good example for strengthening R&D cooperation between academia and industry in Western Balkan economies.

Source: (Israel Innovation Authority, n.d.[22]), *MAGNET Consortiums*, https://innovationisrael.org.il/en/program/magnet-consortiums.

## Conclusion

The region is beginning to catch up with EU and CEEC peers in STI policy development, although significant discrepancies among the economies remain. All economies have recognised the economic importance of creating an innovation-enabling environment; however, policy measures are often focused on short-term impacts instead of creating the foundations of a knowledge economy. STI continues to be underfunded, although all governments have increased budget allocations in recent years, which is a promising sign.

Some economies, notably Montenegro and Serbia, have adopted international good practice in STI policy making in recent years. If implemented thoroughly and provided with sufficient financial resources and operational capacity, impact is expected to become evident in the medium term. Although an adequate policy framework has been in place for several years in Montenegro, renewed commitment is required to maintain momentum. In contrast, Albania, Bosnia and Herzegovina and Kosovo will need to significantly step-up efforts to create an environment conducive to STI.

Providing sufficient financial support for research and human capital development, as well as leveraging regional and European integration, will be critical for the long-term prospects of STI in the Western Balkans. However, if the region manages to successfully unlock the full potential of science, technology and innovation, this field can become a key vehicle for long-term economic prosperity and help to tackle brain drain.

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World Bank (n.d.), *World Bank Development Indicators*, World Bank, Washington DC, https://data.worldbank.org/ (accessed on 31 March 2021). [8]

## Notes

[1] The Central and Eastern European Countries (CEEC) are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] EURAXESS - Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated countries. It supports researcher mobility and career development and enhances scientific collaboration. (https://euraxess.ec.europa.eu/)

[3] Eureka is the largest intergovernmental network for cooperation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and innovation or offers advice, through various programmes (such as EUREKA Clusters, Globalstars, InvestHorizon). (https://www.eurekanetwork.org/)

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[4] Horizon 2020 is the EU's biggest framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument. (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020)

[5] European Research Area (ERA) is the ambition to create a unified research area open to the world, based on the EU Internal Market, that enables free circulation of researchers, scientific knowledge and technology. (https://ec.europa.eu/info/research-and-innovation/strategy/era_en)

[6] Scientific output is defined as number of documents published in a given year.

[7] Marie Skłodowska-Curie Actions (MSCA) is an EU programme which provides grants to support research careers and encourages transnational, intersectoral and interdisciplinary mobility. (https://ec.europa.eu/programmes/horizon2020/en/h2020-section/marie-sklodowska-curie-actions; https://ec.europa.eu/research/mariecurieactions/msca-actions_en)

[8] Montenegro had a score of 22.41 relative to the EU average in 2012, whereas Serbia had a score of 23.62.

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# 13 Digital society (Dimension 10)

The six Western Balkan economies (WB6) have long recognised the significance of the digital economy and society for strengthening ties and co-operation within the region and increasing convergence with the European Union. This chapter reviews their progress through five sub-dimensions: 1) access, which explores government policies and initiatives to enable network infrastructure investment and broadband services take-up and to increase data accessibility; 2) use, which asks whether governments have planned and implemented programmes to develop a user-centric digital government and to help businesses achieve a digital transformation; 3) skills, which examines whether governments are implementing policies to nurture a digitally skilled workforce and to support the growing ICT sector to underpin the development of the digital economy; 4) society, which asks whether governments have planned and implemented programmes to reduce the digital divide and create an inclusive society through digital technologies; and 5) trust, which examines the economies' frameworks and how they are being implemented to protect data and privacy, build trust in e-commerce and ensure cybersecurity through effective digital risk management systems. Each sub-dimension section makes specific recommendations for increasing the capacity and efficiency of systems for developing the digital society in the Western Balkans.

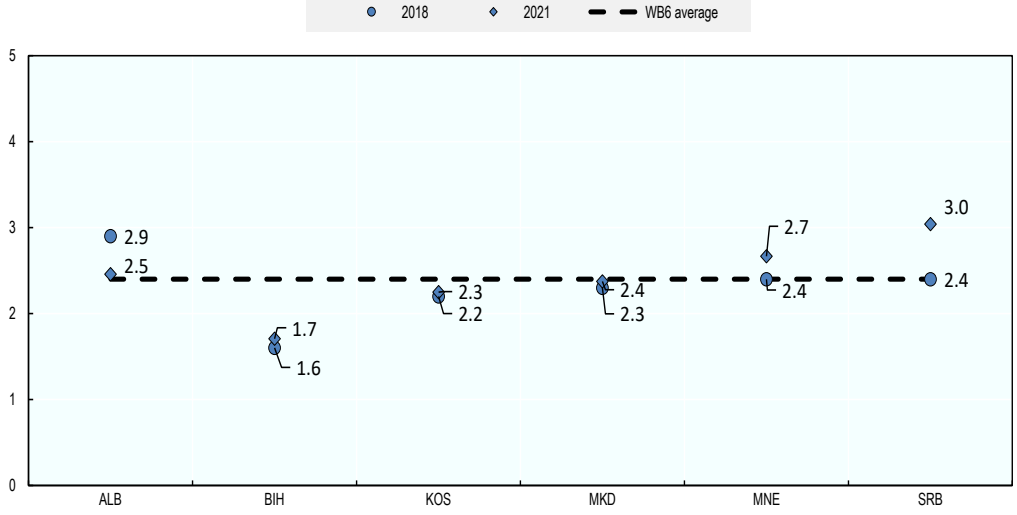
## Key findings

- **Albania, Kosovo, North Macedonia, Montenegro and Serbia have put together economy-wide broadband plans and significant donor financing to develop rural broadband infrastructure**. These donor-supported projects promise to connect every household and every public building with high-speed Internet, even in the most remote areas, in the next two to four years. Moreover, these five economies are making legal and regulatory reforms to enable private sector investments and cost reduction in network deployment.
- **All the WB6 governments are in the process of transforming their public administration into a user-centric public service through digital technologies, but progress has been stronger in Albania, Serbia, Montenegro and North Macedonia**. The economies are also making progress in promoting public sector data accessibility and transparency. However, the digital literacy of the population in some WB6 economies is still low (Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia), increasing the risk of a growing digital divide as over-the-counter services are replaced with online services.
- **All the economies recognise digital skills as a key competence in their education policies, but only Serbia has adopted a Digital Skills Strategy to close the skills gap**. Their governments have incorporated information technology (IT) subjects in education and training systems, but they are not co-operating sufficiently with the industry on curricula design. The COVID-19 crisis has exposed shortcomings in schools' information and communication (ICT) equipment, distance-learning platforms and IT training for teachers. Some of the WB governments (Kosovo, North Macedonia and Serbia) have responded quickly to improve the situation, but more efforts are needed.
- **All WB6 economies, except Serbia, provide insufficient support for business digitalisation and ICT sector growth**. While all the governments have implemented some legal reforms to improve e-commerce and e-business frameworks, only Serbia has implemented effective programmes to promote e-commerce and support the IT industry.
- **All the economies have legal frameworks in place for data protection and privacy, but enforcement is weak**. Although Kosovo, North Macedonia and Serbia have improved their alignment with the European Union's General Data Protection Regulation (GDPR), the WB economies have not ensured sufficient resources and executive power to the competent authorities to implement the framework, build public sector capacities and enforce compliance.
- **The WB6 economies now include measures to protect consumers using e-commerce in their legislation, but their legal frameworks are underdeveloped and opportunities for consumer education are limited**. The competent authorities for consumer protection in the WB6 do not sufficiently supervise and report on e-commerce. Only Serbia is implementing an operational programme for online consumer protection that advises citizens on their rights in e-commerce and how to exercise them.
- **All the WB6 economies are gradually aligning with the EU cybersecurity framework, but insufficient budgetary allocations continue to slow down progress**. All of the economies except Bosnia and Herzegovina have a cybersecurity strategy in place and an economy-wide computer emergency response team (CERT), but lack sufficient human and financial resources for implementation. There are few activities to raise awareness of digital security risks in the public and private sector.

## Comparison with the 2018 assessment

Since the last assessment, Serbia and Montenegro have made progress on developing the digital economy and society (Figure 13.1). Kosovo and North Macedonia have not made any notable improvement between 2018 and 2021. Bosnia and Herzegovina's score is essentially unchanged, but still the lowest of all the assessed economies. Albania's overall score has decreased slightly since 2018, mainly due to an observed slowdown in the trust sub-dimension, in ICT sector support and private sector ICT adoption, but it is still above the WB6 average.

### Figure 13.1. Overall scores for digital society dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Assessment methodology and process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

The previous assessment – the 2018 Competitiveness Outlook (OECD, 2018[1]) – made several recommendations to the WB6 economies for accelerating the implementation of their digital society policies (Table 13.1). Some progress has been made in introducing e-learning platforms and providing computers for students, mainly as a response to the COVID-19 crisis. However, low availability of high-speed Internet connections in schools and limited IT training for teachers remain key impediments to digital skills development. The skills gap continues to impact the labour market, deter business digitalisation, and slow down ICT sector growth. Progress has been strongest in reforming e-commerce frameworks, but support for digitalisation of small and medium-sized enterprises (SMEs) is still insufficient. Improvement has been more incremental in expanding broadband infrastructure and developing e-services for citizens, and support to allow underprivileged groups to benefit from the digital economy is weak. Monitoring and evaluation of digital inclusion is still underdeveloped. Although alignment of data protection frameworks with EU regulations is progressing, implementation is slow, while public sector capacities are still limited.

## Table 13.1. Implementation of the CO 2018 policy recommendations: Digital society

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 Policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Enhance the use of ICT for teaching and learning, as well as for developing e-skills for students and professionals.** | • There is low use of ICTs in education and teachers are poorly-trained or tech-shy.<br>• North Macedonia is implementing a massive teachers' training programme to enhance digital competencies for 25 000 teachers.<br>• The skills gap is still large and co-ordination with the labour market in curricula design is limited.<br>• The COVID-19 crisis forced WB governments to introduce distance learning tools for all education levels. Kosovo and Republika Srpska (RS) provided laptops to underprivileged students, Serbia and North Macedonia introduced learning management systems.<br>• Rural broadband connectivity projects have been launched in all WB economies except Bosnia and Herzegovina. The "Connected Schools" project in Serbia will connect every school in the coming years.<br>• Montenegro is the only WB economy that adopted a Digital Competence Framework in 2020 and is approaching the EU average computer-to-student ratio.<br>• Serbia is the only economy with a Digital Skills Strategy<br>• Serbia and Kosovo are implementing widespread digital skill training for the unemployed and women. | Moderate |
| **Prioritise the inclusion of underprivileged groups in digital strategies.** | • All WB6 economies except Bosnia and Herzegovina have adopted e-accessibility requirements for public sector websites, but implementation is limited.<br>• Digital government strategies promote replacing over-the-counter services with e-services, but only Albania provides hands-on support for e-applications to citizens<br>• Digital agendas and education strategies consider underprivileged groups in principle, but limited activities are funded.<br>• Broadband development policies and programmes promise to connect every household and public building in remote areas, but are still in the initial phase. | Limited |
| **Take steps to systematically respect privacy and data protection (PDP), especially in social media.** | • Only three economies (Kosovo, North Macedonia and Serbia) have updated their PDP frameworks to align with the GDPR, but regulations and implementation are still pending.<br>• PDP authorities continue to suffer from understaffing and challenges to their executive power and capacity to enforce the framework in the majority of the economies.<br>• Limited resources (or none) hinder public sector capacity-building activities on data protection and privacy. | Limited |
| **Promote the adoption of digital technology by SMEs.** | • Serbia and Montenegro are the only economies implementing programmes for digitalising SMEs, but Serbia's is having more impact.<br>• Only three economies (Montenegro, North Macedonia and Serbia) and the RS have updated their e-commerce frameworks.<br>• Some tax relief schemes are in place for purchasing software/hardware in Kosovo, North Macedonia and Serbia. | Limited |

## Introduction

Digital technologies and large-scale data flows fundamentally change how people live and work, interact with one another, participate in the economy, and engage with the government (OECD, 2019[2]). Digital society policies promote the exploitation of opportunities offered by digitalisation and are cross-cutting and diverse by nature. The variety of digital technologies already used in production, or coming in the near future (e.g., the Internet of Things and advanced robotics, industrial biotechnology, 3D printing, new materials and nanotechnology), are bringing about the "next production revolution". And as they transform

production and distribution of goods and services, they have far-reaching consequences for productivity, skills, income distribution, well-being and the environment (OECD, 2017[3]).

The WB6 have long recognised the significance of the digital economy and society for the region, for strengthening ties and co-operation within the region and increasing convergence with the European Union (EU) – ultimately making the Western Balkans fit for the Digital Age. The EU is supporting these efforts by including the Digital Agenda for the Western Balkans as one of the flagships of its strategy for the WB6 (European Commission, 2018[4]). The agenda describes the joint venture between the European Commission and the six Western Balkan economies to invest in broadband connectivity (i.e. deploying broadband infrastructure across the region through a total of EUR 30 million in EU grants under the Western Balkan Investment Framework); increase cybersecurity, trust and the digitalisation of industry; strengthen the digital economy and society; and boost research and innovation (European Commission, 2018[5]).

More recently, the leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan (AP) at the Berlin Process Summit on 10 November 2020 in Sofia. This action plan is to be implemented by the end of 2024 and includes commitments to implement actions in the priority Regional Digital Area. This will become the region's steppingstone for its integration into the pan-European digital area. But as the European Commission is determined to make this decade Europe's "Digital Decade", setting ambitious targets for 2030 to empower businesses and people in a human-centred, sustainable and more prosperous digital future, the WB6 need to accelerate their efforts if they are to catch up, perhaps more than in any other policy domain, to seize the opportunities lying ahead (European Commission, 2021[6]).

This policy domain spans from electronic communications and broadband infrastructure to digital security, and from digitalisation of public administration and services, education, and businesses, to the empowerment of citizens with digital skills and the promotion of the ICT sector to enable innovation and employment opportunities. As digital trends penetrate every policy domain to some extent, the digital society chapter links with almost every other chapter. The closest links are with the following chapter themes:

- **Chapter 10. Education policy** promotes digital skills development and the integration of digital technologies for enhanced teaching and learning at all levels of the education system. It also exploits and depends on information systems and digital tools to provide synchronous (live) and asynchronous (recorded) online learning and life-long learning opportunities. Education policy can shape the outcomes of the digital transformation and ensure that benefits are equally shared among and within countries' populations (OECD, 2019[7]).
- **Chapter 11. Employment policy** seeks to minimise the gap between skills developed during education and those demanded by employers. The digital economy adds another consideration for employment policy makers, as digital skills, on top of any other expertise needed for a job, can help workers easily adapt to a digitalised workplace. Workers without these skills are most likely to bear the costs of digital transformation (OECD, 2019[7]). In the near future, 90% of jobs will require some level of digital skills (European Commission, 2016[8]).
- **Chapter 12. Science, technology and innovation** drive growth and digitalisation is the most significant vector of innovation in firms, science, and governments. In 2015, at the OECD Ministerial Meeting in Daejeon (Korea), the ministers from OECD countries and partner economies recognised that digital technologies are revolutionising science, technology and innovation (STI) (OECD, 2020[9]). But the digitalisation of STI creates short- and long-term policy challenges, creating the need to align innovation policies with digital society policies.
- **Chapter 19. Anti-corruption policy** is strongly linked to the process of digitalising public administration as it enhances transparency and accountability (OECD, 2019[2]). Open data policies can allow for increased public engagement and improve public governance.

## Assessment framework

### *Structure*

This chapter assesses digital society policies in the WB6 through five broad sub-dimensions:

1. **Sub-dimension 10.1: Access** assesses the implementation of high-quality broadband infrastructure and the respective policy framework; analyses whether a regulatory framework is in place to ensure a level playing field in the ICT sector to promote competition and infrastructure investments; and examines whether a framework for data accessibility is in place.
2. **Sub-dimension 10.2: Use** analyses digital government policy development and implementation to assess the digital transformation of governments and the public sector. It also examines private sector ICT adoption to assess how policies promote the use of digital technologies as a growth enabler in firms.
3. **Sub-dimension 10.3: Jobs** explores how digital skills for students are promoted to equip them to benefit from digitalisation and contribute to the digital economy. It also examines whether a policy framework for digital skills for adults is in place and supports lifelong learning systems effectively and overall labour market adaptability. It measures the coherence of policies for ICT sector promotion, their implementation and their outcomes.
4. **Sub-dimension 10.4: Society** evaluates whether a digital inclusion framework has been adopted to overcome the exclusion of socio-economically marginalised groups. It also assesses if targeted policy actions have been implemented and monitored and adjusted in order to adapt technological developments and their impact on socio-economic groups.
5. **Sub-dimension 10.5: Trust** looks at whether the policy framework for privacy protection is based on a robust regulatory and enforcement framework that sufficiently adapts to ever-evolving threats to personal privacy. It also assesses whether a legislative and institutional framework is in place to protect consumers in e-commerce and examines whether an economy-wide framework for digital security risk management has been adopted and implemented to mitigate risks and increase trust in the digital environment, thus fostering the uptake of digital services.

All five sub-dimensions are based on the OECD's Going Digital Integrated Policy Framework (see Box 13.1). The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. Figure 13.2 shows how sub-dimensions and their indicators that make up the digital society dimension assessment framework. For more information on the methodology, see the Assessment methodology and process chapter.

## Figure 13.2. Digital society dimension assessment framework

| Digital society dimension | | | | |
|---|---|---|---|---|
| **Outcome indicators**<br>1. Fixed broadband penetration<br>2. Percentage of individuals with basic or above basic overall digital skills<br>3. ICT task intensive jobs as % of total employment | | | | |
| **Sub-dimension 10.1**<br>Access | **Sub-dimension 10.2**<br>Use | **Sub-dimension 10.3**<br>Jobs | **Sub-dimension 10.4**<br>Society | **Sub-dimension 10.5**<br>Trust |
| **Qualitative indicators**<br>1. Broadband infrastructure<br>2. Regulatory policy framework<br>3. Data accessibility | **Qualitative indicators**<br>4. Digital government<br>5. Private sector ICT adoption | **Qualitative indicators**<br>6. Digital skills for students<br>7. Digital skills for adults<br>8. ICT sector promotion | **Qualitative indicators**<br>9. Digital inclusion policy | **Qualitative indicators**<br>10. Privacy protections<br>11. Consumer protection in e-commerce<br>12. Digital security risk management |
| **Quantitative indicators**<br>1. Fibre broadband connections per 100 inhabitants.<br>2. Mobile broadband connections per 100 inhabitants<br>3. Households with computer access at home<br>4. Households with Internet access at home | **Quantitative indicators**<br>4. Internet users as a share of individuals<br>5. Share of firms making e-commerce sales in past 12 months<br>6. Share of individuals using the Internet to connect with public authorities | **Quantitative indicators**<br>7. Computer-to-student ratio<br>8. Schools connected to the Internet<br>9. Enterprises that provided ICT training to their personnel | **Quantitative indicators**<br>10. Households without Internet at home due to lack of skills<br>11. Households without Internet access at home due to high access costs | **Quantitative indicators**<br>12. Enterprises that defined or reviewed their ICT security policy in the last 24 months |
| **OECD Instruments**<br>*Going Digital Integrated Policy Framework*<br>Policy dimension "Access" | **OECD Instruments**<br>*Going Digital Integrated Policy Framework*<br>Policy dimension "Use" | **OECD Instruments**<br>*Going Digital Integrated Policy Framework*<br>Policy dimension "Jobs" | **OECD Instruments**<br>*Going Digital Integrated Policy Framework*<br>Policy dimension "Society" | **OECD Instruments**<br>*Going Digital Integrated Policy Framework*<br>Policy dimension "Trust" |

The CRM Action Plan (mentioned above) is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area.

In the regional digital area, the WB6 economies commit to closely align rules and regulations with the core principles governing the pan-European digital area by providing broadband access to all, aligning with EU Digital Single Market, reducing roaming costs, promoting digital upskilling, and reskilling, improving data protection, privacy and mutual recognition of trust services across the region.

The regional digital area of the CRM 2021-24 AP includes the following four components: 1) digital infrastructure and connectivity; 2) digital skills and competence; 3) digital economy in the era of new ICT technologies; and 4) trust and security. The findings in this chapter on the access, jobs, use and trust sub-dimensions can inform the implementation of these four components (Box 13.3, Box 13.6, Box 13.8 and Box 13.12).

### *Key methodological changes to the assessment framework*

Since the 2018 assessment, several changes have been introduced to the assessment framework (Figure 13.2). The 2021 assessment now mirrors the OECD's Going Digital Integrated Policy Framework (Box 13.1) and includes five sub-dimensions instead of the four in the CO 2018. New indicators have been included, such as data accessibility and digital government, while other previously examined indicators, such as digital strategy, e-health strategy, e-commerce law and e-authentication framework, are now assessed as integral parts of sub-dimensions such as *use* and *trust*. Thus, the 2021 assessment distinguishes between *access* and *use* of digital technologies, splitting the previously merged sub-dimension into two. It also splits the *digital empowerment* sub-dimension in CO 2018 into the *use* and *society* sub-dimensions, where *society* is mainly focused on digital inclusion. Finally, *e-commerce and e-business*, topics of the third sub-dimension in the previous assessment, are now examined under the *use* and the *jobs* sub-dimensions, where the uptake of e-commerce is a measure of firms' digitalisation and a driver that accelerates ICT sector growth and increases its contribution to the digital economy.

#### Box 13.1. The OECD's Going Digital Integrated Policy Framework

The digital society dimension's assessment framework mirrors policy dimensions of the OECD Going Digital Integrated Policy Framework, developed by the OECD as a key output of the OECD Going Digital project, and published in February 2020:

**Sub-dimension 1: Access** reflects the framework's *Access* policy dimension which demonstrates the importance of access to high-quality communication networks and services at competitive prices as foundation of digital transformation.

**Sub-dimension 2: Use** is based on the *Use* policy dimension of the framework. It emphasises the significance of widespread and effective use of digital technologies and data for development of a digital society.

**Sub-dimension 3: Jobs** mirrors the framework's *Job* dimension, which suggests that policies in place should assure that digital transformation leads towards creating more and better jobs.

**Sub-dimension 4: Society** is based on the *Society* dimension of the framework, according to which digital transformation needs to work for inclusive societies.

**Sub-dimension 5: Trust** reflects the framework's *Trust* policy dimension. It highlights the necessity for the actors of digital transformation (governments, individuals, businesses…) to be confident that engaging in digital environment brings more benefits than downsides, in order to fully embrace and benefit from digital society.

Source: (OECD, 2020[10]), *Going Digital integrated policy framework*, https://doi.org/10.1787/dc930adc-en.

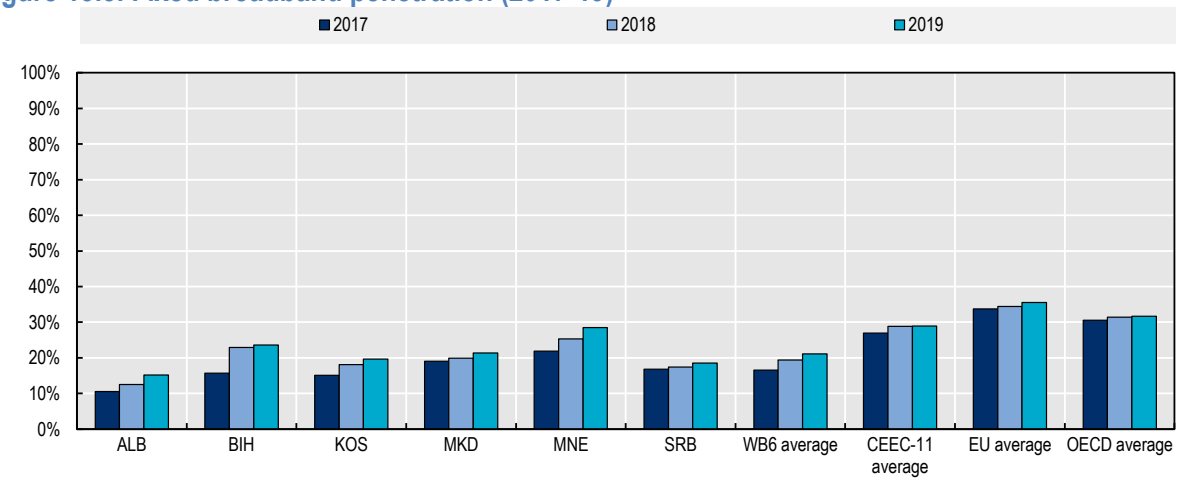
## Digital society performance and context in the WB6

Outcome indicators play a key role in examining the effects of policies and they provide vital information for policy makers to evaluate the effectiveness of existing policies and the need to design new ones. The outcome indicators selected for the Digital Society dimension (Figure 13.2) are designed to shed light on the WB6 economies' performance in terms of broadband development and digital literacy of the population and to indicate the demand for highly skilled ICT professionals in the labour market. This section draws on those outcome indicators.

The assessment indicates that WB economies are still lagging behind EU and OECD economies in fixed broadband penetration, which refers to the number of broadband subscriptions per 100 inhabitants,

including households and enterprises (Figure 13.3). Montenegro is most advanced, while Albania has the lowest penetration of broadband subscriptions in the region. This indicator demonstrates that although broadband development policies have supported (or at least enabled) a steady increase in broadband penetration since 2017, in most cases, the trend is not steep enough to reduce the gap with more developed countries.[1] The Regional Cooperation Council has encouraged the Western Balkan economies to collect data on the new Digital Economy and Society Index (DESI) indicators,[2] which offer additional information on broadband connectivity. For example, the Broadband Competence Office in North Macedonia reports that in 2019, although fixed broadband take-up (i.e., percentage of households with broadband connections) was 70.9%, close to the EU average (77.6%), fast broadband take-up in households was only 21.6%, significantly lagging behind the EU average (48.7%).

## Figure 13.3. Fixed broadband penetration (2017-19)



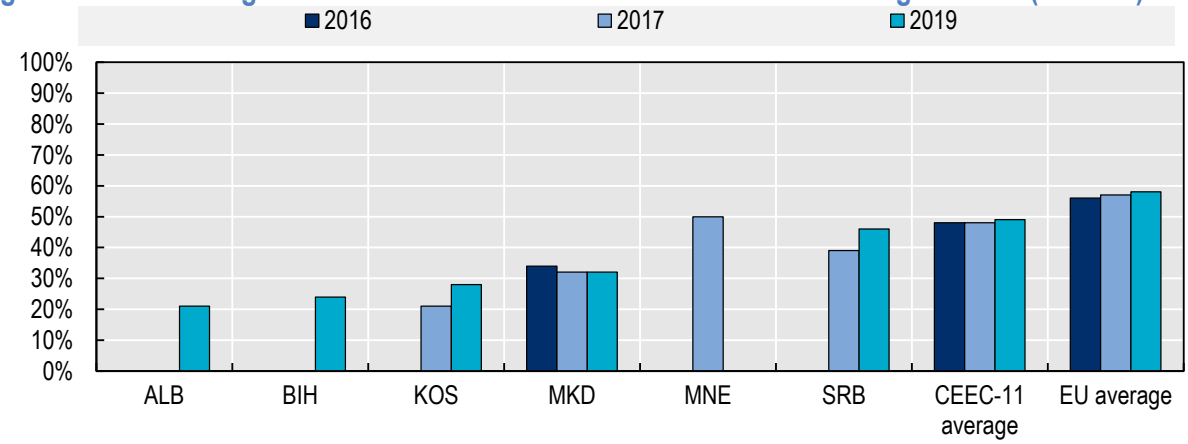

Note: OECD and EU averages are calculated as simple averages. EU includes all EU Member States in 2013-2020 period. CEEC-11 countries are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.
Source: ARKEP (n.d.[11]) (Kosovo) and International Telecommunication Union, retrieved from the World Bank (2021[12]), http://data.worldbank.org/indicator/IT.NET.BBND.P2

StatLink https://doi.org/10.1787/888934254335

The WB6 economies' performance on digital skills development among the population varies significantly (Figure 13.4). Although digital literacy has increased in Montenegro and Serbia since 2018, closely following the CEEC-11 economies,[3] the other WB6 economies have not yet put in place policies and programmes to close the digital skills gap effectively, allowing the digital divide to grow and depriving the population of the opportunity to seize the benefits of digitalisation.

WB6 industry stakeholders agree that skilled ICT professionals are in high demand in the region to support ICT sector growth and firms' digitalisation. They also highlight the digital skills' gap between education and training systems and labour market needs. Data on the percentage of ICT specialists employed as a total of all employed in the WB6 are only available for Montenegro, North Macedonia and Serbia. Data for those three economies show that Serbia has the highest share of ICT professionals, amounting to 2.6% of total employed persons in 2019, while North Macedonia follows with 1.9% and Montenegro with 1.8%. In comparison, the CEEC-11 and EU averages were 3.6% and 3.9% respectively.

### Figure 13.4. Percentage of individuals with basic or above basic overall digital skills (2016-19)




Note: EU includes all EU Member States during the 2013-20 period. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia. Data for 2018 are unavailable.
Source: Eurostat (2019[13]), "Individuals' level of digital skills", https://ec.europa.eu/eurostat/databrowser/view/isoc_sk_dskl_i/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254354

## Access (Sub-dimension 10.1)

High-quality access to communications networks and services at competitive prices is fundamental for the digital transformation and similarly, access to data is vital as a driver of economic activity and innovation (OECD, 2019[2]). The EU's Digital Strategy notes that "European technological sovereignty starts from ensuring the integrity and resilience of our data infrastructure, networks and communications" (European Commission, 2020[14]). Thus, public policies for access and the underlying legal and regulatory framework ensure that continued investment in communication networks and increased uptake of broadband services underpin the adoption of digital technologies, including cloud computing, Internet of Things, artificial intelligence and more.

Overall, four of the six WB economies (Albania, Montenegro, North Macedonia and Serbia) are performing well in this sub-dimension, with Kosovo following closely behind. Bosnia and Herzegovina is still working on the improvement of its policy and regulatory framework for increasing access (Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework). Most of the progress made during this assessment period can be traced back to the adoption and implementation of programmes that support rural broadband development in all economies except Bosnia and Herzegovina. The assessment also indicates that the WB6 economies are still in the initial phase of preparing and implementing a data accessibility framework to support data openness and transparency, lowering the overall scores in this dimension.

### Table 13.2. Scores for Sub-dimension 10.1: Access

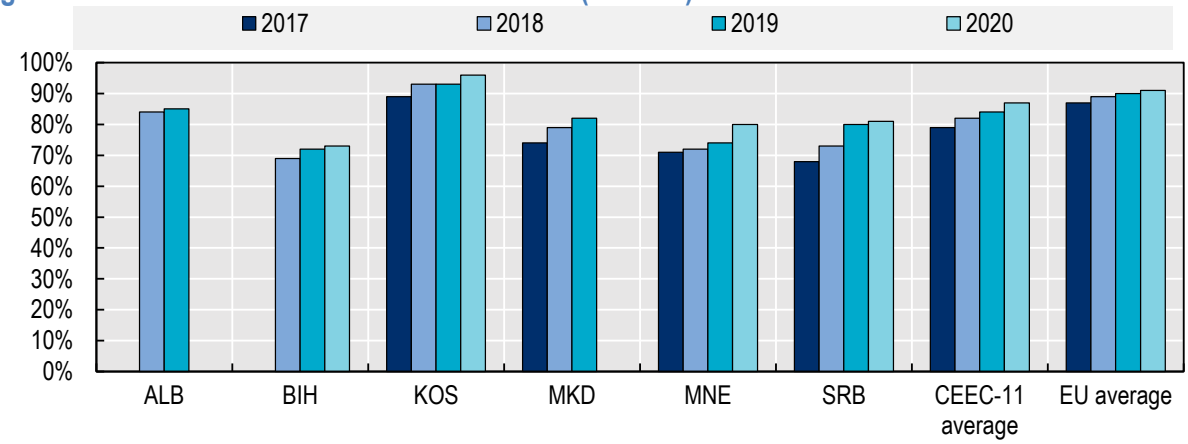
| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 10.1: Access | Broadband infrastructure | 3.5 | 2.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.3 |
| | ICT regulatory policy framework | 3.5 | 2.0 | 2.5 | 3.5 | 3.5 | 2.5 | 2.9 |
| | Data accessibility | 2.5 | 1.5 | 2.5 | 3.0 | 2.5 | 3.0 | 2.5 |
| **Sub-dimension average score** | | 3.2 | 1.8 | 2.8 | 3.3 | 3.2 | 3.0 | 2.9 |

### *Broadband infrastructure development is supported by plans to invest in rural area networks*

As more people and businesses go online, developing reliable, high-quality broadband infrastructure underpins an economy's digital transformation. Extending broadband infrastructure to rural areas is essential to guarantee universal access and to provide all citizens with the opportunity to benefit from the digital economy. This section assesses whether an effective broadband infrastructure policy framework is in place and how it promotes private sector investments in high-speed communications infrastructure and accelerates the uptake of broadband services.

All WB6 economies have made progress in broadband take-up since 2018, as reflected in the data for internet access in households (Figure 13.5). Kosovo had the highest household access in the region in 2020 (96%), exceeding the EU average (91%). The other WB economies are closely following the performance of the CEEC-11, except for Bosnia and Herzegovina, which is falling behind (73% in 2020).

**Figure 13.5. Internet access in WB6 households (2017-20)**



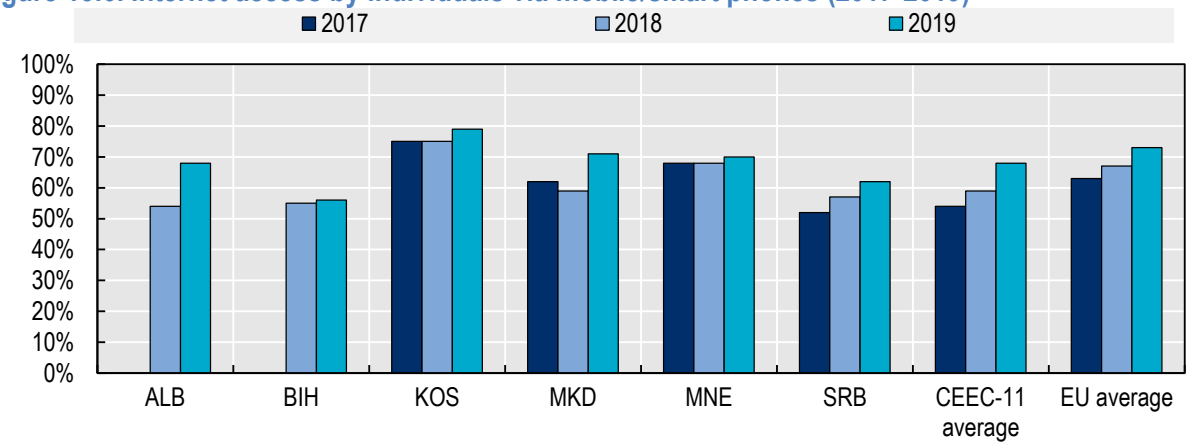

Note: The EU average represents data for EU-28 for the period 2017-19 and the EU-27 estimate for 2020. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, 2020[15]), "Households - level of internet access", https://ec.europa.eu/eurostat/databrowser/view/isoc_ci_in_h/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254373

Internet access via a mobile (smart) phone is also higher in Kosovo (79%) than in the other Western Balkan economies and was above the EU average (73%) in 2019 (Figure 13.6). This could be linked to Kosovo having the youngest population in Europe, who increasingly depends on mobile devices. Use of mobile phones for Internet access is the lowest in Bosnia and Herzegovina and Serbia, the only economies below the CEEC-11 average.

Positively, all Western Balkan economies except Bosnia and Herzegovina have adopted a strategy or broadband development plan going to 2023 or beyond, and are already implementing it. They have leveraged donor support from the Western Balkan Investment Framework (WBIF),[4] the European Bank for Reconstruction and Development (EBRD), or the World Bank through grants for feasibility studies to identify appropriate models of rural broadband development, and through multi-million euro loans to co-finance private sector investment in underserved areas. Legislative reforms are also underway in these five Western Balkan economies to improve the framework for facilitating network infrastructure investment, to align state-aid rules with the EU framework for rapid development of broadband networks, and to reduce the cost of these deployments (e.g., by drafting the law to transpose the Broadband Cost Reduction Directive 2014/61/EU). Bosnia and Herzegovina is in the process of finalising its broadband strategy, which was drafted with contributions from competent bodies from all levels of the government and can be expected for adoption in 2021.

### Figure 13.6. Internet access by individuals via mobile/smart phones (2017-2019)




Note: EU includes all EU Member States in the 2013-20 period. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, 2019[16]),"Individuals - mobile internet access", https://ec.europa.eu/eurostat/databrowser/view/isoc_ci_im_i/default/table?lang=en

StatLink https://doi.org/10.1787/888934254392

Broadband infrastructure mapping has also progressed in the WB6. The same five economies have implemented the initial infrastructure mapping phase activities and are gradually adding layers of information over georeferenced applications. Bosnia and Herzegovina, on the other hand, is yet to make a broadband mapping application available to relevant stakeholders. The WB6 are also jointly implementing the Digital Balkan Highway project, with support from the World Bank, to investigate whether it is possible to improve regional interconnectivity and increase access to the Internet by establishing a regional broadband Internet infrastructure over the transmission grids of state-owned energy companies.

### *The ICT regulatory policy framework is coming into line with the EU Electronic Communications Code*

The ICT regulatory policy framework plays a pivotal role in maximising the benefits of the digital transformation for the economy and society. Regulation can enable investment in infrastructure, promote innovation, and safeguard competition and consumer protection, if carefully applied (OECD, 2012[17]). This assessment measures whether an ICT regulatory policy framework has been adopted and implemented and whether its impact on society and economy is monitored.

Three out of the six WB economies (Albania, Montenegro and North Macedonia) are performing well on this indicator, having completed alignment with the EU 2009 regulatory framework and now implementing it. The other three have not yet updated their legislation to ensure financial and operational independence of their telecommunications' regulatory authorities, which continue to be financed from the state budget. The WB6 economies signed a regional roaming agreement in April 2019, which entered into force in July 2019. Since then the economies have gradually implemented cost reductions on roaming charges within the region, with calls becoming up to eight times cheaper and costs for data dropping on average from EUR 3 per megabyte to EUR 0.20. The agreement leads to the creation of a roaming free region by 1 July 2021 and dialogue has already started with the EU on reducing WB-EU roaming charges. WB citizens pay four times more than EU citizens for the same service due to these roaming costs, a significant burden that cannot be traced to market conditions.

The majority of the WB6 have made improvements to the existing framework to enable investment in communications networks and quality services. For example, Albania (in 2016) and North Macedonia (in 2019) updated their laws on electronic communications to transpose the EU Cost Reduction Directive (i.e., Directive 2014/61/EU on measures to reduce the cost of deploying high-speed electronic communications

networks). Others, like Kosovo, Montenegro, and Serbia, have prepared a new draft of the law to implement cost reductions, due for adoption in 2021.

The WB6 are progressing at different speeds towards their alignment with the EU Electronic Communications Code (EECC) (Directive (EU) 2018/1972). The EECC promotes 5G rollouts and co-investment in very high-capacity networks. It also aims to the separate incumbent operators in distinct wholesale and retail arms, and covers Internet-based services (not previously covered by electronic communications regulation) and improved spectrum management. It is complemented by various directives and regulations, including the e-Privacy Directive, the Telecoms Single Market Regulation, the Roaming Regulation, and the Radio Spectrum Decision. All WB6 economies are looking into further adaptation of their legal and regulatory framework on electronic communications to align with the key elements of the EECC. Serbia and Bosnia and Herzegovina are both preparing a new draft law on electronic communications that will improve their frameworks' alignment with the EECC, although it is still uncertain whether it will completely align with the 2009 regulatory framework.

5G development in WB economies is in the initial phase, but governments in the region are starting to prepare for future 5G rollouts. For example, Montenegro adopted a new radio frequency plan in 2020 to implement the decisions of the World Radio Communication conference (WRC-19). Both Albania and North Macedonia have included 5G rollout targets in their economy-wide broadband plans. Albania has put forward a 5G Strategy (i.e., a roadmap document by the line ministry) to set the process in motion, particularly in freeing up the low-band spectrum for 5G. It issued a test license to one operator in 2019. Serbia has already issued pilot 5G licenses and launched the first test base stations. It also signed an agreement with Bulgaria and Greece to test a 5G cross-border corridor. Kosovo recently started to connect communications towers with fibre optics and 5G-ready equipment. Bosnia and Herzegovina was the last economy in the region to award 4G licences (in March 2019), so the 5G roadmap is expected to take longer than in the other WB6 economies.

The WB6 telecoms regulators are well staffed, collect data regularly and publish reports on the electronic communications market. Three of the six economies (Montenegro, North Macedonia, and Serbia) implement regulatory impact assessments (RIAs) for new regulatory proposals and publish results online. However, implementation of RIAs on all policy and legislative proposals is not effectively systematised in the WB6. North Macedonia is the only economy with an online Unique National Electronic Registry of Regulations (ENER), where all RIA processes are published. Albania has adopted an "RIA light" system and although some progress has been made in enforcing the obligation for RIAs in line ministries, its implementation is slow. Kosovo and Bosnia and Herzegovina are not yet conducting RIAs and their capacities in the field remain low. The implementation of external evaluations and reviews of the stock of significant regulations against clearly defined policy goals is not yet systematic in the Western Balkan region.

### *Implementation of data accessibility frameworks is in the initial phase*

Data exchanged across communications networks are important sources of economic and social value, as well as drivers of innovation. Policy makers should maximise individuals and firms' ability to access and share data, while also protecting digital security and privacy of data subjects through a well-designed overarching legal framework. This assessment measures whether a framework promoting data accessibility has been adopted and designed in such a way as to maximise its positive economic and social effects.

The WB6 economies have made progress in setting up a basic policy framework to promote data accessibility and openness since 2018. The WB6 are all implementing economy-wide action plans stemming from their commitments under the Open Government Partnership (OGP) Initiative. These action plans have led to the development of data accessibility policies, which along with the Public Administration Reform Strategies implemented in the region, promote the adoption of basic legislation on public sector

data transparency, re-use, online publication in machine readable formats, as well as data licensing. Each of the WB6 economies is moving forward at a different pace in implementing the necessary legal and regulatory framework. North Macedonia and Serbia are the only two economies in the region to have implemented an initial alignment with the Public Sector Information (PSI) Directive (2013/37/EU) on open data and the re-use of public sector information. However, only Albania has prepared a draft law to align with the new Open Data Directive (EU) 2019/1024) that replaced the PSI Directive in July 2019. This new law on open data is expected for adoption in 2021.

Serbia adopted a new law on e-government in 2018, promoting data re-use in machine readable formats, as well as an extensive set of bylaws and regulations that lay down rules on formats and registers and the operation of the Open Data Portal. North Macedonia, implementing a Transparency Strategy and an Open Data strategy, adopted a new law on the use of public sector data, amended the law on free access to information and introduced relevant rulebooks. Albania also has a policy document on open data in place, and while the dissolution of the Ministry of State for Innovation and Public Administration in September 2017 greatly affected continuity of implementation of its 2016-2018 OGP action plan (Vurmo, 2019[18]), a new 2020-2022 plan has been developed. Montenegro prepared a new draft law on access to public sector information in 2019, but the law was still pending adoption at the end of 2020. However, the previous amendment of the law from 2017 has already created the basic conditions for data re-use and the obligation for public sector institutions to publish their data in machine readable formats on the open data portal. A basic open data framework is in place in Kosovo, which performed an Open Data Readiness assessment in 2018 to identify and improve shortcomings in relevant legislation and regulations. Positively, a focal point for open data is designated for every ministry in Kosovo to co-ordinate relevant activities.

Bosnia and Herzegovina, on the other hand, has not yet adopted a policy or legal framework on data accessibility at the state level to align with the EU *acquis*. Some progress was recently made in creating obligations for public sector institutions to publish their data online. The Agency for Statistics of Bosnia and Herzegovina was the first institution to demonstrate practical compliance, publishing datasets in machine readable formats on its website. The Public Procurement Office is the next in line. It should be noted that at the entity level, Republika Srpska (RS) has included data accessibility and re-use and obligations for public sector institutions in the recently adopted e-Government Strategy for RS 2020-2022.

All Western Balkan economies, except Bosnia and Herzegovina, have established economy-wide Open Data Portals, including an increasing number of public sector data sets. However, awareness, human capacities and demand for open data are still insufficient. There is also limited understanding of data formats and data licensing in the public sector. The existing frameworks are not stimulating public-private partnerships for data innovation, but nonetheless, Montenegro was the first economy in the region to organise an Open Data Hackathon to stimulate data innovation (Box 13.2).

### Box 13.2. Montenegro's open data hackathon

The open data Hackathon, "Make it accessible and useful", was organised on the 5th of October 2019 by the EU-funded project Odeon – Open Data for European Open Innovation in the framework of the Infofest 2019 Conference in Montenegro. The topic of the competition was the design of innovative applications that create added value from available open data sets for the benefit of the public administration, the business community, and citizens. Six teams participated in the hackathon, contributing their ideas.

Although this was a small-scale competition on open data innovation, it was the first time such an event was organised in Montenegro. The event was an excellent opportunity to showcase how public-private partnerships could be created to design applications based on open data sets, demonstrating how bright entrepreneurial minds can develop new products and services, generating value for the global economy.

Note: The Odeon project is co-funded by the European Regional Development Fund (ERDF) under the INTERREG Mediterranean Program 2014-2020. It is implemented by 10 partners from 7 economies (Italy, Montenegro, Croatia, Slovenia, Greece, Spain, France).
Source: (Odeon, 2019[19]), *News,* https://odeon.interreg-med.eu/pt/news-events/news/detail/actualites/hackathon-open-data-idea-presentations-in-budva-montenegro/.

### Box 13.3. Towards regional digital infrastructure and connectivity in the Common Regional Market

The following key findings of the CO2021 access sub-dimension can inform the implementation of the Common Regional Market Action Plan 2021-24 actions related to the digital infrastructure and connectivity component:

- All the WB economies except Bosnia and Herzegovina are implementing digital strategies or broadband development plans and have launched rural broadband development projects with multi-million euro donor support that promise high speed connectivity to all households and public buildings in the next period. The legal and regulatory framework in these economies has been improved significantly to support private sector investments in network infrastructure. A broadband strategy in Bosnia and Herzegovina is also being prepared.
- 5G development in WB economies is in the initial phase, but governments in the region are starting to prepare for future 5G rollouts. Albania and North Macedonia have included 5G rollout targets in their broadband plans, and Albania issued a first pilot license. Serbia has already issued 5G pilot licences and Montenegro has already adopted a new radio frequency plan in 2020 to prepare for 5G. Kosovo recently started to lay down 5G-ready equipment and fibre connections between towers. Bosnia and Herzegovina is the last economy in the region to award 4G licences (in March 2019), so a 5G roadmap is not yet planned.
- The WB6 have made progress in the implementation of the Regional Roaming Agreement since July 2019, moving closer to the creation of a roaming free region by 1 July 2021. Roaming data traffic is already increasing across the region, and roaming costs have seen significant reductions, of between 83% and 96%, as of the end of 2020.

### *The way forward for access*

- **Complete the alignment of the ICT policy regulatory framework with the EU Electronic Communications Code.** All Western Balkan economies should continue reforms to create an enabling broadband investment framework that facilitates rapid, cost-efficient co-deployment of broadband network infrastructure. They should also continue efforts to finalise and implement the roadmap on WB6-EU roaming charges reduction, as part of the CRM Action Plan 2021-24 (Box 13.3). Bosnia and Herzegovina, Kosovo, and Serbia should accelerate the adoption of the new law on electronic communications to complete alignment with the EU 2009 regulatory framework and to ensure financial and operational independence of the regulatory authority. Bosnia and Herzegovina need to accelerate the adoption of the broadband strategy and to complete the broadband mapping exercise. Serbia should also accelerate the adoption of the Law on Broadband to create an enabling investment environment.
- **Improve the legal framework on data accessibility and strengthen the demand for open data innovation through inclusive co-creation processes.** All WB economies need to prepare and complete their alignment with the Open Data Directive (EU 2019/1024) to improve re-use and openness of public sector information. It is vital that the WB6 allocate sufficient resources for public sector capacity building on data formats and data licensing. It is also critical that the economies stimulate the development of public-private partnerships on open data innovation to demonstrate the benefits of data openness through e-services and applications and to increase the demand for additional open data sets.

## Use (Sub-dimension 10.2)

The rapid integration of digital technologies is transforming today's societies and economies, but creates a large challenge for governments – requiring a genuine revolution in the way they work, organise themselves, interact and provide services to citizens and firms (OECD, 2019[20]). But to realise the full potential of digital technologies for competitiveness and productivity growth, firms also need to transform. The EU's Digital Strategy notes that the growing scale and complexity of investment needed for digital transformation (in systems, skills, business processes, etc.) make the endeavour particularly difficult for non-frontier firms, such as SMEs in less digital-intensive sectors (European Commission, 2020[14]). This sub-dimension assesses WB6 policies and progress on digitalising government services and transforming businesses through digital technologies.

Overall, the WB6 economies perform moderately in this sub-dimension, although Serbia and Montenegro are moving significantly faster than the other economies (Table 13.3). The assessment indicates that the WB6 perform best in the digital government indicator, as the implementation of public administration reform strategies increases the digitalisation of government systems and the proliferation of e-services. On the other hand, four out of the six economies (i.e., Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia) are performing poorly in private sector ICT adoption, which lowers the overall scores in this dimension. This can be traced back to the absence of programmes to support the digitalisation of companies, on top of legal framework inefficiencies that slow down the adoption of e-commerce and e-business practices.

### Table 13.3. Scores for Sub-dimension 10.2: Use

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 10.2: Use | Digital government | 3.5 | 2.0 | 2.0 | 2.5 | 3.5 | 3.5 | 2.8 |
| | Private sector ICT adoption | 1.5 | 1.5 | 1.5 | 1.5 | 2.5 | 3.5 | 2.0 |
| **Sub-dimension average score** | | 2.5 | 1.8 | 1.8 | 2.0 | 3.0 | 3.5 | 2.4 |

### *Digital government is transforming public sector services in the region*

Digital government strategies deal holistically with the incorporation of digital technology and tools into public sector functions, prioritising a "user-driven approach to design develop, deliver and monitor public policies and services centred around people and user needs" (OECD, 2019[2]). This assessment measures how policy frameworks promote public sector digitalisation and examines what progress has been achieved in respective legal and regulatory reforms to improve public service delivery, increase people's engagement, and enhance transparency and accountability.

Albania, Montenegro and Serbia are making headway in digital government, with North Macedonia following closely behind. According to the UN e-Government Survey for 2020, Serbia ranks 58th and Albania ranks 59th out of 193 nations on the EGDI[5] (e-Government development) composite index, while North Macedonia (72nd) and Montenegro (75th) are a little further behind. In the same survey, Albania scores the highest in the region on the Online Service Index (OSI) that assesses the e-government portal, followed by Serbia and North Macedonia. Albania also ranks 36th in the E-Participation Index (EPI), followed by North Macedonia (38th) and Serbia (41st).

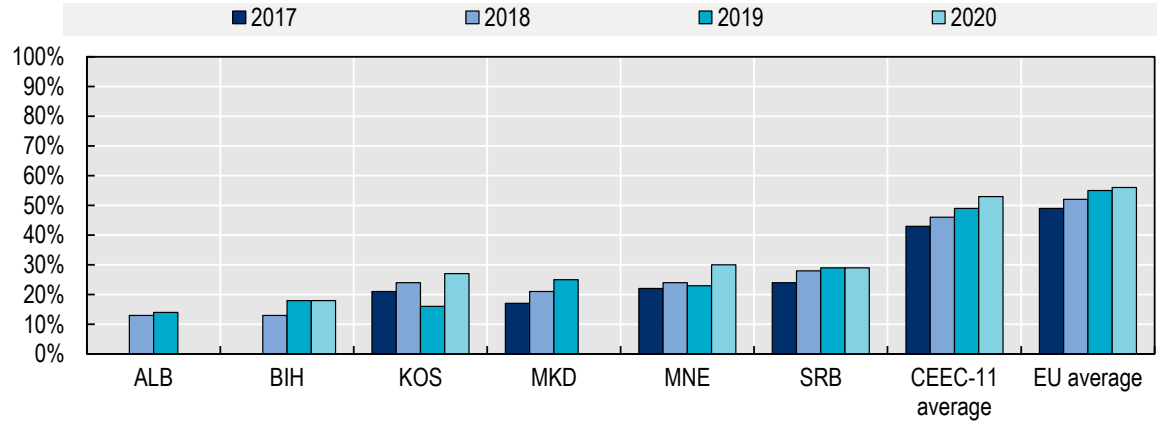
All the WB6 economies, except Bosnia and Herzegovina, are implementing Public Administration Reform Strategies (PARS) action plans and have improved the alignment of their interoperability frameworks with the European Interoperability Framework (EIF). Albania, Montenegro, North Macedonia and Serbia have achieved advanced implementation of their PARS action plans promoting reforms that aim to transform the government into a user-centric public service through digital technologies. They have improved e-services and the government service bus (i.e., the information system used by public sector institutions to exchange data) that connects to the central electronic population registers. New laws on e-government and e-services have been adopted in Serbia (2018), North Macedonia (2019) and Montenegro (2020), along with relevant secondary legislation. All economies, except Bosnia and Herzegovina, have aligned their e-identification and e-document legislation with the eIDAS Regulation on electronic identification, authentication, and trust services (EU 910/2014). Additional reforms are already planned in their respective PARS action plans for the coming period. Stepping-up as a front-runner in the region, Serbia also adopted the Artificial Intelligence (AI) Strategy in December 2019 and the action plan in June 2020, aiming to investigate the integration of AI technologies in e-government services. Positively, in August 2019, North Macedonia and Serbia signed an agreement on mutual acceptance of electronic documents.

The digitalisation of the public administration in Bosnia and Herzegovina has progressed unevenly, due to its complex governance system. A positive step was the adoption of the Strategic Framework for Public Administration Reform (PAR SF) 2018-2022 by the state and the two entity governments (completed in 2020 with the adoption by the government of the RS). However, the action plan has not yet been adopted at any level, putting implementation on hold. In the meantime, the RS government is implementing its own policy and recently adopted a new e-Government Strategy for 2019-2022, which is not yet budgeted. The Federal Ministry of Justice, at the Federation of Bosnia and Herzegovina (FBiH) entity level, has been tasked with collaborating with the cantons to harmonise legislation for the civil service and to draft a rulebook on internal organisation of the entity's government. Despite the adoption of the PAR SF, economy-wide implementation of reforms and service digitalisation is hampered by the lack of political ownership and co-ordination among different levels of the government.

Western Balkan governments have established horizontal co-ordination mechanisms for digital government, while Albania (see Box 13.4), Kosovo and Serbia have dedicated public bodies that manage data centres and e-government systems for the public sector. Serbia has recently launched a unique high-capacity data centre in Kragujevac to enable the next revolution in digital government (Box 13.5). Nonetheless, monitoring e-government indicators continues to be weak, although prescribed by the framework, and data is rarely available online.

Albania, Montenegro, North Macedonia and Serbia have created single-sign-on e-government portals and are constantly increasing the number of e-services, though at different levels of sophistication. The development of an e-government portal is still in the initial phase in Kosovo, and it is yet to be implemented in Bosnia and Herzegovina, where e-services are offered only at the entity level in Republika Srpska. These two economies are still a long way from achieving a fully digital government, and the need for increased co-operation and support in building the capacities of public officials for developing and maintaining e-services is still high. Nonetheless, citizens' engagement with e-government services has been boosted during the COVID-19 pandemic and WB6 governments have exploited existing and new e-services to connect with the population under these emergency conditions. But while participation is on the rise, it remains below the CEEC-11 and EU averages (Figure 13.7).

## Figure 13.7. Rate of Internet use when interacting with public authorities (2017-20)




Note: EU average is for the EU-28 for 2017-19 and EU-27 for 2020. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, 2020[21]), "E-government activities of individuals via websites", https://ec.europa.eu/eurostat/databrowser/view/isoc_ciegi_ac/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254411

### Box 13.4. Co-ordinating a whole-of-government digital transformation in Albania

The National Agency for Information Society (NAIS) is the core institution in Albania for the digitalisation of the government and its services to citizens, businesses and public sector employees. It is responsible for co-ordinating government work in the information and communication technology (ICT) area and the e-services government portal (e-Albania.al). NAIS promotes new technologies, connecting systems to the Governmental Interoperability Platform, drafts strategies and policy implementation plans for e-Government and the Information Society. It is the co-ordinating regulatory authority, responsible for the state databases and electronic signature services in Albania.

Since 2017, based on the Decision on the Reorganisation of the National Agency for Information Society, the information technology (IT) staff of line ministries and institutions have been placed under the organisational chart of NAIS, although they are physically working in the premises of those institution. Their role is to support the employees of the institutions in their daily IT activities, namely in using the IT systems and tools for public administration and managing the e-services provided by their institution. This close co-ordination mechanism has directly connected centralised NAIS staff to all decentralised IT staff around the country, enabled service standardisation and increased the quality of e-services.

NAIS is primarily state funded and employs more than 330 employees, of which more than 90% are highly skilled technical staff. The main challenge that they face is modernising the legal and regulatory framework and changing public officials' mindsets while they attempt to redesign and reform public administration processes through ICT. The top-level government and high-ranking public officials have been strong supporters of online services and digitalisation. In 2018, NAIS prioritised the list of ICT projects needed to improve the e-government infrastructure in Albania and during 2019, approximately 30 systems were either created or upgraded in collaboration with the respective institutions. By mid-2020, more than 139 institutions have access to the e-Signed Documents Circulation System and 53 institutions are connected to the Government Interoperability Platform. By the end of 2020, 1 021 e-services were available to citizens and businesses through the E-Albania Portal.

Source: National Agency for Information Society (NAIS), Albania.

### Box 13.5. A high-capacity data centre in Serbia promoting AI in digital government

On 18 December 2020, the Prime Minister of Serbia, Ana Brnabić, inaugurated the State Data Centre in Kragujevac, which represents an infrastructural milestone in e-government and ICT development in Serbia. Serbia is opening a new chapter, making unprecedented data storage and high computing capacities available, in a facility unique to Central and South Eastern Europe. With a capital investment of EUR 30 million for the construction of the state data centre, the government will work with domestic and global partners, from the private sector and academia, to investigate AI integration in digital government and e-services and will support data innovation demonstrating its commitment to improving public administration services in order to simplify the daily lives of citizens and businesses in the digital economy.

The data centre in Kragujevac has a capacity of approximately 1 200 rack rooms distributed across two facilities, with a total footprint of 14 000 square metres and is designed to host mission-critical servers and computer systems. The Office for IT and eGovernment (ITE) has signed MoUs with major global companies and will also make the services of the state data centre available to commercial users, science, and technology parks and start-ups. The ITE will work to establish an AI platform based on high-performance computers and, together with NVIDIA, will develop a special capacity improvement plan for building one of the fastest AI supercomputers in Southeast Europe. NVIDIA has agreed to provide additional support to start-up companies, including training and applied AI knowledge, as well as joint research in order to create additional value.

Source: (Government of the Republic of Serbia, 2020[22]), *Construction of State Data Centre in Kragujevac goes as planned*, https://www.srbija.gov.rs/vest/en/157502/construction-of-state-data-centre-in-kragujevac-goes-as-planned.php.

### *Private sector adoption is not well supported in the majority of WB6 economies*

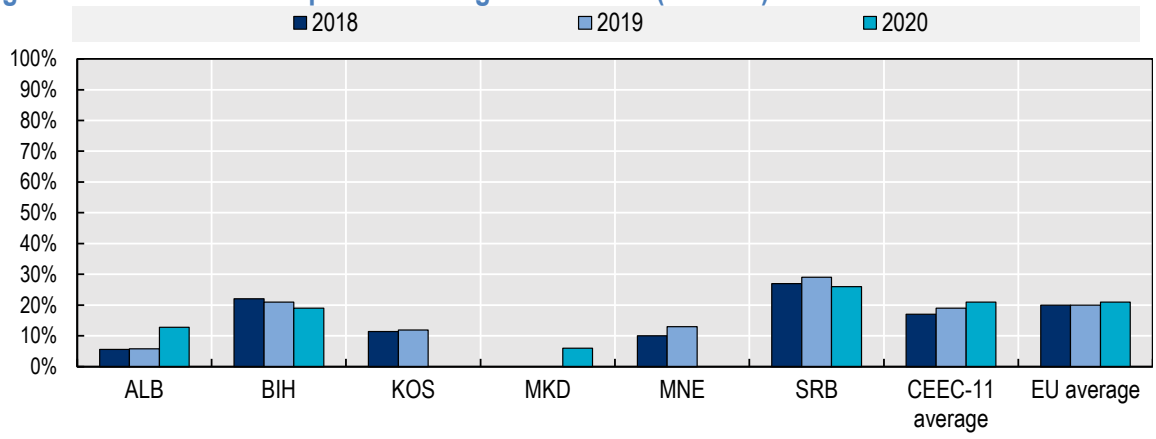
Incorporating digital tools and processes into business practices is essential to increase productivity, access new markets and remain competitive within increasingly digital markets. This section assesses whether a well-designed policy framework to promote private sector ICT adoption is in place and is being implemented in the WB6.

Only two Western Balkan economies, Montenegro and Serbia, have adopted policies to support private sector ICT adoption. Albania, and Kosovo mention firms' digitalisation in their broader policies, such as the Digital Agenda 2020, but no linked programmes or measures are being implemented. North Macedonia, in the absence of an overarching ICT policy, uses the Innovation Strategy and Fund that mainly target start-ups or firms with innovation investment plans. Tax relief schemes for the purchase of ICT equipment and software have been adopted by Kosovo, North Macedonia and Serbia. Despite the significance of a

comprehensive e-commerce framework as a driver for private sector ICT adoption, some of the WB6 governments (like Albania, Bosnia and Herzegovina -excluding the RS entity, and Kosovo) have not yet updated their legal frameworks to support the regulated use of e-commerce and have not designed e-commerce support programmes for SMEs. Republika Srpska amended its e-commerce law in 2016 and created a one-stop-shop e-registration service for businesses, while its Chamber of Commerce offers webinars on e-commerce. Kosovo is implementing an EU-funded IPA II project[6] that aims to reduce the barriers to the practical implementation of e-commerce, like online payment security and discouraging banking sector practices (e.g., fees for international online payment transactions with credit cards) (TEB JSC, 2021[23]). The situation is reflected in the share of WB6 enterprises doing e-sales, which is lower than the EU and CEEC-11 averages in all economies, except Serbia (Figure 13.8).

Serbia is the single economy in the region to have achieved notable impact in this domain. The government is supporting e-traders, and helping to reduce the grey economy from e-sales on social media platforms through the Programme for e-Commerce Development. It is also financing consulting services for digitalisation and equipment purchases through the IT Industry Strategy. The Center for Digital Transformation (CDT) was established in 2018 as a service unit for business digitalisation. It is implementing the GIZ[7]-funded MSMEs 2019-2020 Digital Transformation Support Programme, which was intensified during 2020 to address the adverse effect of the COVID-19 pandemic on micro, small and medium-sized enterprises (MSMEs) through two emergency support programs, SPEED 1.0 and 2.0. This programme has supported more than 700 companies so far, in Serbia and the RS in Bosnia and Herzegovina.

## Figure 13.8. Share of enterprises offering online sales (2018-20)




Note: EU average is EU-28 for 2017-19 and EU-27 for 2020. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: INSTAT (ALB), ASK (KOS), (Eurostat, 2020[24]), "E-commerce sales", https://ec.europa.eu/eurostat/databrowser/view/isoc_ec_eseln2/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254430

Montenegro, on the other hand, despite adopting the Strategy for the Development of MSMEs 2018-2022, has seen slow progress in promoting business digitalisation and e-commerce. The Ministry of Economy's Programme for Improving the Competitiveness of the Economy includes a special budget line for business digitalisation in 2020 that can finance just over 60 companies. A similar business digitalisation programme in 2018 received only 10 applicants (MEK, 2018[25]). This reveals a pattern of limited effectiveness and impact of such programmes, explained by a combination of factors such as low resource allocation, demanding application and project management procedures and misalignment with actual market needs. North Macedonia faced a similar situation with its Support for Digital Transformation in SMEs project, funded by the Ministry of Economy under the Programme for SMEs Competitiveness and implemented by MASIT (the Chamber of Commerce for ICTs), as only 13 companies applied.

### Box 13.6. Towards a digital economy in the Common Regional Market

The following key findings of the CO2021 sub-dimension on use can inform the implementation of the Common Regional Market (CRM) Action Plan 2021-24 actions related to the digital economy in the era of new ICT technologies component:

- The majority of the WB6 economies have improved digital government and e-services development. They have established central e-government portals and are increasing the number of e-services offered to citizens and businesses. They have also improved alignment with the EU Interoperability framework and created e-government systems to exchange data between public sector institutions.
- The majority of the WB6 economies have e-commerce legislation in place, but at least three need to complete these frameworks with regulations and improve e-payment systems.
- Only Montenegro and Serbia have adopted policies that support SMEs' digitalisation. Serbia is the only economy that is implementing a budgeted programme promoting e-commerce, providing financial support, and mentoring for e-traders. On the other hand, Montenegro's SMEs digitalisation programme is having limited impact (like similar projects in other economies during the previous assessment).
- Serbia is the only economy in the region to have adopted an artificial intelligence (AI) strategy to investigate integration of AI in digital government. It has recently established a second state data centre in Kragujevac that will be used to promote AI and high-performance computing (HPC) projects and investments.

### *The way forward for use*

- **Increase resources for government digitalisation and systematise the monitoring of digital government indicators to inform policy making**. All the WB6 economies should continue reforms to create high-quality fully transactional e-services and ensure sufficient funds to implement action plans. Public sector training is particularly important for digital government and should not be neglected in budget allocations. The remaining obstacles to frameworks on e-signatures should be removed in Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia. Bosnia and Herzegovina should also intensify efforts to align with the EU Interoperability Directive (EU) 2016/797 to ensure compatibility of information systems and processes within its territory and with EU Member States.
- **Improve the legal framework for e-commerce and e-business**. While the WB6 economies continue their reforms, Albania, and especially Bosnia and Herzegovina and Kosovo, need to improve their legislation on e-commerce and to reduce bottlenecks in e-payment systems and courier services.
- **Scale up programmes to support SMEs' digitalisation and boost the take up of e-commerce**. The WB6 governments should improve the design of their support programmes and increase budgetary allocations to have a widespread impact on all industry sectors. Chambers of commerce could help assess the type of support needed and propose appropriate financial schemes to make them more attractive to companies (e.g. subsidies for equipment and digitalisation consulting services, tax relief, social security incentives to hire ICT specialists and train staff). The governments could consider the example of Serbia's Center for Digital Transformation (CDT) and MSMEs 2019-2020 Digital Transformation Support Programme or they could review Ireland's successful "Digital Online Trading Voucher" programme (Box 13.7) to design new e-commerce voucher schemes or improve their existing ones.

### Box 13.7. A Digital Online Trading Voucher programme from Ireland

Back in 2014, the Irish government estimated that despite the increasing trend towards online spending, only 23% of small Irish businesses were engaged in any meaningful way in e-commerce sales, and the share was even lower among businesses employing under 10 people. The government recognised the urgency of ensuring that domestic businesses understood that over 70% of e-sales made in Ireland took place in overseas markets and encouraging them and supporting them to adjust to this digital reality. In order to support this goal, the National Digital Strategy, focused on getting more businesses trading online. To this end, the Department of Communications, Climate Action & Environment (DCCAE) launched a Trading Online Voucher Scheme and teamed up with the Local Enterprise Offices (LEO) to deliver this to Irish business. The scheme started with approximately EUR 3 million funding per annum. The scheme is now funded by the Department of Enterprise, Trade and Employment (DETE).

Micro-enterprises in Ireland can get a EUR 2 500 voucher for developing sales on line and access free online training. The vouchers can be used to co-finance up to 50% (initially the scheme offered a 90% funding rate) of costs for third-party services and IT consultation, development or upgrade of an e-commerce website; implementation of online payments or booking systems; purchase of Internet-related software; app development (or multiplatform webpages); development and implementation of a digital marketing strategy; training and skills development specifically to establish and manage an online trading activities; subscription costs to low-cost online retail platform solutions to quickly establish a retailing presence online; purchase of online advertising and purchase of professional photography for e-sales. Following approval of their application, a successful applicant can engage suppliers and, upon completion of the work, submit a request for payment to the LEO in line with the terms and conditions of their voucher.

In the context of COVID-19, the scheme has received unprecedented demand that prompted the government to expand the funding made available to this scheme. By June 2020, the total budget made available reached EUR 20 million, providing approximately 7 700 vouchers in 2020 to small businesses, compared to 1 200 in 2019. At the end of April 2020, the government also launched a EUR 2 million scheme to help retailers in Ireland with a physical store and more than 10 employees to boost their digital presence.

Source: (Local Enterprise Office, 2021[26]), *Trading Online Voucher Scheme*, Ireland, www.localenterprise.ie/Sligo/Financial-Supports/Trading-Online-Vouchers-Scheme/; (OECD, 2021[27]), "The Digital Transformation of SMEs", *OECD Studies on SMEs and Entrepreneurship*, https://doi.org/10.1787/bdb9256a-en.

## Jobs (Sub-dimension 10.3)

Economies' preparedness to seize the benefits of a digital world largely depends on the skills of their populations and a comprehensive set of skills-related policies, reflecting the range of policies on digitalisation. Digital technologies profoundly change jobs and the workplace, as well as the skills people need to remain in employment (OECD, 2019[7]). This makes lifelong learning critical and calls for policies that provide high-quality education and training for all and ensure that education and training systems are well aligned with labour market needs. It is also essential to promote a dynamic, competitive, and innovative ICT sector to stimulate job growth and encourage adequate labour market flexibility.

Overall, the WB6 economies perform moderately on the jobs sub-dimension (Table 13.4). Although Serbia is making headway in digital skills development and ICT sector support, the assessment indicates that the other five economies are weak in ensuring digital skills align with labour market needs and ICT sector

promotion policies. Despite the cross-cutting recognition of the contribution of the ICT sector to the economy, only Kosovo and Serbia have specific policies in place to support the ICT industry, and only Serbia has put together the right mix of instruments to have an impact.

### Table 13.4. Scores for Sub-dimension 10.3: Jobs

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 10.3: Jobs | Digital skills for students | 2.0 | 2.0 | 2.0 | 2.5 | 3.0 | 3.0 | 2.4 |
| | Digital skills for adults | 2.0 | 1.5 | 2.5 | 2.0 | 2.5 | 2.5 | 2.2 |
| | ICT sector promotion | 2.0 | 1.5 | 2.5 | 2.0 | 2.0 | 3.5 | 2.3 |
| **Sub-dimension average score** | | 2.0 | 1.7 | 2.3 | 2.2 | 2.5 | 3.0 | 2.3 |

### *Students' digital skills are hindered by insufficient connectivity and equipment*

Digital skills are a fundamental aspect of the digital economy – it is vital that students leave school with the basic skills needed to navigate digital environments and to innovate in a digital world. The COVID-19 crisis has forced education systems to depend more on ICTs and online teaching methods and forcing Western Balkan governments to respond to the rising demand for technical infrastructure and policies that maximise the effectiveness of online learning (OECD, 2020[28]). This section assesses whether a policy framework promoting digital skills for students has been adopted that equips them to benefit from and contribute to the digital economy.

The WB6 have made uneven progress in developing digital skills for students since 2018. While all economies have set-up basic frameworks that recognise digital skills as a key competence, how this is translated into education practice differs significantly. While Montenegro and Serbia are making headway and North Macedonia is not far behind, the other three economies (Albania, Bosnia and Herzegovina, and Kosovo) have not yet made notable progress in digital skills' development and fine-tuning their curricula to labour market needs. Montenegro is the only Western Balkan economy to have adopted a Digital Competence Framework (DCF), effective since September 2020, in alignment with the European DCF. Serbia, on the other hand, is the only economy to have adopted a Digital Skills Strategy (2020-2024), although a budgeted action plan is still pending. The new Education strategy 2025 in North Macedonia and the Higher Education Strategy in Montenegro promote the integration of ICTs and digital teaching material in schools and curricula design tuned to the needs of the labour market. Albania also recognises digital skills as one of seven key competencies in its National Pre-University Curriculum Framework. Kosovo's Strategic Plan for Education (KESP) 2017-2021 promotes the integration of ICTs in schools, but does not directly address digital skills development.

Bosnia and Herzegovina (at the state level) has adopted Guidelines for the Common Core Curricula in BiH. These recognise digital skills as a key competence and will guide digital competences in the economy's education systems until 2030, in accordance with the European DCF. However, due to the complexity of the education governance system in this economy, with 14 line ministries at different levels of the government, harmonisation of digital skills development is highly challenging. Republika Srpska, however, adopted a new framework law on Vocational Education and Training (VET) during 2019 that delineates digital skills development for VET students.

IT subjects are taught in Western Balkan schools from primary to secondary levels, but only Montenegro, North Macedonia and Serbia can claim a coherent approach to digital skills' development across all levels of the education system. Weak technical and human resources in schools still challenge the development of digital skills in the majority of the WB6. The COVID-19 experience has exposed disparities between private and public schools, and urban and rural areas in terms of Internet connectivity speeds, availability of functional computers and portable electronic devices (e.g., laptops and tablets), as well as teachers' digital competency and readiness to employ e-learning technologies.

But the crisis has also propelled developments in this field. For example, since September 2020 North Macedonia has been implementing a massive programme to enhance the digital competencies of 25 000 teachers. Serbia is implementing the Connected Schools project to connect all schools to high-speed Internet through the Serbian Academic Network –AMRES or through WLAN technologies by the end of 2021, and has delivered 10 000 laptops to classrooms. Both economies introduced learning management systems and e-learning platforms into schools, along with software tools, during 2020. The Republika Srpska entity government has provided IT equipment to VET schools and computers to 1 000 primary school students in 20 underdeveloped municipalities. Kosovo provided EUR 160 000 worth of equipment to schools in 12 municipalities and is developing a data centre for Education and Research and a platform for videoconferencing.

Despite efforts to improve technical resources, schools' connectivity to the Internet remains low in Bosnia and Herzegovina, Kosovo and Albania (in Albania, only 25% of schools have access to the Internet). On a positive note, all schools in Montenegro have access to the Internet and the computer-to-student ratio (1:10) is the highest in the region and approaching the EU average (1:7). In Serbia, 92% of schools are connected with broadband speeds above 10Mbps, while the figures in North Macedonia are 80.7% of primary and 93.6% of secondary schools. In Republika Srpska, the computer-to-student ratio is higher in primary schools (1:5) than in secondary schools (1:14), and while 100% of high schools are connected, only 14% of remotely located primary schools have access to the Internet. However, rural broadband development programmes in the WB6 promise to connect every school with broadband Internet in the next two or three years.

In general, monitoring indicators on digital skills for students are not well systematised in the WB6 and data are not regularly published on online databases. Montenegro is the only economy that conducts external evaluations of the teaching process and progress towards digital skills development, and co-ordinates follow-up activities (including teacher training, modernisation of equipment and methods, preparation of digital textbooks, etc.).

### *The adult digital skills gap persists, constraining the rise of the digital economy*

The OECD estimates that 14% of jobs (on average across OECD member countries) face a high risk of being automated and as many as 32% of jobs are expected to undergo substantial changes in the digital age. Governments must help individuals develop the right skills through an effective lifelong learning system; one that quickly responds to labour market needs (OECD, 2019[7]). This section assesses whether a framework promoting digital skills for adults is in place to help workers adapt to shifting skills' needs and evolving work environments.

Kosovo, Montenegro and Serbia are intensifying efforts in this domain. Serbia is developing a strong framework for adults (workers and marginalised groups), with its Digital Skills Strategy starting in 2021. Although local coalitions for digital skills are not yet in place to ensure stakeholder participation in curricula development, Sector Skills Councils were established in 2018 to reduce skills mismatches. The National Employment Service launched an IT requalification programme that offers specialist IT training for 778 participants in various cities in Serbia during 2018. The government also adopted the Programme for Enhancing Women in ICT 2019-2020 to increase digital and online entrepreneurship competencies for women in rural areas.

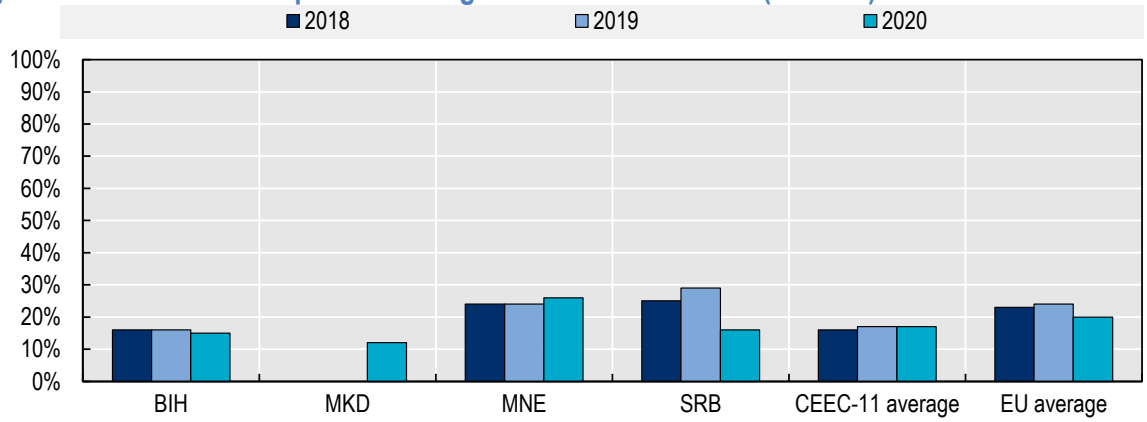
Montenegro has adopted an Adult Education Plan 2019-2022 and a VET strategy to 2021, allocating around EUR 8 million for implementing the strategy (including a EUR 6 million loan from the European Investment Bank). In Kosovo, while the education policy (KESP 2017-2021) makes no specific reference to digital skills, the Employment Agency manages eight Vocational Training Centres (VTC) in seven regions that offer ICT training to the unemployed. It is currently implementing a EUR 3 million IPA 2017 project to train 1 500 men and women in advanced programming skills and to assess their follow-up employability in the local ICT market. The government is also implementing the Youth Online and Upward

(YOU) Programme under the Kosovo Digital Economy (KODE) project, to train 2 000 young people in digital and soft skills.

Progress is slower in Albania, Bosnia and Herzegovina, and North Macedonia. In Albania, digital skills are not prioritised in the Employment and Skills Strategy 2019–2022 or the ongoing VET system reform based on a law from 2017. In North Macedonia, the implementation of the Education Strategy 2018-2025 is not sufficiently co-ordinated with industry stakeholders. Nonetheless, the Adult Education Centre and the Employment Agency offer IT programmes, such as one for unemployed young people that covers both introductory and advanced IT training. In Bosnia and Herzegovina there is no economy-wide framework for digital skills for adults; in the RS entity, 100 unemployed university graduates attended the first IT adult training programme in 2019. The Bit Alliance (the Association of ICT companies) maintains a portal aggregating IT education providers and organises the CoderDojo Free Programming School, (already implemented in 11 cities in Bosnia and Herzegovina).

Recently, under the pressure created during the COVID-19 pandemic, the use of distance learning platforms has been incorporated in some adult training programmes. Companies in the WB6 economies are increasingly providing training opportunities to their employees. According to the European Training Foundation, 67.5% of IT companies in Bosnia and Herzegovina rely on in-house training and 9% of IT companies are providing various adult training courses (ETF, 2019[29]). According to Eurostat, 16% of enterprises from all sectors in Bosnia and Herzegovina provided ICT training to upskill their employees in 2019, which is similar to the CEEC-11 average (17%), while the respective share of enterprises in Serbia (29%) and Montenegro (24%) exceeded both the CEEC-11 and the EU (20%) average (Figure 13.9).

## Figure 13.9. Share of enterprises training their staff in ICT skills (2018-20)




Note: Data for Albania and Kosovo are unavailable. EU average is EU-28 for 2017-19 and EU-27 for 2020. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia
Source: Eurostat (2020[30]), "Enterprises that provided training to develop/upgrade ICT skills of their personnel", https://ec.europa.eu/eurostat/databrowser/view/isoc_ske_ittn2/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254449

However, the mismatch between the skills provided by the education and training systems and those needed by the labour market continues to reduce the impact of WB digitalisation policies. There is insufficient co-operation with industry stakeholders on curricula design (particularly in terms of learning outcomes), except for Serbia, where specific measures are planned to improve it (e.g. the planned establishment of local coalitions for digital skills and the existing Sector Skills Councils). In Kosovo, the ICT Industry Association STIKK has repeatedly signalled the poor quality of digital competencies and IT skills acquired through the education system, as well as the deficit of skilled workers in 83% of companies (STIKK, 2019[31]). Industry stakeholders in North Macedonia and Montenegro paint a similar picture. Finally, quality control of adult education remains insufficient, while statistical data, evidence and analysis on adult education are relatively weak.

### *ICT sector support is not effective*

The ICT sector in North Macedonia, Montenegro and Serbia accounted for 4-5% of GDP in 2017. Despite this relatively small share, it is increasing, and could make a relatively large contribution to growth and productivity performance by growing more rapidly than the rest of the economy. The OECD estimates that 42% of all jobs created between 2006 and 2016 across the OECD were in highly digital-intensive sectors (OECD, 2019[2]). This section measures whether a coherent framework to promote the ICT sector exists and to what extent it is implemented and evaluated.

Only Kosovo and Serbia have dedicated policies or programmes to directly support the growth of the ICT sector. The ICT sector in Serbia enjoys constant export growth and salaries more than twice as high as any other sector. In clear recognition of its contribution to the economy, the Serbian Government has provided sufficient resources and high-level co-ordination by the Office of the Prime Minister to implement the IT Industry Strategy 2020 and is currently preparing a follow up strategy. Kosovo has also adopted an IT Strategy 2020. However, its implementation has been slowed down by limited financial resources and low prioritisation. The Innovation Centre Kosovo (ICK) was established back in 2012 to support entrepreneurship, innovation and commercial business development with a focus on ICT start-ups, leveraging financial support from the Norwegian and Swedish governments. During the period 2018-19, the ICK financed 220 companies with a total of EUR 1.8 million. Positively, 61% of IT companies in Kosovo work in international markets.

Montenegro has adopted the first Smart Specialisation Strategy (S3) in the region, which highlights ICT as a cross-cutting priority and includes the flagship initiative Digital Montenegro, promoting digitalisation of businesses and ICT-related innovation. However, the Montenegrin ICT Association at the Chamber of Commerce points out that the ICT sector has not been supported to underpin this ambitious initiative and suffers from the absence of a dedicated government institution to refer to, since three line ministries implement digitalisation polices. In North Macedonia, the COVID-19 crisis has further postponed the preparation of an economy-wide ICT strategy. In Bosnia and Herzegovina, the Bit Alliance (association of ICT companies) takes initiatives and implements projects to strengthen the IT industry in the absence of relevant government initiatives. The Bit Alliance has adopted the IT Manifesto as a model strategy for the development of the IT industry. This defines the three most significant pillars for the further development of the industry as education, legislation and the economy, in line with the EU 2020 Strategy (Bit Alliance, 2019[32]).

Positively, ICT sector companies in Albania, Kosovo, and Serbia benefit from tax relief (e.g., profit tax rate reduced to 5% in Albania, and VAT reduced to 8% for ICTs in Kosovo). Also, in all WB6 economies, except Bosnia and Herzegovina, the ICT industry benefits from horizontal co-funded programmes for the industry, such as competitiveness or innovation funds, start-up support (e.g., through incubators, hubs, and tech-parks) and research and development grants. The communications subsector is also indirectly supported through broadband development programmes in these five economies. But support to the IT subsector is not sufficient to underpin the economies' agendas for digital transformation.

Western Balkan industry stakeholders consulted for this assessment report that finding or training highly skilled ICT professionals is difficult and retaining them is even harder, since brain drain heavily affects this industry. Tax incentives and social security relief have not been provided to help retain talent. In most WB6 economies, IT companies suffer from limited access to finance and are not sufficiently specialised or differentiated in terms of technologies, target industries (vertical specialisation) and specific functional areas (horizontal specialisation), which limits their competitiveness.

### Box 13.8. Towards a regional skills and competence framework in the Common Regional Market

The following key findings from the CO2021 jobs sub-dimension can inform implementation of the Common Regional Market Action Plan 2021-24 actions related to the digital skills and competences component:

- Only Serbia has adopted a Digital Skills Strategy and implementation is starting in 2021. The other WB economies include references to digital skills in education sector strategies, but mainly focus on ICT integration in education systems.
- Only Serbia and North Macedonia have introduced Learning Management Systems that include a platform for e-learning, software tools for students and teachers and learning resources. All economies introduced some e-learning platforms in education and training systems during 2020, as an emergency response to the COVID-19 crisis, but the creation of digital content is not adequately systematised in the region.

### *The way forward for jobs*

- **Adopt a common digital competence (CDC) framework for students and a CDC framework for ICT professionals and involve the ICT industry in curriculum design to reduce the skills gap**. WB6 governments should prioritise measures to empower citizens, equip students and up-skill workers with the digital skills necessary for seizing the opportunities and reaping the benefits of digital transformation. Gradual transition from basic to advanced skills should be carefully designed for the education system. Closer co-operation with ICT industry stakeholders should be embedded into curricula design, especially for VET education and training and life-long learning programmes. WB6 governments can benefit significantly from regional initiatives on digital upskilling (Box 13.9).
- **Design dedicated policies and programmes to help the ICT industry grow and in turn boost the digitalisation of the economy**. WB6 governments need to invest in empowering the domestic ICT industry to find, train and retain talent through favourable social security or taxation regimes. The industry also needs support to strengthen exports and technology transfer and to gradually re-brand the domestic ICT industry from an outsourcing destination to an innovation hub. Serbia's positive example could be followed, focusing on IT industry promotion policies that align with the digital agenda in each economy.

### Box 13.9. A regional working group on digital upskilling in the Western Balkans

According to the Regional Cooperation Council (RCC), the Western Balkan Digital Economy and Society Index (DESI) for 2019 shows that while around 80% of the citizens are active Internet users (at least once a week), approaching the EU average (85%), knowledge of basic digital skills in the WB6 remains below the EU average (58%) for all economies except Serbia (67%), ranging from 50% in Montenegro to 32% in Kosovo.

In an attempt to close the digital skills gap in the Western Balkan economies, the RCC created a Regional Working Group (RWG) on Digital Skills to open a regional dialogue on the challenges of digitalisation, upskilling and digital literacy. The newly established RWG is tasked to support economies to develop digital skills strategies and to regularly review the needs and challenges in implementing them. The first RWG meeting was held in April 2020 and was attended by representatives of Western Balkan governments, agencies, academia, and the European Commission, as well as representatives from international organisations dealing with digital skills.

Source: (RCC, 2020[33]), *RCC initiates regional working group on digital upskilling in the Western Balkans*, https://www.rcc.int/news/620/rcc-initiates-regional-working-group-on-digital-upskilling-in-the-western-balkans.

## Society (Sub-dimension 10.4)

The EU's digital strategy encourages the development of "technology that works for the people", meaning that the digital transition should put people first and make a real difference to their lives, by creating opportunities for all (European Commission, 2020[14]). As digitalisation increases, it becomes increasingly important that governments find the right policy mix to reduce the use gap between those with high versus low education levels, and empower everyone with skills to thrive and trust in a digital world (OECD, 2019[2]).

Overall, only two economies, Serbia and Albania, have improved their performance on the society sub-dimension since 2018 (previously assessed as e-inclusion) (Table 13.5). Some of the other four economies have made small improvements in their frameworks but have not advanced their enforcement and implementation significantly.

### Table 13.5. Scores for Sub-dimension 10.4: Society

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 10.4: Society | Digital inclusion | 2.5 | 1.5 | 1.5 | 1.5 | 2.0 | 3.5 | 2.1 |
| **Sub-dimension average score** | | 2.5 | 1.5 | 1.5 | 1.5 | 2.0 | 3.5 | 2.1 |

### *Digital inclusion is not systematically reviewed*

Digital transformation promises benefits and opportunities, but also creates inclusiveness challenges. Governments need to put together policies to reduce digital divides and include everyone in the digital society – notably women, the elderly, low-income individuals, remotely located communities and marginalised groups. This section assesses if policies are being implemented to achieve digital inclusion, and how progress is being monitored to inform policy design and programme adjustments.

Digital agendas and information society policies implemented in the WB6 build on digital inclusion principles. The rural broadband development programmes recently launched in five WB economies, except Bosna and Herzegovina, promise to connect every household with high-speed Internet, ensuring inclusive access in terms of network availability. The WB6 are also deploying, though at varying speeds, public administration digitalisation and e-government services to gradually replace over-the-counter services. Albania, Montenegro, North Macedonia and Serbia are implementing e-government service bus systems

that enable data exchanges between public sector bodies and e-services without document collection by citizens. In this process, governments and public authorities need to ensure that nobody is left behind. Notably, Albania provides assistance to all those who are unable to apply online for e-services from trained employees at local Post Offices or ADISA[8] counters. Serbia has planned specific regulations for digital inclusion under its education reform, such as the regulation for Resource Centres for Assistive Technologies (supporting schools in inclusive education) and the instructions for the development of teaching materials in line with universal design principles to ensure accessibility, inclusiveness and usability of materials for teachers and students by accommodating gender, race, ethnicity, age, stature, disability and learning preference.

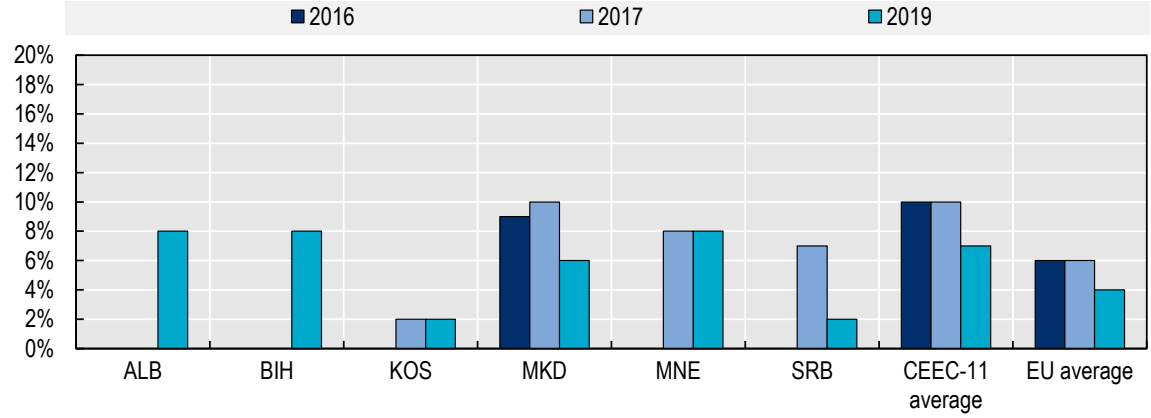
E-consultation portals for legislative and policy proposals have been created and are gradually being used in all WB6 economies to enable inclusive decision-making processes through digital technologies. Albania and Serbia, and Kosovo and North Macedonia to a lesser degree, are creating registries and Multi-user Information Systems (MIS) for social services (e.g., economic aid and disability payments, registries of persons with disabilities and other marginalised groups, registries for domestic violence, etc.).

Obligations for the web presentation of public sector bodies in line with international e-accessibility standards were enacted in 2018 in North Macedonia and Serbia, and in 2019 in Albania, with some evidence of practical implementation. Montenegro updated its framework in 2020 with a new Rulebook on e-Accessibility standards, which includes e-accessibility requirements for ICT products and services – the first in the WB6. Kosovo has not yet adopted e-accessibility standards for public bodies' websites and Bosnia and Herzegovina has an outdated state law from 2009 that was never enforced.

The WB6 are implementing some projects to improve digital inclusion for marginalised groups. Serbia is implementing the Programme for Enhancing Women in ICT (in rural areas), as well as donor-funded projects in the field of online safety, protection from digital violence and support to increase digital literacy among vulnerable groups of the population.[9] Donor-funded or civil society projects for women in the digital economy are also available in Bosnia and Herzegovina, Kosovo and North Macedonia, where the Innovation Fund also provides grants for companies that minimise social exclusion through technological solutions. The Ministry of Justice and Human and Minority Rights in Montenegro has provided free training and certification testing for the Roma population, campaigns for persons with disabilities, etc. Positively, the number of households that does not access the Internet due to lack of skills is decreasing across the WB6 (Figure 13.10). In Serbia and Kosovo, the share of total households with no Internet skills was 2% in 2019, lower than the EU average (4%). Lack of Internet access at home due to the high cost of access has also been steadily decreasing in the WB6. In 2019, the share of households without internet access due to high costs was close to the EU average (2%) in all economies, except Montenegro, where it was estimated around 8% (Figure 13.11).

Serbia is the only economy that provides strong co-ordination for implementing the digital inclusion framework at the highest level and across government bodies, through the Social Inclusion and Poverty Reduction Unit (SIPRU). The SIPRU publishes a Report on Digital Inclusion every four years, but despite their efforts, monitoring is insufficiently systematised and is dispersed across government bodies implementing respective programmes, which is also the case in all WB6 economies.

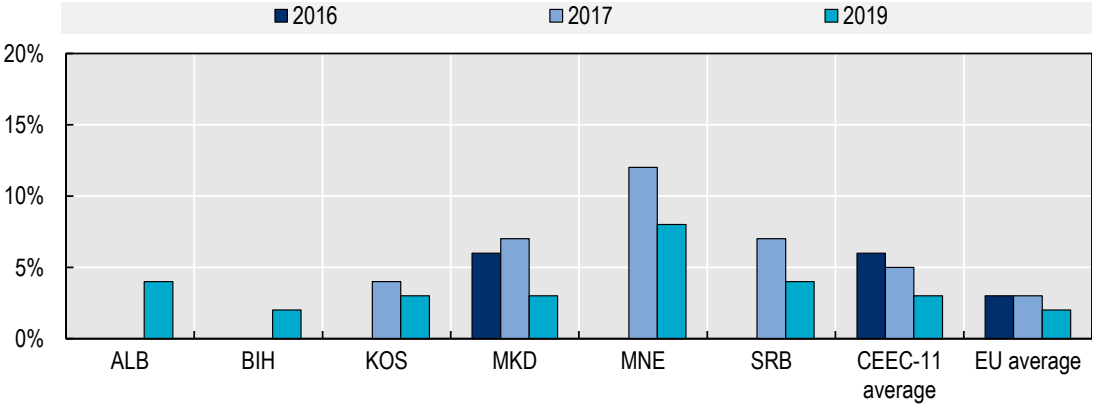
## Figure 13.10. Households without access to the Internet at home because of lack of skills (2016-19)




Note: EU average includes all EU Member States in the period 2013-20. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: ALB (INSTAT), (Eurostat, 2019[34]), "Households - reasons for not having internet access at home", https://ec.europa.eu/eurostat/databrowser/view/ISOC_PIBI_RNI__custom_366736/default/table?lang=en

StatLink https://doi.org/10.1787/888934254468

## Figure 13.11. Households without access to the Internet at home because of high access costs (2016-19)




Note: EU average includes all EU Member States in the period 2013-20. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, 2019[34]), "Households - reasons for not having internet access at home", https://ec.europa.eu/eurostat/databrowser/view/ISOC_PIBI_RNI__custom_1065139/default/table?lang=en.

StatLink https://doi.org/10.1787/888934254487

### *The way forward for society*

- **Adopt accessibility requirements in public procurement procedures for ICT products and services**. Bosnia and Herzegovina and Kosovo need to adopt and enforce e-accessibility requirements, while all WB6 economies except Montenegro need to complete their frameworks to include accessibility requirements in public procurement for ICT products and services and to create corresponding certification schemes. WB governments could consider how the Swedish government is approaching the implementation of ICT accessibility standards in public procurement (Box 13.10).
- **Systematise indicator monitoring for digital inclusion.** Western Balkan governments should create a dedicated public sector body to oversee, co-ordinate and monitor the various activities on digital inclusion, following the model of the Social Inclusion and

Poverty Reduction Unit (SIPRU) in Serbia. All WB6 governments need to create public databases that provide access to regularly collected data and analysis of digital inclusion.

### Box 13.10. Working for digital inclusion in procurement in Sweden

The COVID-19 crisis has tested our societies' response to implementing digital accessibility of public goods and services. It has highlighted how people with disabilities could have been so much more included in education, work, healthcare and making everyday life work, if governments had improved their use of tools for accessibility in public procurement of ICT. According to G3ict's DARE Index 2020, only 46% of 105 countries surveyed are in the process of implementing policies on accessibility of ICT products and services in public procurement.

In January 2021, about 100 individuals from the public sector, disability rights organisations and industry joined a roundtable on digital accessibility and universal design in procurement organised by The Swedish Disability Rights Federation, G3ict, Microsoft, and the European Disability Forum, to discuss sustainable strategies to systematically include digital accessibility in all procurement procedures.

Accessibility requirements are mandatory in the Swedish Public Procurement Act, implemented after receiving a special recommendation from the UN in 2014 to systematically set requirements for accessibility in all agreements on public procurement. The Swedish national procurement strategy emphasises universal design and accessibility, but many organisations still find it difficult to specify accessibility requirements in procurement of ICT products and services, among others. For this reason the Swedish Public Procurement Agency provides tools and support for the whole procurement process, including how to follow up accessibility requirements. They also welcome questions via their online forum where they answer questions on how to apply standards like the EN 301 549 accessibility standard developed to support EC rules that add accessibility criteria to the public procurement of ICT products and services and the EN 17161:2019 standard on accessibility following a Design for All approach in products, goods and services.

Note: Sweden transposed the EU Procurement Directive (2014/24/EU) on 1st January 2017, which requires that the requirements defined in other EU Acts, such as the Web Accessibility Directive (EU 2016/2102) or the European Accessibility Act (EEA) ((EU) 2019/882) on the accessibility requirements for products and services, are used in public procurement procedures. Member states need to comply with the EEA by 28 June 2022 and complete its implementation by 2025.

Source: The National Agency for Public Procurement of Sweden (n.d.[35]), *Public Procurement*, www.upphandlingsmyndigheten.se/en/about-public-procurement/; G3ict (2020[36]), *The DARE INDEX 2020 Report Global Progress in Digital Accessibility Implementation by CRPD States Parties*, https://g3ict.org/upload/accessible_DARE-Index-2020-Global-Progress-by-CRPD-States-Parties-ENGLISH.pdf; G3ict (2021[37]), *Time to Act! Make Digital Inclusion in Procurement a Habit in Sweden*, https://g3ict.org/blogs/time-to-act-make-digital-inclusion-in-procurement-a-habit-in-sweden.

## Trust (Sub-dimension 10.5)

Trust in the digital economy and society is critical for reaping the benefits of digitalisation. The COVID-19 crisis has demonstrated the importance of digital technologies for business continuity, both in the public and the private sector. It has also moved more consumers online and challenged the balance between data protection rights and public health protection. Digital infrastructures had to be rapidly scaled-up and processes had to be adjusted, creating opportunities that malicious actors leverage for their purposes. Thus, increased e-commerce activity has come with more reports of unfair, misleading and fraudulent commercial practices online, making the elderly and low-income consumers more vulnerable (OECD, 2020[38]). Under these circumstances, preparedness is key and there is a need for proactive policies to ensure trust and improve digital security (OECD, 2020[39]).

Overall, WB6 economies perform moderately on the trust sub-dimension (Table 13.6). All six economies have at least some relevant policies and a basic legal framework being implemented. However, lower scores in this assessment than in 2018 indicate that some economies need to improve their alignment with EU and international frameworks and ensure their implementation to address today's challenges in terms of data and privacy protection, online consumer protection and digital security. The majority of WB6 governments have not allocated sufficient resources for implementing existing frameworks, and more importantly they have not implemented awareness-raising campaigns to help citizens and business understand the risks and how to manage them.

### Table 13.6. Scores for Sub-dimension 10.5: Trust

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 10.5: Trust | Privacy protections | 2.5 | 2.0 | 2.0 | 2.5 | 2.0 | 2.5 | 2.3 |
| | Consumer protection in e-commerce | 2.0 | 1.5 | 2.5 | 2.0 | 2.0 | 2.5 | 2.1 |
| | Digital security risk management | 2.0 | 1.5 | 2.0 | 2.0 | 3.0 | 3.0 | 2.3 |
| **Sub-dimension average score** | | 2.2 | 1.7 | 2.2 | 2.2 | 2.3 | 2.7 | 2.2 |

### *Privacy and data protection frameworks are not sufficiently enforced*

The growing volume of personal data collected, analysed and exchanged has created new risks to people's privacy that call for comprehensive and agile policy and regulatory frameworks on data and privacy protections. This section assesses whether the policy and regulatory framework for data protection and privacy is in place and examines if competent authorities have the resources to implement it.

All WB6 economies have personal data protection (PDP) frameworks in place, but the majority have not improved their enforcement significantly since 2018. The assessment suggests that the WB6 economies have not sufficiently instilled a culture of data privacy and access-to-information mindsets in the public sector. Only three economies in the region have updated their existing PDP frameworks to align with the General Data Protection Regulation (EU 2016/679): Serbia in 2018, Kosovo in 2019 and North Macedonia in 2020. Albania and Montenegro have started preparations for a new law, while Bosnia and Herzegovina drafted a new PDP law in 2018, but has not adopted it yet. The government of the RS is preparing a law on information security that will also cover digital privacy issues at the entity level.

However, even in the three most advanced economies, the main difference between the GDPR and the new PDP legislation lies in the the penal policy, which remains mild in comparison to the stringent penal policy and extremely high fines introduced by the GDPR. The new PDP law in Serbia (applied in the second half of 2019) and the secondary legislation adopted in the course of 2019 and 2020 are in line with the principles and rules envisaged by the GDPR. However, the new law does not cover rules on video surveillance and processing of biometric data, which are important aspects of data processing (RCC, 2020[40]). Sectoral or special laws and regulations governing data processing activities in Serbia require harmonisation with the new PDP law. In Kosovo, by-laws deriving from the new law (such as allowing fines to be imposed) and sub-normative acts for certification criteria and procedures for data controllers and processors, are pending. North Macedonia's new law will only come into force in August 2021, after an 18-month transition period. The new law is aligned with the GDPR, but further harmonisation of existing special or sectoral legislation is required.

Serbia has partially aligned its new PDP law with the EU Police Directive (EU 2016/680) on the protection of natural persons with regard to the automatic processing of personal data by competent authorities. It is also the only WB economy to have ratified the 2018 Council of Europe (CoE) Protocol amending the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (CETS No.223).[10] Bosnia and Herzegovina and North Macedonia have signed the protocol, and Albania is preparing relevant legislation.

All WB6 economies face difficulties enforcing their existing PDP frameworks. The competent authorities (PDP agencies or commissioners) for supervising enforcement and implementing compliance inspections lack staff and resources for internal training and public sector capacity building. In Albania, Kosovo, Montenegro and Serbia, the responsibilities of these authorities extend to supervising the framework for access to public information. The assessment shows that the majority of public officials are not prepared to fully respect the right to access public information. In some cases, the lack of political commitment exacerbates the situation. In Kosovo, for example, a PDP Commissioner has not been appointed for more than three years, which means that there is practically no institutional mechanism in place to perform inspections. In Serbia, the Commissioner's annual report was considered by the National Assembly in 2018, for the first time since 2014. Certain conclusions to strengthen the enforcement of the framework were adopted, although are yet to be implemented.

The COVID-19 crisis has further exposed challenges of limited awareness of PDP rights and obligations, with authorities struggling to find the right balance between health protections and respecting the confidentiality of personal health data and the right to the private life of citizens. For example, measures on personal data disclosure taken by public institutions in Montenegro to address the COVID-19 pandemic have raised questions by civil society organisations on disproportionality (AZLP, 2020[41]). In this context, the Information and Data Protection (IDP) Commissioner in Albania strengthened the personal data protection framework by adopting three guidelines in 2020.

### *Consumers have limited opportunities to learn about their rights in e-commerce*

The absence of direct contact in online commerce makes a predictable and trustworthy e-commerce marketplace all the more important. In this context, the role of consumer protection authorities becomes essential and creates a need to strengthen policies and capacities for consumer protection in e-commerce (OECD, 2016[42]). This section assesses if policies or programmes are in place and whether they adequately educate online consumers on their rights and how to exercise them.

The majority of the WB6 economies have not sufficiently updated their frameworks to promote consumer protection in e-commerce. Serbia is the only economy that has demonstrated commitment to improve the alignment of its consumer protection framework with international practices and to prioritise consumer awareness. The UNCTAD B2C e-Commerce Index 2020[11] includes Serbia, North Macedonia and Bosnia and Herzegovina in the top-10 transition economies. Serbia ranks 43rd out of 152 economies (excluding Kosovo), followed by North Macedonia (52nd), Bosnia and Herzegovina (70th), Montenegro (78th) and Albania (86th) (UNCTAD, 2020[43]).

All WB economies (except Bosnia and Herzegovina) have adopted polices or programmes for consumer protection that include some measures for e-commerce, but implementation is slow. The laws on consumer protection have been updated to increase alignment with the EU Directive on consumer rights (2011/83/EU) in Albania (2013), Kosovo (2018), Montenegro (2019) and Serbia (2018), as well as in the RS in Bosnia and Herzegovina (2017). Albanian legislation is being updated to reduce the cost of shipping and to transpose the EU regulation on cross-border parcel delivery services (2018/644/EU), which is expected around June 2021. Montenegro is also working on subsequent secondary legislation and two relevant regulations were adopted in 2020. On the other hand, although North Macedonia prepared a new draft of the Law on Consumer Protection in 2019, it has not been adopted. Legislation at the state level in Bosnia and Herzegovina is outdated, and the government of the FBiH has not yet adopted a relevant framework. E-commerce legislation is in place in all WB6 economies and in line with the e-Commerce Directive (2000/31/EC). However, only North Macedonia, Serbia and the RS have updated their legislation since 2017 to further improve their alignment with the EU *acquis*.

All the WB6 economies apart from Bosnia and Herzegovina have tasked their consumer protection authorities with enforcing the framework and monitoring consumer protection in e-commerce, but data collection is poor. The consumer protection authorities in the five economies publish monitoring reports,

but few include information on e-commerce complaints, either because data are insufficiently monitored or because complaints on e-commerce are infrequent. Positively, the Ministry of Trade and Industry in Kosovo published a report in 2020 that includes data on online shopping complaints. The situation is different in Bosnia and Herzegovina, where the Ombudsman for Consumer Protection and Market Surveillance Agency of Bosnia and Herzegovina operates under the consumer protection law of 2006, which does not address e-commerce transactions.

WB6 citizens' online shopping culture is changing and trust is increasing with gradual improvement of e-payment systems, but e-commerce is still low in the region compared to the EU average. In 2019, the share of the population that had made Internet purchases in the previous 12 months was 34% in Serbia, 30% in Kosovo, 29% in North Macedonia, 23% in Bosnia and Herzegovina, 16% in Montenegro and 7% in Albania. All of these are much lower than the EU average of 63% (Eurostat, 2021[44]). WB6 governments provide limited opportunities for consumer education in e-commerce. Although their frameworks foresee awareness-raising activities, resources to implement them are limited. Serbia is an exception, launching a good practice initiative that could be replicated in the region (Box 13.11).

### Box 13.11. Promoting trust in e-commerce and online consumer education in Serbia

Serbia has demonstrated commitment to improving consumer protection in e-commerce through its Strategy for Consumer Protection for 2019-2024 and Programme for the Development of e-Commerce (2019-2020). These aim to address obstacles to e-commerce growth (e.g., strengthening consumer confidence in online shopping, empowering e-traders, improving logistics flows, promoting electronic payment, etc.).

A platform for e-commerce, the '*Smart and Safe*' platform, has been created offering information and web services for consumers on a dedicated portal hosted by the Ministry of Trade, Tourism and Telecommunications (MTTT). A public awareness campaign was also implemented to boost consumers' trust in e-commerce, promoting e-banking and card payments. The platform includes a guide for consumers in e-commerce and tips for e-traders (https://pametnoibezbedno.gov.rs/elektronska-trgovina) and the "eShop fast, easy and simple" video campaign (https://pametnoibezbedno.gov.rs/video/4).

Serbia has also leveraged donor funding to build public sector capacities for consumer protection. An example is the twinning project Further Development of Consumer Protection in Serbia, jointly funded by the EU and the Republic of Serbia to the tune of EUR 1.425 million, and implemented from 2017 to 2019. The project supported the transfer of expertise on consumer protection from the Ministry of the National Development of the Republic of Hungary and the Regional Development Agency Senec-Pezinok of Slovakia.

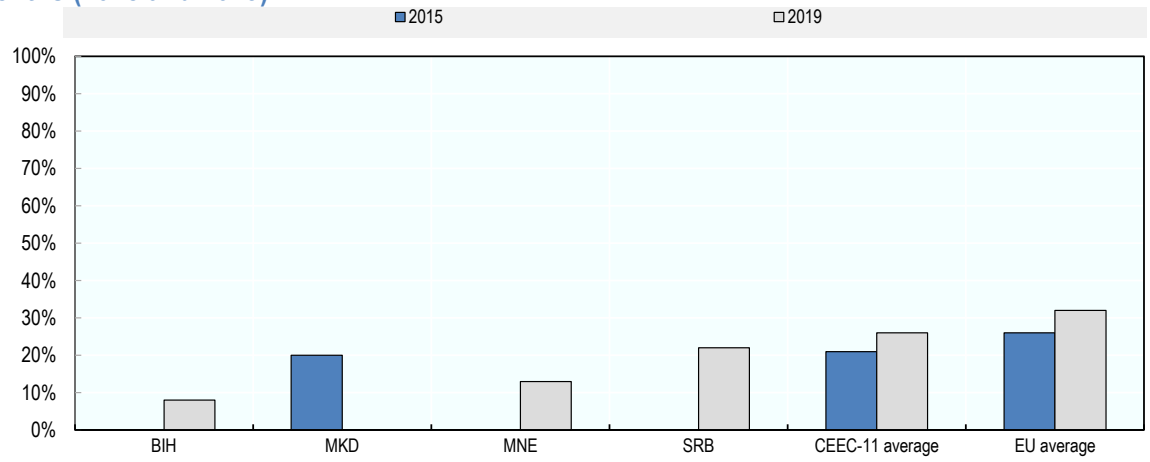
Source: (Government of the Republic of Serbia, n.d.[45]), *eCommerce The Future is Now*, www.srbija.gov.rs/tekst/en/129967/ecommerce.php ; (Ministry of Trade Tourism and Telecommunications, n.d.[46]), *Sektor za zaštitu potrošača*, https://zastitapotrosaca.gov.rs/o-nama#S4.

## *Digital security risk management is slowly coming into line with the EU cybersecurity framework*

Digital security threats are growing in number and sophistication, pushing governments to adopt digital security risk management policies that strengthen digital security and ensure that all stakeholders understand the risks and how to manage them (OECD, 2015[47]). This section examines whether the WB6 have established comprehensive cybersecurity strategies and allocated sufficient resources to protect critical infrastructure and sensitive data.

All WB6 economies have ratified the CoE Convention on Cybercrime (CETS No.185) and all, apart from Bosnia and Herzegovina, have a cybersecurity strategy in place and are implementing it. However, Kosovo has not updated its strategy beyond 2019 and North Macedonia has not fully budgeted its action plan since 2018. Republika Srpska (RS) in Bosnia and Herzegovina is preparing a cybersecurity strategy at the entity level. Kosovo, Montenegro, North Macedonia and Serbia have each established a dedicated cybersecurity council or body to provide cross-cutting co-ordination for implementing the strategy and overall data collection. However, relevant reports are not publicly available in any economy. Overall, monitoring of digital security and risk management awareness activities among public and private sector stakeholders are weak in the WB6, which is reflected in the low share of enterprises that have created an ICT security policy in the last two years (Figure 13.12).

## Figure 13.12. Enterprises that have defined or reviewed their ICT security policy in the last 24 months (2015 and 2019)




Note: No data are available for Albania and Kosovo. EU includes all EU Member States in the 2013-20 period. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Eurostat, 2019[48]), "Security policy: measures, risks and staff awareness", https://ec.europa.eu/eurostat/databrowser/view/isoc_cisce_ra/default/table?lang=en

StatLink https://doi.org/10.1787/888934254506

The majority of WB6 economies have made progress in aligning with the eIDAS Regulation on electronic identification, authentication, and trust services (EU 910/2014). Serbia adopted a new law on e-identification and trusted services in 2017 and has completed the regulations needed for full alignment with the eIDAS Regulation. North Macedonia and Montenegro adopted new legislation in 2019 and Kosovo followed in 2020, but subsequent regulations in the economy are still pending. Albania adopted a new law in 2015, but full transposition of eIDAS is planned in 2021. Relevant legislation in Bosnia and Herzegovina is based on an outdated e-signature law from 2006 that was never implemented. However, in October 2019, the Office for the Supervision and Accreditation of Certifiers in Bosnia and Herzegovina registered the first trust service provider to introduce qualified electronic signatures in the economy. In the Republika Srpska, updated legislation on eID is already being implemented and relevant bylaws are in place.

The WB6 economies are also in the process of aligning their laws with the Network and Information Security (NIS) Directive on security of network and information systems (EU 2016/1148). New laws on information security or cyber security have been adopted in Albania, Montenegro, North Macedonia and Serbia, although each economy has a different harmonisation pathway for completing the alignment. Kosovo is also preparing a relevant new law. In Bosnia and Herzegovina, the state government is planning to draft relevant legislation, while the entity government in Republika Srpska is already preparing a new Law on Information Security in line with the NIS Directive, to replace the existing law from 2011. Since 2018, Albania, Kosovo, Montenegro and Serbia have all adopted legislation identifying critical infrastructure, further improving their alignment with the EU framework.

The WB6 have established economy-wide computer emergency response teams (CERTs), in line with the NIS Directive, though most are significantly understaffed and only marginally operational. In Kosovo and North Macedonia they are operating with only two staff members each. Montenegro's CIRT.ME, Albania's AL-CSIRT (an integral part of the National Authority on Electronic Certification and Cyber Security; AKCESK) and the Serbian NCERT have recently increased their staff to six or seven employees. Bosnia and Herzegovina has not established a CERT at the state level, but an entity-level CERT is operating in the RS. The WB6, except Serbia, have not made satisfactory progress in creating additional public and private computer security incident response teams (CSIRTs). In Serbia, in contrast, 13 additional special CERTs have been created. In most WB6 economies, CERTs depend significantly on donor-funded projects for capacity building and international co-operation, which is critical in this line of activity, although Serbia is stronger than the other economies in technology transfer and tools for digital security risk management. Positively, Albania (AL-CSIRT), Kosovo (KOS-CERT) and North Macedonia (MKD-CIRT) have signed an MoU on co-operation, which is a step towards implementing the CRM Action Plan (Box 13.12).

### Box 13.12. Towards a common regional approach to digital trust and security

The following key findings of the CO2021 sub-dimension on trust can inform implementation of the Common Regional Market (CRM) Action Plan 2021-24 actions on the CRM trust and security component:

- Three WB economies (Kosovo, North Macedonia and Serbia) have aligned their frameworks on data protection with the EU GDPR (EU 2016/679) and the other three WB economies (Albania, Bosnia and Herzegovina, and Montenegro) are preparing to follow, but in most cases secondary legislation and full harmonisation are pending.
- Competent authorities for data protection and privacy in the majority of the WB6 have limited human resources and power to supervise and enforce the frameworks.
- The WB6 economies (except Bosnia and Herzegovina) have a cybersecurity strategy and legislation in place and are gradually aligning with the NIS Directive (EU 2016/1148). These five economies have established an economy-wide CERT team for incident response. However, budgetary allocations for action plans and CERT technical and human resources are limited in the majority of WB economies.
- The majority of WB governments have updated legislation on e-identification to align with the eIDAS Regulation (EU 910/2014), but further work is needed in some WB economies to complete the alignment, adopt regulations and improve implementation of e-signature schemes. Mutual recognition of e-identification schemes across the region has not been promoted.

### *The way forward for trust*

- **Complete alignment with the EU General Data Protection Regulation and ensure stronger enforcement of the framework.** Albania, Bosnia and Herzegovina, and Montenegro need to accelerate the adoption of new legislation on data protection and privacy, aligning with the GDPR (EU 2016/679). Kosovo, North Macedonia and Serbia should prioritise the harmonisation of sectoral legislation and improve regulatory compliance to complete alignment with the GDPR. All WB6 economies need to ensure that authorities supervising implementation of the data protection and access to public information framework have sufficient human and financial resources to fulfil their enhanced responsibilities. WB governments also need to guarantee the authorities' executive power and capacity to enforce compliance by public and private sector entities. An adequate

budget is also vital to build the capacity of public officials to cultivate a new data privacy and transparency culture.

- **Complete the framework on consumer protection in e-commerce and provide opportunities for consumers to learn about their rights and how to exercise them.** Bosnia and Herzegovina and North Macedonia need to accelerate the adoption of a consumer protection policy or programme that includes protection in e-commerce and a law on consumer protection that aligns with the EU framework. Albania, Kosovo and Montenegro need to continue legislative improvements to remove any obstacles to e-commerce take-up. All economies need to ensure that consumer protection legislation addresses fraudulent or misleading practices, privacy issues, dispute resolution, and redress in e-commerce transactions. They also need to increase efforts to monitor online consumer protection indicators and to implement awareness-raising campaigns such as Serbia's (Box 13.11), to educate consumers and build trust in e-commerce.
- **Strengthen human and technical capacities for cybersecurity and complete alignment with the NIS Directive on information systems and networks security**. Bosnia and Herzegovina and Kosovo need to adopt new policies on cybersecurity that go beyond 2021 and accelerate the adoption of legislation aligned with the NIS Directive (EU 2016/1148), including also the definition of critical infrastructure. Bosnia and Herzegovina needs to increase efforts to establish a CERT to start international co-operation on incident response management. Kosovo and North Macedonia need to increase the human and financial resources of their CERTs, while all economies need to invest in public sector capacity building to strengthen cybersecurity and improve digital security risk management capabilities.

## Conclusion

The WB economies have made strides in promoting broadband development and digital government to underpin the digital economy. They have continued on their path to EU integration by aligning – to varying degrees – their legal and regulatory frameworks on interoperability, e-identification, e-commerce, e-accessibility, data protection, and cybersecurity. They have also laid the foundations for data accessibility, openness and transparency by setting out and harmonising legal frameworks.

However, weaknesses remain. Support for SME digitalisation and ICT sector growth is underfunded. Lack of co-ordination with industry stakeholders on digital skills development is hindering the closure of the skills gap. Digital inclusion programmes and awareness-raising activities for building trust in the digital economy are also poorly supported.

The successful implementation of the digital society and economy in the WB6 is closely tied to implementing the recommendations put forward in this chapter. Achieving greater digital literacy for the population; improving access to high-speed Internet, data and digital technologies for individuals and businesses; and leveraging regional co-operation will ultimately help increase integration with the global digital economy.

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## Notes

[1] It should be noted, however, that this indicator is affected by the average number of people in a household, which may be higher in some of the WB6 (e.g. in Kosovo) than in EU Member States, leading to fewer subscriptions as a percentage of the population. A more careful look into the data behind this indicator may also find that WB6 subscriptions often offer much lower data speeds on average than those in the EU Member States.

[2] The Digital Economy and Society Index (DESI) is s a composite index that summarises relevant indicators on Europe's digital performance, under the EU's digital strategy Shaping EU's Digital Future. Data for the EU average retrieved from https://digital-agenda-data.eu/charts/analyse-one-indicator-and-compare-countries.

[3] The 11 Central and Eastern European countries (CEECs) which have joined the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[4] An initiative funded by the European Union https://www.wbif.eu/.

[5] The EGDI, which assesses e-government development at the economy level, is a composite index based on the weighted average of three normalised indices: the Telecommunications Infrastructure Index (TII) based on ITU data, the Human Capital Index (HCI) based on UNESCO data, and the Online Service Index

(OSI) based on data from an independent Online Service Questionnaire (OSQ), conducted by UNDESA, and a Member State Questionnaire (MSQ).

[6] The IPA II three-year project EU Support to Digitalisation of Businesses through ICT (European Commission, 2019[49]).

[7] German Organization for International Cooperation (GIZ).

[8] The Agency for the Delivery of Integrated Services Albania (ADISA) is an agency of the Albanian Government under the supervision of the Prime Minister's Office (https://adisa.gov.al/).

[9] A variety of projects on digital inclusion in Serbia and North Macedonia are referenced in the Digital Inclusion Atlas (https://digitalinclusion.eu/digital-map/), which was created by the European Knowledge Community on Digital Inclusion, supported by the MEDICI project *(*Mapping the Evolving Digital Inclusion Landscape to Support Cohesion and Integration) and funded by the European Parliament.

[10] All EU member states have signed the Protocol (Council of Europe Treaty 223), but not all states have ratified it until 31/03/2021 (www.coe.int/en/web/conventions/full-list/-/conventions/treaty/223/signatures?p_auth=oUeuTKBx).

[11] The UNCTAD B2C E-commerce Index measures an economy's preparedness to support online shopping.

# 14 Transport policy (Dimension 11)

The Western Balkans is a strategic region with excellent potential for transit traffic. A well-developed, sustainable, efficient, interoperable and integrated transport network could be a driver of closer co-operation with neighbouring European Union (EU) economies, leading to a single European and more competitive transport market. This chapter assesses the transport policy framework in the six Western Balkan (WB6) economies. It starts with a brief overview of the transport competitiveness of each economy, including performance on various global indicators, and then focuses on the three sub-dimensions that contribute to overall transport performance. The first sub-dimension, planning, measures the extent to which an orderly, coherent, consistent and transparent process is in place for developing transport policy and infrastructure. The second sub-dimension, governance and regulation, determines how well transport infrastructure and networks are regulated and operated, with a focus on rail, road, aviation, inland waterways and maritime transport. The third sub-dimension, sustainability, measures progress towards resource efficiency, environmental protection, reducing health impacts and increasing road safety. The chapter includes suggestions for enhancing policies in each of these sub-dimensions in order to improve transport performance and foster the competitiveness of the WB6 economies.

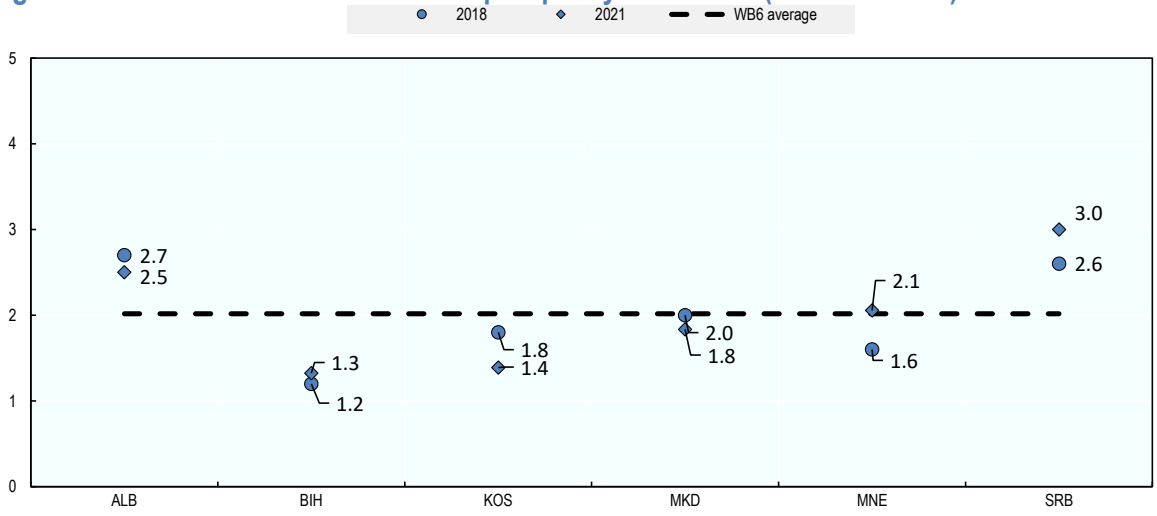
## Key findings

- **Since the last Competitiveness Outlook (CO) assessment in 2018, the Transport Community Permanent Secretariat (TCPS) has been established with the aim of deepening the integration of the Western Balkans' transport markets into the EU market**. The TCPS will help WB6 economies adopt and implement EU legislation in the area of transport regarding common standards, network efficiency, and quality of service offered to citizens and businesses. Its headquarters have been in Belgrade, Serbia since 2019, operating under the Transport Community Treaty (TCT). The Ministerial Council of the TCPS endorsed regional action plans for roads, railways, road safety and transport facilitation in October 2020.
- **Five of the WB6 economies have developed long-term transport strategies, while Serbia is currently in the procurement process for developing its new strategy**. The development of these strategies is mainly funded by international financial institutions (IFIs). A remaining challenge, also noted in the previous CO assessment, is that most of the economies' transport-related strategies lack corresponding monitoring and implementation plans.
- **Only Albania and Serbia have well-developed project prioritisation tools**. The other WB6 economies still have weak secondary legislation on project identification, selection and prioritisation, which impacts the effective spending of funds.
- **A key achievement regarding transport facilitation is the opening of a one-stop shop** on Corridor X in July 2019 at the road border crossing point between North Macedonia and Serbia. This form of cross-border co-operation could have positive effects by reducing long queues and waiting times, and could facilitate regional traffic.
- **Rail regulatory reforms have continued to a certain extent**, promoting harmonisation with the EU *acquis* and the TCT; however, the rail market is not yet fully opened, and more efforts are needed to align this area with the TCT.
- **The WB6 economies have achieved better results in improving road safety** and reducing the total number of road fatalities in the period 2017-2019 (10%) than Central and Eastern European countries (CEEC) (3%), the EU (3%) and the OECD (7%).
- **An asset management system is still in the early phases of development**, with most economies (Albania, Bosnia and Herzegovina, Montenegro, North Macedonia, Serbia) taking steps mainly related to the road sector, and some in the rail sector.
- **The environmental sustainability of the transport sector is partially covered through various strategies**. However, there is no single tool to monitor the implementation of recommended actions and measures at various locations.
- **Combined transport, as a transport mode which has the best cost efficiency, decreases environmental pollution, and increases co-operation between freight forwarding network companies, is underdeveloped in the region**. However, there have been positive movements in Albania, Bosnia and Herzegovina, Montenegro and Serbia, which participated in the Integrating Multimodal Connections in Adriatic-Ionian Region project (2018-20) jointly with Croatia, Greece, Italy and Slovenia. This project provided an incentives programme for intermodality in Serbia.

## Comparison with the 2018 assessment

Albania, Montenegro and Serbia have improved their scores for transport policy since the previous CO assessment; however, performance in Bosnia and Herzegovina and Kosovo is below the WB6 regional average (Figure 14.1). It is important to note that transport policy scores between the 2018 and 2021 assessment cycles are not directly comparable due to the upgrade of the assessment framework.

### Figure 14.1. Overall scores for the transport policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition and removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Progress on implementing the policy recommendations made in the CO 2018 has been limited overall (Table 14.1), although there has been some progress regarding transport policy making, partial alignment with the EU *acquis* and transport facilitation.

## Table 14.1. Implementation of the CO 2018 policy recommendations: Transport policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 Policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Strengthen the effectiveness of the new transport strategies and the project selection process** | • Albania adopted a new tool in 2020 for project selection and prioritisation and a financial information system. Together these will lead to the controlled spending of state funds allocated for transport infrastructure.<br>• Serbia adopted a new tool for project selection and prioritisation in 2019 that includes affordability, project implementation framework and *ex post* assessment. | Limited to moderate |
| **Complete transport market reforms** | • Rail markets are mainly liberalised for local operators in all WB6 economies, while full liberalisation is expected once all regional economies become EU members. | Limited to moderate |
| **Address the drivers of logistics performance, which is key to enabling trade competitiveness, in a co-ordinated way** | • There is no defined regional approach to drivers of logistics performance. Some regional economies have developed internal logistics strategies (e.g. Albania and Serbia) and decided on the locations of new intermodal terminals.<br>• A new intermodal terminal in Belgrade (Serbia), Batajnica, is under construction. Serbia is also preparing four additional projects connected with the inland ports of Bogojevo, Prahovo, Sremska Mitrovica and Belgrade, all of which involve the construction of intermodal terminals within the ports. The Port of Belgrade is envisaged to be developed as a dry port to be used for the most important sea ports in neighbouring economies.<br>• An intermodal terminal near Skopje (North Macedonia), Trubarevo, is planned, with the government in the phase of engaging a designer.<br>• Logistics and combined transport are still not well co-ordinated with other transport modes. There have been no visible developments during the assessment period, except in Serbia where an incentives programme for shifting freight to intermodal transport was launched in 2018. | Limited to moderate |
| **Make the resilience of key transport infrastructure assets a policy priority** | • Most WB6 economies have made early development steps to establish an asset management system for roads (the newly developed bridge management system in North Macedonia, tendered in 2019, will be a component of the road asset management system). Efforts regarding other transport modes do not exist or are in the early planning phase. | Limited |
| **Integrate key aspects of sustainability such as environmental quality into transport strategies** | • Environmental sustainability in the transport sector is partially covered through various strategies, but there is no single tool to monitor the implementation of recommended actions and measures at various locations.<br>• The TCPS is currently developing a Sustainable and Smart Strategy for the Western Balkans.<br>• Albania is drafting a new Transport Sector Strategy 2021-2026 based on the EU's Sustainable and Smart Mobility Strategy. | Limited to moderate |

## Introduction

The Western Balkans is a strategic region with excellent potential for transit traffic. A well-developed, sustainable, efficient, interoperable and integrated transport network could be a driver of closer co-operation with neighbouring EU economies, leading to a single European and more competitive transport market.

Connectivity is seen as a platform that boosts the competitiveness of the region, opens policy dialogue and strengthens bilateral and multilateral co-operation in the region.

The Western Balkans clearly still needs considerable investment in transport infrastructure to be in line with Trans-European Transport Network (TEN-T) standards. As a first step, the policy framework needs to be brought into line with the EU *acquis* and the Transport Community Treaty (TCT) (EUR-Lex, 2017[1]), following the recommendations made in this chapter.

The transport dimension has close links with other dimensions assessed in this publication:

- **Chapter 4. Investment policy and promotion.** Transport infrastructure investment can be a key trigger for better connectivity by helping improve access to remote and abandoned areas and to international markets. Properly planned investment policy in transport infrastructure could lead to better quality transport, and thus increase the region's attractiveness.
- **Chapter 5. Trade policy** focuses on trade facilitation, which depends mainly on the physical infrastructure of transport, traffic management, and customs and border crossing points, as well as customs clearance processes, etc. Trade performance could be boosted once infrastructure is well developed; therefore, policy makers should integrate the vision of the transport dimension into trade policy plans.
- **Chapter 7. Tax policy** focuses on establishing an efficient system of taxes and charges, including for transport infrastructure and transportation services. Taxes should be based on the marginal social costs approach (including health, environment, accidents, congestion) to maximise social welfare.
- **Chapter 12. Science, technology and innovation** can be important for developing innovative methods for greener transport infrastructure, developing an efficient transportation system and providing better user experience. The average fuel consumption of the car fleet has decreased at the EU level (Faberi et al., 2015[2]) thanks to the progress achieved with new cars. This trend should be supported by policy makers.
- **Chapter 13. Digital society** focuses on digitalising transport services to boost the quality of living conditions for people. Digital tools and systems also facilitate the data collection used for transport planning, and therefore impact the spending of funds.
- **Chapter 15. Energy policy.** Transport is one of the key polluters, thus energy policy approaches targeting energy savings and emissions in the transport sector are essential. Inefficient fuel consumption leads to higher levels of pollution, which increases the costs to society and to the environment.
- **Chapter 16. Environment policy** focuses on reducing emissions across the region, for example through adequate transport policies with sufficient rules on fuel and car models. Environmental policy is also directly related to impact assessments regarding the construction or reconstruction of transport infrastructure.
- **Chapter 18. Tourism policy.** Transport infrastructure is important for connecting tourists to destinations, and facilitating internal movement between attractions, accommodation and commercial services. Better connectivity, including greater transport infrastructure capacities and faster border crossing points, could boost the development of tourism.

## Assessment framework

### *Structure*

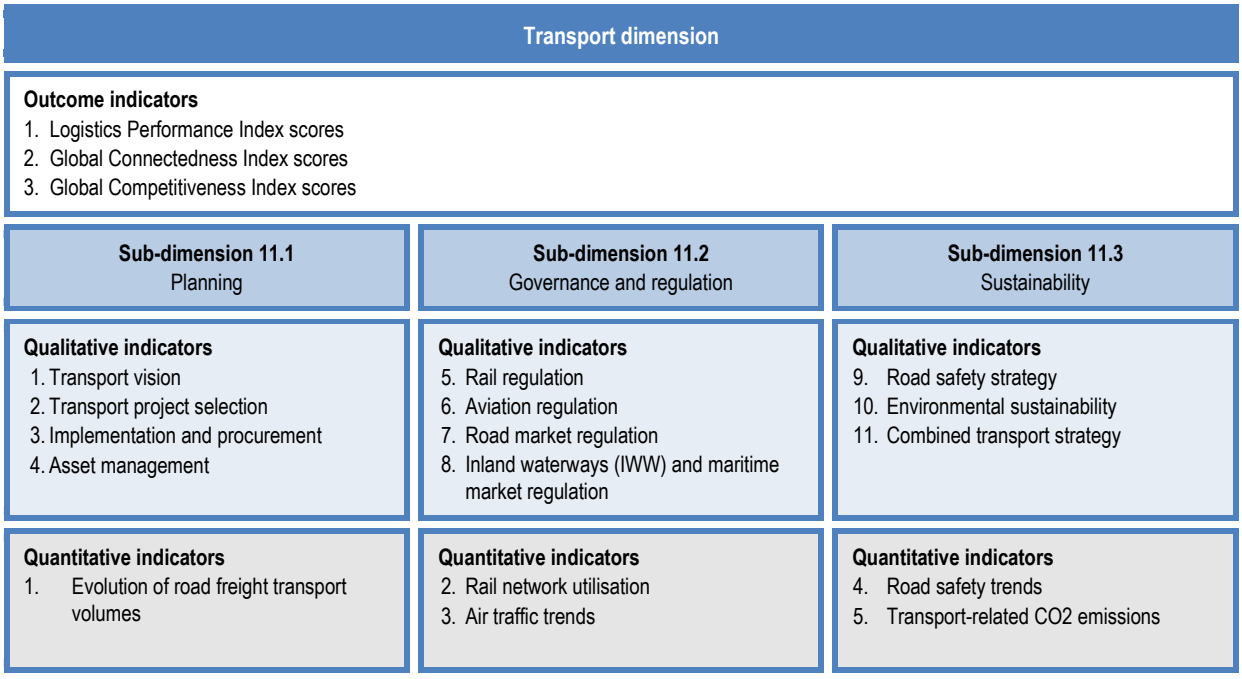
This chapter assesses transport policies in the WB6 through three broad sub-dimensions:

1. **Sub-dimension 11.1: Planning** assesses whether the transport dimension vision has set clear and measurable objectives. It covers all transport modes equally, including allocated budgets of actions and measures, a responsible agency for implementation, and timelines for implementation.
2. **Sub-dimension 11.2: Governance and regulation** assesses whether stable, transparent, and sustainable measures are in place to facilitate and attract investment, as well as the operation of safe, interoperable, reliable and efficient transport. It also assesses the level of harmonisation of regional legislation with the EU *acquis* and the TCT as a base for the development of regional and single European transport markets.

3. **Sub-dimension 11.3: Sustainability** assesses the challenges that WB6 economies face in reducing road fatalities, promoting the development of environmentally sustainable transport infrastructure and ensuring long-term competitiveness.

Figure 14.2 shows how the sub-dimensions and their indicators make up the transport policy dimension assessment framework. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment.

## Figure 14.2. Transport policy dimension assessment framework




The leaders of the WB6 economies endorsed the Common Regional Market 2021-2024 Action Plan (CRM 2021-24 AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The Action Plan is made up of targeted actions in four key areas: 1) regional trade; 2) regional investment; 3) regional digitalisation; and 4) regional industrial and innovation activities.

In the regional trade area, the WB6 economies have committed to closely aligning rules and regulations with the core principles governing the EU internal market based on the "four freedoms" of enabling goods, services, capital and people to move more freely across the region. The regional trade part of the CRM 2021-24 AP includes five components: 1) cross-cutting trade measures; 2) goods; 3) services; 4) capital; and 5) people. The key findings of the CO 2021 transport policy dimension can inform the implementation of the actions under the relevant components of the Common Regional Market Action Plan (Box 14.1).

### *Key methodological changes to the assessment framework*

Since the previous CO 2018 assessment the list of qualitative and quantitative indicators has expanded. Qualitative indicators under sub-dimension 11.2 were extended to include IWW and maritime market regulation. Quantitative indicators were also upgraded. Additionally, the qualitative analysis was adjusted for almost all levels and indicators to reflect remaining challenges noted in the previous CO assessment. The description was also upgraded to be consistent with the findings of the previous CO assessment.

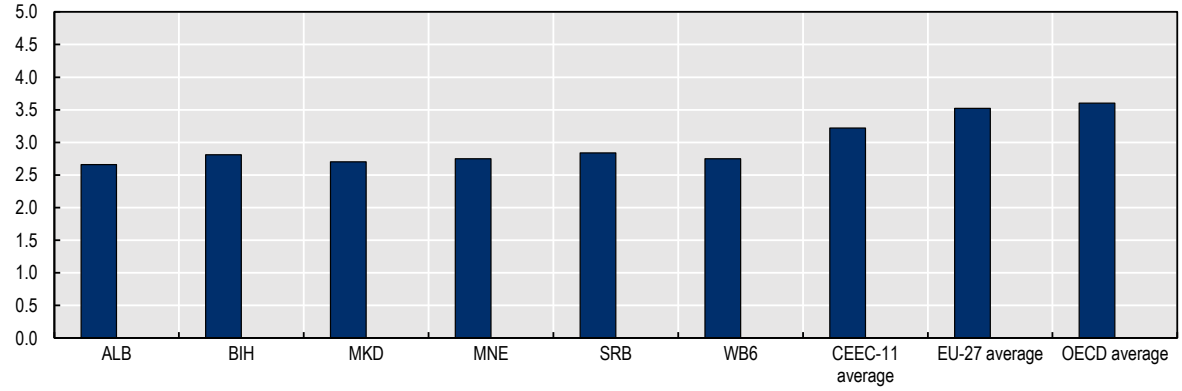
## Transport policy performance and context in the WB6

The overview of transport policy in the WB6 economies is assessed against the following outcome indicators for transport performance: the Logistics Performance Index (LPI), the Global Competitiveness Index (GCI) and the DHL Global Connectedness Index (DHLGCI).

The World Bank's LPI is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation (World Bank, 2020[3]). It is based on a survey of port operators, shippers and freight forwarders and produces a composite index that reflects questionnaire responses. The LPI is oriented towards assessing the transport of manufactured goods rather than bulk commodities and is more applicable to high-value goods.

The five WB6 economies for which data are available perform below the Central and Eastern European countries (CEEC-11), OECD and EU averages on the LPI (Figure 14.3). Over the period 2016-18, LPI average scores were the same as during the previous CO assessment, between 2.5 and 3, with Serbia receiving a marginally higher score than its neighbours.

### Figure 14.3. WB6 Logistic Performance Index scores (2016-2018)

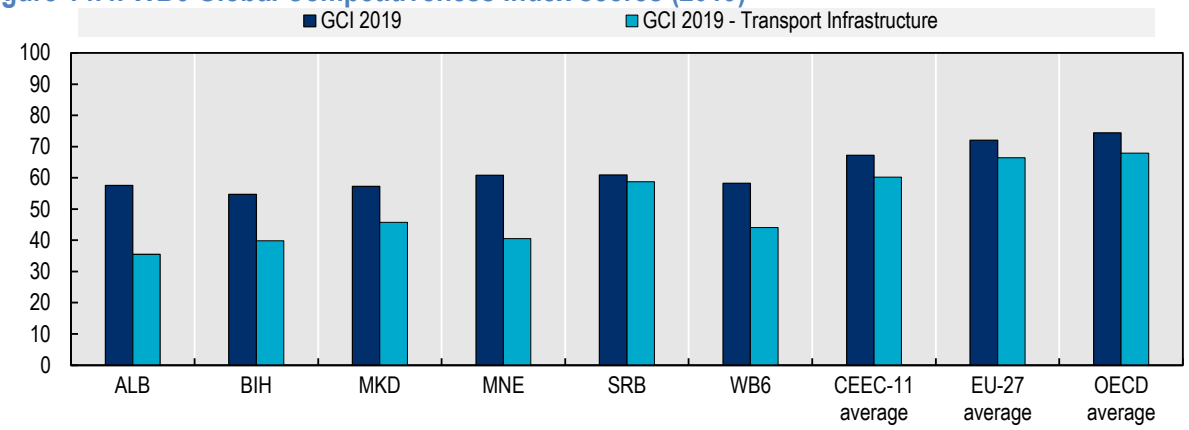



Note: Data for Kosovo not available. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. OECD and EU averages are calculated as simple averages.
Source: (World Bank, 2020[3]), *Logistics Performance Index Dataset (database)*, retrieved from: https://lpi.worldbank.org/.

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Like the LPI, the World Economic Forum's GCI measures perceptions rather than actual performance (WEF, 2019[4]). The GCI is based on unique data from the Executive Opinion Survey, which surveys top business executives in all participating economies. Figure 14.4 shows the most recent score for the five participating WB6 economies in the infrastructure domain, the most relevant of the 12 pillars of competitiveness covered by the index. Serbia receives the highest score for the overall GCI, while Serbia and Montenegro receive the highest scores for transport infrastructure, although these are still below the CEEC-11, EU and OECD averages.

## Figure 14.4. WB6 Global Competitiveness Index scores (2019)

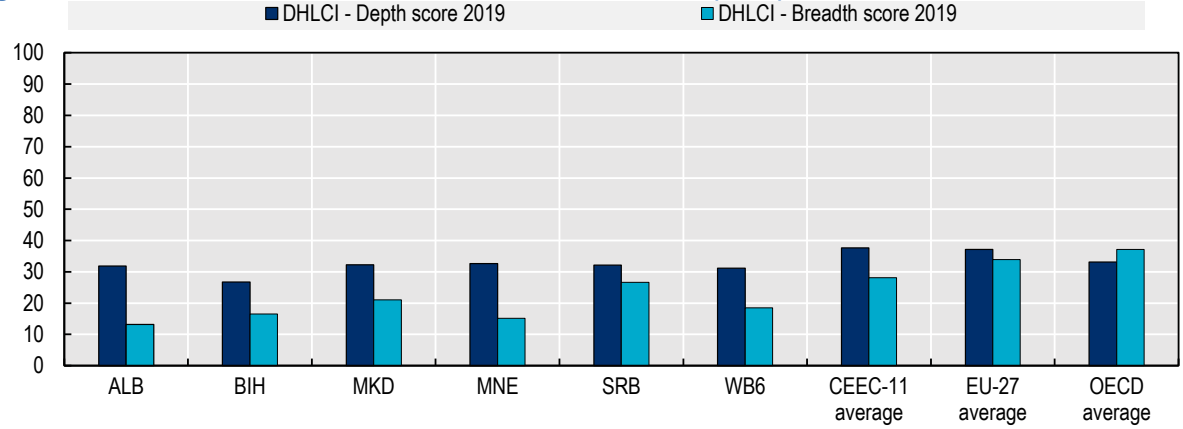



Note: Data for Kosovo not available. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. OECD and EU averages are calculated as simple averages.
Source: (WEF, 2019[4]), *Global Competitiveness Report*, http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf.

StatLink https://doi.org/10.1787/888934254544

The DHLGCI is an output indicator that assesses the integration of economies in global trade flows (DHL, 2019[5]). It identifies four specific categories of flow: 1) trade flows (products and services); 2) investment flows (capital); 3) information flows; and 4) people flows. "Depth" refers to the size of an economy's international flows compared to a relevant measure of the size of its domestic economy. It reflects the importance of pervasive interactions with the rest of world. "Breadth" measures how closely an economy's distribution of international flows with its partner economies matches the global distribution of the same flows in the opposite direction. The five WB6 economies covered by the index fare well for their economic internationalisation (depth) but less so for trade diversification (breadth), given their small size (Figure 14.5).

## Figure 14.5. WB6 DHL Global Connectedness Index scores (2019)




Note: Data for Kosovo not available. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. OECD and EU averages are calculated as simple averages. OECD and EU averages are calculated as simple averages.
Source: (DHL, 2019[5]), *DHL Connectedness Index Dataset (database)*, https://www.dhl.com/global-en/spotlight/globalization/global-connectedness-index.html.

StatLink https://doi.org/10.1787/888934254563

The multi-dimensional approach to assessing competitiveness through outcome indicators mentioned above provides a mixed picture. The average top performer is Serbia, but there is still a performance gap between the WB6 economies and the CEEC-11/EU/OECD averages.

Outcome indicators also suffer from year-on-year variations due to external factors, as well as infrastructure quality and regulatory changes. In order to fully assess transport competitiveness these indicators need to be used in conjunction with an analysis of what determines competitiveness across all transport sectors, as provided in the next section.

## Planning (Sub-dimension 11.1)

Transport planning involves actions and measures designed to ensure that there is sufficient investment in the transport sector to achieve broader economy-wide development goals. Transport planning can only be effective if followed by a transport policy that targets socio-economic welfare and a competitive transport market. Without a clear and transparent transport planning pathway the region risks jeopardising value-for-money investments in transport infrastructure, which affects costs, quality and sustainability.

Regional action plans for roads, railways, road safety and transport facilitation were endorsed by the Ministerial Council of the TCPS[1] in October 2020. Their concrete aims are safer roads, reduced waiting time at borders and common crossing points, reliable and modern railways, and roads of the future with integrated green and digital elements. Additionally, the TCPS is currently developing a Sustainable and Smart Strategy for the Western Balkans, expected to be adopted by the WB6 economies during 2021. This will be the foundation of a regional transport system that strives for a green and digital transformation and that is more resilient to future crises (for more information on the WB6 commitments to and recommendations for deepening regional transport integration, see Box 14.1).

Some of the WB6 economies are more advanced than others in developing their transport visions and strategies, including high-level identification and prioritisation processes (Table 14.2). Albania and Serbia have the highest average score in this sub-dimension, which is significantly above the other four economies. This is due to well-developed project prioritisation processes and stronger performance in the implementation and procurement indicator compared to the other WB6 economies. However, monitoring of transport strategies in all WB6 economies needs to be improved. All WB6 economies have shown limited progress in improving their asset management practices, translating into a low score for this indicator.

### Table 14.2. Scores for Sub-dimension 11.1: Planning

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 11.1: Planning | Transport vision | 4.0 | 2.0 | 2.0 | 2.5 | 2.5 | 3.5 | 2.8 |
| | Transport project selection | 4.5 | 0.8 | 1.0 | 2.5 | 2.5 | 4.0 | 2.6 |
| | Implementation and procurement | 3.0 | 2.0 | 2.0 | 2.5 | 2.5 | 4.0 | 2.7 |
| | Asset management | 1.5 | 1.0 | 1.0 | 1.5 | 0.0 | 1.5 | 1.1 |
| **Sub-dimension average score** | | 3.3 | 1.5 | 1.5 | 2.3 | 1.9 | 3.3 | 2.3 |

### *Transport visions could be updated and monitored more systematically*

Economies need a clear and coherent transport vision to ensure that the sector contributes to the overall economy-wide vision and aspirations. Each part of the transport network contributes to economic development, but the benefits of a transport system as a whole are greater than the sum of its parts.

Two WB6 economies, Montenegro and North Macedonia, have adopted new transport strategies since the last CO assessment (Table 14.3) that have included efforts to align with international best practice and the TCT. At the time of writing, Albania had secured financial support from the EU to develop a Transport Sector Strategy and related action plan for 2021-2026, which is expected to be finalised by mid-2021, and Serbia was in the final procurement stage to engage a consultant to develop its strategy for the period 2022-2030.

## Table 14.3. WB6 economies' transport strategies

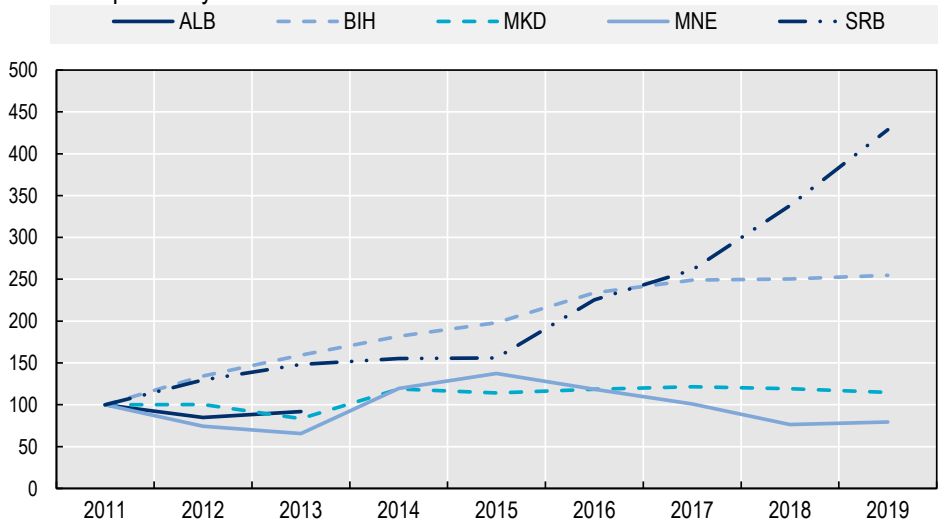
| | Current transport strategies | Period covered by the strategy | Validity | Availability of monitoring report for strategy implementation |
|---|---|---|---|---|
| ALB | Transport Sector Strategy | 2016-2020<br>2021-2026 | Expired<br>Drafting | Yes |
| BIH | Framework Transport Strategy of Bosnia and Herzegovina | 2016-2030 | Valid | Partially (only in Republika Srpska) |
| KOS | Sectorial Strategy for Multimodal Transport | 2015-2025 | Valid | No |
| MKD | National Strategy for the Transport Sector | 2018-2030 | Valid | Yes* |
| MNE | Transport Development Strategy of Montenegro | 2019-2035 | Valid | Yes** |
| SRB | Plan of Rail, Road, Inland Waterway, Air and Intermodal Transport Development<br>Draft Transport Strategy of the Republic of Serbia***<br>National Transport Strategy | 2015-2020<br>2016-2025<br>2022-2030 | Expired<br>n/a<br>Procurement process ongoing | No |

*Note: At the time of writing the first monitoring report (which should be updated annually) of the National Strategy for the Transport Sector for the period 2018-2020 was being approved by the government, and is not yet publicly available.
**Note: Monitoring of the strategy will be conducted by the co-ordination body of the Ministry of Transport and Maritime Affairs as prescribed in the strategy, but at the time of writing there was no monitoring report available.
***Note: Not approved by Parliament. Since the last CO assessment, Serbia has continued to follow its Plan of Rail, Road, Inland Waterway, Air and Intermodal Transport Development 2015-2020. A new strategy for 2022-2030 is in the last stage of the procurement process.

It is difficult to evaluate the impact and effectiveness of these strategies as there is no consistency of monitoring at the regional level, and most are neither developed nor monitored consistently. The strategies appear to focus mainly on removing physical bottlenecks and harmonising legislation with EU standards, but they are weak on sustainable transport development, digitalisation and intelligent transport systems. It will not be enough to simply remove bottlenecks to improve the competitiveness of the region as a single market, it will also be important to promote the development of sustainable transport modes such as combined transport and railways for freight, and active modes of transport for passengers. The growing demand for road freight is critical to enhancing competitiveness (Figure 14.6), as it shows an increase in traffic and presents a challenging trend for long-term sustainability. Harmonisation with EU standards and the TCT will accelerate following the integration of the WB6 economics into the Single European Transport Area.

## Figure 14.6. Evolution of road freight transport volumes

Index of tonne-km transported by road: 2011=100




Note: Data for Albania only available for 2011, 2012 and 2013. Data for Kosovo not available.
Source: (ITF, n.d.[6]), *ITF Transport Statistics*, https://doi.org/10.1787/trsprt-data-en.

StatLink https://doi.org/10.1787/888934254582

At the time of writing, the TCPS was developing the Transport Community Information System – Transport Observatory. Its architecture is expected to be finalised during 2021 and will define a data collection mechanism, including identifying data sources. The methodology for data analysis and performance monitoring, including key performance indicators,[2] outputs and statistical reporting to fulfil TCT reporting duties, will also be finalised. Existing and future information systems will be assessed and utilised, such as the Galileo Green Lane mobile solution (EUSPA, 2020[7]) (developed by the European Global Navigation Satellite System Agency), the TENtec information system (European Commission, 2021[8]) (set up by the European Commission to co-ordinate and support the TEN-T), and the Corridor Performance Measurement and Monitoring System (Isik et al., 2018[9]), which is expected to be developed by the World Bank.

### Box 14.1. Towards smoother regional mobility in the Common Regional Market

The following key findings of the CO 2021 transport policy dimension can inform the implementation of the actions under the relevant components of the Common Regional Market Action Plan:

- A key achievement in transport facilitation since the last CO assessment is the opening of a one-stop shop on Corridor X at the road border crossing point between North Macedonia and Serbia in July 2019.
- Due to COVID-19, all regional economies have introduced green lane measures on the major corridors for the transport of emergency goods. These require that freight vehicles and drivers should be treated in a non-discriminatory manner. Passing through these green lane border crossings (including any checks and screenings) should not exceed 15 minutes, and procedures should be minimised and streamlined.
- Transport facilitation needs to remain a key priority for the WB6 economies. Key measures for economies include:
  - Implementing one-stop shops.
  - Improving and upgrading existing information and communication technology (ICT) infrastructure.
  - Constructing or modernising infrastructure to remove physical and technical barriers and to increase capacities at border crossing points and common crossing points.
  - Building capacity to improve performance efficiency.

### *Transport project selection could be more transparent*

The transport project selection indicator measures the extent to which transport projects are identified, prioritised, and selected consistently, realistically and rigorously. There is limited transparency regarding the project selection process in the WB6 region, which should become a greater focus for economies, even though some (Albania and Serbia) have developed good prioritisation tools since the CO 2018 assessment. With a well-developed and transparent project prioritisation process, WB6 economies can ensure the integrity of the transportation system and increase predictability in the planning and decision-making process. A systematic approach will also increase the influence and involvement of local communities in the decision-making process.

On average, the WB6 economies achieve a score of 2.6 for transport project selection, which is significantly higher than the last CO assessment (Table 14.2). Four economies have advanced their systems, with Albania (score of 4.5) and Serbia (score of 4.0) developing very good project prioritisation tools (Box 14.2). There are no reports available on these recently applied tools, but their effectiveness is expected to be

visible during the next CO assessment. Bosnia and Herzegovina has the lowest score (0.8) in the region as it still has not developed a national project selection system.

In the context of the Western Balkan Investment Framework (WBIF), WB6 economies have continued to follow an established high-level project selection process through national investment committees (NICs), as promoted by the European Commission (European Commission, 2015[10]). NICs are responsible for setting up and managing the single project pipeline (SPP) and programming financial sources. NICs only cover projects financed by the EU and related IFIs, whereas SPPs also cover projects financed by bilateral funds, such as in Serbia. However, as project financing has been further diversified since the last CO assessment, some infrastructure projects that have a large impact on the transport network were excluded from the SPP and went ahead without NIC approval. A notable example is the construction of several motorways and railways within the region using other bilateral funds (e.g. from China, Russia, the United States and Azerbaijan).

Most capital transport investment projects funded though the WBIF are subject to a cost-benefit analysis (CBA) that includes a rigorous assessment of IFIs or other bodies (e.g. Joint Assistance to Support Projects in European Regions – JASPERS[3]). The European Commission's Guide to Cost-Benefit Analysis of Investment Projects is used for these projects (European Commission, 2014[11]). For all other projects, a CBA is provided if required by local legislation, but does not appear to have ever led to the cancellation of an investment. Economy-wide guidelines for CBA only exist in Serbia for road transport, but they are outdated and require updating or redeveloping. There are some very good examples of how local projects have been assessed and CBA utilised, but in general capacity building is needed in this area as it is one of the most important elements of project selection.

### *Implementation and procurement lack a systematic approach*

A rigorous process for implementation and procurement is the logical continuation of a coherent planning and systematic prioritisation process to help meet planned outcomes and spend budgets efficiently.

On average, the WB6 economies achieve a score of 2.7 for the implementation and procurement indicator, ranging from 2.0 for Bosnia and Herzegovina and Kosovo to 4.0 for Serbia (Table 14.2). All transport infrastructure projects funded at least partly by the government are subject to domestic procurement laws in all WB6 economies, but there are some cases where the Practical Guide to contract procedures for EC external actions has been applied. However, the WB6 economies still lack a systematic approach to the procurement of large transport projects, such as following dedicated guidelines, despite efforts to attract private investors to the region and to accelerate infrastructure investment.

Since the last CO assessment there have been several design and construction activities related to the Indicative extension of the TEN-T to WB region transport network,[4] notably new road and railway corridors, the rehabilitation of existing roads and railways, ports, and the construction and upgrade of intermodal terminals and airports.

Experiences of investment through public-private partnerships (PPP) vary across the region. Many concession attempts have failed as the economies have not properly assessed the potential (e.g. traffic demand) of the given asset. Concession attempts have also failed due to the lack of cost-effective offers, such as the concession for motorway section Doboj-Vukosavlje (Corridor Vc). Albania has the most active transport PPPs among the WB6 economies, with the amendments to the Law on Concession (2019) prescribing the unification of award procedures for road concessions/PPPs with all other concession/PPP procedures. It is good to note that Serbia is the first WB6 economy in which concession is a legally mandatory way to obtain the right to become a port operator.

### *Transport infrastructure asset management is in the early stages of development*

Some WB economies have attempted to develop a transport infrastructure asset management[5] system, mainly for road transport, within the last two decades, but such systems are generally still underdeveloped in the region. On average, WB6 economies scored 1.1 for this indicator, with scores ranging from 0.0 for Montenegro to 1.5 for Albania, North Macedonia and Serbia (Table 14.2). The main obstacles to an effective asset management system are the legal framework, implementation capacities, and funds for frequent and costly updates. Consequently, transport infrastructure assets are not properly operated or maintained, which limits their long-term usefulness.

Developments to date have mainly been in the road sector, followed by the railway sector. For example, North Macedonia has begun using the Road Asset Management System (RAMS), while the bridge asset management system was being developed at the time of writing and will be part of RAMS. Some efforts have been made in the last 15 years in Bosnia and Herzegovina to establish an asset management system, as presented in the Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to the WB6, but they have not been successful (CONNECTA, 2018[12]). However, Bosnia and Herzegovina (Republika Srpska) has established an asset management system for highways through an ongoing project to implement a full RAMS by the end of 2022.

### *The way forward for planning*

- **Ensure regional action plans and the Sustainable and Smart Strategy for the WB6, developed by the TCPS and endorsed by the Ministerial Council, are fully transposed into local legislation and implemented following the defined timeframe**. The concrete aims of the regional plans (for roads, railways, road safety and transport facilitation) are safer roads, reduced waiting times at border and common crossing points, reliable and modern railways, and roads of the future with integrated green and digital elements. The development of the Sustainable and Smart Strategy for the WB6 is ongoing, expected to be adopted by the WB6 economies by summer 2021, and will be a driver of the upgrade and development of national sustainable transport strategies.
- **Develop a tool for project identification, selection, prioritisation and implementation, and apply it to all transport projects**. WB6 economies could use the tools developed in Albania and Serbia, which introduced well-developed systems in 2019/20 and are now beginning their implementation (Box 14.2).
- **Develop domestic CBA guidelines specific to the WB6 economies**. It is very important for each economy to develop its own CBA guidelines with accompanying technical instructions. The guidance needs to be updated at least every two years. A good example is the United Kingdom's Transport Analysis Guidance,[6] which provides information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure consistency in the discount rates used for similar projects in the same economy, a benchmark is needed for all technical and economic parameters, including the financial and economic discount rate in domestic guidance documents. The rate needs to be applied consistently in project appraisals across the economy. Empirical research needs to be conducted to generate input data to calculate externalities.

- **Accelerate the development of an asset management system for all transport infrastructure, and ensure it is in line with the domestic inventory system**. Developing sound asset management practices[7] enables economies to collect data and to manage and analyse conditions across all transport modes. Data can be used to optimise transport sector maintenance strategies and justify maintenance budgets by directing funds to areas with the greatest return on investment. Performance-based maintenance contracts are already implemented, though not extensively, in some WB6 economies such as Albania, Bosnia and Herzegovina and Serbia (CONNECTA, 2018[12]). These are an essential component of a road asset management system and, if well-developed, lead to predefined good road conditions at relatively low cost. The quality of transport infrastructure affects an economy's investment attractiveness and signals whether it is a good market for foreign direct investment.

### Box 14.2. Effective tools to manage transport projects in Albania and Serbia

Albania and Serbia are the only two economies in the WB region with a sound tool for transport project identification, selection, prioritisation and implementation.

In 2018, **Albania** adopted the Decision on Public Investment Management Procedures. For the purpose of budget planning on investment expenditure, the projects are divided into two groups: 1) capital administrative expenditure on equipment, furniture, computers, IT, etc; and 2) expenditure on investment projects, including capital expenditure on infrastructure such as new constructions, reconstructions, rehabilitation with design costs, expropriation costs, purchase of larger technological equipment, implementation of works and supervision; and capital expenditure for capacity development, including research projects, technical assistance and capacity building.

The following project management cycle is applied:

1. Project identification based on an analysis of the public's needs.
2. Project evaluation and preparation, including an evaluation of the economic and financial justification.
3. Project approval and financing.
4. Project implementation.
5. Monitoring of project implementation, which should ensure that project activities are in line with planned activities.
6. Evaluation and audit, including implementation-related reporting and financial audit through the project performance indicators.
7. The following steps are applied based on the project cycle presented above:
8. Identify the project idea based on an analysis of public needs.
9. Review the draft idea (project management team leader and responsible authorities).
10. Prepare detailed project and evaluation, and a shortlist of alternatives.
11. Submit investment project proposal to the ministry responsible for investment projects.
12. Review the proposal (Council of Ministers).
13. Final approval, after the approval of investment projects within the annual budget.

As per Decision No. 290 of 11 April 2020, a financial management information system has been installed in every spending unit, including in all ministries, and is integrated into various departments to be used for all steps in the project management cycle.

In **Serbia**, the procedure for project identification, analysis of relevance, pre-selection, funding, implementation and monitoring is clear and publicly available, and co-ordinated through the Ministry of Finance. This procedure was adopted in 2019 though the Rulebook on the Management of Capital Projects.

The prioritisation process, which is applied to all projects, applies a CBA, an environmental and social impact analysis, and a safety assessment, among other things. Once the project is approved for financing there is a special procedure, similar to the one in Albania, that forms the preparation of a plan for project implementation. During project implementation there are specific procedure forms for reporting. One type of report is the interim report for the presentation of the current project status, which covers the activities carried out and the plan to execute the remaining project activities. At the end of the project, a final report needs to be developed. Development of "Public Investment Management Information System - PIMIS" software is underway. This activity should improve the efficiency of a single record of capital projects.

There are three categories of project: 1) less than EUR 5 million; 2) between EUR 5 and 25 million; and 3) over EUR 25 million. *Ex post* monitoring is conducted for the third category three years after completion, which is a significant improvement on local legislation.

Source: (Government of Albania, Council of Ministers, 2018[13]), *Albania – Decision of the Council of Minsters No 185/2018*, http://80.78.70.231/pls/kuv/f?p=201:Vendim%20i%20KM:185:29.03.2018; (QBZ, 2020[14]), *Decision of the Council of Minsters No 209/2020*, https://qbz.gov.al/eli/vendim/2020/04/11/290; (Republic of Serbia, Legal Information System, 2019[15]), *Serbia – Rulebook on the management of capital projects*, https://www.pravno-informacioni-sistem.rs/SlGlasnikPortal/eli/rep/sgrs/vlada/uredba/2019/51/1 (Ministry of Finance, 2020[16]), *Serbia – Project cycle process: Forms*, https://www.mfin.gov.rs/dokumenti/saobracaj/.

## Governance and regulation (Sub-dimension 11.2)

Governance drives the performance of the transport sector. The appropriate governance of transport infrastructure ensures the development of a safe, efficient and interoperable transport market. Transport planning requires governance of the ownership and management of transport infrastructure assets, regardless of whether the ownership is public or private. Well-governed transport infrastructure assets fulfil domestic goals related to welfare and profit.

The governance and regulation sub-dimension comprises four qualitative indicators to analyse progress in rail, aviation, road, and IWW and maritime transport regulation reforms (Table 14.4). Due to the complexity of assessing rules and the coexistence of regulations at different levels, as well as the lack of applicability to all economies, the indicator scores for road market regulation and IWW and maritime transport regulation have not been calculated. Although not scored, these indicators are discussed in the text to assess achievements in these sectors.

Governance and regulation is the sub-dimension within the transport policy dimension in which the WB6 economies perform the best on average. Within this sub-dimension, the WB6 economies performed the best in the aviation regulation indicator, translating overall good advancement in harmonising the sector with key EU regulations and international good practices. Slight stagnation has been noticed regarding reforms in railway market regulation since the last CO assessment, with only Serbia and Montenegro scoring above the regional average for this indicator due to more advanced levels in applying approved reforms.

### Table 14.4. Scores for Sub-dimension 11.2: Governance and regulation

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 11.2: Governance and regulation | Rail regulation | 1.5 | 1.3 | 1.5 | 1.5 | 3.5 | 3.5 | 2.1 |
| | Aviation regulation | 3.5 | 2.5 | 1.5 | 3.5 | 3.0 | 4.0 | 3.0 |
| | Road market regulation | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| | IWW and maritime market regulation | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **Sub-dimension average score** | | 2.5 | 1.9 | 1.5 | 2.5 | 3.3 | 3.8 | 2.6 |

### *Rail regulation is gradually opening markets*

The rail regulation indicator assesses progress in implementing strategies for rail reforms, which are crucial for the common rail market and harmonisation with EU rail policies. The most important reforms are related to market liberalisation, the interoperability of the rail network and safety. The WB6 rail market is mostly liberalised, but only for domestic operators, with many regional economies expecting to fully open their rail markets once they join the EU.

On average, the WB6 economies achieved a score of 2.1 for the rail regulation indicator, ranging between 1.3 for Bosnia and Herzegovina and 3.5 for Montenegro and Serbia (Table 14.4). Since the last CO assessment, the WB6 economies have made moderate progress in opening their rail markets. The most recent regional rail plan is driven by the TCPS, and all WB6 economies participated in the endorsement process of the Action Plan for Rail for the period 2020-2023 (TCPS, 2020[17]). This action plan covers rail market opening; passenger rights; governance; interoperability; cross-border and common crossing operation; and the modernisation of the rail network with clear deadlines for signing, transposition and implementation. Serbia has the highest number of private operators (ten).

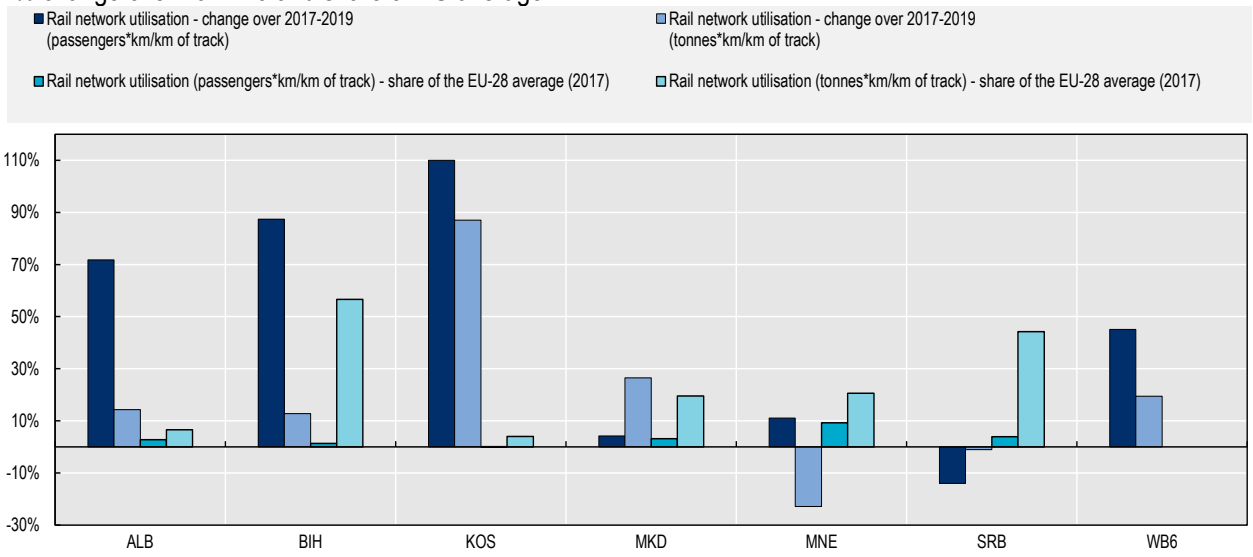
Rail infrastructure is currently being modernised (e.g. rail Route 4 though Serbia and Montenegro between Belgrade and Bar, Corridor Vc in Bosnia and Herzegovina) or built (e.g. Corridor VIII in North Macedonia, doubling and modernising rail Corridor X through Serbia) (European Commission, 2015[18]). Corridor X is the backbone of the railway network and requires immediate modernisation to revive rail transit though the region. Corridor Vc and Route 4 have to be upgraded to link central European countries with the Adriatic Sea.

Figure 14.7 shows the level of rail network utilisation in the Western Balkans between 2017 and 2019. It is clear that the best performer in terms of rail network utilisation (transported tonnes per km of rail track) is Bosnia and Herzegovina (a 56% share of the EU average rail network utilisation) followed by Serbia (44%). The biggest increase in rail network utilisation, both for passengers and freight, was in Kosovo. Negative trends were noticed in Montenegro for the freight rail network and in Serbia for passenger rail network utilisation.

It is expected that rail will become more attractive once the works are completed and all reforms are fully implemented – for example the Interoperability Directive (EUR-Lex, 2016[19]) and the Rail Freight Corridor Regulation (EUR-Lex, 2010[20]).

## Figure 14.7. Rail network utilisation in the Western Balkans (2017-19)

% change over 2017-19 and share of EU average




Note: A passenger-kilometre or tonne-kilometre is the unit of measurement representing the transport of one passenger/tonne by a defined mode of transport (road, rail, air, sea, inland waterways, etc.) over one kilometre.

Source: Input provided by the government as part of the quantitative questionnaire (CO2021); Statistical data retrieved from WB6 statistical offices.

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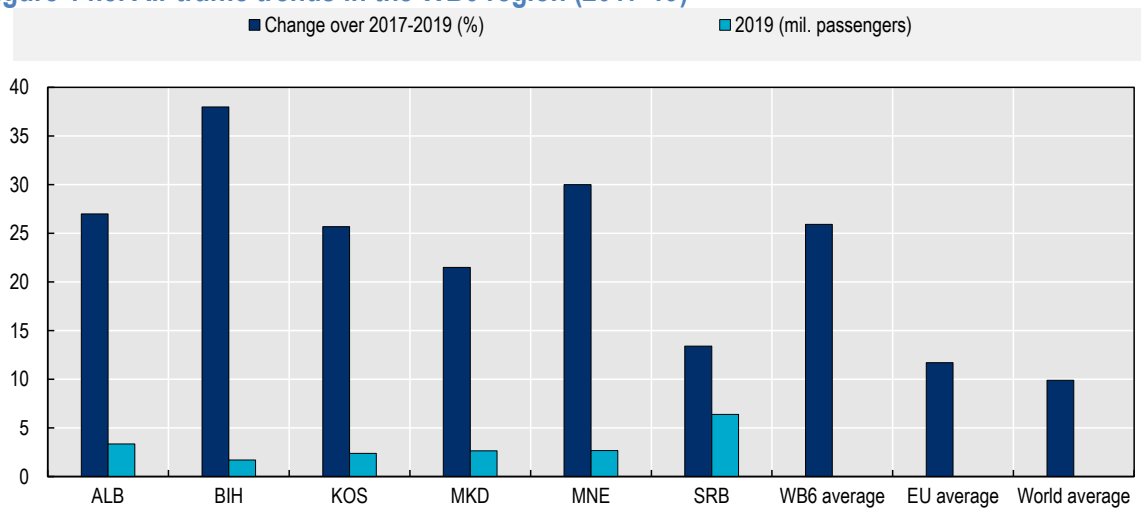
### *Aviation regulatory reforms could be accelerated to match growth in the sector*

The aviation regulation indicator assesses the WB6 economies' regulatory harmonisation with EU legislation, including on cross-border co-operation, performance schemes, safety promotion and the transparent regulation of airports to promote more efficient aviation services in the WB6 economies. The Single European Sky is part of the European Common Aviation Area Agreement signed in 2006. As parties to this agreement, the WB6 economies are committed to aligning some of their aviation regulation with the EU *acquis* in exchange for full access to the single European aviation market.

The average regional score for this indicator (3.0) is the highest average score among all scored indicators. At the economy level, Serbia has the highest score (4.0) and Kosovo the lowest (1.5). The process of transposing EU policies into domestic legislation continues to progress in the region. Bosnia and Herzegovina's Air Navigation Services Agency took over responsibility for the air traffic control of its skies in December 2019 from Croatia, Montenegro and Serbia, which had undertaken air traffic control in Bosnia and Herzegovina since 1992. This means that all charges will now be paid directly to Bosnia and Herzegovina, which will lead to revenue that could increase financial capacities and fund human resources. The Airport Charges Directive (EUR-Lex, n.d.[21]) has not yet been transposed and implemented in all WB6 economies.

Growth has been significant in this transport mode in the period 2017-19 for the WB6 region compared to the EU and world averages (Figure 14.8). Given this growth, as well as its projected importance, it is important that all six economies continue regulatory reforms and bring the governance of the aviation sector closer to European standards and international best practice.

## Figure 14.8. Air traffic trends in the WB6 region (2017-19)




Note: Data for Bosnia and Herzegovina are for the period 2016-2018.

Source: Input provided by the government as part of the quantitative questionnaire (CO2021); (IATA, 2020[22]), *Slower but Steady Growth in 2019*, https://www.iata.org/en/pressroom/pr/2020-02-06-01/; (Statista, 2020[23]), *Air passenger transport in the European Union 2008-2019*, https://www.statista.com/statistics/1118397/air-passenger-transport-european-union/; Statistical data retrieved from WB6 statistical offices.

StatLink https://doi.org/10.1787/888934254620

### *Road market regulation continues to be harmonised*

The road market regulation indicator assesses the standards and framework conditions in place in WB6 economies for the creation of a Single European Transport Area. The long-term goals for the region are to open road markets through a well-developed system with effective border control, harmonised employment conditions in the road transport profession, cabotage rules to guarantee equal market access opportunities and reduce empty runs, road user charges, and social and safety standards that follow the latest EU standards.

Given the complexity of assessing these rules, and the coexistence of regulations at different levels, this assessment does not provide a score for the road market regulation indicator.

The most recent regional road plans are driven by the TCPS, with all WB6 economies having participated in the endorsement process of the Road Action Plan for 2020-2023 (TCPS, 2020[24]). This plan covers the road maintenance system, intelligent transport system deployment, road transport climate resilience, and enhancing regional co-operation and experience exchange with clear deadlines for preparation and implementation.

Overall, the WB6 economies continue to progress on this indicator by aligning parts of their rules with the EU *acquis* regarding working hours, safety standards and the licencing of truck drivers. All WB6 economies (except for Kosovo) continue to participate in the European Conference of Ministers of Transport's multilateral quota system, which enables hauliers to undertake an unlimited number of multilateral freight operations in 43 participating European economies (ITF, 2014[25]). This is a complementary system for non-EU Member States, as access to the international road haulage market is regulated in the EU by regulation 1072/2099 (EUR-Lex, 2009[26]).

As in the last CO assessment, data collection continues to be an obstacle for promoting an efficient and safe road network, and the WB6 economies have not yet fully developed their data collection systems to monitor the road transport market. The transparency of data is still low and data exchange between key stakeholders could be improved.

### *IWW and maritime market regulation is in the early stages*

The IWW and maritime market regulation indicator measures progress in implementing strategies for IWW and maritime reforms in the applicable economies.

This regulation is in the early stages of preparation. Albania's project on Enhancing the Development of the Albanian Maritime Sector through Technical Assistance and Increased Partnership,[8] funded by IFIs, is expected to provide a baseline assessment of the institutional and financial set-up of the maritime transport sector. It will also develop the institutional and legal framework to support maritime sector development, based on the Norwegian experience as a leading maritime country. The framework in Serbia on market access to port services and the financial transparency of ports, developed and adopted before the adoption of EU regulation 2017/352 (EUR-Lex, 2017[27]), was already in line with EU regulation. Considerable efforts have been made in recent years in Serbia on IWW and maritime market regulation, including privatising port operators and creating incentives for combined transport. In Montenegro, the government adopted the Rulebook on Internal Organisation and Systematisation of the Ministry of Transport and Maritime Affairs in April 2019, which established the Directorate for Maritime Transport and Inland Navigation and the Directorate for the Application of Standards to Protect the Sea from Pollution and Inland Waterways. There are still no specific incentives in the region for shifting to the use of IWW and maritime transport due to a lack of relevant actions which should be driven through strategies and secondary legislation. Even though these modes can offer benefits in terms of competitiveness in size, cost, environmental performance and safety, allocated funds for incentives are an obstacle and often budgets for such types of incentives are transferred to some items with shortfalls in the budget. In this regard, the project "Grendel – Green and efficient Danube fleet", financed by the EU, could serve as an efficient tool for defining the appropriate and harmonised State Aid scheme to enable incentives in this regard. In most applicable economies there is no roadmap for institutionalisation or a policy and operational framework.

Monitoring indicators to assess the performance of all transport modes either do not exist, are not properly established or are not properly updated. Missing indicators include average user costs, travel time and reliability satisfaction levels, value of assets, market research and customer feedback, quality of user information, and audit programmes. Regular data surveys are neither planned soundly (including the purpose, level of data needed and budget allocated) nor conducted regularly. Surveys that have been conducted have only been for the purposes of specific projects and not for general transport infrastructure assessment and planning. Therefore, the basis for a quality assessment of transport network performance is lacking.

### *The way forward for **governance and regulation***

- **Accelerate the transposition and implementation of the EU *acquis* and aim to fully align with the TCT.** Updating the legislation will be a challenge for all WB6 economies and will require human, financial and technical capacities to ensure effective transposition and implementation.
- **Consider a corridor approach wherever possible throughout the region.** Such an approach can only be considered through well-organised bilateral and multilateral co-operation. Co-operation and exchange of good practice among WB6 economies needs to be enhanced and intensified and should take place regularly. Such regular regional discussion would help pave the way for a single and competitive regional transport market.
- **Continue efforts to fully liberalise the rail market.** Liberalisation of the rail market in the region could significantly boost competitiveness. Once the market is liberalised, passengers will see service level improvement and there will be a sizable impact on the long-distance rail freight market for operators and investors.
- **Establish programmes and provide regular data surveys to assess the performance of all transport modes**. Missing transport performance indicators include average user costs, travel time

satisfactory level reliability, value of assets, market research and customer feedback, quality of user information and audit programmes.

## Sustainability (Sub-dimension 11.3)

Sustainable transport plays an important role in policy formulation in OECD countries due to environmental concerns and sustainability objectives (OECD, 2012[28]). The promotion and development of sustainable transport is directly linked with environmental protection and climate impact (addressed in all transport modes), economic efficiency (competitive market) and social progress (improved safety, quality of life). While increasing transport demand boosts economic growth, it can have an adverse effect on the environment and safety, which are directly related to quality of life and market competitiveness. Therefore, the development of sustainable transport modes with better logistics would lower costs and deliver reliable services through faster, safer and more efficient transport.

The regional average score for the sustainability sub-dimension is much lower than for the other two transport policy sub-dimensions (Table 14.5), showing that there is significant room for improvement across all indicators in all WB6 economies. Of the three indicators assessed, road safety is the most advanced, while combined transport has seemingly been neglected in most WB6 economies and is still in its infancy at the regional level. The development and implementation of sustainable transport strategies (and the integration of sustainability objectives into existing policies) also shows room for improvement across the region.

### Table 14.5. Scores for Sub-dimension 11.3: Sustainability

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 11.3: Sustainability | Road safety strategy | 1.5 | 1.3 | 1.5 | 1.5 | 2.5 | 2.5 | 1.8 |
| | Environmental sustainability strategy | 1.5 | 0.5 | 1.5 | 0.5 | 1.5 | 1.5 | 1.2 |
| | Combined transport strategy | 1.5 | 0.5 | 0.5 | 0.5 | 0.5 | 2.5 | 1.0 |
| **Sub-dimension average score** | | 1.5 | 0.8 | 1.2 | 0.8 | 1.5 | 2.2 | 1.3 |

### *Road safety strategy updates are held back by resource constraints*

The road safety strategy indicator measures progress in implementing strategies for road safety. An effective road safety strategy should create safer transport infrastructure, better road safety management, and protect road users.

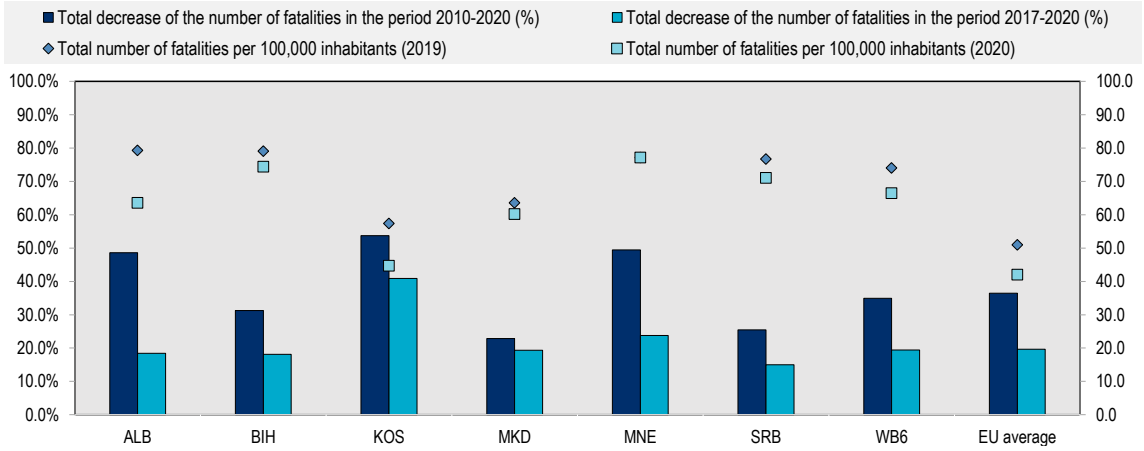
On average, the WB6 economies score 1.8 for the road safety strategy indicator, ranging between 1.3 for Bosnia and Herzegovina and 2.5 for Montenegro and Serbia (Table 14.5). The most recent regional road safety plans have been driven by the TCPS, with all WB6 economies participating in the endorsement process of the Road Safety Action Plan for the period 2020-2023 (TCPS, 2020[29]). This plan covers actions related to road safety management, promotion of safer infrastructure and protection of road users, and enhanced co-operation and exchange of experience with clearly defined implementation guidelines and supporting parties. Financial and organisational limitations mean that some WB6 economies (e.g. Serbia) have not succeeded in developing a new road safety strategy to replace one that has expired.

Reports monitoring the implementation of road safety strategies are rare in the region (they exist in Albania,[9] Republika Srpska and Montenegro). Without them, new strategies cannot draw on or rectify the issues revealed in the monitoring. There are Road Safety Agencies in Serbia and Republika Srpska, but systems for road safety audits and inspections are only beginning to be developed in the region. Most economies rely on IFI support and there is a lack of locally developed primary and secondary legislation in most of the region (apart from Republika Srpska and Serbia) to promote safer infrastructure. The region

also lacks appropriate staffing and funding for some key activities such as education, awareness campaigns, development of road safety co-ordination bodies in local communities, and the development and upgrade of road safety databases.

Despite the lack of updated road safety strategies and established road safety agencies in the region there have been good results on road safety. The WB6 average decrease in the number of fatalities over 2010-20 was higher than the CEEC-11, EU and OECD averages (Figure 14.9). Three economies have met or nearly met the goal of the EU's Policy Orientation on Road Safety 2011-2020 to reduce road fatalities by 50% between 2010 and 2020 – Kosovo has achieved a 53.7% decrease, and Montenegro (49.5%) and Albania (48.6%) have nearly achieved the goal. The total number of fatalities per 100 000 inhabitants in the WB6 region was almost the same as the CEEC-11 average in 2019, but still much higher than the EU and OECD averages.

## Figure 14.9. Road safety trends (2010-2020)




Note: OECD data for 2010, 2017 and 2019 do not include following countries: Canada, Colombia, Luxembourg, Mexico, Switzerland. Traffic accident data for 2020 are not available for Bosnia and Herzegovina, Montenegro, North Macedonia, CEEC-11, EU and OECD.

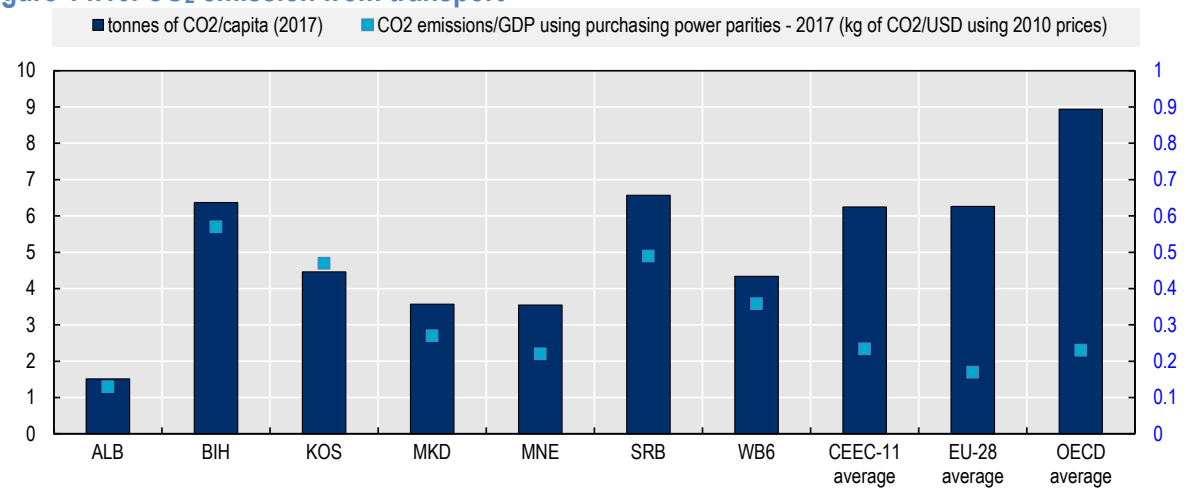
Source: Inputs provided by the government as part of the quantitvative questionnaire (CO2021); Statistical data retrieved from WB6 statistical offices.

StatLink https://doi.org/10.1787/888934254639

### *Environmental strategies for transport are underdeveloped*

The WB6 economies' $CO_2$ emissions from transport, when measured in tonnes of $CO_2$ per capita, are lower than CEEC-11, EU and OECD averages (the bars in Figure 14.10). However, when measured in tonnes per GDP using purchasing power parity, their performance is worse (blue line in Figure 14.10). Serbia has the highest emissions per capita, while Albania has the lowest. $CO_2$ emissions illustrate the direct dependence of the region on fossil fuels.

## Figure 14.10. $CO_2$ emission from transport




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. PPP = purchasing power parity.
Source: (IEA, 2020[30]), *CO2 Emissions from Fuel Combustion: Overview*, https://www.iea.org/reports/co2-emissions-from-fuel-combustion-overview.

StatLink https://doi.org/10.1787/888934254658

The environmental sustainability strategy indicator measures how strategies plan to green transport activities and transport infrastructure. It also assesses the level of legislation and measures introduced to reduce energy consumption in transport services, increase the share of electrical transport through electricity recuperation, facilitate cycling, and reduce carbon dioxide ($CO_2$) emissions without compromising on efficiency and mobility.

On average the WB6 economies score 1.2 for this indicator, with scores ranging between 0.5 (Bosnia and Herzegovina and North Macedonia) and 1.5 (all other regional economies) (Table 14.5). Environmental sustainability in the transport sector is partially covered through various strategies, action plans, and primary and secondary legislation, but there is no single mechanism to assess implementation of the recommended actions and measures.

The economies' legislation contains targets such as a reduction of the noise impact from transport to the levels recommended by the World Health Organisation/EU in Albania; the promotion of bio-fuels and other renewable fuels in Bosnia and Herzegovina; and a modal shift from road, reduction of greenhouse gas (GHG) emissions, vehicle labelling for emissions, carbon footprint calculators and eco-driving in North Macedonia. By 2030, GHG emissions levels should be reduced by 30% compared to baseline 1990 levels in Montenegro, and in Serbia there are incentives for purchasing new electric vehicles. The first e-mobility pathway at the economy level is also under development in Serbia, funded by the World Bank, and is expected to be finalised in 2021.

Since the last CO assessment, climate resilience design guidelines for public enterprises for roads have been developed in North Macedonia and Serbia, in co-operation with the World Bank. These guidelines will help economies to better understand the impact of climate change on roads and enable appropriate, timely and properly prioritised investment decisions.

### *Combined transport is still not prioritised*

The combined transport strategy indicator measures whether WB6 economies are developing and implementing integrated logistics strategies that can promote a corridor approach and intermodal solutions. Most WB6 economies still do not consider combined transport a priority and are still not planning to develop stand-alone strategies or to institutionalise this mode of transport. On average, the WB6 economies score

1.0 for this indicator, ranging from 0.5 for Bosnia and Herzegovina, Kosovo, Montenegro, and North Macedonia to 1.5 for Albania and 2.5 for Serbia (Table 14.5).

Reforms in this area have generally been slow; however, Albania finalised its Intermodal Transport Strategy in early 2021, while in Serbia the new multimodal transport strategy Five-year Action Roll-on Plan is under development and expected to be finalised later in 2021.

The first rail freight corridor (the Alpine-Western Balkan Rail Freight Corridor[10] through Austria, Slovenia, Croatia, Serbia and Bulgaria) started operating in January 2020 and will increase competitiveness regarding the modal shift to rail.

There is a signed construction contract for the multimodal terminal, Batajnica, near Belgrade, and an ongoing procurement process for developing an intermodal terminal, Trubarevo, near Skopje.

### *The way forward for sustainability*

- **Ensure that road safety remains a key priority.** Monitoring reports for implementing road safety strategies need to be upgraded/developed in all WB6 economies. The monitoring results of existing road safety strategies, including lessons learnt, should be used to update the framework when developing new strategies. Impact assessments of new strategies should also be carried out. Road Safety Agencies need to be established (except in Serbia) with the appropriate staffing and funding resources to undertake the activities defined in the related action plans. All WB6 economies should strive to secure the newly defined goal of the EU's Vision Zero strategy for 2050, which has also set an intermediate goal for 2021-2030 of halving the number of road fatalities (European Commission, 2019[31]). Bosnia and Herzegovina, North Macedonia and Serbia should aim to compensate for poor results from the previous decade and exceed the goal of reducing road fatalities by 50% in this decade. Public awareness and education activities should be strengthened, and innovative funding ideas in the road safety sector should be promoted (Box 14.3).
- **Develop roll-out strategies for electric vehicle charging infrastructure**. Serbia is already working on the development pathway for e-mobility, and other WB6 economies should follow this good regional example (e.g., Albania is incorporating e-mobility in its new transport strategy for 2021-2026, which is in the development phase). This is important for the region's decarbonisation trends and for the goal of net-zero GHG emissions by 2050, which is an objective defined by the European Green Deal (European Commission, n.d.[32]) and in line with the EU's commitment to global climate action under the Paris Agreement (European Commission, n.d.[33]).
- **Maintain transport facilitation as a key priority for WB6 economies.** Implementing the following measures will be a key trigger for increasing the competitiveness and connectivity of WB6 economies, and drive deeper integration with the European market:
  - Create one-stop shops (OSSs) at border crossing points; improve and upgrade existing ICT infrastructure; construct or modernise infrastructure to remove physical and technical barriers and to increase capacities at border crossing points and common crossing points; build capacity with the purpose of improving performance efficiency.
  - Good examples in the region could be used as inspiration, for example North Macedonia and Serbia have recently introduced a well-developed OSS system and in 2021 finalised project documentation for implementing a pilot project for an electronic queuing management system (see also Estonia example in Box 14.4). However, interest in this project is currently low, but with the project documentation ready it can be used as soon as a party is ready to pursue implementation.
- **Develop stand-alone combined transport strategies where relevant** (i.e., Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia). The timely development of a combined transport framework in the entire WB6 region could generate substantial benefits for

economies. Such strategies promote sustainable transport by shifting freight transport from roads, which is not considered an environmentally friendly mode of transport, to other more sustainable modes. Combined transport is also a cost-saving shipping resource that can leave more time and resources for shipping companies to conduct new business. Therefore, incentives for shifting freight to combined transport are needed, such as Serbia's incentives programme introduced in 2018.

- **Develop integrated environment and transport action plans.** Such plans should integrate existing and new indicators to measure sustainability in transport policy. A good example is the Transport and Environment Reporting Mechanism[11] developed by the European Environmental Agency, which prescribes indicators for measuring the environmental performance of transport in the EU. Another example is the UK's Emission Factor Toolkit, which helps local authorities assess local air quality (Box 14.5).

### Box 14.3. Innovative ideas in road safety: Road safety social impact bonds, Montenegro

In 2018, the United Nations Development Program (UNDP) in Montenegro, in co-operation with the key domestic players in road safety, developed the idea of road safety social impact bonds as an innovative and alternative performance-based public financial instrument that shifts the policy framework from inputs and outputs to outcomes and value-for-money. This innovative idea involves the private sector investing in road safety improvements to strengthen sustainability together with the public sector. The public partner commits to paying the outcome payments to the investor if (and only if) the predefined and measurable social goals are met. This idea has great potential to help other economies in the region (and beyond) replicate and scale-up the model.

Source: (UNDP Montenegro, 2014[34]), *Rethinking Road Safety in Montenegro*, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

### Box 14.4. Electronic queuing management system at border crossing points in Estonia

The electronic queuing management system (e-QMS) is a transport facilitation mechanism designed to convert physical queues into virtual queues at border control points (BCPs) through an IT application. It was implemented in 2011 in Estonia.

The e-QMS system process contains four main steps: 1) pre-registration; 2) virtual queuing, 3) physical queuing; and 4) BCP check-in. Pre-registration can be undertaken via a web portal, text message or kiosk. A vehicle can wait virtually until the booked time when it has to appear physically in the waiting area, which is where the vehicle arrives to physically queue before being called for further BCP check-in procedures. The waiting area could be located close to or far from the BCP.

The benefits of the e-QMS are:

- Time savings through shorter waiting times, especially for heavy goods vehicles.
- More streamlined operations on site and increased performance by border agencies.
- Reduced truck queue lengths.
- Increased capacity throughput at BCPs.
- More secure cargo and improved trade and logistics performances.
- Enhanced road safety and less air and environment pollution.
- Increased economic activity around cross-border regions.

Source: (Estonia Border, n.d.[35]), *Go Swift, Queue Management Service*, https://www.estonianborder.eu/yphis/borderQueueInfo.action.

### Box 14.5. Emissions Factor Toolkit, United Kingdom

The Emissions Factor Toolkit (EFT) was published by the UK's Department for Environment, Food and Rural Affairs (DEFRA) in 2020. It assists local authorities in carrying out reviews and assessments of local air quality as part of their duties under the Environment Act 1995.

The EFT allows users to calculate road vehicle pollutant emission rates for nitrogen oxide ($NO_X$), $PM_{10}$, $PM_{2.5}$ and $CO_2$ for a specified year, road type, vehicle speed and vehicle fleet composition. The EFT is updated periodically due to changes in underlying data such as vehicle fleet composition and emissions factors. $CO_2$ emission rates can also be calculated for petrol, diesel and alternative fuelled vehicles.

The EFT can be downloaded from DEFRA's website. It provides emission rates for 2018 through to 2030, and considers composition fleet data for motorways, urban and rural roads, fleet composition based on European emission standards, scaling factors reflecting improvements in the quality of fuels, and some degree of retrofitting and technology conversions into the national fleet.

Source: (DEFRA, 2020[36]), *Emissions Factors Toolkit*, https://laqm.defra.gov.uk/review-and-assessment/tools/emissions-factors-toolkit.html.

## Conclusion

The WB6 economies have made moderate progress towards improving regional transport competitiveness. New regional action plans, if effectively implemented, will make transport infrastructure more useful, thereby improving regional competitiveness. The recently approved well-developed project selection frameworks created by some regional economies (Albania and Serbia) should serve as a good example for other economies and ensure that limited budgets are spent on investments that generate the greatest benefits for society. Governance and regulation are sufficiently developed to accelerate harmonisation with EU rules. The level of reduction in road fatalities in the WB6 reveals very good progress in comparison with the CEEC-11, EU and OECD averages.

However, there are still challenges for the region's transport sector. There is not yet synergy between strategies and action plans for infrastructure development, asset management systems, environmental sustainability and combined transport performance. Systems to monitor the implementation of strategies and action plans need to be improved and lessons learned should be applied during strategy updates. There is no programme for a comprehensive data collection system, including performance indicators; when developed this needs to be regularly conducted. Human resources and financial capacity need to be built for the effective implementation of approved policies and strategies.

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## Notes

[1] The Transport Community Permanent Secretariat, Transport Community: https://www.transport-community.org/.

[2] The Terms of Reference covers the following minimum key performance indicators: infrastructure quality indicators, TEN-T standards compliance indicators, travel time related indicators (including cross-border waiting times), transport services quality related indicators, environmental related indicators (greenhouse gas emissions), safety related indicators, project related indicators, and acquis transposition rate/progress.

[3] JASPERS, https://jaspers.eib.org/.

[4] Indicative extension of TEN-T to Western Balkans Core Network https://ec.europa.eu/commission/presscorner/detail/de/STATEMENT_15_4826.

[5] An appropriate definition of “asset management” for the roads sector was proposed by the OECD in 2001: “A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organised and flexible approach to making the decisions necessary to achieve the public’s expectations.” (OECD, 2001[37]).

[6] The Government of the United Kingdom (2019), Transport Analysis Guidance, Special attention to be paid to the TAG unit A1-1 Transport analysis guidance (TAG) on the principles of cost-benefit analysis and how they should be applied in the context of transport appraisals. For more information, please see: https://www.gov.uk/guidance/transport-analysis-guidance-tag

[7] Periodical and regular measurements to monitor the conditions of infrastructure assets, assessment of the value of assets and costs for non-maintained assets, adoption of asset management strategies, consistent approach in the identification of the mix and timing of asset operation and construction strategies, etc.

[8] See https://www.al.undp.org/content/albania/en/home/projects/enhancing-the-development-of-albanian-maritime-sector-through-te.html.

[9] A lack of staff in Albania meant that the 2019 monitoring report was much less detailed than the report for 2016.

[10] Alpine-Western Balkan rail freight corridor (2020), https://www.rfc-awb.eu/.

[11] Transport and Environment Reporting Mechanism, https://www.eea.europa.eu/themes/transport/term.

# 15 Energy policy (Dimension 12)

The competitiveness of any economy is heavily influenced by its energy policies. This chapter investigates the energy policies in the six Western Balkan economies (WB6) and analyses to what extent their energy markets follow international good practices to optimise their efficiency and competitiveness. It does so by assessing three sub-dimensions. The first, governance and regulation, focuses on how the energy markets are governed and whether policy is conducive for establishing efficient and competitive energy markets. The second explores how stable and secure the energy supply is, whether it is diversified, and how it promotes sustainable energy. The third sub-dimension analyses how energy markets are operated, whether competition is used to promote efficient allocation of energy resources, and the degree of regional integration of the WB6 energy markets. A cross-cutting dimension, energy incentives and subsidies, explores whether such measures embody hidden and long-term costs which distort competitiveness. For each sub-dimension, the chapter includes suggestions to strengthen energy policies and their implementation, which in turn will foster the competitiveness of the WB6 economies and lead to climate-resilient energy sectors.

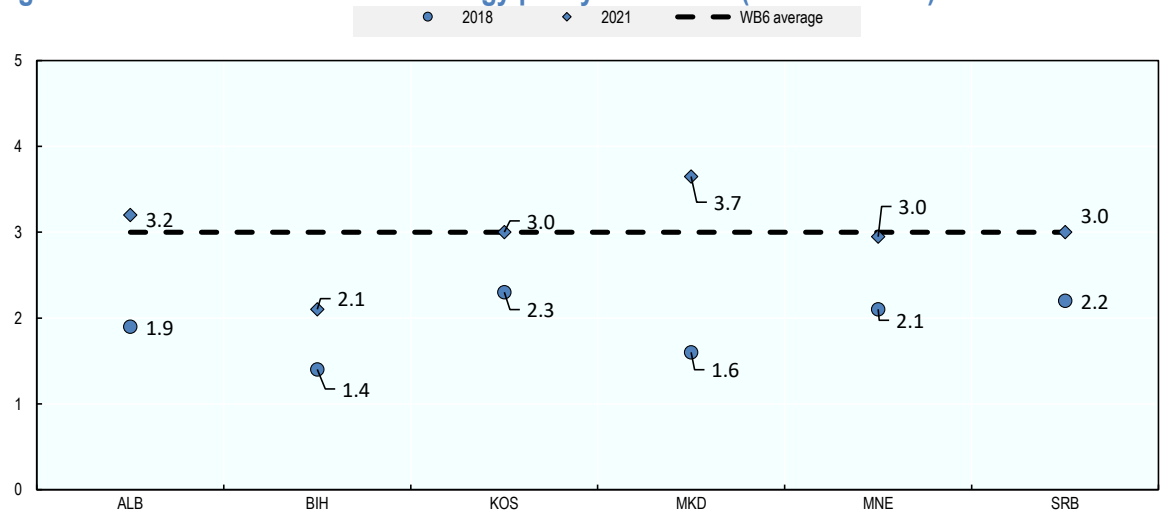
## Key findings

- **The WB6 have advanced legislative frameworks that transpose a significant share of the EU's Third Energy Package.** These frameworks are supplemented by a large number of policies that conform with international good practices. However, implementation has significant room for improvement and key policy documents urgently need to be updated. For the most part this issue is currently being tackled by the WB6 as they are drafting their new National Energy and Climate Plans.
- **There has been significant progress in deploying EU-style organised markets in energy.** Most recently, Albania, Kosovo and Montenegro have established power exchanges.
- **WB6 economies differ in the quality of their markets and their associated frameworks, including across the main forms of energy within an economy.**
- **Some of the fundamentals of competitive energy markets are still missing in some WB6 economies.** These include unbundling of key natural monopolies – i.e., transmission system operators and distribution system operators – and lack of third-party access to key energy infrastructure.
- **Renewable energy and energy efficiency are both in their early stages across the WB6 region**. Aside from hydropower generation, renewable energy's share in energy generation remains low and the WB6 economies' approaches to subsidising and assigning new renewable energy projects need to be improved.
- **Energy efficiency is slowly being improved as building certifications are rolled out across the WB6**. However, funding is scarce and often limited to public buildings. Moreover, strategies for industrial energy efficiency are often lacking, and the legislative framework for energy efficiency labelling of products is patchy.
- **Regional market integration and market coupling amongst the WB6 economies and with their European neighbours remain largely absent**. However, increased use of joint co-ordinated auctions for interconnector capacity is a positive step forward.
- **Human resources in key public entities involved in regulating energy markets lack technical capacity,** especially for energy efficiency.
- **Subsidies continue to distort markets in the region.** The continued subsidisation of fossil fuels is particularly counterproductive to economies' goals of reducing greenhouse gas emissions and governments' financial support for renewable energy and energy efficiency.

## Comparison with the 2018 assessment

The WB6 have made significant progress in reforming their energy policies since 2018, and most of the foundations for a competitive energy market have been laid. Accordingly, the average regional score has progressed from 1.9 just three years ago to 3.0 (Figure 15.1). However, further improvement is needed. The legislative framework needs to be finalised, and the WB6 economies need to begin implementing this legislation in order to truly establish a competitive and integrated energy market across the region.

### Figure 15.1. Overall scores for the energy policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the restructuring of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

The previous assessment suggested several recommendations that would, if implemented, see the WB6's energy sectors be driven by competition and in turn help to support the overall competitiveness of the economy. While progress has been made, in some economies more than others, a significant share of the recommendations remains to be implemented (Table 15.1). A major reason for this slowdown in progress is certainly the global COVID-19 pandemic, but significant internal roadblocks such as lack of political will to undertake certain reforms and resistance by energy sector stakeholders are also playing their part. The deployment of organised markets, lack of liquidity, and market integration and coupling remain the most significant challenges for most energy sectors in the WB6 region. Nonetheless, the WB6 energy sector remains vibrant and offers much potential.

## Table 15.1. Implementation of the CO 2018 policy recommendations: Energy policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 Policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Remain committed to reforming national and regional energy markets.** | • The WB6 continue to bring their energy sector framework into line with their international commitments associated with their Energy Community membership and EU accession aspirations.<br>• For most WB6 economies (Albania, Bosia and Herzegovina, Kosovo, North Macedonia and Montenegro), the functional and operational deployment of organised markets remains outstanding and the WB6 are still at the early stages of regional market integration and coupling (i.e. only Serbia has an operational day-ahead market while all but Serbia use the joint auctioning allocation of capacity platform SEE CAO). | Moderate |
| **Adopt and implement urgently, the EU Third Energy Package with compliant primary and secondary legislation.** | • All WB6 economies have made progress in transposing the EU Third Energy Package as can be seen by comparing the transposition assessment of the Energy Community Secretariat in 2020 to that of 2018.<br>• Similarly, overall implementation has increased as shown by the Energy Community Secretariat's assessments (Energy Community Secretariat, 2018[1]) (Energy Community Secretariat, 2020[2]).<br>• However, neither the transposition nor implementation of the Third Energy Package is complete. | Moderate |
| **Ensure that energy policy strategies and action plans set-out measurable objectives and outcomes.** | • The WB6 economies have developed various policies with measurable objectives, including energy strategies, national renewable energy action plans, and national energy efficiency plans.<br>• However, most of these strategies and plans provide guidance until 2020 and thus need to be updated.<br>• The WB6 are all drafting National Energy and Climate Plans—although they are at different stages of the process, with Serbia's being the furthest from completion (Energy Community Secretariat, 2021[3]). | Advanced |
| **Implement energy policy fully, including action plans and strategies.** | • The WB6 have made progress since the last Competitiveness Outlook but most policies and action plans have only partially been implemented, as delays have hampered progress.<br>• Some of the identified infrastructure projects have also experienced delays.<br>• Several WB6 economies are unlikely to achieve their renewable target for 2020, signifying that not all National Renewable Action Plans have been implemented as expected. | Moderate |
| **Strengthen administrative and institutional capacity and provide additional resources.** | • There remains a need to endow energy regulators with additional human resources.<br>• Across the entire WB6 there is a significant shortage of staff competent in tackling issues like renewable energy and energy efficiency. | Limited |

## Introduction

Primary energy consumption in the WB6 stood at 72 megajoules (MJ) per capita in 2018—versus 129 in the European Union (EU) and 108 in the CEEC-11[1] (Eurostat, 2021[4]; Eurostat, 2021[5]). Energy plays a pivotal role in almost any economic activity. Accordingly, the competitiveness of the entire economy is heavily influenced by its energy market. If an energy market is efficient and competitive with regard to price formation and allocation, and if the energy is provided in a stable, predictable and secure manner, economic activities will be more competitive. Conversely, if a market is distorted, has market barriers, or provides an unstable supply, the cost of energy and thus the cost for any subsequent economic output in the value chain will be higher and therefore less competitive on an international basis.

Given the centrality of energy to overall competitiveness, this chapter investigates the WB6 energy policies and analyses to what extent their energy markets employ international good practices to optimise their efficiency and competitiveness. Energy policy typically addresses five overarching objectives: energy

market structure, energy security, environmental and climate considerations, competitiveness, and economic development. These objectives are particularly relevant for the WB6 economies, as they are in transition from monopoly-driven closed-off markets with ageing infrastructure to EU-style organised and integrated energy markets with new legislative frameworks and modernised infrastructure.

Given the breadth and depth of the impact of energy on the operation of the economy, this chapter is closely linked to several other chapters in this report. The most pertinent links are:

- **Chapters 4 and 6. Investment policy and promotion and access to finance.** There is a need for substantial financial investment in the energy sector, particularly for the deployment of renewable energy and energy efficiency.
- **Chapter 5. Trade policy.** Changes in the energy sector will have an impact on any economic activity, and thus also on economies' competitive positions on the international market.
- **Chapter 14. Transport policy.** Energy is the key input for various modes of transportation. As such, it is also related to the transport sector's level of greenhouse gas emissions.
- **Chapter 16. Environment policy.** Energy is a key contributor to greenhouse gas emissions. Therefore, policies on greenhouse gas emissions, greenhouse gas pricing and renewable energy are all highly relevant to energy policy.

## Assessment framework

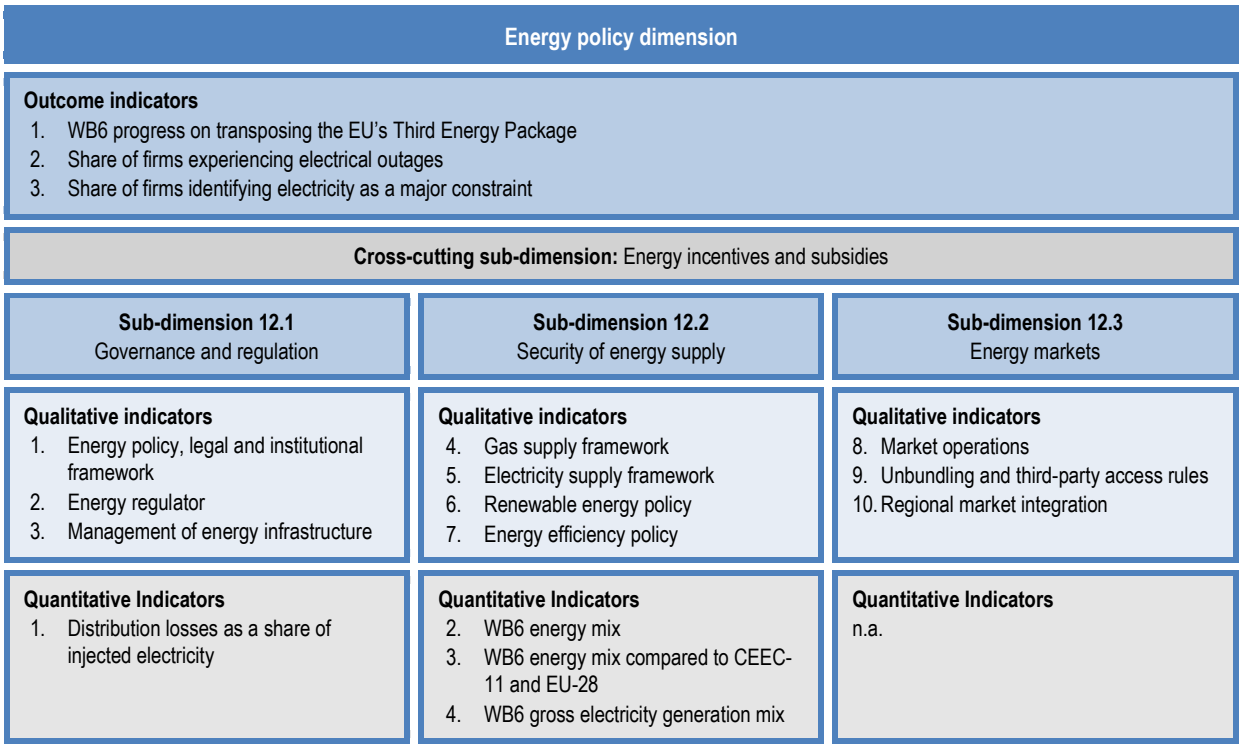
### *Structure*

This chapter assesses policies related to energy in the WB6 by assessing three broad sub-dimensions and one cross-cutting sub-dimension:

1. **Sub-dimension 12.1: Governance and regulation** focuses on how the energy markets are governed and guided by policy makers, and whether policy is informative and conducive to establishing an efficient and competitive energy market.
2. **Sub-dimension 12.2: Security of energy supply** focuses on how stable and secure the energy supply is and thus how susceptible the WB6 economies are to supply disruption. This sub-dimension also investigates the extent to which the energy supply is diversified, and how it promotes sustainable energy supply and efficient consumption in preparation for becoming a climate-resilient energy sector.
3. **Sub-dimension 12.3: Energy markets** focuses on how energy markets are operated and to what extent competition is used to promote efficient allocation of energy resources. Moreover, given the size of markets and the positive forces of international trade in promoting efficiency, this sub-dimension also investigates to what extent the WB6 energy markets are coupled and integrated, and thus open to international competition.
4. **Cross-cutting sub-dimension: Energy incentives and subsidies** focuses on the scale of subsidisation and cross-subsidisation in the energy sector and the extent to which they distort competition and fairness in the market.

The assessments for these sub-dimensions were carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. Figure 15.2 shows how the sub-dimensions and their indicators make up the energy policy dimension assessment framework. For more information on the methodology see the Assessment methodology and process chapter.

### Figure 15.2. Energy policy dimension assessment framework




#### *Key methodological changes to the assessment framework*

There have been two main changes to the methodology in the Competitiveness Outlook 2021. The first main change is a restructuring of the sub-dimensions and what they cover—various topics have been merged and indicators have been moved.

Moreover, this latest assessment is more focused on the energy markets' organisation and the energy sources covered. The assessment foregoes an in-depth analysis of oil and oil products' markets in WB6 economies. This does not mean that oil and oil products are not relevant for the WB6 economies' competitiveness, nor that these markets are in perfect alignment with international good practices and standards, but rather that the oil markets are globally integrated. In other words, the analysis has instead focused on markets that are largely still absent and are more driven by economy-specific or regional factors—such as electricity and natural gas markets.

## Energy performance and context in the WB6

Overall, the WB6 economies have made strong progress towards introducing legislative frameworks that reflect international good practice. The Energy Community (Box 15.1) estimates that WB6 transposition of the EU's Third Energy Package (Box 15.2) rose from 48% in 2018 to 55% in 2020 (Figure 15.3). The Third Energy Package is the international good practice benchmark for WB6 economies. Its importance stems from several factors. First, the EU is the largest integrated energy market bordering the WB6 region. Second, all of the WB6 economies are Energy Community members and thus have committed themselves to transposing the Third Energy Package. Finally, many of the WB6 economies are in the process of negotiating their entry into the EU, which also requires them to transpose the Third Energy Package.

### Box 15.1. The Energy Community

The Energy Community is an international organisation operating as an international regulatory entity that brings together the European Union (EU) and its neighbouring market, including the WB6 economies, under one unifying legislative and regulatory framework in support of a widely integrated energy market.

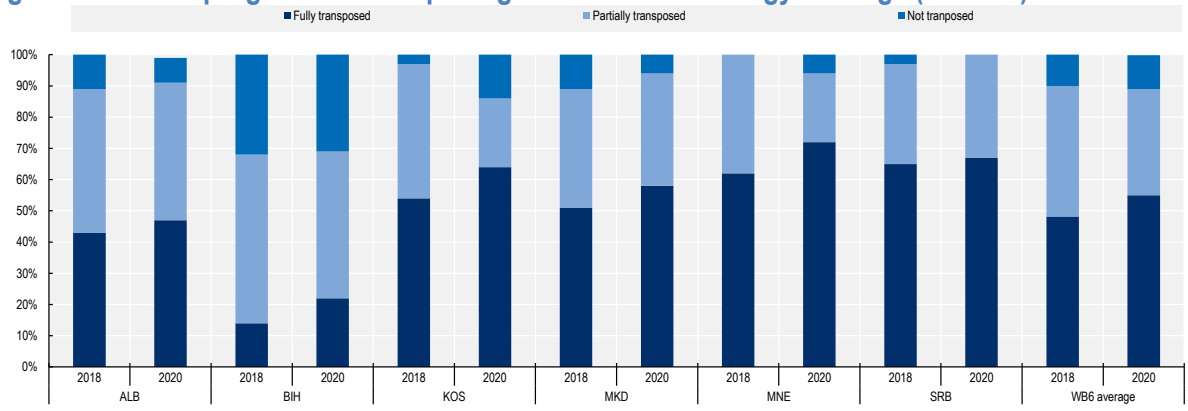
The Energy Community was established in 2005 and consists of a variety of bodies which are governed by the Energy Community's Council of Ministers and supported by a Secretariat. The Energy Community's operational sphere encompasses the entire EU and all the WB6 economies, as well as Ukraine, Moldova and Georgia, with Norway and Turkey participating as Observers.

The Energy Community *acquis*, which contracting parties need to transpose and implement, largely consists of the EU's Third Energy Package and a significant number of associated Network Codes.

In its role as a permanent body within the Energy Community structure, the Energy Community Secretariat continuously monitors and assesses the state of the energy markets within the Energy Community. It offers in-depth analysis to the public as well as support to contracting parties in transposing and implementing the Energy Community *acquis*. To this end, the Energy Community Secretariat's work on the WB6 economies' energy markets is an invaluable source of information for this chapter.

Source: For more information, please see https://www.energy-community.org/aboutus.

## Figure 15.3. WB6 progress on transposing the EU's Third Energy Package (2018-20)




Note: Please note that the WB6 score reflects the unweighted economy score provided by the Energy Community.
Source: (Energy Community Secretariat, 2018[1]), *2018 Implementation Report*, https://www.energy-community.org/implementation/IR2020/IR2018.html; (Energy Community Secretariat, 2020[2]), *2020 Implementation Report*, https://www.energy-community.org/dam/jcr:0af3b17a-3759-4a23-a2ef-3134784e217c/EnC_IR2020.pdf.

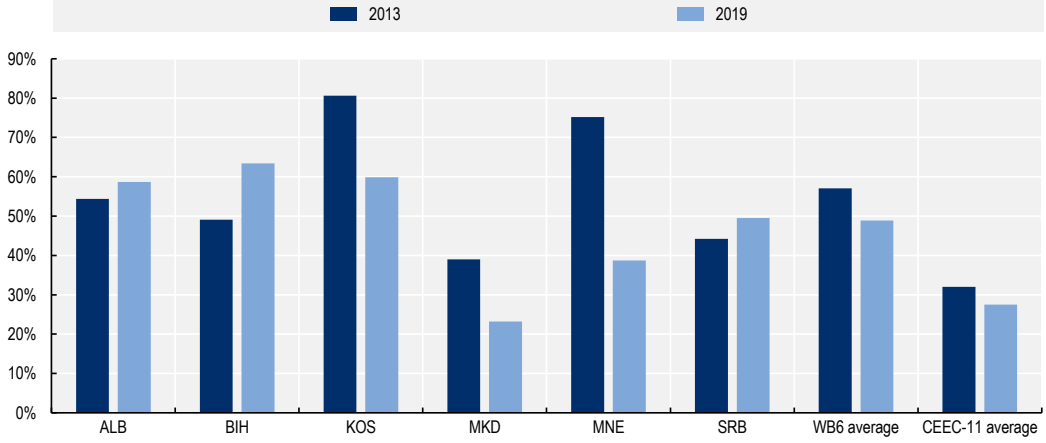
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However, despite these positive developments, businesses' perceptions of the energy sector in the region, and thus its impact on the competitiveness of the economies, remain negative. While the percentage of surveyed firms experiencing energy outages has gone down since 2013, it remains high, at just under 50% (World Bank, 2021[6]) (Figure 15.4). Moreover, the share of surveyed companies that identify electricity as a major constraint has increased by 10 percentage points (World Bank, 2021[6]) (Figure 15.5).

The rising share of surveyed companies that perceive energy to be a major constraint is driven by a variety of factors—for example, the share of industries that rely on energy as a major input is growing, as is the number of companies facing rising electricity prices. Another factor is likely the constraints imposed by the difference between the energy market legislation and how the market actually operates. This factor can

also be seen in the Energy Community's rating of the WB6's implementation of the Third Energy Package. The Energy Community perceives the implementation of the Third Energy Package in the WB6 to be at 56% (Energy Community Secretariat, 2020[2]), which has risen from 46% in 2018 (Energy Community Secretariat, 2018[1]).

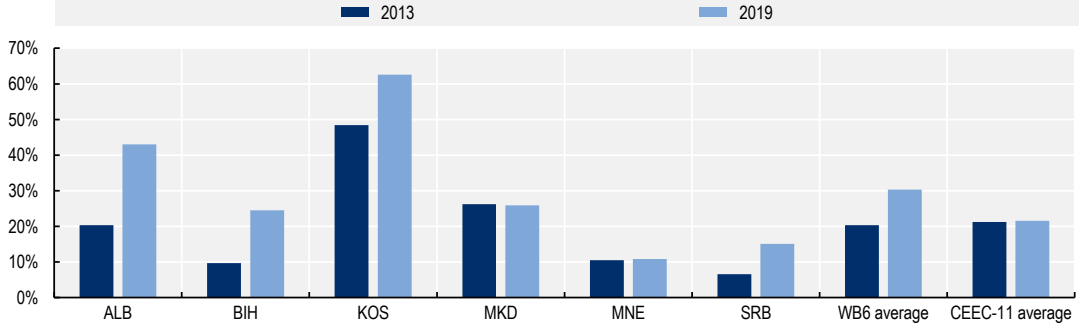
### Figure 15.4. Share of WB6 firms experiencing electrical outages (2013 and 2019)




Note: Please note that the WB6 percentage is the *unweighted* average. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: (World Bank, 2021[6]) *Enterprise Survey*, https://www.enterprisesurveys.org/en/custom-query.

StatLink https://doi.org/10.1787/888934254696

### Figure 15.5. Share of firms identifying electricity as a major constraint (2013 and 2019)




Note: Please note that the WB6 percentage is the *unweighted* average. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: (World Bank, 2021[6]) *Enterprise Survey*, https://www.enterprisesurveys.org/en/custom-query.

StatLink https://doi.org/10.1787/888934254715

Overall, the WB6 have solid legislative frameworks in place. Although these frameworks are not complete and need to be further developed, they do represent a good base for a competitive energy market. Accordingly, the focus should now be on implementing these frameworks, and on reducing the negative impact of energy outages and constraints on the WB6 economies by improving the quality of the energy supply.

## Governance and regulation (Sub-dimension 12.1)

The governance and regulation sub-dimension analyses to what extent the WB6 economies have the necessary framework to establish competitive energy markets and to foster their growth in the long run. More precisely, the sector's governance and regulation provide the backbone for energy sector

development, influencing the climate for investment and security of returns. In markets that have strong governance, clear directions and independent regulation, the energy sector responds to market signals and is more likely to lead to sustainable and efficient outcomes driven by competition (OECD, 2001[7]).

The Western Balkans as a region has made tremendous progress on governance and regulation. The sub-dimension regional score has risen from 2.2 in the last Competitiveness Outlook to 3.1. Leading the region are North Macedonia and Albania, which have strong legislative and policy frameworks in place as well as strong independent regulators (Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework). Nonetheless, there remains room for improvement within each of the indicators across the Western Balkans, with Bosnia and Herzegovina holding the greatest potential for improvement—in particular as in some sectors Bosnia and Herzegovina (particularly the Federation of Bosnia and Herzegovina) is not even compliant with the Second Energy Package.

**Table 15.2. Scores for sub-dimension 12.1: Governance and regulation**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 12.1 Governance and regulation | Energy policy, legal and institutional framework | 3.0 | 2.0 | 3.5 | 3.5 | 3.5 | 3.5 | 3.2 |
| | Energy regulator | 4.0 | 1.5 | 3.0 | 4.0 | 4.0 | 3.5 | 3.3 |
| | Management of energy infrastructure | 3.5 | 1.5 | 3.5 | 3.5 | 2.0 | 3.0 | 2.8 |
| **Sub-dimension average score** | | 3.5 | 1.7 | 3.3 | 3.7 | 3.2 | 3.3 | 3.1 |

### *Energy policy and legislative frameworks are progressing well and should now be fully implemented*

A comprehensive policy framework, supported by strong primary and secondary legislation as well as efficient institutions, sets the goals for economies. Furthermore, it sends strong signals to investors about the stability of returns on their investments. This indicator measures and analyses the extent to which the WB6 economies have designed and implemented a primary framework that promotes competition and efficiency in the energy market based on international good practices.

Overall the WB6 economies have a strong foundation; many have extensive legislative and policy frameworks in place that mirror those of the European Union. This in large part means that WB6 economies follow the EU principles of an organised market, employing competitive price formation—with equal opportunities and without discrimination, and ensuring sustainability and transparency of the market in meeting future energy needs. However, not all of the Third Energy Package has been transposed, and less of it has been implemented. For example, Bosnia and Herzegovina (with a score of 2.0; Table 4.3. Scores for Sub-dimension 1.1: Investment policy framework) is largely behind the rest of the WB6, operating some of its natural gas market segments based on an out-of-date legislative framework.

While most of the WB6 economies have extensive energy policy frameworks in place, in most cases these are only valid until 2020, and therefore need to be updated to reflect current international good practice. To this end, it should be noted that all WB6 economies, while at different stages, are working on drafting new policy based on the latest standards in the National Energy and Climate Plans[2] (Energy Community Secretariat, 2021[3]).

### Box 15.2. The EU Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-optimal market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Co-operation of Energy Regulators, ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all of the WB6 economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB6 economies as members of the Energy Community, whose *acquis* reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude, the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Co-operation of Energy Regulators.

### *Energy regulators could be more independent financially and politically*

Energy regulation is a key aspect for an economy's competitiveness. The responsibility of the energy regulator is to provide clear and transparent implementation and enforcement of the energy sector rules, without prejudice or favouritism. To do so, the regulator must be fully independent from any other state enterprise, and its functions and responsibilities must be clearly defined with full accountability. If the regulator is able to carry out its functions independently and without prejudice, the investor climate is significantly improved by greater stability. Accordingly, this indicator assesses the extent to which WB6 economies' energy regulators conform with international good practice in terms of independence and endowment of powers and resources.

The WB6 economies have strong institutional frameworks for their energy sectors, reflected in the overall strength of their independent regulators. In principle, the WB6 regulators follow the standards for independent regulators set out in the European Union Third Energy Package. To this end, they are equipped with sufficient powers and resources to act as key market enforcers.

However, there are some common shortcomings when comparing the WB6 energy regulators to their counterparts in the EU. First, the energy regulators of Kosovo and North Macedonia are not as strongly financially independent as they could be. In the case of Kosovo, the energy regulator's budget is a line item in the government accounts, rather than an independent account held by the regulator. Moreover, in some WB6 economies, energy regulators' salaries are bound to public salary schemes or conditions, which limits their ability to retain key staff in a competitive sector where technical staff are highly priced.

Furthermore, the regulators in North Macedonia and Serbia have expressed a need for additional staff going forward—although additional staff for all WB6 regulators would be recommended. The additional staff are needed to maintain current output levels as the regulators are taking on an increasing number of roles and responsibilities. There are also some issues surrounding the selection of the commissioners, i.e. the governing bodies of a regulator. Some economies have failed to fill all the positions on the board of commissioners. In Kosovo, for example, there are currently three vacant positions, meaning the regulator's governing body lacks a quorum to make decisions. In other cases, such as Bosnia and Herzegovina, Kosovo, Montenegro and North Macedonia, the selection of commissioners is either unnecessarily complex and lengthy, or is open to political influence, as the shortlisting of candidates for parliament approval is done by government, and there are limited requirements for who the government nominates. Moreover, in Serbia the regulator is limited in its ability to define its internal structure - requiring approval from parliament.

### *Infrastructure management is outdated*

Energy security and reliability of supply are closely linked, and both require dependable and efficient energy infrastructure. Energy infrastructure includes all parts of the energy system—from fuel production and generation to transmission and distribution. This indicator assesses whether or not the WB6 economies have a clear vision for rehabilitating, maintaining and expanding their infrastructure.

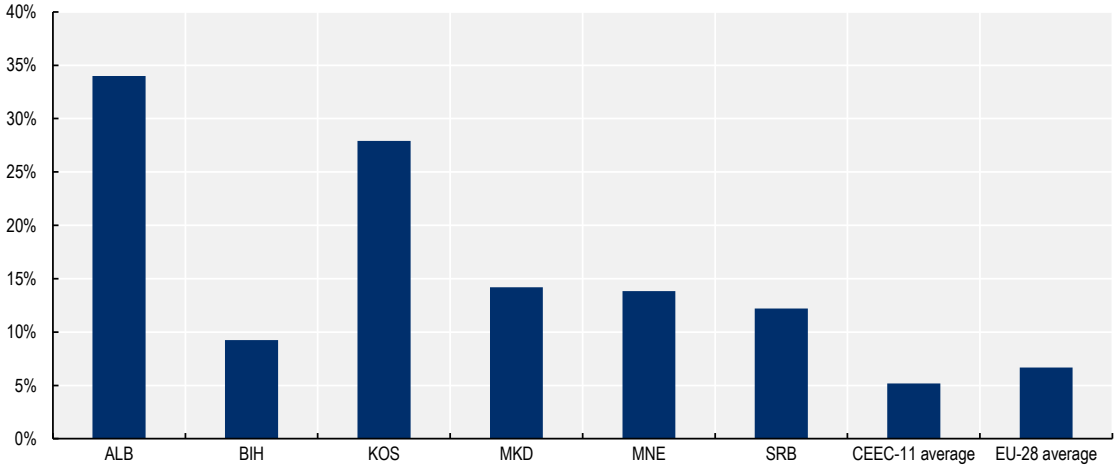
Unlike the regulators' shortcomings, for the most part the WB6 policies on infrastructure management closely reflect the practices of the European Union. That is, Most WB6 economies have extensive policy documents that guide the expansion of infrastructure, with the Ten-Year-Network Development Plans produced by the distribution and transmission system operators of electricity and natural gas being particularly important.

However, the WB6 economies continue to use existing approaches to generation infrastructure, often still relying on coal (Figure 15.7), which they plan to continue to rely on in the future as a key source for electricity generation. This situation is aggravated by the sluggish expansion of infrastructure for diversifying energy sources. Moreover, WB6 asset management often reflects a rather basic approach to asset capturing and maintenance planning using simple software tracking tools.

Another key issue related to infrastructure is the quantity of losses in the distribution of electricity. All WB6 economies have very high distribution losses—ranging from nearly 35% in Albania to around 10% in Bosnia and Herzegovina. These are well above the EU and CEEC-11 averages of 6.7% and 5.2% respectively (Figure 15.6). These losses are detrimental to the WB6's economic competitiveness as they represent cost and risk to companies. The WB6 need to tackle the issue from two angles. The first angle, technical losses, reflects the need for infrastructure improvements. The WB6 distribution systems require sizeable medium to long-term investment for modernising and refurbishing existing infrastructure and building new infrastructure. In this respect, medium to long-term planning is key, including plans for the recovery of funds necessary to carry out the investment. Addressing the second problem of non-technical

losses will require a mixture of infrastructure investment and improvement in customers' payment morale and reduction of energy theft.

### Figure 15.6. Distribution losses as a share of injected electricity (2018)




Note: This figure shows the distribution losses as a percentage of injected electricity into the distribution grid. EU average is EU-28 but excluding Bulgaria and Romania. CEEC-11 average includes Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia, but excludes Bulgaria and Romania.

Source: Adapted from (Council of European Energy Regulators, 2020[8]) *2nd CEER Report on Power Losses*, https://www.ceer.eu/documents/104400/-/-/fd4178b4-ed00-6d06-5f4b-8b87d630b060; (ERE, 2020[9]) *Annual Report – The situation of the power sector and ERE activity during 2019*, https://ere.gov.al/doc/ERE_annual_report_2019_26102020.pdf; (FSHU Sh.A., 2020[10]) *Application for the retail price of electricity for 2020*.

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### *The way forward for governance and regulation*

- **Complete the transposition and implementation of the Third Energy Package.** This is essential as it will ensure that WB6 economies have a comprehensive legislative and policy framework for the energy sector. The Third Energy Package still reflects in many ways the international good practices to establish and stimulate a competitive energy market, even though it has now been replaced in the EU by the Clean Energy Package (Box 15.2).
- **Strengthen the regulators, including their independence, their powers and their resources.** Specifically, the following issues should be tackled:
  - **Improve the selection of commissions** and reduce government influence in the selection process. The improvements should aim to reduce the timeframe of the selection process and thus ensure that the regulator's governing body has a decision-making quorum—this is particularly relevant for Kosovo.
  - **Strengthen the WB6 regulators' power to set salaries**.
  - **Increase staffing levels, especially of technical staff**, to continue to operate at current, or even higher levels of quality despite expanding roles, requirements, and responsibilities for regulators.
- **Invest further across the entire WB6 region to achieve four key goals:** 1) replacing ageing infrastructure; 2) diversifying supply and sources/routes; 3) increasing interconnections; and 4) strengthening the climate resilience of the energy sector. These investments would go a long way towards increasing the stability, security and efficiency of infrastructure, and would promote competition by establishing the physical flows that create opportunities for trade flows.
- **Reduce distribution losses**. This will require investment accompanied by legislative changes and enforcement that increase the cost of illicit consumption of energy.

## Security of energy supply (Sub-dimension 12.2)

Security of supply is essential for steady economic activity. The uninterrupted supply of energy allows for planning and cost minimisation across all sectors, while the absence of steady supply increases operational costs and reduces competitiveness. Supply security can be split into two elements:

1. **The supply security of energy:** whether or not WB6 economies are in a position to provide an adequate supply of energy for day-to-day consumption of the entire economy, are prepared for supply distribution or demand emergencies, and are seeking to diversify the energy mix and supply of energy.
2. **The long-run sustainability of the energy sector:** including the development of renewable energy sources and improving energy efficiency to simultaneously increase the viability of an economy while also increasing its resilience to and co-operation on climate change. Given the mounting pressure on non-renewable energy sources globally, and the reliance of many economies on a single source of energy, the benefits of diversifying the energy mix through renewables and curbing demand growth through energy efficiency have enormous potential to improve the competitiveness of the energy sector. While the development of sustainable energy also faces challenges, mainly due to insufficient global market development, governments are encouraged to prioritise this policy direction in the face of climate change.

The WB6 economies have made significant progress in this sub-dimension since the last CO assessment, with the score rising from around 1.8 to 2.9. The improvement in the score reflects the implementation of policies to guarantee energy supply security. This includes the increased diversification and expansion of the natural gas supply, increasing renewable generation, and the deployment of energy efficiency measures (Table 15.3). However, despite advances, and almost uniformly across the WB6, there remains significant room for improvement in the area of renewable energy penetration and energy efficiency improvement. Nonetheless, North Macedonia is leading the region as it has consistently implemented frameworks and policies in line with international standards and practices.

### Table 15.3. Scores for sub-dimension 12.2: Security of energy supply

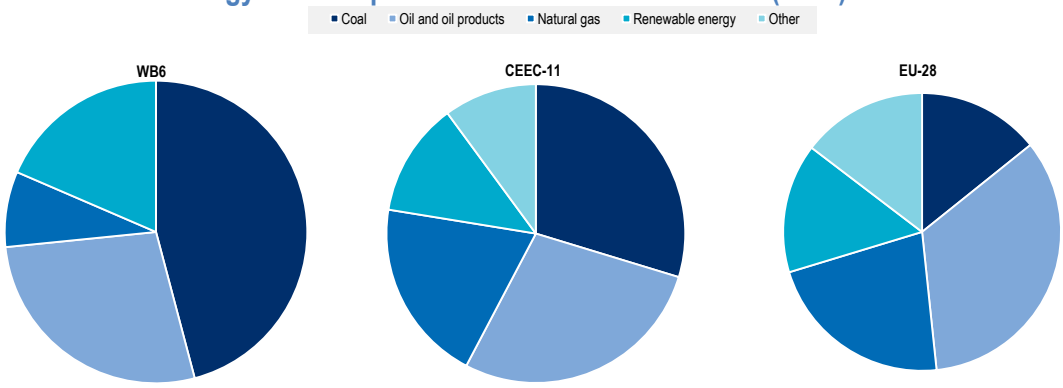
| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 12.2: Security of energy supply | Natural gas supply framework | 2.0 | 3.0 | 1.5 | 3.5 | 2.0 | 2.0 | 2.3 |
| | Electricity supply framework | 4.0 | 3.0 | 3.5 | 3.5 | 3.0 | 3.0 | 3.3 |
| | Renewable energy policy | 3.5 | 2.5 | 3.5 | 4.0 | 3.0 | 3.5 | 3.3 |
| | Energy efficiency policy | 2.0 | 2.0 | 2.5 | 3.5 | 2.5 | 3.0 | 2.6 |
| **Sub-dimension average score** | | 2.9 | 2.6 | 2.8 | 3.6 | 2.6 | 2.9 | 2.9 |

### *The natural gas supply framework exposes the WB6 to single-supplier and supply-route risks*

The natural gas supply framework indicator assesses to what extent the WB6 economies are prepared to overcome emergencies or diversify their energy mix to include natural gas in order to ensure a continuous energy supply to customers. Failure to provide this steady supply could have detrimental effects on the competitiveness of these economies.

When considering the natural gas supply framework, it should first be highlighted that in the WB6 economies natural gas accounts for a considerably smaller share of the primary energy consumption mix than in their European Union, CEEC-11 and regional counterparts (Figure 15.7).

## Figure 15.7. The WB6 energy mix compared with the EU and CEEC-11 (2018)



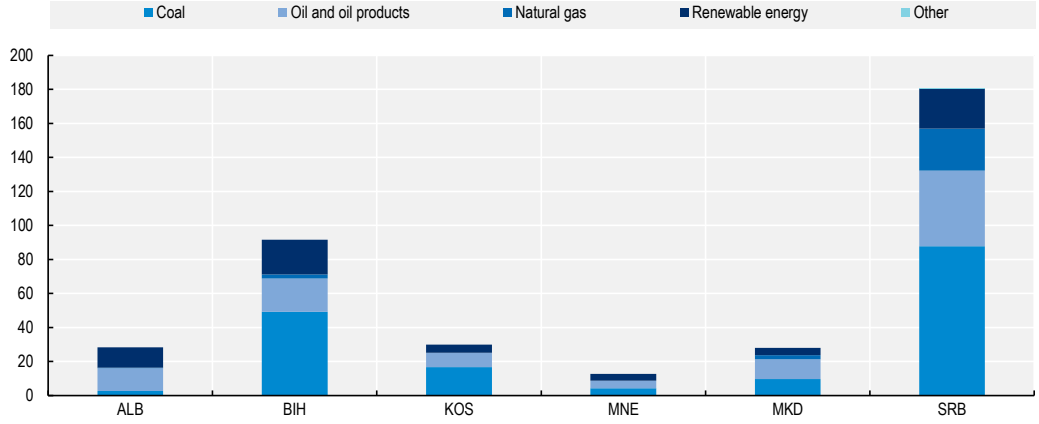

Note: Energy mix reflects primary consumption excluding geothermal and net imported or net exported electricity. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: Eurostat (2021[4]), *Complete Energy Balance*, https://ec.europa.eu/eurostat/web/energy/data/database/.

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This is due in large part to the fact that Kosovo and Montenegro do not have a natural gas market at all (Figure 15.8), and Albania has been only recently connected to an international natural gas pipeline via the Trans-Adriatic Pipeline.[3]

## Figure 15.8. The WB6 energy mix (2018)

Terawatt-hour




Note: Energy mix reflects primary consumption excluding geothermal and net imported or net exported electricity.
Source: Eurostat (2021[4]), *Complete Energy Balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

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Given the limited natural gas penetration and spread of markets in the WB6, it is no surprise that the legislative framework for natural gas and associated markets is not as well-developed as for electricity in the region. Furthermore, those WB6 economies that do have natural gas markets are almost exclusively sourcing their gas from Russia and often via a single import route, with Serbia building an alternative import route for Russian natural gas. Albania is the only WB6 economy not to receive its natural gas from Russia, obtaining it from Azerbaijan instead. Consequently, the region is very exposed to single-supplier and supply-route risks. Moreover, Bosnia and Herzegovina and Serbia's natural gas supplies continue to be oil-indexed, even though this is not in line with EU good practice, as it disconnects the natural gas pricing from supply and demand market realities.[4]

Given the low natural gas share in the energy mix, and the substantial level of oil and coal consumption, there is further room to expand natural gas as a substitute for other fossil fuels, thereby diversifying the energy mix while lowering greenhouse gas emissions. However, the environmental and security benefits

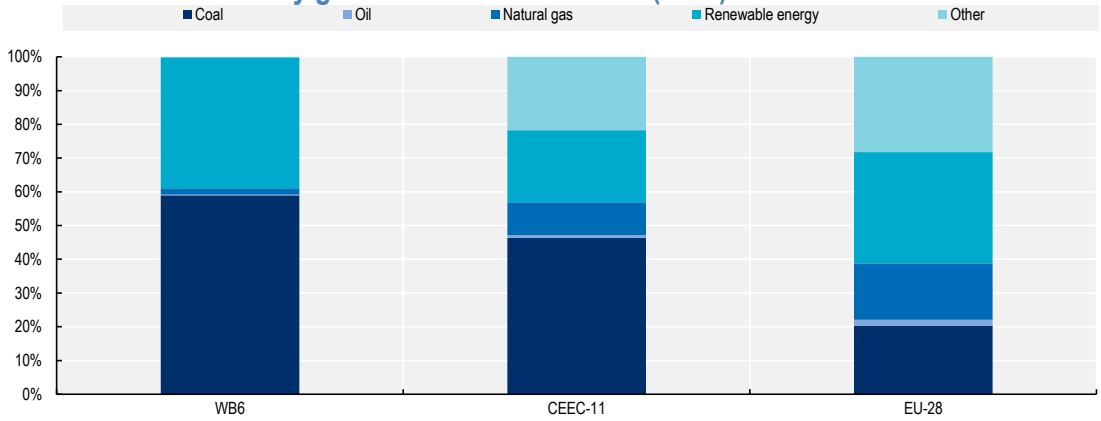
of expanding the natural gas market should be carefully weighed against the cost of the additional infrastructure required to do so. A possible outcome of this consideration could be to skip investing in natural gas infrastructure and instead concentrate on renewable energy and energy efficiency measures instead.

### *The electricity supply framework is well-advanced but over-reliant on coal*

A reliable electricity supply is vital for any well-functioning economy. Communication infrastructure, as well as industrial and service sectors, all depend on reliable and efficient electricity systems. The electricity supply framework assesses the extent to which governments have designed policy, legal, and institutional frameworks to ensure the delivery of a reliable and efficient electricity supply in a timely manner.

The WB6 economies have well-advanced legislative frameworks, and most have some form of emergency plan or strategies in place and have undertaken stress tests. However, several gaps remain. The WB6's electricity generation mix is dominated by coal, which accounted for over 50% of gross generated electricity in 2018 (Figure 15.9). Moreover, the WB6 region appears to be planning to continue relying on coal-fired generation, with new generation capacity planned, both to meet growing demand and to replace ageing capacity. This is particularly challenging as WB6 economies are, as part of the Berlin process formulated in the Sofia Declaration (Berlin Process, 2020[11]), committed to the transition to a low-carbon electricity sector. However, the policies of expanding coal generation are often old, and in most circumstances, based on information provided by WB6 governments, it appears that they will not materialise.

**Figure 15.9. Gross electricity generation mix in the WB6 (2018)**




Note: CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Eurostat (2021[4]), *Complete Energy Balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

StatLink https://doi.org/10.1787/888934254791

### *Renewable energy policy has scope to move beyond hydro generation*

Renewable energy development should be one of the key areas of energy policy in all economies. Increasing renewable energy has several benefits. For one, it strengthens energy security as it is a local source of energy, diversifies the local energy mix and helps reduce reliance on imported energy. For another, once established, the low marginal cost of renewable generation compared to fossil fuel generation capacity can put downward pressures on energy prices. Finally, increasing renewable generation has the potential to lower greenhouse gas emissions and other air pollutants, which in turn would improve the quality of life in WB6 economies and support the sustainability and climate resilience of the energy sector. It is an essential element for most economies to reach their COP21 commitments. However, as a relatively new global supply, renewable energy sources face significant challenges.

The renewable energy policy indicator assesses to what extent the WB6 economies have a clear strategic vision for renewable energy development, backed by a legal and regulatory framework. These are mostly in place in the WB6 in the form of National Renewable Energy Action Plans, as well as strong institutions and support mechanisms for their implementation.

Renewable energy accounted for nearly 40% of the WB6's generated electricity in 2018, yet nearly all of this was derived from hydro generation, which has been an energy source in the WB6 for many years now (Eurostat, 2021[4]). Hydro generation continues to dominate renewables despite the great potential for wind and solar generation, whose combined potential in the WB6 region as a whole could be three times the size of the remaining hydro potential (IRENA, 2019, p. Table 3.1[12]). Thus, renewable generation other than hydro is still very much in its infancy. The WB6 economies urgently need to support the expansion of renewable generation by establishing a supportive and sustainable environment—most notably with regards to pricing and grid integration.

One tool for increasing the attractiveness of renewable energy generation is the Guarantee of Origin certificate. These are provided to renewable generators who can sell them on to consumers who would like to certify that their consumption originates from renewable energy. These certificates also represent an additional income source for renewable generators as they allow them to capture customers paying higher margins. Many WB6 economies are in the process of deploying such certification systems, but with the exception of Serbia, they are not yet fully operational in most economies.[5] The legislation governing the certificates reflects the EU's Third Energy Package, which permits economies to forgo issuing the certificates to generators who receive public aid, which many economies have opted to do. It should be stressed that in its Clean Energy Package, the EU reformulated the clause to require certificates to be issued to subsidised generation, although income from the certificates needs to be accounted for in the subsidy.

### *Energy efficiency is still in its early stages in the WB6*

Energy efficiency is an economy's "hidden fuel", providing significant potential for curbing demand growth and redirecting energy consumption. Accordingly, the energy efficiency policy indicator assesses to what extent the WB6 economies are in a position to undertake the necessary investments, based on whether or not they have competitive energy efficiency markets, a clear policy direction, strong legislation, and modern building codes.

While the WB6 economies do have extensive energy efficiency policies in place—such as National Energy Efficiency Action Plans – the legislative framework is patchy.[6] This is particularly true for energy efficiency labelling of products for which North Macedonia has the most extensive Third Energy Package-compliant legislative framework, and Albania and Bosnia and Herzegovina have the least compliant frameworks (Energy Community Secretariat, 2020[2]). Moreover, while the legislative framework is mostly in place for the energy efficiency performance of buildings, the certification of buildings is in the early stages, and the focus is mainly on new builds at the moment. In part, the slow uptake of energy efficiency provisions could be due to limited funding, as the funds that are available seem to be almost exclusively focused on the energy performance of public buildings. Energy efficiency audit requirements are in the process of being deployed across the WB6, in line with Article 8 of the Energy Efficiency Directive. However, progress is being slowed down by a lack of trained and certified auditors. In general, there is a significant shortage of technical staff in public institutions that deal with energy efficiency.

### *The way forward for security of energy supply*

- **Increase the stability of energy supply** by enhancing the policies tackling supply emergencies and implementing existing energy (supply) strategies more rapidly as projects are falling behind schedule. While some of the WB6 economies plan to continue to rely primarily on coal-fired power

generation to help ensure energy supply security, with the increasing need for energy sectors to minimise their carbon emissions, it would be advisable for these economies to look to renewable sources instead—in combination with the possible introduction of some form of greenhouse gas pricing. Finally, key infrastructure investment is needed to reduce the WB6 electricity distribution losses, which impose additional costs on the competitiveness of the WB6 economies.

- **Pursue a policy of increased renewable generation as the primary source of supply growth.** This will be particularly important should carbon border taxes be introduced, as is currently being discussed in the European Union, since this would mean that energy-intensive economic sectors would be increasingly uncompetitive. This can be achieved as follows:
  - **Improve the value-added proposition of renewable energy projects** by implementing, in line with international standards, competitive assignment of renewable projects (e.g., auctions) and by adjusting support schemes from feed-in tariffs to feed-in premiums or contract-for-differences (Box 15.3). These changes should build investors' confidence as the new approaches imply increased sustainability in the market due to their competitive nature and alignment with market realities.
  - **Develop and deploy Guarantee of Origin certificates**. This will primarily involve establishing or designating a platform where stakeholders, such as renewable generators and consumers, request the issuing, registration and eventual transfer and calculation of certificates.
- **Prioritise the increased implementation of energy efficiency.** Doing so will help reduce energy price rises and climate impacts on consumption, and thus also support the overall economy in becoming more efficient and competitive. The following steps can improve energy efficiency:
  - **Improve national strategies** to provide more economic sectors with detailed guidance on energy efficiency requirements.
  - **Finalise the legislative base for energy efficiency** to include requirements for industrial and commercial enterprises, energy product labelling, and certification of energy performance for buildings. The operational deployment of energy efficiency audit requirements for industry should be accelerated—including the training and certification of auditors, and all economic entities should be encouraged to undertake energy audits.
  - **Transpose and implement the European Union's Clean Energy Package (**Box 15.2**)**. This package reflects the EU's latest best efforts for promoting a clean and sustainable energy sector, with a focus on energy efficiency.
  - **Increase the human resource capacity of public entities**. Many of the WB6 economies have a significant shortage of key staff to tackle energy efficiency, which is hampering progress. If they have not done so already, all WB6 economies should establish and equip energy efficiency agencies.
  - **Increase the availability and coverage of energy efficiency funding**—including for private endeavours—to accelerate energy efficiency measures across society. The widening of the financial support base can take different forms, from cheaper loans tied to energy efficiency requirements to direct financial support, such as tax credits, etc.
  - **Increase public acceptance through public information campaigns** on the need for and benefits of energy conservation.

### Box 15.3. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated independent of the electricity market price (Banja et al., 2017, p. 15[13]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (Council of European Energy Regulators, 2018, p. 12[14]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (European Commission, 2014, pp. 12-13[15]). The latter has been a problem especially as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (European Commission, 2013[16]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (European Commission, 2013, p. 8[16]).

The European Commission suggests using a feed-in premium scheme in combination with the following good practice recommendations (European Commission, 2013[16]):

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable project and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

However, the Council of European Energy Regulators reports that in 2016/17, 17 of the 27 European Union member countries still used some form of feed-in tariff, although mainly for small projects, while around 16 used feed-in premiums, including to complement feed-in tariffs (Council of European Energy Regulators, 2018[14]).

For further and more detailed exploration of renewable energy subsidies and best practice please see the sources below. Meanwhile, for more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.

Source: (Banja et al., 2017[13]), "Renewables in the EU", https://e3p.jrc.ec.europa.eu/sites/default/files/documents/publications/kjna29100enn.pdf; (Council of European Energy Regulators, 2018[14]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (European Commission, 2013[16]), European Commission guidance for the design of renewable support schemes, https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (European Commission, 2014[15]), *Guidelines on State Aid for Environmental Protection and Energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Energy markets (Sub-dimension 12.3)

Energy markets provide a platform for energy trade and can range widely in size, type and level of competitiveness. Differences in energy markets are influenced by all the afore-mentioned aspects of the energy sector, including governance, legislation, regulation, energy mix, and infrastructure.

Overall, a sub-optimal market stifles competition and leads to inefficiency through prices that do not reflect the true scarcity of an energy product. This ultimately results in inadequate investment signals and sub-optimal energy consumption.

The average score for the WB region has risen from 1.9 in the last Competitiveness Outlook to 3.0 (Figure 15.1), as the WB6's energy markets have improved with increased liberalisation, price deregulation on the wholesale level, and deployment of power exchanges. Albania and North Macedonia are leading the regional scores in part due to their efforts to deploy an organised market and efforts to increase regional integration (Table 15.4). Meanwhile, Kosovo and Montenegro are prime examples of improvement in the area of the unbundling of, and third-party access to, their energy markets. However, there remain significant hurdles in the region with regard to unbundling within and third-party access to natural gas markets—in particular in Serbia and Bosnia and Herzegovina—and room for improvement in the deployment of organised markets. Moreover, regional integration and market coupling are largely absent.

### Table 15.4. Scores for sub-dimension 12.3: Energy markets

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 12.3: Energy markets | Market operation | 3.0 | 1.5 | 2.5 | 4.0 | 3.5 | 3.5 | 3.0 |
| | Unbundling and third-party access | 3.5 | 1.5 | 4.5 | 3.5 | 4.0 | 2.5 | 3.3 |
| | Regional market integration | 3.5 | 2.5 | 2.0 | 3.5 | 2.0 | 2.5 | 2.7 |
| **Sub-dimension average score** | | 3.3 | 1.8 | 3.0 | 3.7 | 3.2 | 2.8 | 3.0 |

### *Energy markets are moving towards international good practice*

Market operations are an essential cornerstone of market development and integration as they account for the physical implementation and operation of the market. The efficient implementation of physical markets is, together with non-discriminatory treatment of market participants, a necessary precondition for efficiency gains through an economy's own internal market, as well as through regional integration. The latter is especially relevant for the WB6 economies, as integrating their relatively small energy markets regionally and with their EU neighbours could allow them to reap the benefits of competitive energy markets. Accordingly, the market operation indicator assesses the state of the physical markets in the WB6 economies, including how efficient they are and to what extent they encourage competition.

The WB6 economies have made good progress on this indicator—most markets have been partially liberalised, and prices are increasingly being deregulated. However, some market segments remain regulated, in particular the retail markets, where consumers are captured by dominant market incumbents—often under the umbrella of universal suppliers[7] whose position as sole supplier is reinforced by the lack of competition. Nonetheless, it is positive to note that more economies have deployed organised wholesale markets. The most recent economies to do so are Albania, Kosovo and Montenegro, which have all set up power exchanges,[8] although they have yet to start operating. North Macedonia has nominated the market operator and is working on deploying the organised (wholesale) market, but is very much in the early stages. In addition, state law does not cover the operational deployment of an organised market so deployment is subject to the adoption of a new law. However, there are several market segments in the WB6 economies that still lack working organised marketplaces. These are urgently needed as their absence is a significant barrier to market integration and coupling.

### *Unbundling and third-party access are also approaching international good practice*

Unbundling the operations of different parts of the energy sector is one of the key requirements for competitive markets. This means that companies that operate electricity and heat generation, electricity or gas transmission and electricity, gas, or heat distribution should be managed and operated by separate entities. This separation is necessary in order to avoid vertical integration and minimise monopolistic behaviour. Transmission and distribution networks are natural monopolies, providing opportunities to limit third-party access if the same entity owns and operates both the network and generation. Markets with fully integrated operators and lack of third-party access tend to distort fair competition; thus, unbundling in combination with full third-party access to the network is a prerequisite for a competitive market. This indicator assesses the extent to which these key natural monopolies are unbundled and grant access to infrastructure in line with international good practice.

The WB6 region is nearing full implementation of international good practice on unbundling. This is also true for allowing non-discriminatory third-party access to natural monopoly-owned infrastructures. Most WB6 economies have the legislative basis for unbundling, in line with the EU's Third Energy Package (apart for some market segments in Bosnia and Herzegovina). Albania is a particularly positive example, as, after many years of having had a bundled electricity distribution company, it is making progress in conjunction with an international donor project to unbundle the company. Most recently, the distribution system operator has been legally unbundled, but functional unbundling is yet to be completed. Meanwhile, Bosnia and Herzegovina and Serbia are lagging behind, particularly with regard to natural gas, where unbundling and third-party access are lacking. Bosnia and Herzegovina has not even started unbundling; whereas in Serbia progress has been made towards legal unbundling, but functional unbundling is not in place yet.

### *Regional market integration is making slower progress*

The regional market integration indicator assesses to what extent markets can be and are efficiently integrated and coupled. Market integration and its benefits are based on two pillars:

1. **Harmonised regulations within the region.** These allow for the faster, more efficient development of energy trade and the integration of several economies into a common shared market. Prices in these regional markets respond to various supply and demand forces, often resulting in more competitive prices and a larger variety of market products—while simultaneously lowering supply risk.
2. **Improved and co-ordinated interconnection management**. A co-ordinated network and interconnection reliability are paramount for transferring trade flows to consumers in the most efficient way possible on a regional level. Networks with high congestion and poor reliability are unable to operate a highly competitive market with a large number of transitions and heavy flows. Alternatively, when congestion and reliability are properly managed, markets are able to respond by providing fast responses and higher quantities, and thus also competitive prices.

Progress towards regional integration is limited. The Energy Community Secretariat found that the transmission networks of the Energy Community Contracting Parties—including the WB6 economies—are more strongly interconnected than those of the majority of EU Member States (Energy Community Secretariat, 2021, p. 85[17]). However, it noted that although market integration in the WB6 area is not hindered by the lack of interconnectors, it is limited by inefficiencies arising from the absence of short-term co-ordinated capacity calculation and an efficient mechanism for allocation and use (Energy Community Secretariat, 2021, p. 85[17]). Moreover, despite various international projects, market coupling remains absent. However, this is in part due to the absence of working organised markets in most WB6 economies until very recently.

### *The way forward for energy markets*

- **Seek to expand the competition-driven efficiency gains of an organised energy market**. In particular:
  - **Continue the liberalisation and price-deregulation of the wholesale and retail market**. WB6 economies need to eliminate existing market barriers. Moreover, in some cases due to lack of competition, the balancing market is also still regulated. Accordingly, as markets are deregulated and liberalised, the WB6 economies need to devise and implement strategies that promote market entry, liquidity, and, ultimately, competition.
  - **Deploy and operationalise organised energy markets**.
- **Unbundle key natural monopolies**, such as the transmission system operators and distribution system operators. Separating these entities from vertically integrated energy companies is essential to create a level playing field for all generators and suppliers.
- **Prioritise non-discriminatory third-party access** to the market on a functional level. Together with unbundling, non-discriminatory third-party access is crucial for promoting market entry and participation, and thus also competition and efficiency of markets—particularly for international flows, given the small size of most WB6 energy markets.
- **Enhance regional co-operation and move towards eventual market integration and coupling**. Specifically this requires improvements to the optimised and co-ordinated allocation of cross-border interconnections; better regional market coupling, so that there is a regional price response and anchoring; reducing regional barriers, including recognising licences from other economies; and accommodating regional market coupling by promoting cross-border trading activities. These steps should help ease market variations and fluctuations, while simultaneously safeguarding the market against manipulation by dominant energy entities in a specific market.

## Energy incentives and subsidies (cross-cutting sub-dimension)

Subsidisation and cross-subsidisation in the WB6 energy sectors is a cross-cutting sub-dimension assessed in this edition of the Competitiveness Outlook, though it is not scored. Given the nature of subsidisation and cross-subsidisation, this sub-dimension does not have any specific indicators that can be considered. While broadly speaking there is subsidisation of primary energy, conversion of energy, and consumption, the subsidisation that occurs within these areas and across them can take many forms. The absence of a score also reflects the fact that every economy has some form of subsidisation in place, often to protect consumers or to encourage the development of a new market segment such as renewable energy or implementation of energy efficiency measures. Thus, the presence of subsidisation is not always negative, making scoring it a difficult and very subjective task. This section therefore explores the presence of subsidisation outside of common norms and analyses their potential distortive impact on market equilibrium.

Subsidisation is an essential tool for directing energy policy and the energy market, since it can help support fragile or nascent energy sources. However, any subsidisation, whether direct or indirect, does distort the market away from the competition-driven optimal equilibrium created between price-driven supply and demand. Therefore, subsidisation needs to be carefully designed and, in many cases, limited to certain conditions (e.g., on time, form or size). Failure to do so will lead to a sector that distorts either consumption or supply to the point where the market deviates from its long-term equilibrium. This deviation tends to be associated with increased hidden and long-term costs, which in turn lower the competitiveness of the entire economy.

### *Significant levels of subsidisation across the WB6 are distorting the market*

One main area of concern for subsidisation in the WB6 energy market is the systemic subsidisation of coal-fired power generation across most of the region. Miljević (2020[18]) estimates that taken together, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia provided EUR 72.71 million in direct subsidies to coal and lignite electricity producers in 2019. However, it should be noted that this level of subsidisation has been significantly reduced from the nearly EUR 165 million provided in 2015. Overall, this subsidisation distorts the energy market in the WB6 by artificially increasing the economic viability of coal-fired generation and lowering energy prices. Furthermore, this subsidisation is counterproductive to the region's aim of reducing carbon emissions and of subsidising renewable energy and energy efficiency, since it increases the financial support required to make renewable energy or energy efficiency viable.

Another concern is the market distortion arising from the blanket use of universal suppliers to supply small consumers, and exclusive generation contracts between generators and universal suppliers. The functional impact of these two practices is a reduction in market liquidity and thus a weakening of the economic forces that drive efficiency in a competitive energy market to lower prices. Moreover, the use of universal suppliers to supply all households and small consumers is often associated with low prices—possibly below market prices—which then have to be offset by higher prices for industrial consumers or through state subsidisation. This can also take the form of regulated retail prices that do not reflect market prices. Overall, lower prices push household, small industrial, and commercial consumer demand above the optimal level, and the cost of this distortion is carried in one way or another by the economy. Ultimately, these practices introduce inefficiencies into the market that negatively affect economic competitiveness.

Another form of subsidisation in the WB6 region is differentiation of payment for electricity consumption, in particular for public entities. In Albania, Kosovo and Serbia the different payments approach for public entities has largely resulted in transferring the cost of their electricity consumption to wider society. This means these entities' consumption is distorted from their efficient level, and the cost of this deviation is carried by society.

Albania demonstrates yet another subsidisation practice present in the WB6 – the existence of outstanding payments between non-energy sector stakeholders and energy stakeholders, outstanding payments among energy stakeholders, as well as outstanding payments owed by energy stakeholders to the government. These outstanding payments are a form of subsidisation as they imply that the costs associated with their activities are not paid and thus that the entities had lower operational costs than other non-state entities. This in turn leads to distorted demand and sub-optimal market outcomes.

Also of particular interest are exemptions in Bosnia and Herzegovina and Kosovo for renewable generators to bear full responsibility for their electricity imbalances.[9] Taking Kosovo as an example, the legislation governing renewable energy stipulates that renewable generators need only pay 25% of their imbalance cost. While in general financial support is seen as necessary for aiding renewable generation growth, this particular subsidisation approach encourages renewable generators to forgo good forecasting practices to the extent where imbalances become greater. These increased imbalances create a security of supply risk, and avoidable extra costs that end up being carried by society or specific groups of consumers in a non-transparent manner.

A final form of subsidy in the WB6 is the use of congestion revenues for reducing transmission tariffs. In essence, international trade flows are subsidising domestic consumers. Since regional integration is a key consideration for the WB6 energy markets and their liquidity, congestion revenues should, in line with EU good practices, be used to increase or maintain cross-border interconnection capacity and to reduce regional or national congestions. However, the use of revenue to reduce transmission tariffs is not prohibited by EU regulations.[10]

### *The way forward for energy incentives*

Overall, the WB6 should strive to keep market interventions to a minimum—in particular subsidies. Of course, certain types of subsidies are inevitable, such as those for vulnerable customers and renewable energy generation, or those in places where markets fail to consider long-run externalities. However, beyond those exceptional circumstances, money spent on subsidisation largely distorts markets that inevitably costs society both directly in terms of the value of the subsidisation and indirectly through the loss of efficiency in market-driven outcomes. Therefore, the WB6 economies should:

- **Eliminate the subsidisation of fossil fuels—in particular coal and coal-fired generation**. This is particularly important given the rise of climate pressures on energy markets and the associated subsidisation of renewable energy. While both are supported simultaneously, subsidising coal is counterproductive to the subsidisation scheme for renewable energy as it increases the need for financial support for renewables.
- **Undertake an extensive information campaign** which highlights the need to reduce subsidies—including large-scale or blanket subsidies for consumers.

## Conclusion

Overall, the WB6 economies have made good progress in establishing the foundations for competitive energy markets by developing extensive legislation, regulation and policy frameworks. The focus now needs to be on implementing and deploying these frameworks. This includes measures to ensure non-discriminatory access to the markets, promotion of competition—including reducing the dominance of incumbents—and perhaps most importantly, deploying organised markets together with the promotion of regional integration and coupling. Overall, these measures will ensure that markets are driven by competition, and thus will lead to the most cost-effective approach to energy in the WB6. This in turn would support the wider competitiveness of the economies in general, given the importance of energy in any value chain.

Improvements in energy supply security have been slow and renewable energy deployment and energy efficiency improvements are still very much in their early stages. Tackling these will help ensure access to a stable, quality supply of energy on a business level, while diversifying energy sources and supply options on the macro level. Finally, the WB6 economies are only at the beginning of creating a sustainable energy sector.

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## Notes

[1] The 11 Central and Eastern European countries (CEECs) joining the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] Under EU Regulation 2018/1999 on the Governance of the Energy Union and Climate Action, all EU Member States are required to draft a National Energy Climate Plan (NECP) every two years. The NECPs are integrated plans that require co-ordinated government planning and should cover five areas: 1) Energy efficiency; 2) renewable energy; 3) Greenhouse gas emissions (reduction); 4) interconnections, and 5) research and innovation. The drafting requirement was extended to the Energy Community Contracting Parties—including WB6 economies – through the adoption of Ministerial Council Recommendation 2018/1/MC-EnC. For more information please see https://ec.europa.eu/energy/topics/energy-strategy/national-energy-climate-plans_en and https://www.energy-community.org/regionalinitiatives/NECP.html.

[3] The Trans Adriatic Pipeline (TAP) connects Italy, Albania, and Greece to the Trans-Anatolian Natural Gas Pipeline so that supplies from Azerbaijan can be transported via Turkey and Georgia to these economies. The TAP started commercial operations on 15 November 2020. For more information see https://www.tap-ag.com. It should be stressed that prior to TAP, Albania did have some domestic natural gas supply and consumption. According to Instat (Instat, 2021[24]) natural gas consumption accounted for around 2% of primary energy consumption. This share is expected to rise now that TAP has started commercial operations.

[4] Oil indexation was once the dominant pricing format for natural gas in Europe. This largely reflected that at the time, natural gas spot markets were not liquid enough to provide good price signals. Moreover, natural gas was competing with oil consumption in power generation and heating and oil indexation was a good approach to ensure that natural gas was competitive with the main alternative fuel. Oil indexation is often also justified due to natural gas being a by-product of oil exploration or by natural gas investment competing with oil for capital investment. However, oil indexation implies that in the current market situation the natural gas price does not reflect the supply and demand realities which are largely now disconnected from oil, both in terms of alternative demand and on the production side. Furthermore, Europe has a variety of liquid natural gas spot markets that offer good pricing and indexation points, especially considering the interconnected nature of Europe's natural gas markets. There is an extensive literature on the benefits and drawbacks of natural gas being priced via oil indexation; this endnote only scratches the surface. Some examples of the literature are: (Dubreuil, Gergely Molnar and Jeon, 2020[19]), (European Commission, 2015[20]), (Melling, A.J. (2010), Natural gas pricing and its future- Europe as the battleground, 2010[22]), (IEA, 2020[21]), and (Stern, 2007[23]).

[5] A Guarantee of Origin certificates mechanism is operational in Serbia. The Serbian transmission system operator is the issuing body and has been a member of the Association of Issuing Bodies (AIB) since September 2019. In November 2020, the Serbian transmission system operator connected to AIB HUB, which allows exchange (import and export) of Guarantee of Origin certificates between Serbia and other AIB members.

[6] It should be stressed that in the context of the Berlin Process the WB6 economies have committed to "Prioritise energy efficiency and improve it in all sectors" (Berlin Process, 2020[11]).

[7] As per EU regulation 2019/944 Article 27, a universal supplier is a designated entity charged with the duty to make sure that all households (and if applicable small enterprises) have access to electricity at specified quality at competitive, easily and clearly comparable transparent and non-discriminatory prices.

[8] A power exchange, also referred to as an energy exchange, is a multi-layered system operated by a market operator that facilitates the trading/exchange of energy between third party buyers and sellers. Such markets can include wholesale markets with day-ahead, intraday and futures markets.

[9] Imbalances refer to the difference between the nominated versus actual consumed, generated or supplied electricity. More precisely, EU regulation 2019/943 Whereas (15) defines imbalances to be the "difference between the allocated volume and the final position in the market". Furthermore, Article 5 of the same regulation states that "all market participants shall be responsible for the imbalances they cause in the system". For more information please see (Emissions-EUETS.com, 2021[25]).

[10] See EU Regulation 714/2009, Article 16, Paragraph 6.

# 16 Environment policy (Dimension 13)

This chapter assesses the quality of legal and policy frameworks for the environment, and the extent of their implementation, in the six Western Balkan economies (WB6). The chapter analyses three sub-dimensions built around the OECD Green Growth Indicator framework, the European Commission's EU *acquis* indicators and the United Nations Sustainable Development Goal indicators. The first sub-dimension, resource productivity, assesses how policies facilitate efficient material resource use in production and waste generation and the extent to which they combat climate change. The second sub-dimension, natural asset base, examines to what extent the economies' natural assets are being preserved for future generations. The third sub-dimension, environmental quality of life, assesses the impact of environmental conditions and risks on people's quality of life and well-being.

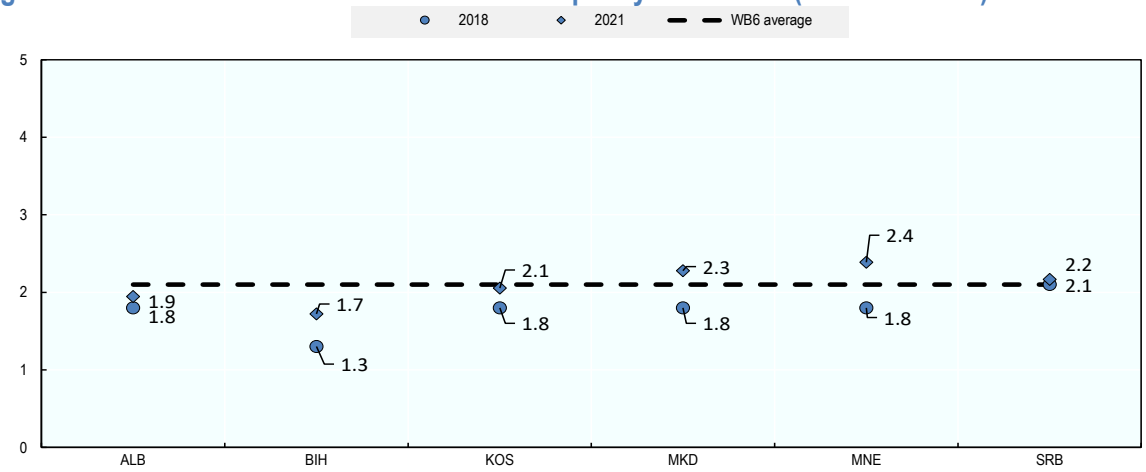
## Key findings

- **Climate change adaptation measures are gradually being introduced across the region, though climate change mitigation efforts need to be scaled up**. Major climate-related risks are being identified throughout the region but renewable energy targets and schemes are lacking.
- **Air pollution remains one of the main environmental challenges in the region, with $PM_{2.5}$ levels two to three times above the maximum limits recommended by the World Health Organization. However, some progress has been achieved** thanks to relatively well-developed legislative frameworks, local air quality plans, upgraded monitoring systems and awareness-raising activities.
- **All WB6 economies have adopted policy frameworks for biodiversity conservation.** Plans for endangered species and protected areas have also been adopted in most WB6 economies. Nevertheless, biodiversity and forestry monitoring systems and public inventories are rarely in place, which impedes proper implementation.
- **The groundwork for the freshwater management legislative framework has been done** in most assessed economies. However, international co-ordination of transboundary river basins has primarily been driven by donors rather than WB6 economies. Although all assessed economies have a legal framework for planning and managing hydropower plants (the main source of renewable energy in the region), in practice mandatory environmental impact assessments have largely been circumvented.
- **Water supply and sanitation systems remain inadequate**. Investments are ongoing but water service fees remain too low to cover or complement the infrastructural investment costs and water supply services. Moreover, insufficient institutional capacities and poor co-ordination among responsible local authorities impede implementation of water management measures.
- **There have been no major changes to land-use frameworks** in most assessed economies, except for North Macedonia. Progress has been observed in Albania, the Republika Srpska (RS) in Bosnia and Herzegovina, and Kosovo, where municipal development plans are being prepared together with local municipalities to foster sustainable territorial development and rational land use.
- **Recycling rates of municipal waste remain extremely low** across the region. They are less than 5% for all economies except for Albania (18.5%) and significantly lower than in the European Union (47%). Some actions have been undertaken on waste management and to develop a circular economy. However, there are no specific policy frameworks. Serbia is the only economy to have adopted a circular economy roadmap.
- **Industrial waste management frameworks could improve further** and the policy and legislative bases for soil protection are almost non-existent. Progress on identifying contaminated areas has only been recorded in Kosovo and Montenegro.
- **Unregulated burning and illegal dumping of waste** is still prevalent in the region, posing problems to the environment and public health through groundwater, soil and air pollution. Some projects are being implemented to clean up and combat illegal landfills, but progress has been limited.

## Comparison with the 2018 assessment

Since the last assessment, the six Western Balkan (WB6) economies have slightly improved their scores in the environment policy dimension (Figure 16.1). While the situation in Bosnia and Herzegovina[1] has improved, its score is still the lowest of all the assessed economies. Montenegro and North Macedonia have made the most progress between 2018 and 2021 and rank first and second respectively in the Western Balkan region for environment policy.

### Figure 16.1. Overall scores for the environment policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition of new sub-dimensions and relevant qualitative indicators, and removal of some sub-dimensions and qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

There has been only limited progress overall on implementing the policy recommendations made in the CO 2018 (Table 16.1), although there are large differences in implementation across economies. Moderate advances have been made in accelerating the transition to a low-carbon economy, but improvements in defining clear roles and responsibilities at local levels, strengthening natural asset management, and institutionalising the collection of key environmental data are limited.

## Table 16.1. Implementation of the CO 2018 policy recommendations: Environment policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Integrate environmental considerations and international commitments into the main economic and sectoral policies** | • Progress has been achieved in harmonising legislation with the EU *acquis*, in particular air quality and industrial risks and accidents.<br>• Very little progress has been achieved in translating multilateral environmental agreements into relevant policy frameworks, such as the UN Convention to Combat Desertification. | Limited |
| **Accelerate the transition to a low-carbon and circular economy** | • Climate change goals have been integrated into energy strategies in Bosnia and Herzegovina and North Macedonia and in the transport strategy in Albania.<br>• Serbia has developed a roadmap for circular economy commitments and Albania and North Macedonia are preparing documents that will include a circular economy framework.<br>• Some actions have been taken, such as improving recycling rates of packaging waste and introducing extended producer responsibility in some WB6 economies (North Macedonia, Republika Srpska in Bosnia and Herzegovina, and Serbia).<br>• The current energy mix is still highly dependent on fossil fuels and only a few renewable energy targets have been set. | Moderate |
| **Increase the use of economic instruments to incorporate environmental costs and benefits into budgets** | • Although the polluter pays principle is legislated, it is still not applied effectively.<br>• Coal is still subsided in some WB6 economies (Kosovo, Serbia) and renewable support schemes remain weak.<br>• Across the WB6, waste disposal and water tariffs are too low to cover service costs (including infrastructure construction and maintenance). Projects remain largely dependent on donor funding. | None |
| **Define clear roles and responsibilities in the institutional frameworks for environmentally sustainable development to strengthen policy implementation, enforcement and compliance** | • Poor domestic co-ordination among water-related public institutions is hampering proper policy implementation (including international projects).<br>• Forestry legal and policy frameworks are in place, but local forest management human and financial capacities are insufficient which limits proper enforcement and compliance (especially for tree logging and forest fires).<br>• In terms of land use, Albania, Kosovo and the Republika Srpska in Bosnia and Herzegovina are preparing municipal land development plans together with local municipalities, which aim to foster sustainable territorial development and rational land use. | Limited |
| **Improve framework conditions for green investment and innovation** | • Measures to provide incentives for businesses to adopt greener technologies remain sporadic and are still largely lacking in the region.<br>• One exception is Serbia's recently adopted roadmap for a circular economy which encourages industry to innovate, increases market opportunities for production through circular business models, creates new jobs and improves the business climate while preserving the environment.<br>• For more please see sub-dimension 1.3 on green investment in the investment chapter (Dimension 1). | Limited |
| **Strengthen natural asset management** | • Implementation of water management strategies has been limited. Donors have driven the international co-ordination of transboundary river basins, but efforts are hampered by poor domestic as well as intraregional co-ordination.<br>• Local authorities' resources are limited for capacity building and to strengthen forest management and law enforcement. National forest inventories are lacking in Bosnia and Herzegovina, Kosovo and North Macedonia.<br>• No major changes were recorded to land-use legislative and policy frameworks (except some progress in the legislation of North Macedonia). | None |
| **Institutionalise the collection of key environmental statistics, and policy monitoring and evaluation activities** | • Overall, there is insufficient timely and accurate data for the government to design and monitor progress in implementing environmental policies.<br>• Progress has been made in monitoring and collecting data on air quality and biodiversity (new monitoring stations and improved information systems) in most WB6 economies.<br>• Data and projections for water demand in the agriculture and industry (including energy) sectors and from households are not available and consequently do not guide decisions about handling competing uses.<br>• Progress in collecting key forestry statistics has been made in Montenegro and Serbia. Land-use data are still largely lacking across the region. | Limited |

## Introduction

Climate change is increasingly affecting people's lives, disrupting economies and transforming ecosystems. Considering the Western Balkans' vulnerability to the impacts of climate change, building resilience to natural disasters and other environment-related risks will be necessary for the region's economic growth and people's well-being. To develop and maintain their competitiveness (especially in the long run), the WB6 economies need to pursue green growth, i.e., sustaining economic growth while safeguarding their natural assets to maintain the environmental services on which their citizens' well-being depends. By aiming to achieve the net-zero goal for greenhouse gas emissions and mainstreaming environmental considerations into all areas of policy, including by adopting a circular economy, the WB6 can increase their efficiency and competitiveness, spurring green innovation, new markets and jobs. Current business models need to adapt to account for climate change, resource bottlenecks, air and water pollution, and irreversible biodiversity loss (OECD, 2017[1]).

The Competitiveness Outlook's environment policy dimension assesses the WB6's key environmental characteristics, and their policies to protect natural resources and facilitate their sustainable use. Policies that affect the environment are cross-cutting, meaning that policy design and implementation need to be well integrated into key economic and sectoral policies – both vertically (international, central, local) and horizontally (inter-sectoral and across line ministries) – including energy, transport, agriculture, and health. Therefore, this chapter is related to all other dimensions in the Competitiveness Outlook, but has strongest links to the following:

- **Chapter 4. Investment policy and promotion** is key to enabling an economy to establish a specific environment that is conducive to scaling up green investments to support green growth.
- **Chapter 7. Tax policy** can offer incentives for adopting environment-friendly technologies and discouraging harmful practices.
- **Chapter 14. Transport policy** is an essential component for reducing emissions across the region through sustainable transport frameworks, containing adequate rules and options for green fuel and car models. Environment policy is also directly related to the impact assessment for constructing transport infrastructure.
- **Chapter 15. Energy policy** and power generation have impacts on air, water and land and account for large shares of WB6 economies' greenhouse gas emissions. Hence, energy policy frameworks need to be fully aligned with climate change objectives, and policies supporting energy efficiency and renewable energy sources need to be implemented.
- **Chapters 17 and 18. Agriculture and tourism** depend on high-quality natural assets and are particularly vulnerable to the negative effects of air, land, and water pollution as well as climate change – for instance ambient air pollution can reduce crop yields, and litter can deter tourists. In turn, these sectors also use natural resources and can be sources of local and transboundary pollution; their activities must therefore be managed to minimise any negative environmental impacts.

## Assessment framework

### *Structure*

This chapter examines policies to facilitate greener growth in the WB6 by assessing three broad sub-dimensions:

1. **Sub-dimension 13.1: Resource productivity** assesses how policies facilitate efficient material resource use in production and waste generation and the extent to which they combat climate change.
2. **Sub-dimension 13.2: Natural asset base** focuses on the extent to which natural assets are being preserved and managed for the economy and future generations (especially freshwater, biodiversity, forestry and land).
3. **Sub-dimension 13.3: Environmental quality of life** examines how environmental conditions affect people's health and quality of life by measuring air pollution frameworks, water supply and sanitation systems, and industrial waste management.

The three sub-dimensions are based on the OECD Green Growth Indicator framework (Box 16.1) and indicators are also directly linked to the United Nations Sustainable Development Goals. The OECD supports the United Nations in ensuring the success of the 2030 Agenda for Sustainable Development by bringing together its existing knowledge, and its unique tools for monitoring performance. Figure 16.2 shows how the sub-dimensions and their indicators make up the environment policy dimension assessment framework.

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information on the methodology see the Assessment methodology and process chapter.

### Box 16.1. Green Growth Indicator Framework

The CO environment dimension's assessment framework is based on the OECD Green Growth Indicator (GGI) framework, developed by the OECD in the 1990s (last updated in 2017).

**Sub-dimension 13.1: Resource productivity** corresponds to GGI area 1. "Environmental and resource productivity - How productive is the economy in using natural capital? Indicates whether economic growth is becoming greener with more efficient use of natural capital and to capture aspects of production which are rarely quantified in economic models and accounting frameworks."

**Sub-dimension 13.2: Natural asset base** corresponds to GGI area 2. "Natural asset base - Are we preserving the natural asset base of our economy? Indicates the risks to growth from a declining natural asset base."

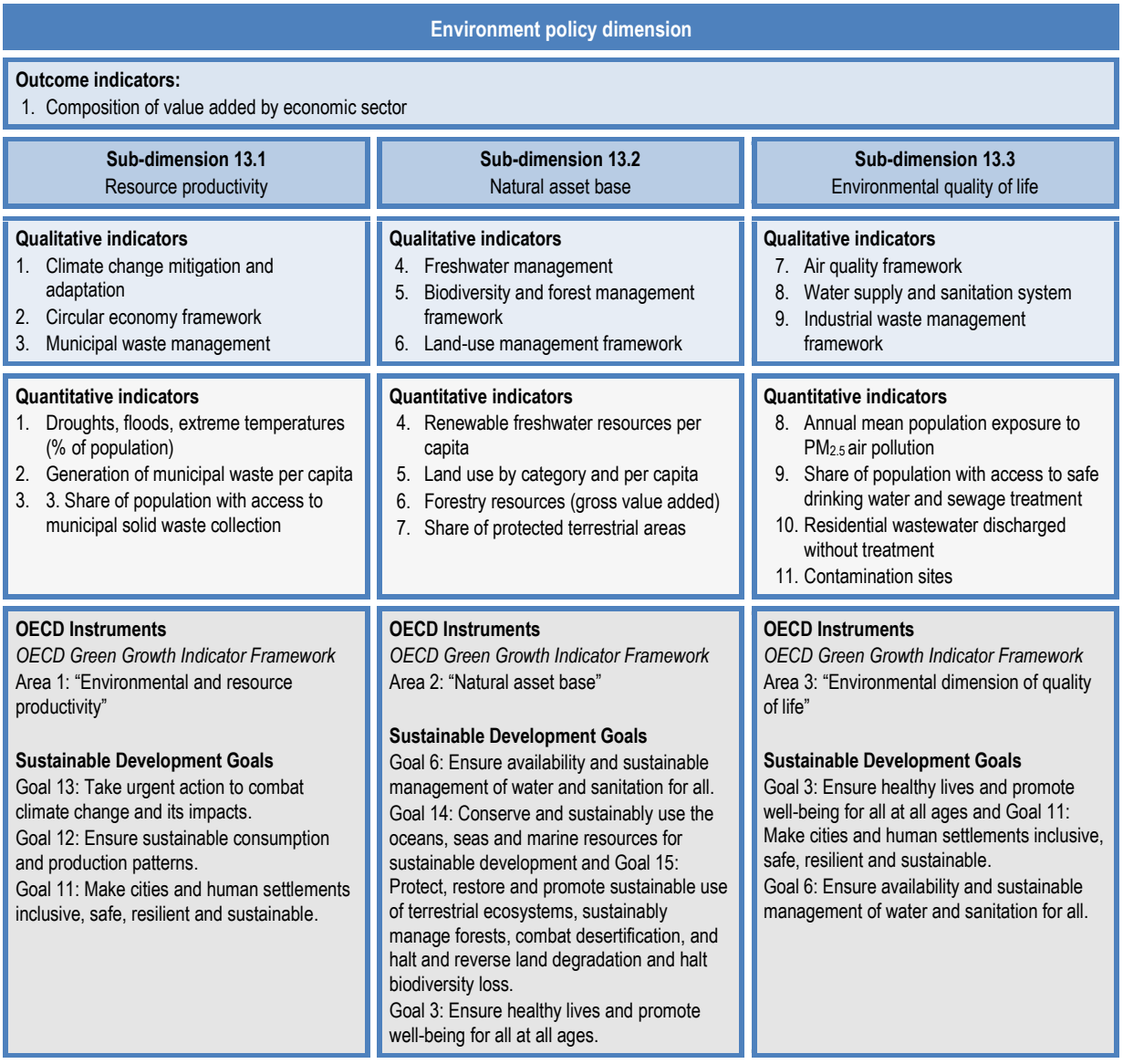
**Sub-dimension 13.3: Environmental quality of life** corresponds to GGI area 3. "Environmental dimension of quality of life – How does environmental quality interact with people's health and lives? Indicates how environmental conditions affect the quality of life and wellbeing of people."

The overall assessment also considers GGI area 4. "Economic opportunities and policy responses – are policies effective in delivering green growth? Indicates the effectiveness of policies in delivering green growth and describe the societal responses needed to secure business and employment opportunities." It also assesses whether tools to complement environmental policies are in place and how efficiently and effectively they are implemented.

By using the GGI framework, this assessment leverages the decades of work at an international level to assess the environment in a way that is internationally comparable and joins over 130 green growth publications in OECD and partner economies.

Source: (OECD, 2017[2]), *Green Growth Indicators Framework*, https://www.oecd.org/greengrowth/green-growth-indicators.

## Figure 16.2. Environment policy dimension assessment framework




The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan (AP) at the Berlin Process Summit held on 10 November 2020 in Sofia. The Action Plan is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area.

The regional industrial and innovation area includes a component on green and circular economy value chains (Priority 8.4). As part of this area, the WB6 economies commit to closely transform their industrial sectors, shape their value chains and prepare them for the realities of today and the challenges of tomorrow. The findings in the resource productivity sub-dimension, and in particular the circular economy indicator, can inform the implementation of the actions under this component (Box 16.3).

### *Key methodological changes to the assessment framework*

The CO 2021 environment policy dimension assessment framework has been slightly redesigned and restructured since the 2018 edition. It now 1) includes the key priorities of the EU Green Deal (European

Commission, 2019[3]), such as the increasing importance of a circular economy; and 2) places a stronger focus on measures to build resilience to climate change-related natural disasters, which present a growing challenge for the WB6. The sub-dimension on "policies for green growth", present in the 2018 assessment, has been removed and integrated into the three other sub-dimensions.

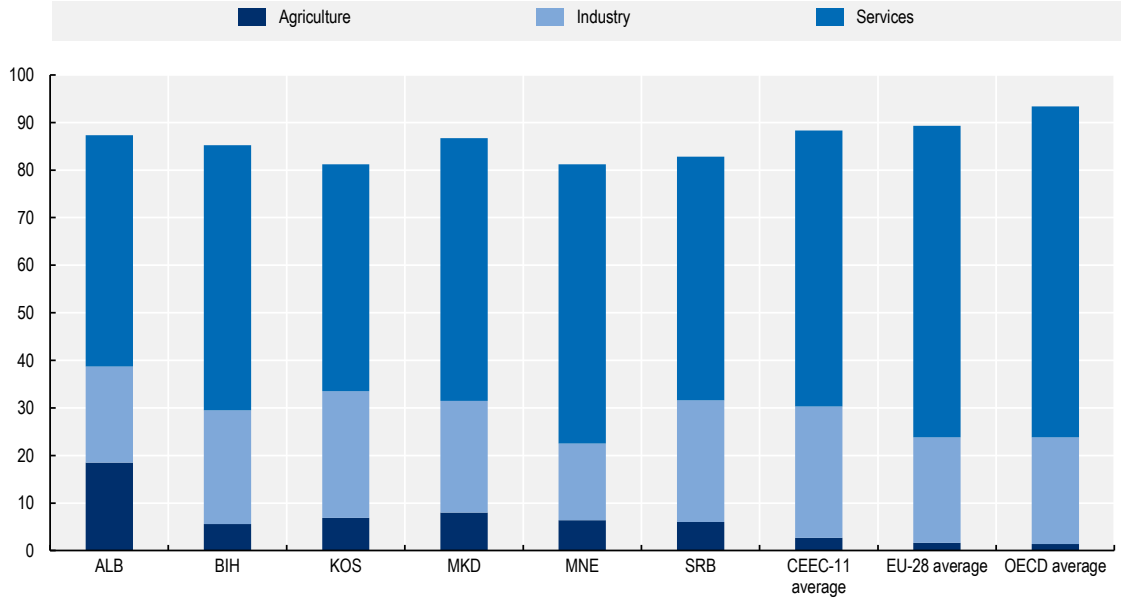
## Environment policy performance and context in the WB6

Outcome indicators assess the performance of overall framework conditions for enabling businesses to be competitive while taking environmental concerns into account. The WB6 lack data for measuring outcome indicators such as environmentally adjusted economic productivity (carbon, water or material productivity). Moreover, greenhouse gas (GHG) inventories have not been conducted by the WB6 during the assessment period. Instead, the composition of value added between economic sectors (Figure 16.3) sets the broader context for looking at green growth, as economic sectors use natural capital and pollute in different ways. The industry sector includes energy, mining, and construction – as such, it is the most resource-intensive economic sector. The agriculture sector uses significant amounts of land and water, and agricultural inputs may be a source of pollution. The service sector is the least resource intensive.

Services contribute the greatest share of value added in the WB6 economies, accounting on average for about 52% of gross domestic product (GDP) (Figure 16.3). However, this share is smaller than in the OECD and CEEC-11,[2] where services contribute about 70% and 58% respectively on average. Industry contributes about 23% to value added in the WB6, as in OECD and EU countries. Agriculture's share in the six economies accounts for 8.5% on average, ranging between 5.6% in Bosnia and Herzegovina to 18.5% in Albania. This is significantly larger than OECD and CEEC-11 averages, which are each at about 1.4% and 2.7% respectively.

### Figure 16.3. Composition of value added by economic sector (2019)

% of GDP




Note: CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (World Bank, 2019[4]), "Value added by sector" (dataset), https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS.

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Air quality is still a predominant concern in the region, with pollution levels ranking among the highest in Europe – see Environmental quality of life (Sub-dimension 13.3) and Figure 16.12. These levels are of even greater concern in the context of the COVID-19 pandemic. Exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to COVID-19 (OECD, 2020[5]). Moreover, non-OECD, non-EU European economies, including the WB6, are among the most susceptible to changes in crop yields caused by air pollution, especially wheat, with a model predicting yield decreases of up to 20% by 2060 (OECD, 2016[6]). Given that agriculture accounts for a considerably larger portion of the WB6 economies than in the OECD, these economies could be particularly vulnerable to the negative effects of air pollution.

## Resource productivity (Sub-dimension 13.1)

This first sub-dimension assesses whether policies facilitate efficient material resource use in production and waste generation and the extent to which they address climate change goals. A high level of resource productivity safeguards the environment by reducing the amount of resources an economic activity requires and thereby lessening the associated environmental impacts; it also improves resource security and strengthens economic competitiveness (OECD, 2016[7]). Three qualitative indicators are used to assess resource productivity in the six WB economies. These explore the existence and degree of implementation of frameworks for: 1) climate change adaptation and mitigation; 2) a circular economy; and 3) municipal solid waste management (Table 16.2).

Performance across all WB6 economies is similar for the resource productivity sub-dimension (Table 16.2), although Montenegro has made the most progress since the previous assessment. On average, the six economies score 2.0 overall, indicating that relevant policy frameworks have been adopted. Nevertheless, they have considerable potential for using their available natural resources more productively. Climate change mitigation and adaptation as well as municipal solid waste management are equally advanced with overall scores of 2.3, indicating that policy frameworks are in place, challenges have been identified and implementation has begun. However, circular economy initiatives are still at an early stage of development, and although some actions have been taken, policy frameworks are still largely lacking throughout the region.

### Table 16.2. Scores for Sub-dimension 13.1: Resource productivity

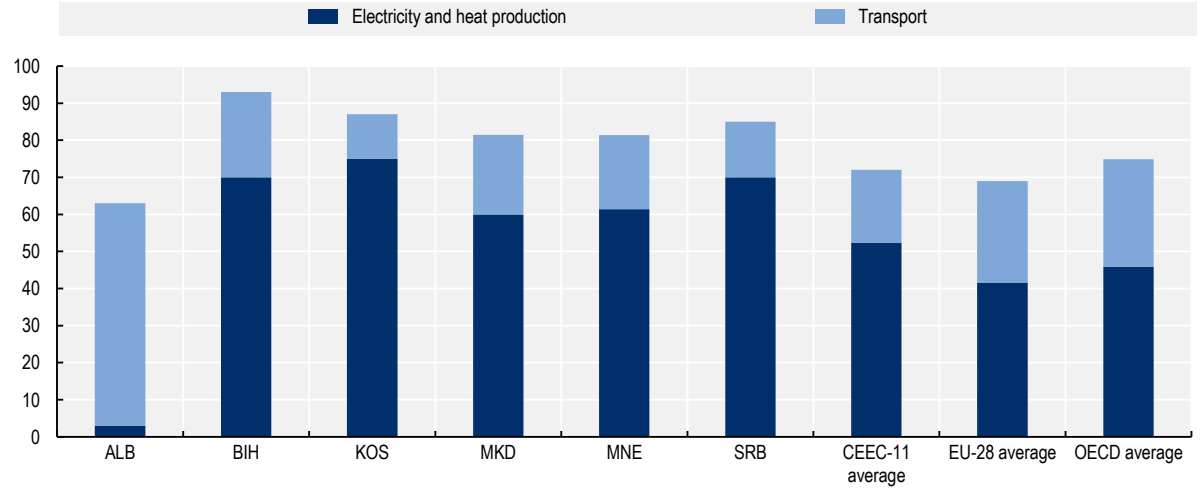
| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 13.1: Resource productivity | Climate change mitigation and adaptation | 2.0 | 2.0 | 2.0 | 2.5 | 3.5 | 2.0 | 2.3 |
| | Circular economy framework | 1.0 | 1.5 | 1.0 | 1.0 | 1.0 | 2.0 | 1.3 |
| | Municipal solid waste management framework | 2.5 | 1.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.3 |
| **Sub-dimension average score** | | 1.8 | 1.7 | 1.8 | 2.0 | 2.3 | 2.2 | 2.0 |

### *Climate change adaptation legal and policy frameworks are gradually being introduced*

Electricity generation and heat production account for the majority of carbon dioxide ($CO_2$) emissions in the six economies – ranging from 61.4% in Montenegro to almost 75% in Kosovo (Box 16.4) – followed by the transport sector, which accounts for around 18% on average. The exception is Albania, where 60% of its $CO_2$ emissions come from transport, as almost 100% of its electricity generation comes from hydropower.

## Figure 16.4. $CO_2$ emissions by sector (transport, electricity and heat production)

% of total $CO_2$ emissions




Note: Latest data available for each economy. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities; for EU and OECD see (World Bank, 2020[8]), "$CO_2$ emissions by sector" (dataset), https://data.worldbank.org/indicator/EN.CO2.TRAN.ZS.

StatLink https://doi.org/10.1787/888934254829

Climate change adaptation legal and policy frameworks are being gradually introduced across the six economies, while climate change mitigation efforts need to be stepped up. Albania (2021), Montenegro (2019), and Serbia (2021) have recently adopted laws on climate change which establish the institutional frameworks and rules for monitoring, reporting and verifying greenhouse gas (GHG) emissions. While Bosnia and Herzegovina (BIH), Montenegro and North Macedonia already had climate change strategies in place, Albania and Kosovo have adopted climate change strategies and related action plans on mitigation and adaptation since the last assessment. This leaves Serbia as the only economy that has not adopted a long-term strategy that encompasses energy and climate targets, although it was developing the integrated National Energy and Climate Plan (NECP) at the time of drafting.[3] Climate change goals have been integrated into sectoral strategies in Albania (transport), Bosnia and Herzegovina (energy), and North Macedonia (energy). North Macedonia was preparing a long-term strategy on Climate Action to 2050 at the time of drafting and is the first contracting party under the Energy Community to integrate the pillars of energy and climate into its national energy strategy (European Commission, 2020[9]). Further alignment is needed by Bosnia and Herzegovina and Kosovo (especially with regards to transport, industry and agriculture policies). No systematic monitoring and evaluation of the strategies are conducted in Bosnia and Herzegovina or Kosovo, while Albania and Serbia plan to do so under their recently adopted laws on climate change.

Apart from Kosovo, all WB6 economies are Non-Annex I signatories to the UN Framework Convention on Climate Change (UNFCCC) and its Paris Agreement and are also parties to the Kyoto Protocol. As requested by the Paris Agreement, the five economies have submitted their Nationally Determined Contributions (NDCs), which are currently being updated. All five economies have to submit regular reports in the form of national communications and Biennial Update Reports to the UNFCCC. Nevertheless, the frequency of these reports varies considerably among the economies (UNFCCC, n.d.[10]).[4] As for Kosovo, its Energy and Climate Plan (2021-2030), which was being developed at the time of drafting, should set GHG emission reduction targets.

In general, the transition to renewables has been progressing very slowly in the region. While Albania's new Law on Climate Change sets a 32% renewable energy target by 2030, North Macedonia has revised its original 28% renewable energy target downwards to 23.9% of gross final energy consumption. As in

the last assessment, most of the renewable energy produced in the region comes from hydroelectricity, despite the great untapped potential for renewable energy in all the economies, especially solar and wind (see Energy policy chapter).

Major climate-related risks have been identified in Bosnia and Herzegovina, Kosovo and North Macedonia as well as to some extent in Albania and Serbia.[5] In Montenegro, the Ministry of the Interior is currently preparing a disaster risk assessment which will cover major climate change-related risks. The WB6 have also undertaken actions related to water-related disasters, and floods in particular. Some flood risk management measures have been implemented through the regional project Adaptation to Climate Change through Transboundary Flood Risk Management in the Western Balkans (2016-2020).[6] However, other natural disasters, such as earthquakes, have not been taken as much into consideration in the region.

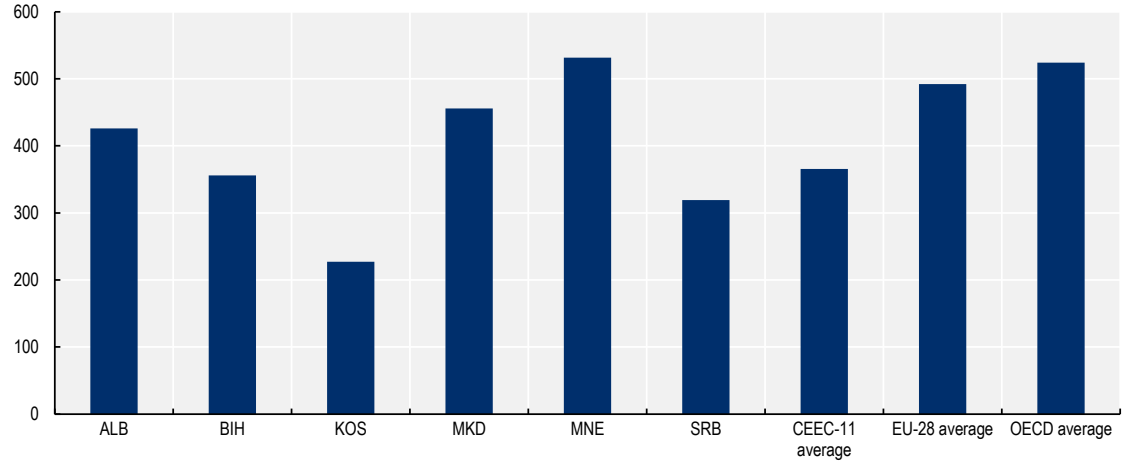
### *Circular economy frameworks remain underdeveloped in the region*

Limited progress has been achieved in developing circular economy frameworks in all WB6 economies except for Serbia. With an average of 1.3, scores for the circular economy framework are the lowest for all indicators in the environment policy dimension (Table 16.2).

In all six economies except Montenegro, waste generation per capita remains below the EU and OECD averages (Figure 16.5). Nevertheless, very little has been done to decrease the amount of waste and volumes are increasing constantly. Recycling rates for municipal waste in all six economies also remain extremely low (Figure 16.6). Albania recycles around 18.5% of its municipal waste, which is the highest rate in the WB6 region, but still significantly lower than the European Union average (47%). All other assessed economies recycle less than 5% of their municipal waste, and the rest is largely landfilled. Only a few recycling centres exist, although new recycling yards and sorting plants are being constructed throughout the region. Some progress has been achieved since the last assessment: North Macedonia has increased the recycling rate of its packaging waste, the RS in BIH has established a packaging waste management system and introduced extended producer responsibility, and Serbia has a new regulation for reducing packaging waste (2014-2020). According to relevant authorities, the recycling industry is currently gaining momentum in Kosovo as the private sector takes advantage of a lucrative opportunity for exporting secondary material within the region and to several EU Member States. In addition, awareness-raising activities on recycling are organised in schools throughout the WB6, though on a rather ad-hoc basis.

## Figure 16.5. Municipal waste generation per capita (2018)

Kilograms, yearly



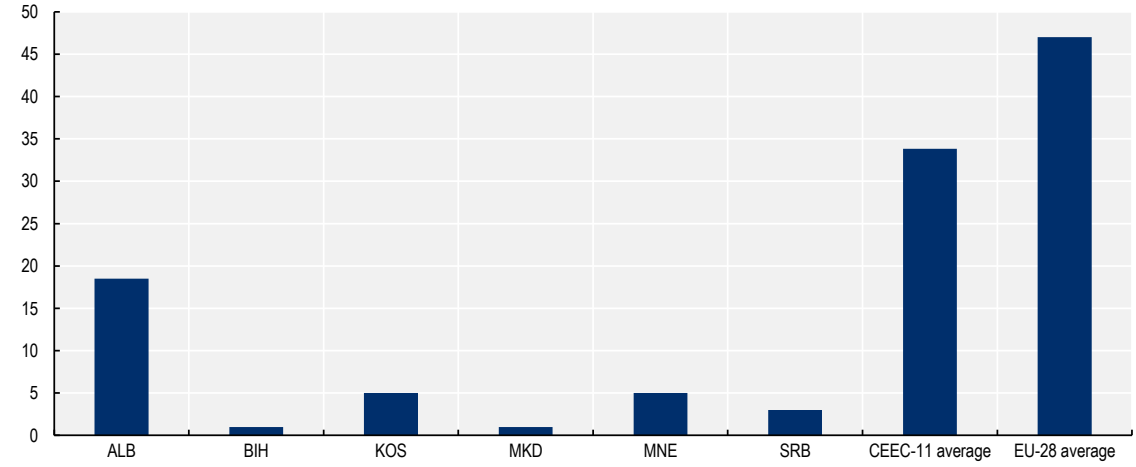

Note: CEEC-11=the 11 Central and Eastern European countries joining the EU: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities and statistical offices; (OECD, 2020[11]), *OECD Environment Statistics* (database), https://data.oecd.org/waste/municipal-waste.htm.

StatLink https://doi.org/10.1787/888934254848

## Figure 16.6. Municipal waste recycling rates (2018)

% of total municipal waste




Note: CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities and statistical offices; (Eurostat, 2020[12]), *Eurostat Statistical Recovery Dashboard*, https://ec.europa.eu/eurostat/data/database.

StatLink https://doi.org/10.1787/888934254867

In 2020, Serbia was the first WB6 economy to have prepared a roadmap for a circular economy, which it aims to harmonise with EU recommendations (Box 16.2). North Macedonia is preparing a new Law on Waste, which should promote the circular economy and the use of secondary raw materials, in line with the EU *acquis* in this area. The Albanian government also plans to revise its legislative framework in this area, such as through the new law on extended producer responsibility, which is slated for adoption during 2021 and which will promote a circular economy. The legislative framework in all other economies is being developed, although the topic of circular economy is mostly covered indirectly in different strategies.

The findings of this assessment are also relevant for the WB6 economies' implementation of the Common Regional Market Action Plan, which includes a component on green and circular economy value chains (Box 16.3).

### Box 16.2. Serbia's roadmap for a circular economy

A Special Working Group for a Circular Economy (CE) within the Ministry of Environmental Protection developed a Roadmap for a Circular Economy in Serbia in April 2020. This important guiding document outlines courses of action for the transition from a linear to circular economy in Serbia. It is modelled on similar documents developed in EU countries, such as Finland, France, the Netherlands, Slovenia and Spain. In order to be fully aligned with the EU's newly adopted documents (the Green Deal and the new Circular Economy Action Plan), this initial document will be harmonised with EU recommendations. The working group will undertake a range of activities for this purpose, including developing an updated Circular Economy Roadmap 2.0.

The aim of the roadmap is to initiate a dialogue between decision makers and representatives of industry, academia and civil society in order to encourage industry to innovate, increase market opportunities for production through circular business models, create new jobs and improve business while preserving the environment. It aims to encourage the whole of society to adopt radical changes in their attitudes towards resource limits. The roadmap is accompanied by a communication plan that contains measures to raise public awareness on CE and whose main goal is to inform and involve as many actors as possible and thus achieve broad social consensus for implementation.

The key drivers for developing the roadmap are grouped into four main areas:

1) **Economic**: boosting competitiveness, market development, (horizontal) economic diversification and development, and application of new business models and new technologies.

2) **Political**: regional positioning, creating a national political consensus, pursuing the EU accession process and implementing various international obligations on environmental protection and climate change.

3) **Environmental**: reducing waste, reducing GHG emissions, conserving natural resources, and improving energy independence and the use of renewable energy.

4) **Social**: improving social welfare, improving consumer rights, decreasing household budgets, improving people's health and creating green jobs.

Source: (Government of Serbia, 2020[13]), *Roadmap for a Circular Economy,* https://www.ekologija.gov.rs/sites/default/files/2021-01/mapa-puta-za-cirkularnu-ekonomiju-u-srbiji.pdf.

### Box 16.3. Towards green and circular economies in the Common Regional Market

The regional industrial and innovation area of Common Regional Market (CRM) 2021-2024 Action Plan includes a component on green and circular economy value chains (Priority 8.4). The following key findings of the CO 2021 resource productivity sub-dimension, and in particular the circular economy indicator, can inform the implementation of the actions under this component:

- With the adoption of its Roadmap for a Circular Economy in 2020, Serbia is the first economy in the region to prepare such a document, in line with its EU commitments.
- In all other economies, circular economy, sustainable production, and consumption standards are not yet established.
- Albania and North Macedonia are in the process of preparing documents to promote a circular economy framework.
- The legislative framework in other economies is being developed, although the topic of circular economy is mostly covered indirectly in different strategies and thus not supported by proper implementation.
- Some specific actions have been taken in some economies, such as improving recycling rates of packaging waste and introducing extended producer responsibility mechanisms. Implementation remains limited otherwise.

## *Municipal solid waste strategies are in place and starting to be implemented*

Municipal solid waste management safeguards the environment and public health. All six economies have strategies that lay out objectives for municipal solid waste management, and implementation has begun. Since the last assessment, Albania has adopted two waste management strategies[7] (in 2019 and 2020) and laws and strategies are being revised in Kosovo, Montenegro and Serbia to transpose the relevant EU directives. Serbia's implementation is quite advanced thanks to its good institutional capacity and strong co-ordination with local authorities. However, although mechanisms for monitoring implementation or targets are envisaged in the strategies, they are largely lacking in all assessed economies.

Across the WB6, waste disposal tariffs are too low to cover the costs of municipal waste collection, let alone the costs of infrastructure construction or maintenance. Consequently, waste collection and treatment infrastructure remains largely dependent on donor funds, which impedes regular maintenance (Eunomia, 2017[14]). In a positive move, Albania has developed a new methodology to calculate waste management costs, which has improved its waste service.

Primary waste selection is almost non-existent throughout the region and there is no systematically organised separate collection, sorting or recycling of municipal waste. Nevertheless, waste separation at source has been slowly introduced since the last assessment in certain municipalities in Kosovo and Montenegro, and the RS in BIH has introduced "green islands" for the separate collection of waste in public areas. Moreover, there has been large-scale investment in new waste treatment facilities in Albania and Serbia.

The continued prevalence of unregulated burning and illegal dumping of waste in the region poses threats to the environment and public health through groundwater, soil and air pollution (UNECE, 2019[15]). Although all assessed economies have sanctions and mechanisms to report these practices in their legal frameworks, implementation has been weak. Some actions are underway to improve the situation: civil society organisations have been mapping illegal dumpsites across BIH and Montenegro; projects to clean up and combat illegal landfills have been implemented in Kosovo and Serbia; illegal dumpsites are being closed in BIH; and Albania's Waste Management Plan foresees replacing illegal dumpsites with 10 regional controlled landfill sites by 2028.

### *The way forward for resource productivity*

- **Improve waste management by enforcing measures to separate and reduce waste and increase recycling and recovery in line with circular economy principles**. The WB6 economies should strengthen their legal and policy frameworks for a circular economy in line with EU regulations. Serbia's Roadmap for a Circular Economy could serve as a model (Box 16.2). Governments need to step up enforcement efforts and strengthen co-operation with local governments to improve waste management.
- **Put in place educational and awareness raising activities for waste prevention, separate collection, waste reduction and recycling**. Public awareness and support are key factors in changing behaviour and thus for the success of waste policies. Good practice from OECD countries might serve as inspiration (Box 16.4).

#### Box 16.4. Municipal waste management: public information and awareness raising in the OECD

Educating young people can be a key pathway to raising public awareness. Several OECD countries have established environmental education initiatives. For example, Colombia's Communication and Environmental Agenda (2010-14) fostered educational projects on the environment across all school levels. Israel has a Green Education Project and also provides grants for "green schools" that promote resource efficiency and the separate collection of waste streams.

Poland's Ministry of Environment organised awareness campaigns such as "Don't Litter Your Conscience", which uses the character of a priest to tell parishioners to separate recyclable waste and not burn household waste in their gardens or dump it illegally. Campaigns and activities to address illegal dumping are carried out in Hungary, where the Ministry for Agriculture supports the "TsSzedd!" ("Pick up!") Campaign to raise awareness of sound waste management practices.

Civil society organisations can also play an important role in promoting public awareness. "Let's do it! My Estonia" is an independently organised annual day of community activities, including litter clean-up. In Slovenia, about 200 000 volunteers worked together in 2010 for "Let's clean Slovenia in one day", involving activities to clean up litter and illegal waste sites matched with environmental education.

Some OECD countries work via local government. In Israel, for example, the Ministry of Environmental Protection funds municipal activities for environmental education and awareness raising, and the country's 2010 Recycling Action Plan acknowledges the need for further actions to raise public awareness and change behaviour towards separate collection.

Working with business, including producer responsibility organisations (PROs), can play an important role in fostering public awareness of recycling. In Korea, voluntary agreements with business include activities to raise public awareness on waste reduction and recycling; the country's PROs spend between 1% and 5% of their profits on information and awareness campaigns.

Source: (OECD, 2019[16]), *Waste Management and the Circular Economy in Selected OECD Countries: Evidence from Environmental Performance Reviews*, https://doi.org/10.1787/9789264309395-en.

- **Establish a regional Green Start-up Network based on existing domestic start-up programmes.** As recommended in the CRM Action Plan (2021-2024); (Box 16.3), this network should identify key circular and green business opportunities and boost business networking. Good practice from the Interreg Europe Green Start-up Support (GRESS) project, financed by the EU, could serve as a good example for a WB6 green regional network (Box 16.5).

### Box 16.5. Green start-up support

The shift towards a low-carbon economy offers many business opportunities. The EU Small Business Act highlighted that the EU and Member States should enable small and medium-sized emterprises (SMEs) to exploit these opportunities. The objective of the Green Start-up Support (GRESS) project is to improve SMEs' competitiveness by strengthening capacities for the formation of sustainable and competitive start-ups and spin-offs within the green economy.

The partners (Bulgaria, Greece, Italy, Norway and Poland) apply a policy-learning process involving five steps: 1) mapping the status of green growth in each region; 2) scanning and exchanging experience and identifying good practice for mutual learning; 3) assessing and ranking relevant practices through peer assessments in Regional Stakeholder Groups; 4) generating ideas on policy interventions with interregional knowledge transfer; and 5) developing and monitoring regional action plans.

The resulting policies are envisaged to improve awareness of the opportunities for SMEs in the green and blue economy, increase the number of participants and improve the quality of training programmes for green start-ups, attract more SMEs to participate and succeed in public procurement for green products and services, improve SMEs' access to risk capital outside the local region, make cities and regions more attractive for young entrepreneurs in green sectors, launch incentive schemes for green start-ups, enhance the performance of ecosystems, and increase the number of competitive start-ups and spin-offs within the green economy and improve their chances of survival.

Source: (GRESS-Interreg Europe, n.d.[17]), *Green Startup Support*, Project Summary, https://www.interregeurope.eu/gress.

## Natural asset base (Sub-dimension 13.2)

This sub-dimension assesses the extent to which the natural asset base is being preserved for economic activity and for future generations. Safeguarding the quantity and quality of water, forest and biodiversity resources protects current and future public health and the livelihoods that depend on them. This entails effective management of resource supply and demand as well as balancing competing uses. Three qualitative indicators assess the presence and implementation of management frameworks for: 1) freshwater; 2) biodiversity and forests; and 3) land use.

On average, the WB6 economies achieved a score of 2.1 for the natural asset base sub-dimension (Table 16.3), signifying that the relevant policy frameworks are mostly adopted. Across these economies, biodiversity and forestry policies are the most advanced and implementation is beginning, but inventories and monitoring programmes are still lacking. Little progress has been achieved on land-use management frameworks and implementation is slow.

### Table 16.3. Scores for Sub-dimension 13.2: Natural asset base

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 13.2: Natural asset base | Freshwater management | 2.5 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.1 |
| | Biodiversity and forestry framework | 2.5 | 1.5 | 2.5 | 3.0 | 3.0 | 2.0 | 2.4 |
| | Land-use management framework | 1.5 | 1.5 | 2.0 | 2.5 | 1.0 | 1.5 | 1.7 |
| **Sub-dimension average score** | | 2.2 | 1.7 | 2.2 | 2.5 | 2.0 | 1.8 | 2.1 |

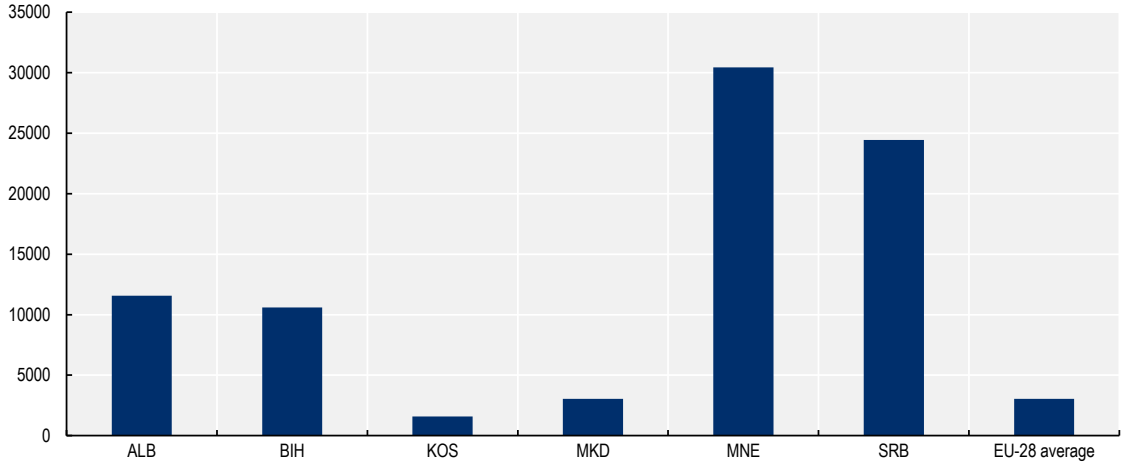
### *Freshwater management frameworks are hampered by poor co-ordination*

The Western Balkans are home to rich, diverse and interconnected transboundary freshwater resources, from the karstic regions of the Dinaric Alps and the Adriatic coast to the Danube, Drin and Vardar river basins and the ancient lakes of Ohrid, Prespa and Skadar. However, water resources are distributed

unevenly across the region (Figure 16.7) and are used differently by the assessed economies. In contrast to most OECD countries, where agriculture uses the largest share of water resources, in Albania, BIH, Kosovo and Montenegro, households account for the largest share (Figure 16.8). In Serbia, the industrial sector accounted for 75% of total freshwater abstractions in 2017, mainly for cooling purposes in electric power generation. Anthropogenic pressures on water resources, including water pollution resulting from insufficiently treated industrial and municipal wastewater, still raise key concerns in this area. Moreover, the lack of data and projections on water demand from agriculture, industry (including energy) and households in all assessed economies complicates decisions on handling competing uses now or in the future.

## Figure 16.7. Renewable internal freshwater resources per capita (2017)

$m^3$ per capita



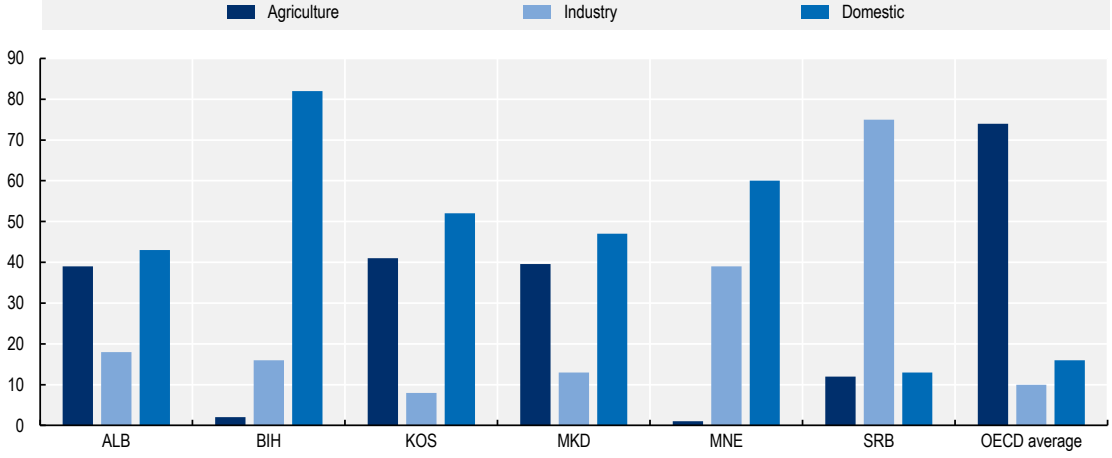

Note: Latest data available for each economy (2018-2020). EU data is from 2017.

Source: Data based on responses to Environmental Policy questionnaires sent by domestic authorities and statistical offices; (World Bank, 2017[18]), "Renewable internal freshwater resources per capita" (dataset), https://data.worldbank.org/indicator/ER.H2O.INTR.PC?locations=EU.

StatLink https://doi.org/10.1787/888934254886

## Figure 16.8. Freshwater abstractions by sector (2017)

In %




Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities and statistical offices; (World Bank, 2017[18]) "Freshwater abstractions by sector" (dataset), https://data.worldbank.org/indicator/ER.H2O.INTR.PC?locations=EU.

StatLink https://doi.org/10.1787/888934254905

The groundwork for the freshwater management legislative framework has been done in most of the assessed economies. Albania and North Macedonia have adopted new laws and strategies, though there

have been no major changes to the frameworks in BIH, Montenegro and Serbia. Kosovo's framework is still only partially developed and efforts need to be stepped up to complete it. Implementation has been rather limited throughout the region. Some positive developments have been noted in Montenegro, which has signed the new EU-Instrument for Pre-Accession Assistance (IPA) project on Support to the implementation and monitoring of water management. Kosovo has created reservoirs to improve drinking water supply, but their safety management is inadequate, especially in light of water stress resulting from climate change (European Commission, 2020[9]). Moreover, monitoring and evaluation mechanisms are largely lacking, except in Serbia which conducts annual water status monitoring.

The planning and management of hydropower plants, including a requirement for a detailed environmental impact assessment (EIA), are regulated by law in all assessed economies. However, the legal procedures have been largely circumvented in all six economies, in particular for mini hydropower plants. In practice, there are too many cases in which licences for hydropower plants are given before an EIA report is issued or without taking the EIA report into account. This problem is particularly important in Albania, as most of its nationally produced electricity comes from hydropower.

Donors have driven the international co-ordination of transboundary river basins,[8] but efforts are hampered by poor domestic co-ordination among water-related public institutions. River basin management systems involving co-operation with neighbouring economies have been developed since the last assessment in Albania, BIH, Kosovo and North Macedonia.

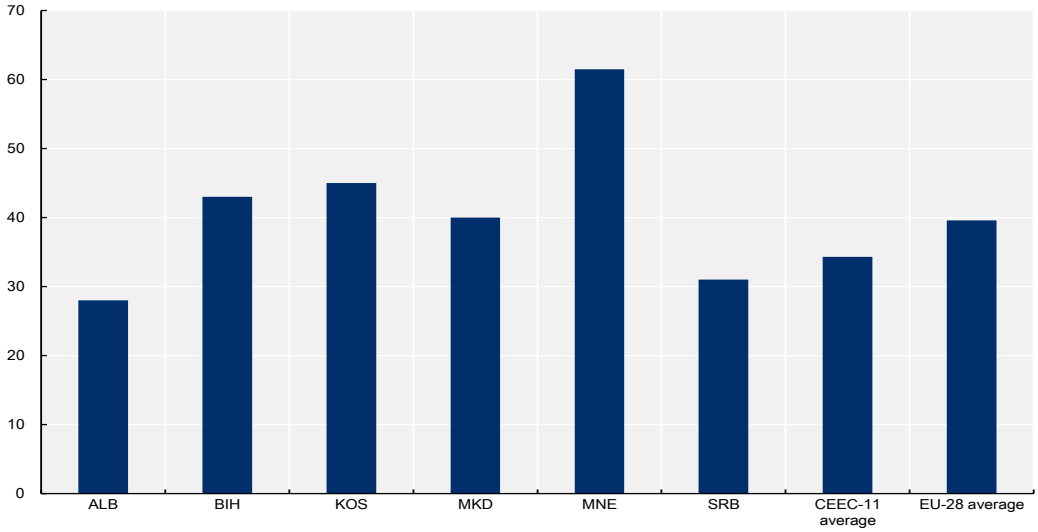
### *Biodiversity and forestry frameworks are in place but laws are not properly enforced and inventories are mostly lacking*

The Western Balkan's richly varied geography is mirrored in the diversity of its flora and fauna. Moreover, the region's forests serve as valuable sources of income (timber and other forest products, agroforestry, and recreation) and reservoirs of biodiversity, which also provides social benefits. Forests in the WB6 cover a larger share of territory than in the average OECD country (Figure 16.9), with Montenegro being the most forest-rich economy, accounting for 61.5% of its territory. However, human pressures are major threats to protecting biodiversity and maintaining forestry resources, and include illegal logging, tourism, urbanisation, hydropower, pollution, illegal waste, as well as forest fires, climate change and invasive species.

Strong biodiversity and forestry frameworks are key to overcoming these challenges and conserving the region's ecosystems. All assessed economies have adopted policy frameworks for biodiversity conservation. North Macedonia adopted its National Biodiversity Strategy in 2018 and was drafting a new Law on Nature at the time of writing. Biodiversity frameworks are also being updated in Kosovo, the Federation of Bosnia and Herzegovina (FBiH) and Serbia. Since the last assessment a new Law on Forests (2020) and Forest Policy Document (2018) have been adopted in Albania and a Forest Management Programme was adopted in Montenegro in 2019.

## Figure 16.9. Forest area in the Western Balkans (2018)

% of total land area




Note: CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy questionnaires sent by domestic authorities and (World Bank, 2018[19]), "Forest area" (dataset), https://data.worldbank.org/indicator/AG.LND.FRST.ZS?locations=OE.

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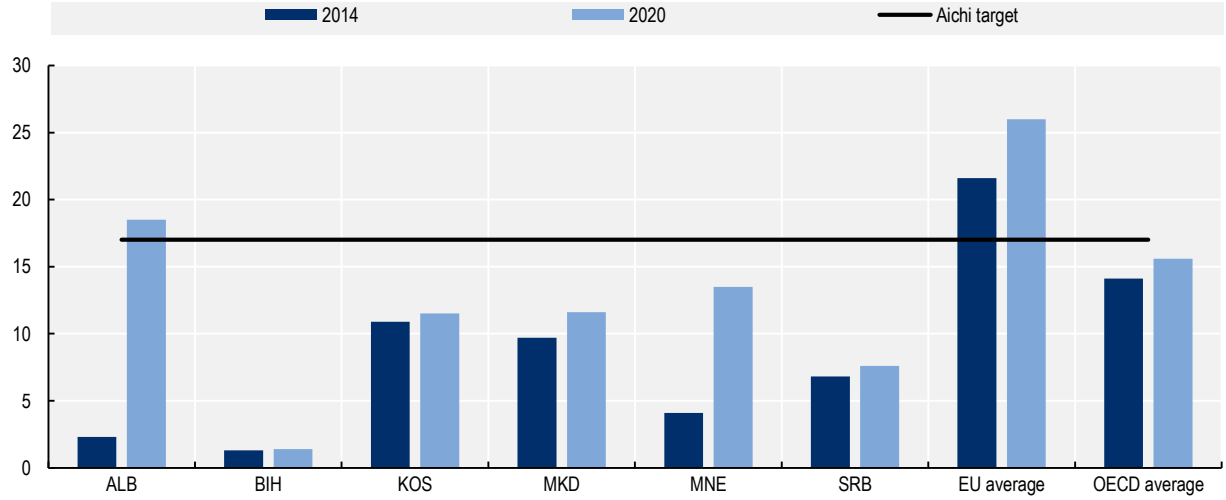
Biodiversity is monitored annually in Albania, whose government has developed a national biodiversity platform, which is currently the largest aggregator of primary biodiversity data in the economy. It also monitored annually in Montenegro through direct co-operation with institutions responsible for different thematic areas as prescribed by the Law on Nature Protection. Information is also collected in Kosovo (biodiversity indicators, including conservation status of threatened species and habitats) and Serbia (indicators on biodiversity, forestry, hunting and fishing, as well as sustainable use of natural resources) by their respective statistical offices. North Macedonia plans to establish a monitoring system under the biodiversity strategy. Entities in BIH lack the capacity to establish their own monitoring systems as stipulated in their respective laws on nature protection (UNECE, 2019[15]). Moreover, up-to-date forest inventories are lacking in BIH, Kosovo and North Macedonia. Forest inventories exist in Albania (completed in 2021) and in Montenegro, and Serbia's Second National Forest Inventory is expected to be completed by 2022. Even when forestry legal and policy frameworks are in place, local forest management capacity and enforcement are insufficient. Illegal logging and forest fires are legally regulated in all assessed economies; however, sanctions are rarely enforced.

Implementation of biodiversity and forestry strategies has been rather limited since the last assessment, in particular because of poor co-ordination among the relevant bodies at central and local levels. Nevertheless, Albania, both entities of BIH, Kosovo and North Macedonia have adopted plans for the protection of endangered species and fauna, as well as proclaiming new protected areas. Most economies have also established information systems for nature protection.

All WB6 economies (except Kosovo due to its status), are parties to the Convention on Biological Diversity (CBD), an international treaty with 196 parties. The CBD includes the 20 Aichi Biodiversity Targets, which address five strategic goals. Aichi Target 11 states that by 2020, at least 17% of a party's terrestrial territory should be designated as protected areas.[9] Progress towards this target has been made in almost all assessed economies (Figure 16.10), but only Albania has managed to exceed the 17% target, reaching 18.5% in 2020 despite having one of the lowest levels in 2014. With over 10% of their land area designated as protected, Kosovo, Montenegro and North Macedonia have also made significant progress.

## Figure 16.10. Terrestrial protected areas (2014 and 2020)

% of total land area




Note: The latest data for Bosnia and Herzegovina are from 2018. EU average is EU-28 for 2014 and EU-27 for 2020.

Source: For WB6: Data based on responses to Environmental Policy questionnaires sent by domestic authorities and statistical offices and (OECD, 2020[20]), *Protected Areas (database)*, https://data.oecd.org/biodiver/protected-areas.htm.

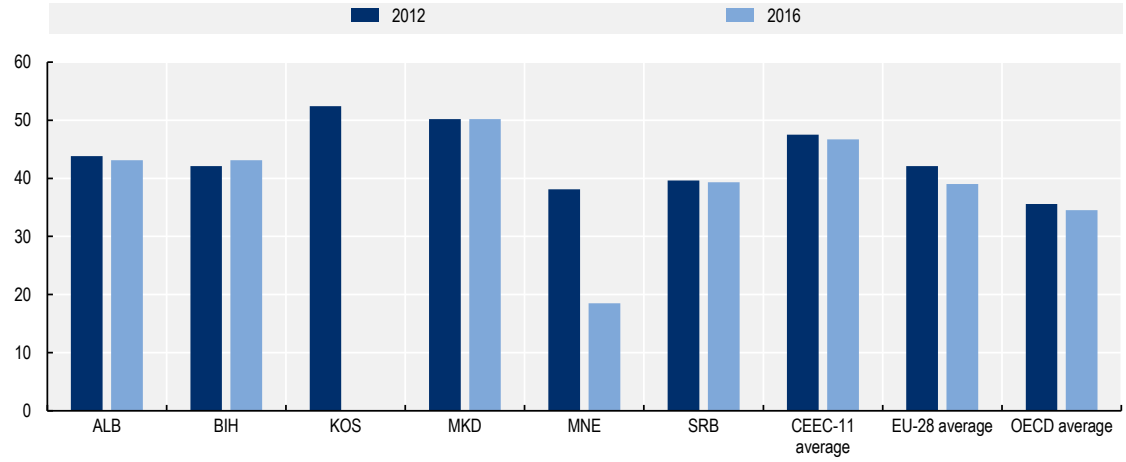
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### *Land-use frameworks could be more coherent and better developed*

In addition to the above-average share of land covered by forests, agricultural land (especially arable and permanent cropland) accounts for a larger share of the territory in the assessed WB6 economies than it does in OECD economies (Figure 16.11). This trend has been slowly decreasing in recent years, with the most pronounced example being Montenegro (down from 38% in 2012 to 18.5% in 2016).

## Figure 16.11. Agricultural land (2012 and 2016)

% of total land area




Note: No data available in Kosovo for 2016. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities and statistical offices and (World Bank, 2016[21]), Agricultural land, World Bank data (Database), https://data.worldbank.org/indicator/AG.LND.AGRI.ZS?end=2016&name_desc=false&start=1961.

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Land-use frameworks have changed little in most assessed economies since the last Competitiveness Outlook, except for North Macedonia. Major developments have been noted in North Macedonia's legislative framework with the adoption of a new Law on Urban Planning (2020), and the upcoming Law on Spatial Planning and National Spatial Plan (expected in 2021). Serbia has a relatively well-developed land-use framework, a new Spatial Plan for the period 2021-35 is being prepared and monitoring is in place. In all other economies legislative frameworks are still underdeveloped, and little progress has been achieved on the policy side. Montenegro has adopted a new Spatial Plan and Kosovo is updating relevant strategies which will indirectly regulate land use.

Some projects on agricultural land consolidation[10] exist in Kosovo, and Serbia is in the process of establishing a domestic soil monitoring programme. Albania, Kosovo and the RS in BIH are preparing municipal land development plans together with local municipalities, which aim to ensure sustainable territorial development and rational land use. The fact that key indicators of land-use management are not collected regularly (except for agricultural, forest and other semi-natural land in Serbia), or georeferenced or harmonised across public bodies, is holding back proper implementation. Also, outdated building codes and illegal construction remain important challenges in the region, especially in Albania in light of the economy's vulnerability to geophysical hazards, such as earthquakes. The Western Balkan region is threatened by multiple hazards; the 2020 floods in Kosovo and Serbia and the 2019 earthquake that hit Albania highlighted the weaknesses of land-use frameworks and systems.

### *The way forward for the natural asset base*

- **Design and implement effective, efficient, and inclusive freshwater policy responses to water challenges**. The WB6 should ensure the proper collection of data and projections on water demanded from different economic sectors to guide decisions on water use. The OECD Toolkit for Water Policies and Governance – especially Turkey's data collection example – is a good source of advice on this matter (Box 16.6).

#### Box 16.6. The OECD Toolkit for Water Policies and Governance

The OECD Toolkit for Water Policies and Governance was launched in March 2021 to support better water policies for better lives across governments and stakeholders in OECD member and non-member economies. It compiles policies, governance arrangements and related tools that facilitate the design and implementation of water management practices in line with the OECD Council Recommendation on Water. The recommendation was unanimously adopted by the OECD Council in December 2016 and puts forward an international standard with high-level policy guidance on a range of topics relevant for the management of water resources and delivery of water services.

The toolkit highlights good practices and recommendations on the following areas: 1) general water policy, 2) managing water quantity, 3) improving water quality, 4) managing water risks and disasters, 5) ensuring good water governance, 6) ensuring sustainable finance, investment and pricing for water and water services, and 7) pricing instruments for water management services.

For instance, the toolkit provides policies and tools implemented in different countries on using data and information to guide policy, which is currently lacking in the WB6. Relevant data on water resources and water services is the basis for tailored water governance strategies, measurement of results and indications of possible bottlenecks. Production and exchange of information is also vital to building trust and a shared vision among responsible authorities and stakeholders. National statistical offices have a key role in generating such data and/or harmonising metrics to allow comparability across units and time. Sub-national levels of government and regional/local development agencies also have an important role to play in collecting and using data to inform the water policy process.

In 2013, **Turkey** created an online National Water Information System (NWIS) that compiles nationwide data on water quality and quantity, allocation regimes and water-related risks. The NWIS shows water data at basin level and aims to encourage all water-related actors to be active stakeholders in data production. Furthermore, the NWIS helps identify data gaps and duplications and gathers data, maps, statistics, and policy documents on nine modules: environmental infrastructure, basin management, climate change, groundwater, surface water, water quality, drought, floods and water allocation.

Source: (OECD, 2021[22]), *Toolkit for Water Policies and Governance: Converging Towards the OECD Council Recommendation on Water*, https://doi.org/10.1787/ed1a7936-en.

- **Enforce close regional co-operation at the river basin level to protect and manage water**, bringing together all interests upstream and downstream. A joint approach to the diverse and interconnected transboundary freshwater resources in the WB6 is still in its infancy and the main river basin management projects are donor driven. All EU Member States have used a river basin approach for water management since the adoption of the EU Water Framework Directive, which establishes a legal framework to protect and enhance the status of aquatic ecosystems, prevent their deterioration and ensure long-term, sustainable use of water resources. The International Commission for the Protection of the Danube River (ICPDR), which implements the EU Water Framework Directive, could be a model for other river basins in the region (Box 16.7).
- **Develop a comprehensive land-use policy framework to ensure effective land-use planning, preserve land and foster resilience** to hydro-meteorological and geophysical hazards. To achieve this, the WB6 should focus on establishing an all-inclusive land-use policy framework focusing on modernising the building codes, updating seismic hazard maps and combatting unregulated and illegal building activities by enforcing the cadastre.

### Box 16.7. The International Commission for the Protection of the Danube River (ICPDR)

The International Commission for the Protection of the Danube River (ICPDR) works to ensure the sustainable and equitable use of waters in the Danube River Basin. The work of the ICPDR is based on the Danube River Protection Convention (DRPC), the major legal instrument for co-operation and transboundary water management in the Danube River Basin. In 2000, the ICPDR contracting parties nominated the ICPDR as the platform for the implementation of all transboundary aspects of the EU Water Framework Directive (WFD).

**The goals of the ICPDR**

Three key elements of the ICPDR's management plans provide the three pillars of action that are needed for the Danube to achieve:

- a Cleaner Danube – this means reducing pollution from settlements, industry and agriculture;
- a Healthier Danube – this means protecting rivers as ecosystems that provide a living environment for aquatic animals and plants, as well as services for people such as drinking water and recreation;
- a Safer Danube – this means a safer environment for people to live without the fear of major flood damage.

**Of the many challenges faced by the ICPDR, the highest priorities remain:**

- Organic substance pollution
- Nutrient pollution

- Hazardous substance pollution
- Hydromorphological alterations
- Flood risk management.

Source: (International Commission for the Protection of the Danube Rive, 2020[23]), webpage, https://www.icpdr.org/main.

## Environmental quality of life (Sub-dimension 13.3)

The third sub-dimension assesses how environmental conditions affect people's health and quality of life. Three qualitative indicators assess the environmental quality of life in the WB6 economies: 1) the air quality framework; 2) the water supply and sanitation system; and 3) industrial waste management. Air pollution is a very serious environmental threat, resulting in premature deaths, increased respiratory disease and lower crop yields. The absence of high-quality water supplies and sanitation can increase health costs and decrease labour productivity. Finally, poorly managed industrial waste can result in contaminated land, with serious repercussions for human and natural health.

On average overall, the WB6 economies score 2.3 for this sub-dimension (Table 16.4), indicating that policy frameworks for air quality, water supply and sanitation and industrial waste management have mostly been adopted. The economies, especially Montenegro and North Macedonia, have made the most progress in developing frameworks for air quality, which is one of the most pressing issues in the region. Industrial waste management frameworks and implementation are still lagging behind.

### Table 16.4. Scores for Sub-dimension 13.3: Environmental quality of life

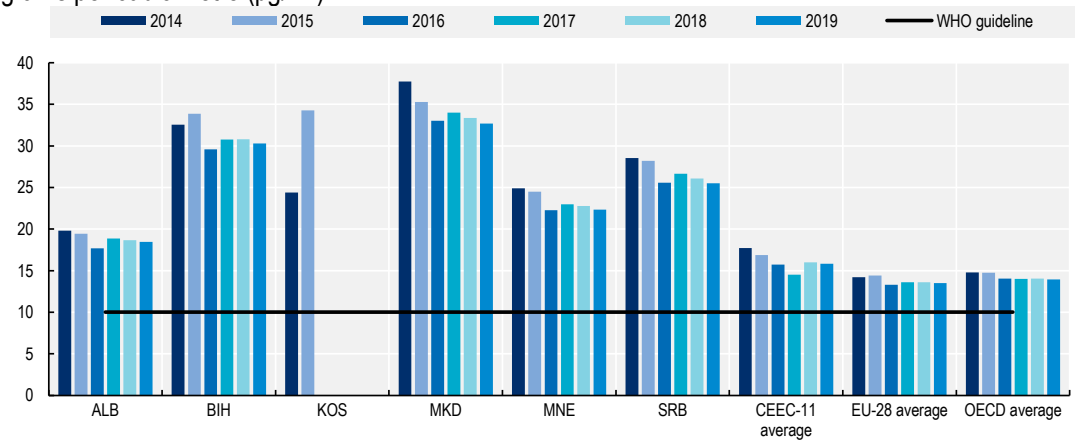
| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 13.3: Environmental quality of life | 1. Air quality framework | 2.0 | 2.0 | 2.5 | 3.5 | 3.5 | 2.5 | 2.7 |
| | 2. Water supply and sanitation system | 2.0 | 2.0 | 2.5 | 1.5 | 2.5 | 3.0 | 2.3 |
| | 3. Industrial waste management | 1.5 | 1.5 | 1.5 | 2.0 | 2.5 | 2.0 | 1.8 |
| **Sub-dimension average score** | | 1.8 | 1.8 | 2.2 | 2.3 | 2.8 | 2.5 | 2.3 |

### *Air pollution levels remain high, but action is being taken*

Air quality is still a major concern in the region, with concentrations of air pollutants such as fine particulate matter ($PM_{2.5}$) ranking among the highest in Europe. $PM_{2.5}$ is the air pollutant posing the greatest risk to health globally, affecting more people than any other pollutant. With an average concentration of 25.77 $\mu g/m^3$ in 2019 for the six economies, the exposure of these economies' populations to $PM_{2.5}$ is two to three times higher than the WHO recommended highest levels of 10 $\mu g/m^3$. It is also much higher than OECD and CEEC-11 values (Figure 16.12). However, promisingly, since 2014, $PM_{2.5}$ levels have been slowly decreasing in all economies in the region.[11] Across the region, power generation, heating, industry, and transport are the main sources of air pollution. The problem is exacerbated in winter, when air pollution increases due to solid fuel heating (using coal as a low-cost source of energy). Some of the WB6 economies plan to continue to rely primarily on coal-fired power generation to supply growing energy consumption, and to expand their existing coal fleet, while continuing to subsidise coal (Kosovo and Serbia in particular). Uncontrolled pollution, notably from outdated thermal power plants, calls for urgent action. In 2016, 16 coal-fired thermal power plants in the WB6 emitted more sulphur dioxide than all of the 250 plants in the EU combined (Balkan Green Foundation, 2016[24]).

## Figure 16.12. Annual mean population exposure to $PM_{2.5}$ air pollution (2014-19)

Micrograms per cubic metre (µg/m³)




Note: $PM_{2.5}$ – fine particulate matter. Data for Kosovo only available until 2015. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (OECD, 2020[25]), *OECD Environment Statistics* (database), https://stats.oecd.org/Index.aspx?DataSetCode=EXP_PM2_5. For Kosovo: (World Bank, 2019[26]), *Air pollution management in Kosovo*, https://documents1.worldbank.org/curated/en/214511576520047805/pdf/Air-Pollution-Management-in-Kosovo.pdf

StatLink https://doi.org/10.1787/888934254981

Nevertheless, with an average of 2.7 for the air quality framework indicator (Table 16.4), the six assessed economies have made considerable progress in developing their frameworks and harmonising their legislation with the EU *acquis* (such as Directive 2008/50/EC on ambient air quality). Since the last assessment, Albania's main law on the protection of ambient air quality has come into force (in 2018) and Albania, Kosovo, Montenegro, North Macedonia and Serbia have all adopted policy frameworks with clearly defined objectives for air quality management. Meanwhile, the Swedish Environmental Protection Agency Programme on improving air quality and air quality management in Bosnia and Herzegovina (2017-2021) aims to build the capacity of the key government institutions to manage air quality and improve air quality data collection. Local air quality plans, urgently needed for areas in which pollutant levels regularly exceed health guidelines, have been developed in North Macedonia and Serbia and are being prepared in Albania (started in 2021) and Kosovo (envisaged for the 2020-2025 period).

Implementation varies across the assessed economies. Implementation in Montenegro and North Macedonia is relatively advanced with several programmes in place for reducing air pollution and raising public awareness of air quality improvements. An air protection programme is being developed in Serbia and is expected to align Serbia's practices with EU directives.[12] Ad-hoc measures are taken when pollution limit values are exceeded in Albania and BIH. However, Kosovo has not yet implemented most measures in its air management strategy. For instance, the 2018 ban on the use of coal for heating in public buildings was not backed up by any financial support and consequently has not seen any meaningful implementation.

The fact that air quality frameworks do not stipulate clear obligations for polluters in the assessed economies impedes the efficiency of responses. In the EU, best available techniques for a range of industrial processes and emission rates must be taken into account by industry. They can also serve as a good basis for the WB6 (Box 16.8).

Air quality is monitored regularly across the region by permanent air quality monitoring stations and information on air quality is mostly made available promptly. The exception is Albania, where all stations have been turned off due to a lack of funding (European Commission, 2020[27]). Since the last assessment, North Macedonia has been working on establishing a national environmental information system to gather environmental data in one central database. Montenegro has re-established reporting on air pollutant

emissions and provided all missing data for the period 2011-18, which will help in measuring the effect of air quality measures on actual emission levels. In Kosovo, a new action plan for air quality monitoring is under development with international support. Although air monitoring has improved in BIH, it is not well co-ordinated, with different methodologies used by different entities, which means there are no air quality data for the entire economy.

### Box 16.8. The EU's Best Available Technique Reference Documents (BREFs)

The BREFs are a series of reference documents covering, as far as practical, the industrial activities listed in Annex 1 to the EU's integrated pollution prevention and control (IPPC) Directive. They provide descriptions of a range of industrial processes and their respective operating conditions and emission rates. Member States are required to take these documents into account when determining best available techniques generally or in specific cases under the directive. They can also serve as a good basis for potential candidates.

The BREFs were developed to exchange information between industrial sectors and non-government organisations (NGOs) in different Member States and the European Integrated Pollution Prevention and Control Bureau (IPCC/EIPPCB).

Non exhaustively, these documents cover:

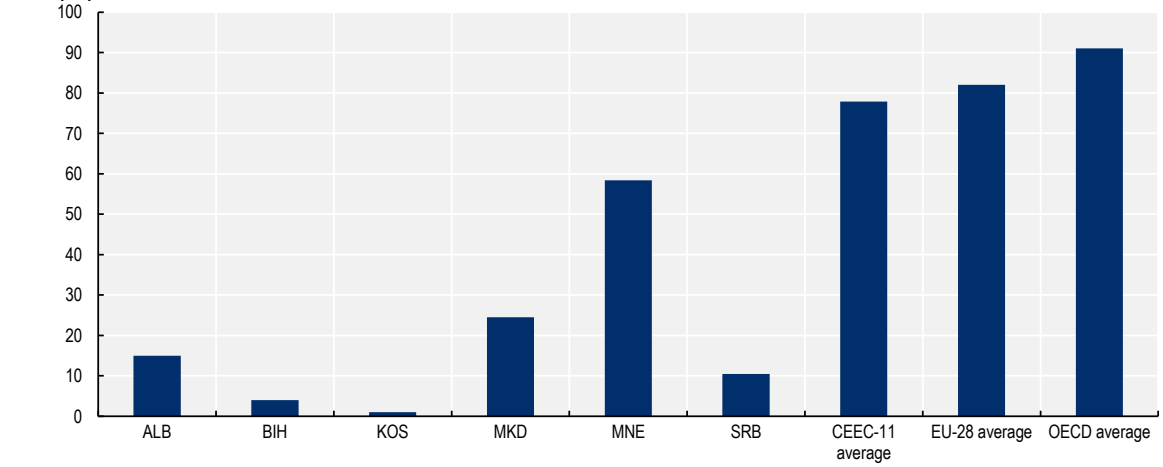
- common waste gas treatment in the chemical sector
- emissions from storage
- ferrous metals processing industry
- industrial cooling systems
- large combustion plants
- refining of mineral oil and gas
- waste incineration and treatment.

Source: (EEA, n.d.[28]), *EU Best Available Techniques Reference Documents (BREFs),* https://www.eea.europa.eu/themes/air/links/guidance-and-tools/eu-best-available-technology-reference.

### *Water supply and sanitation strategies are in place but need sustainable funding*

Access to an improved water source (e.g., household connection, public standpipe or protected dug well) is nearly universal in all assessed economies (all over 95%). A smaller share of the population is connected to sewage systems: 35% in BIH, 51% in Albania and 58% in Serbia (UNECE, 2019[15]). Far fewer people are connected to wastewater treatment facilities, with the average for the WB6 around 6.5%, which is significantly lower than the EU average of 86%. However, this share varies from 58.4% in Montenegro to 1% in Kosovo (Figure 16.13). Moreover, water pollution and water losses from the system are key challenges. The losses range between 33% in Serbia to almost 60% in Bosnia and Herzegovina, Kosovo, and North Macedonia, often due to outdated water supply networks. Despite these statistics, only the government of North Macedonia has started to take action to decrease these losses. In addition, infrastructure is often made of hazardous material – such as asbestos in BIH.

## Figure 16.13. Population connected to wastewater treatment facilities (2018)




Note: Data for Bosnia and Herzegovina are the simple average of FBiH and RS. There are no wastewater treatment plants in the Brcko District. No data available for Croatia. CEEC-11=Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: Data based on responses to Environmental Policy Questionnaires sent by domestic authorities and statistical offices and (OECD, 2018[29]), *Wastewater treatment*, https://stats.oecd.org/Index.aspx?DataSetCode=WATER_TREAT.

StatLink https://doi.org/10.1787/888934255000

The water supply and sanitation legislative framework is almost fully aligned (95%) with the EU *acquis* in Montenegro and North Macedonia.[13] Serbia needs to make significant efforts to further align its legislation with the EU *acquis* and to strengthen administrative capacity, in particular for monitoring, enforcement and inter-institutional co-ordination (European Commission, 2020[9]). Kosovo's policy framework has been complemented with a new strategic plan for regional water companies (2018) and Albania's legislative and policy frameworks were being updated at the time of drafting with the preparation of the Law on Water Supply and Sewerage Sector and a new strategy.[14] No major changes have been recorded in Bosnia and Herzegovina, but the Water and Sanitation Infrastructure Project (WATSAN) implemented in both entities will harmonise the water supply and sanitation frameworks with EU legislation.[15]

Water supply and sanitation infrastructure projects have been implemented since the last assessment, with new wastewater treatment plants (WWTP) being constructed in all assessed economies. WWTPs are also planned in Belgrade and Skopje where a lack of plants means that all wastewater is discharged untreated into rivers. However, water supply and sanitation infrastructure projects are still largely dependent on donor funding throughout the assessed economies, and water tariffs are too low to cover service costs. The long-term affordability of new infrastructure maintenance under these conditions appears doubtful. For instance, although eight new plants were built in Albania in 2016, the lack of finance and limited technical capacities rendered three of them idle, and their long-term operational arrangements are unclear (UNECE, 2019[15]).

### *Industrial waste management frameworks could be strengthened further*

Little progress has been achieved on the industrial waste management framework. Across the assessed economies, laws and strategies on waste management also regulate the management of industrial waste. As regards managing and controlling industrial risks and accidents, the EU Seveso-III Directive (2012/18/EU) has been fully transposed into legislation in Kosovo, Montenegro, and North Macedonia, and partially in Albania (European Commission, 2020[9]). Alignment with most of the EU *acquis* is at an early stage in Serbia, including on the Industrial Emissions Directive. However, Serbia adopted its long-awaited national emission reduction plan in 2020 and established a database strengthening the monitoring of Seveso III operators (European Commission, 2020[9]).

In terms of chemicals, North Macedonia, Serbia, and the RS in BIH have an official register of chemicals on the market, as well as classification, packaging and labelling rules. Kosovo and Montenegro are working on establishing a domestic chemical register. By law, any chemicals produced in or imported into Albania need to be registered on an electronic chemical register, but the register has not yet been established. Pollutant Release and Transfer Register (PRTR) systems have been established in Albania, North Macedonia and Serbia. The PRTR Protocol has been ratified by Montenegro but the register has not yet been set up. Kosovo and the FBiH and RS in BIH have established their registers but they are still not fully operational. No hazardous waste disposal facilities exist in any of the assessed economies and waste must be exported for treatment. A project is being implemented for this in Kosovo, but it has been stalled for the past two years.[16]

There is no policy or legislative basis for soil protection in any of the assessed economies, except for Serbia, which recently established a national soil monitoring programme. Serbia has also established reporting on contaminated sites in 2020 through the cadastre of contaminated sites information system as part of the environmental information system. Provisions for soil protection will also be included in the amendments to the Law of Environment of North Macedonia, which was in the process of being adopted by the government at the time of drafting. Developments on identifying contaminated areas have only been recorded in Kosovo and Montenegro, with the former starting a World Bank-financed project to clean up contaminated areas.

### *The way forward for environmental quality of life*

- **Improve air quality by decreasing dependence on fossil fuels in the energy mix, upgrading household heating systems, reducing transport emissions, and decreasing emissions from industry.**
- **Phase out coal subsidies and decarbonise the energy sector, and introduce incentives that support renewable integration**. This will be particularly important if the EU moves to introduce a carbon border tax (currently being discussed), as this would make energy-intensive economic sectors increasingly uncompetitive. For more information, see the Energy policy chapter.
- **Include measures to prevent air emissions from industry** more regularly in the environmental permits for industrial facilities. These could follow those described in the EU Best Available Technique Reference Documents (Box 16.8).
- **Promote sustainable transport options**: modernise the bus fleet (low-emitting buses), and influence private vehicle purchasing and renewal decisions through ecological vehicle taxes which vary according to vehicle age and level of $CO_2$ emissions. France's bonus-malus scheme could be a good model to follow, which imposes a fee on vehicles with high $CO_2$ emissions or fuel consumption and provides a rebate for vehicles with low $CO_2$ emissions or fuel consumption (Box 16.9).

### Box 16.9. Feebate schemes to incentivise low-carbon vehicles

Feebates, also called bonus-malus schemes, levy a sliding scale of fees (excise taxes) on products (or activities) with above-average emissions, and a sliding scale of rebates (subsidies) for products (or activities) with below-average emissions. By encouraging consumers to shift to less polluting vehicles to benefit from the rebate and avoid the tax, they have been shown to substantially encourage the uptake of motor vehicles with lower $CO_2$ emissions – e.g., in France (D'Haultfœuille, Givord and Boutin, 2014[30]). The strength of the incentives to reduce emissions depends on the amount by which feebates make low-carbon products cheaper than high-carbon products. Feebates are typically designed to be revenue-neutral – the fees collected on carbon-intensive products are used to subsidise the cleaner alternatives – even if in fact they have sometimes turned out to be more costly than intended (Teusch and Braathen, 2019[31]). They generally do not raise government revenues that could be used for other purposes, including redistribution. However, the fact that feebates provide both carrots (i.e., the rebate) and sticks (i.e., the fee) may increase the public acceptability of this instrument.

Governments can complement these instruments with carbon price trajectories that provide guidance to consumers and producers without the need to raise carbon prices immediately when the economy has yet to recover from the crisis. Design challenges vary by instrument and may include agreeing a reasonable strike price, setting a credible baseline against which to measure emissions reductions and defining emission intensity standards for a wide range of products.

Source: (OECD, 2020[32]), *Green Budgeting and Tax Policy Tools to Support a Green Recovery*, https://doi.org/10.1787/bd02ea23-en.

- **Increase the number of wastewater treatment plants and reassess the fee structure so that fees cover the service costs.** Enforce the implementation of the water-user and polluter pays principles[17] for all water users and dischargers, paying attention to vulnerable social groups. Ensure regular maintenance of the existing WWS network.
- **Introduce land-use management and soil protection legislative and policy frameworks.** There are almost no relevant frameworks in the region and processes remain ad-hoc. Given the environmental importance of soil protection in most economies of the region, it is important to introduce a comprehensive policy framework for identifying, characterising and remediating contaminated sites. This should be backed up by concrete guidelines to facilitate the process of further land identification and its clean-up. Economies could follow the approach taken by Israel (Box 16.10).

### Box 16.10. Cleaning up contaminated sites in Israel

Contaminated land has been discovered in hundreds of industrial, commercial and agricultural areas in Israel. These areas include several sites where hazardous waste was buried before the hazardous waste management site at Ramat Hovav was established. Such sites affect soil and water, with groundwater contamination found at 30% of sites.

Steps have been taken to develop a comprehensive framework for the identification, characterisation and remediation of contaminated sites. In 2000, the MoEP formulated a policy for cleaning up contaminated land and prepared several guidelines to facilitate the process. These documents included preliminary clean-up targets for 100 pollutants to serve as a basis for land remediation and guidelines on planning and implementing soil site characterisation, as well as guidelines for remediating contaminated soil at petrol stations. In 2009, the MoEP identified the 20 most severely polluted sites and began remediation measures. For example, EUR 42 million was allocated for remediating the

hazardous waste treatment site at Ramat Hovav, which included a closed landfill, sedimentation and evaporation ponds, and temporary storage areas.

Since addressing past pollution will probably take decades, immediate actions focused on immediate risks, such as at Ramat Hovav, and monitoring other sites for potential contamination. A comprehensive framework for rehabilitation efforts was developed. It framework included instruments to carry out soil surveys on land suspected to be polluted (within the framework of building permits and real estate transactions, and state-owned land leasing agreements), with contamination and clean-up status recorded in the land registry. A database of contaminated and potentially contaminated sites (which includes state-owned land, such as army bases, defence industry sites, government-owned companies, as well as privately owned contaminated areas) was created. A risk-based methodology for soil and groundwater, approved in 2011, has enabled better risk assessment procedures.

Source: (OECD, 2011[33]), *Environmental Performance Reviews, Israel*, https://doi.org/10.1787/9789264117563-en.

## Conclusion

The environmental legislative framework is relatively well advanced in the Western Balkan economies; progress has been made to transpose EU environmental directives and adopt missing legislation on climate change and on managing water, biodiversity, and forestry. However, the challenge now lies in implementing key measures. Air pollution, unregulated and illegal dumping of waste and the lack of wastewater treatment remain the most pressing challenges in the region. Poor co-ordination mechanisms among central, regional and local authorities and lack of human and financial resources are hampering proper implementation, while the lack of environmental monitoring systems, national inventories and statistics is hindering evidence-based policy making.

Long-term economic competitiveness and social development depends on fostering growth while safeguarding natural assets which provide vital resources and environmental services. Despite some progress, a sufficiently coherent policy framework to grow and boost competitiveness in an environmentally sustainable way is still lacking in all six Western Balkans economies. Successful green growth in the region is closely tied to the implementation of the recommendations put forward in this chapter, as well as in the other chapters relevant to environmental policy.

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## Notes

[1] In Bosnia and Herzegovina, competences for environment and climate change rest with the two entities, and Brčko District. In the FBiH, the competence is shared between the Federation and the ten cantons. At the state level, the Ministry of Foreign Trade and Economic Relations (MOFTER) BIH is responsible for defining policies and basic principles, co-ordinating activities and consolidating entity plans with those of international institutions in the area of energy, agriculture, protection of environment and use of natural resources and tourism. Entity level institutions are responsible for strategic framework, policy setting, data exchange and reporting.

[2] The 11 Central and Eastern European countries (CEECs) joining the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[3] The NECP will define targets in the field of renewable energy sources, energy efficiency and GHG emissions reductions to 2030, and with a long-term vision to 2050. The NECP is prepared through the IPA 2017 project Further Development of Energy Planning Capacity, which started in February 2021.

[4] North Macedonia in particular hasn't submitted national communications since 2014 and Albania hasn't submitted any Biennial Update Reports.

[5] In Albania, climate-related risks are partly identified in the UNFCC report and a Disaster Risk Reduction strategy is being prepared. Serbia has a programme for disaster risk management but climate change policies are not sufficiently reflected in it. More information in the Albania and Serbia profiles.

[6] The project focuses on the development of integrated water resource management and implementation of adaptation strategies in the Drin River Basin, covering the following economies: Albania, Kosovo, Republic of North Macedonia and Montenegro. It is implemented by GIZ. The main objective is to mitigate the impacts of climate change by focusing on flooding and drought risk management as well as strengthening regional co-operation as it pertains to the management of water resources.

[7] The Waste Management Strategy (WMS) with the related Waste Management Plan (WMP) (2020-2035) and the National Sectorial Plan for Solid Waste Management (NSPSWM) (2019-2035).

[8] For instance, the West Balkans Drina River Basin Management project is led by the World Bank and aims at managing the transboundary Driva River Basin (2016-2021) between Bosnia and Herzegovina, Montenegro and Serbia. The World Bank is also providing technical assistance for improving the effectiveness of the joint flood management by the economies co-operating in the Sava River basin (Bosnia and Herzegovina, Montenegro, Serbia).

[9] Aichi Target 11 also covers marine protected areas. Limited progress has been achieved in Albania, with 3% of its marine areas protected (the target being 6% by 2020). No marine protected areas have been established in Montenegro (the target being 10% by 2020 but research is currently underway into three potential marine protected areas (Platamuni, Katic and Stari Ulcinj). No data are available for Bosnia and Herzegovina, but the authorities report that the Aichi Biodiversity Targets have not been achieved.

[10] The current agricultural land consolidation project, Strengthening Spatial Planning and Land Management (SSPLM), involves 21 cadastral zones and 10 municipalities. It aims to provide technical

assistance for the preparation of municipal land development plans, and is to be finalised by the end of 2021.

[11] Data are unavailable for Kosovo beyond 2015.

[12] Supported by an EU-funded project, Serbia was developing the Air Protection Programme and Action Plan at the time of drafting (to be finalised in 2021). This programme is expected to provide a basis for further developing and adopting bylaws and the continued implementation of EU legislation in the field of air protection.

[13] The legislative framework in North Macedonia was amended in 2017 with the adoption of the Law on Setting the Prices for Water Services, which represents the main legal act in this area and is almost fully aligned (95%) with the EU *acquis*. In addition to this legislative change, in 2017 the government conducted a National Water Study on an investment framework for the implementation of projects for water supply and wastewater treatment, in accordance with the requirements of the relevant EU Directives.

[14] Although the legislative and policy framework in Albania is not fully aligned with the EU *acquis* in the area of wastewater management, monitoring mechanisms are envisaged, the responsible institution has been assigned and concrete objectives, budget, measures and a timeline have been set.

[15] The overall objectives of WATSAN (to be finalised by the end of 2021) are to improve the living conditions of the population, secure adequate hygiene in water supply and sanitation, and implement environmental protection measures, in line with the obligations of EU accession and harmonisation with EU legislation, in particular the Water Framework Directive, Drinking Water Directive and Urban Waste Water Directive.

[16] The government had planned to build a central disposal facility for hazardous waste in 2018 in the municipality of Fushe Kosove/Kosovo Polje. It organised several rounds of consultations with citizens, but agreement to build the facility could not be reached. See Kosovo economy profile.

[17] The polluter pays principle is a basic principle of all European environmental policies. It is specifically referred to in the EU Water Framework Directive (WFD), which establishes clear requirements concerning financing for water management in EU Member States. The polluter pays principle states that those who pollute should bear the costs of preventing damage to human health or the environment.

# 17 Agriculture policy (Dimension 14)

Agriculture is a key pillar of the Western Balkan economies, providing a significant share of total employment, and is one of the three most important sectors in terms of contribution to GDP. With this in mind, this chapter assesses the performance of agriculture policies in the six Western Balkan economies (WB6), looking at four sub-dimensions. The first, agro-food system capacity focuses on rural infrastructure capacity (particularly irrigation) and the role of skills and education in productive, sustainable and competitive agriculture. The second sub-dimension looks at the effectiveness of agro-food system regulations in safeguarding public safety and the environment in two areas: inputs and crop products, and natural resources such as land and water. The third, agricultural support systems, covers the policy, governance and instruments in the agricultural sector. Finally, the agricultural innovation system sub-dimension considers innovation and extension services – key tools in an economy's path towards productive and sustainable agriculture. Each sub-dimension provides recommendations for the way forward.

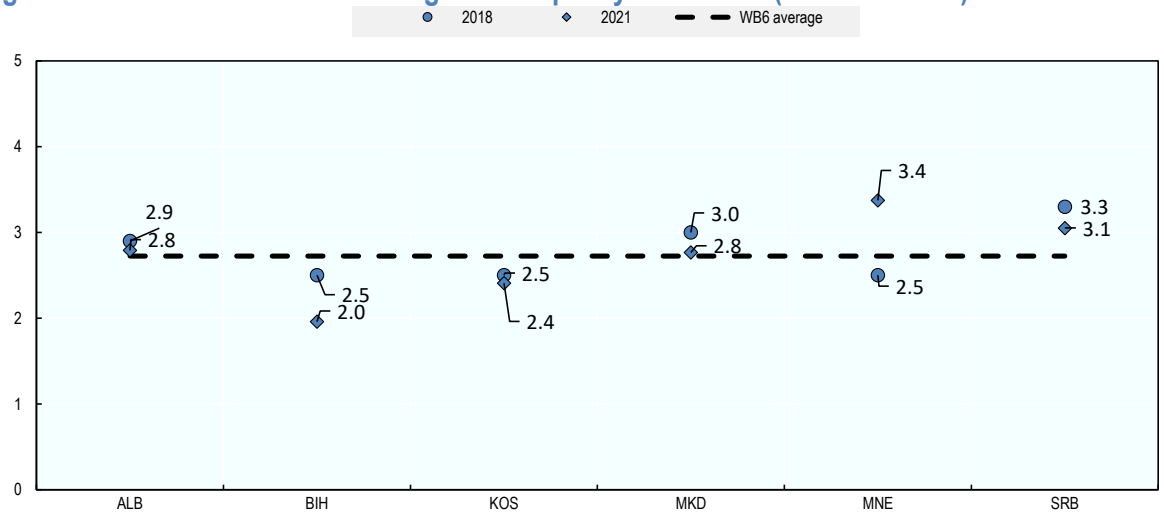
## Key findings

- **All the WB6 economies have undertaken sizeable investments in road infrastructure over the last decade**. They continue to support rural infrastructure projects such as sewage systems, electricity and gas supply, and broadband Internet, which are some of the key preconditions for a competitive agriculture sector.
- **Investment in irrigation systems is increasing**, but limited progress has been made to improve irrigation efficiency and sustainability, or to monitor soil erosion, drainage, and soil moisture.
- **Implementation of the Instrument for Pre-Accession Assistance for Rural Development (IPARD) programme continues to improve** among the accredited economies (Albania, Montenegro, North Macedonia and Serbia), and IPARD disbursement authorities are increasing their administrative capacity. However, the criteria for IPARD funding and national budget subsidies are not fully harmonised.
- **Bosnia and Herzegovina and Kosovo continue to prepare for full accreditation of their IPARD payment agency and appropriate reforms**. More effort is needed to finalise land parcel identification systems (LPIS) and other relevant criteria for IPARD accreditation in these two economies.
- **Common market organisation (CMO) legislation and reforms should be further enhanced** by all six economies.
- **Agricultural education and training are still underfinanced** and the number of agriculture students continues to fall. Domestic strategies either fail to address agricultural education or, if they do address it, measures are not yet implemented.
- **Weak inter-sectoral co-operation between agricultural and other relevant institutions (environment, education)** is holding back the performance of the sector and slowing down reforms.
- **Capacity for monitoring and evaluation is limited**. All six economies have made some effort to improve and create a system of evidence-based policies, but their efforts need to be increased significantly.
- **Investment in agricultural research projects remains poor** and agriculture extension services are patchy in both scope and quality.

### Comparison with the 2018 assessment

The WB6 have continued with the reforms to their agriculture policies and increased the investments and efforts in this respect. They have slightly improved their scores since 2018. Montenegro and North Macedonia have made the most progress (Figure 17.1).

## Figure 17.1. Overall scores for the agriculture policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

Implementation of the 2018 recommendations has been limited overall (Table 17.1), especially defining clear roles and responsibilities at local levels, strengthening natural asset management and institutionalising the collection of key environmental data.

## Table 17.1. Implementation of the CO 2018 policy recommendations: Agriculture policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| **Strengthen inter-sectorial co-operation** | • Limited efforts have been made overall and formal mechanisms for inter-sectorial co-operation are still missing. | Limited |
| **Reorient agricultural producer support towards better productivity and sustainability objectives** | • The IPARD-accredited economies have implemented the decoupling of measures.<br>• As of 2021, domestic agriculture and rural development strategies have increased and diversified the economic support measures oriented towards competitiveness and productivity. | Moderate |
| **Fully implement farmland consolidation plans** | • Farmland consolidation plans have been partially implemented but full consolidation is still a long way off.<br>• Progress has been made in Albania, Montenegro, North Macedonia and Serbia, but farmland consolidation is still an open issue in Bosnia and Herzegovina and Kosovo. | Moderate |
| **Enhance the quality and impact of the agricultural innovation system** | • In Albania, Kosovo, Montenegro and Serbia, investment in research and development (R&D) in agriculture have increased. Bosnia and Herzegovina and North Macedonia still have very limited support for innovation in agriculture. | Limited |
| **Enhance environmental objectives across agricultural policy frameworks** | • Environmental objectives have been widely introduced into agriculture policy frameworks.<br>• A few of the WB6 economies have introduced agri-environment measures but implementation is still limited. | Limited |
| **Strengthen policy analysis to better inform policy development** | • Moderate efforts to improve policy analysis and establish efficient monitoring systems have been made.<br>• Awareness of the importance of evidence-based policies has increased. | Moderate |

## Introduction

Agriculture is a significant pillar of the Western Balkan economies. It provides an important share of total employment, and is one of the few sectors with the potential for competitiveness on the global market. Agriculture is a heavily subsidised economic activity, and is the main source of income for almost 40% of the total population in the WB6 economies.

Further analysis of this dimension reveals important links to other policy areas; thus, an inter-sectoral approach and good co-ordination will be crucial for creating sustainable policy mechanisms that boost the productivity and competitiveness of the agriculture sector. These include the following challenges within the specific policy areas:

- **Chapter 5. Trade policy**. Agriculture and trade are highly interdependent. Over the past decade, international agro-food markets have undergone some significant changes, which have brought them closer together. Since 2000, agri-food trade has grown strongly as world markets have responded to a more rules-based trading environment, lower tariffs and reduced trade-distorting producer support (OECD, 2019[1]). But agri-food trade is not only growing, it is also becoming global. A growing share of agri-food trade takes place in global value chains (GVCs) that link agri-food sectors with other sectors of the economy around the world (OECD, 2020[2]). Since agri-food products in GVCs may cross borders several times before reaching final consumers, their costs can be increased by uncontrolled non-tariff measures such as those related to laws or requirements such as sanitary and phytosanitary measures (SPS), technical barriers to trade and customs procedures (OECD, 2019[1]).
- **Chapter 10. Education policy.** Education policy in all six Western Balkan economies is the responsibility of the relevant education ministries while the agriculture education framework is based on national agriculture and rural development strategies. The strategies foresee a number of measures that address barriers to agriculture development, but no specific measures have been dedicated to improving agricultural education and training. Meanwhile the number of agriculture students is falling across the region while the labour market lacks a skilled and trained workforce.
- **Chapter 11. Employment policy**. Agriculture students have very limited contact with the real labour market during their studies. There are no mechanisms to support part-time employment while studying; such mechanisms could potentially overcome the supply-demand imbalance in the market. The seasonal agricultural workforce faces a number of difficulties registering their part-time employment and receiving social benefits due to inappropriate legal frameworks.
- **Chapter 12. Science, technology and innovation.** Agriculture is not a dynamic field for applied science and research in WB6 economies. Research is largely dependent on donor-funded projects, while national funding for research is extremely limited, meaning projects tend to be *ad hoc*. Over the past two decades, all six economies have seriously neglected the need to secure permanent funding to maintain existing research infrastructure and facilities, as well as to develop and adopt new methodologies.
- **Chapter 16. Environment policy.** Efforts to regulate natural resources have been limited, especially effective measures to stop the loss of agricultural land and more efficient inspection and control mechanisms. Agri-environment measures are to be implemented through agriculture support mechanisms. However, inter-sectoral co-operation with environment ministries will need to be a priority to ensure the sustainable use of natural resources.

## Assessment framework

### *Structure*

This chapter assesses agricultural policies in the WB6 economies by assessing four broad sub-dimensions:

1. **Sub-dimension 14.1: Agro-food system capacity** focuses on the role of rural infrastructure, irrigation and education. It describes the policy reforms undertaken and achievements in facilitating productive, sustainable and competitive agriculture.
2. **Sub-dimension 14.2: Agro-food system regulation** assesses how effectively regulations safeguard public safety and how burdensome they are for farmers and agri-businesses to comply with in two areas: products, such as inputs (fertiliser and pesticides) and crops; and natural resources, such as land and water.
3. **Sub-dimension 14.3: Agricultural support system.** This focuses on the policy, governance and instruments supporting the agricultural sector. The various ways this support is delivered has different implications for agricultural production, trade and incomes.
4. **Sub-dimension 14.4: Agricultural innovation system** considers the agricultural research and innovation system as a key tool in the path towards productive and sustainable agriculture, improving the economic, environmental and social performance of the agri-food sector.

Figure 17.2 shows how the sub-dimensions and their indicators make up the agricultural policy dimension assessment framework.

### Figure 17.2. Agriculture policy dimension assessment framework

| Agriculture policy dimension | | | |
|---|---|---|---|
| **Sub-dimension 14.1** Agro-food system capacity | **Sub-dimension 14.2** Agro-food system regulation | **Sub-dimension 14.3** Agricultural support system | **Sub-dimension 14.4** Agricultural innovation system |
| **Qualitative indicators**<br>1. Rural infrastructure policy framework<br>2. Irrigation policy framework<br>3. Agricultural education system | **Qualitative indicators**<br>4. Regulations on natural resources<br>5. Regulations on products | **Qualitative indicators**<br>6. Agricultural policy framework<br>7. Domestic producer support instruments<br>8. Agricultural trade policy<br>9. Agricultural tax regime<br>10. Sanitary and phytosanitary (SPS) measures | **Qualitative indicators**<br>11. Agricultural research and development framework<br>12. Agricultural extension services framework |
| **Quantitative indicators**<br>1. World Economic Forum (WEF) electricity and telephony index<br>2. Share of agricultural area equipped for irrigation<br>3. Mechanisation<br>4. Higher education graduates in agriculture<br>5. Farmer demographics | **Quantitative indicators**<br>6. Agricultural land<br>7. Arable land per capita<br>8. Agricultural freshwater withdrawals<br>9. Livestock density<br>10. Fertiliser use<br>11. Pesticide use<br>12. Agricultural greenhouse gas emissions | **Quantitative indicators**<br>13. Budgeted outlays to implement agriculture strategy by component<br>14. Producer Support Estimate<br>15. Import tariffs on capital goods, intermediate and agricultural goods by commodity<br>16. Export subsidies, export credit support, export duties and/or export | **Quantitative indicators**<br>18. Public expenditure on agricultural R&D, level, structure (institution vs project) and source<br>19. Share of farms using extension services<br>20. Share of producers and agri-business adopting an innovation |

| | | | |
|---|---|---|---|
| | | prohibitions by commodity<br>17. Tax rates in agriculture which differ from standard tax rates | |

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information, see the Methodology and assessment process chapter.

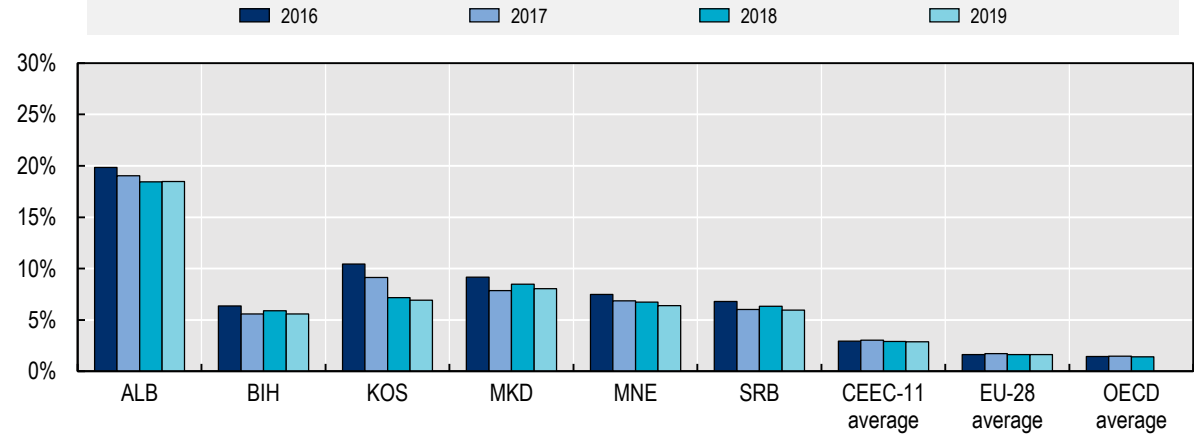
### *Key methodological changes to the assessment framework*

There have been no significant methodological changes to the agricultural policy assessment framework since the 2018 Competitiveness Outlook. Few changes have been made to either the quantitative or qualitative questionnaires. The qualitative questionnaire has adopted more specific questions in each of the sub-dimensions about the process of developing, implementing and monitoring agriculture policies, as well as the impact of domestic and IPARD agriculture support measures.

## Agricultural policy performance and context in the WB6

Agriculture traditionally plays an essential employment role, being the prevalent activity of the WB6 economies' rural population. The sector's contribution to gross domestic product (GDP) is much higher than in the OECD, EU and Central and Eastern European economies (CEEC-11)[1] (Figure 17.3). However, its contribution fell during 2016-19 in all of the assessed economies, by an average of 2.46%. The greatest decline was in Kosovo, where agriculture's share of total GDP fell by 3.53% (from 10.45% in 2016 to 6.91% in 2019). The smallest declines were in Bosnia and Herzegovina and Serbia, both around 0.7% over the three years.

### Figure 17.3. Share of agriculture value added (2016-19)



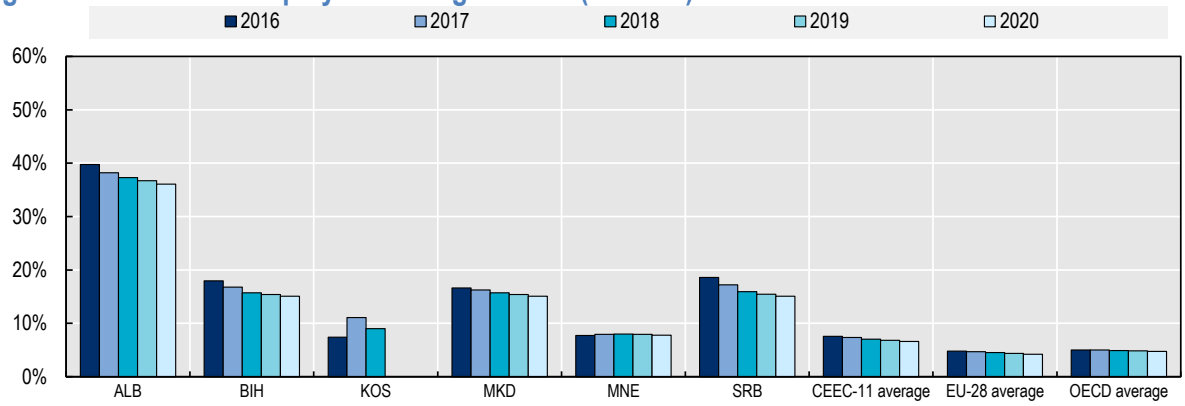

Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: World Bank national accounts data, and OECD national accounts data files, retrieved from: https://data.worldbank.org/.

StatLink https://doi.org/10.1787/888934255019

Agriculture's share of employment varies across the region (Figure 17.4). It is very significant in Albania, where it is the largest employer and accounted for 36% of jobs in 2019, but relatively moderate in Kosovo

and Montenegro, where its share was around 7%. In Bosnia and Herzegovina, North Macedonia, and Serbia agriculture accounts for around 15% of employment. In comparison, the share is 9% across the CEEC-11, while in the OECD and EU economies it is 4% on average.

### Figure 17.4. Share of employment in agriculture (2016-20)



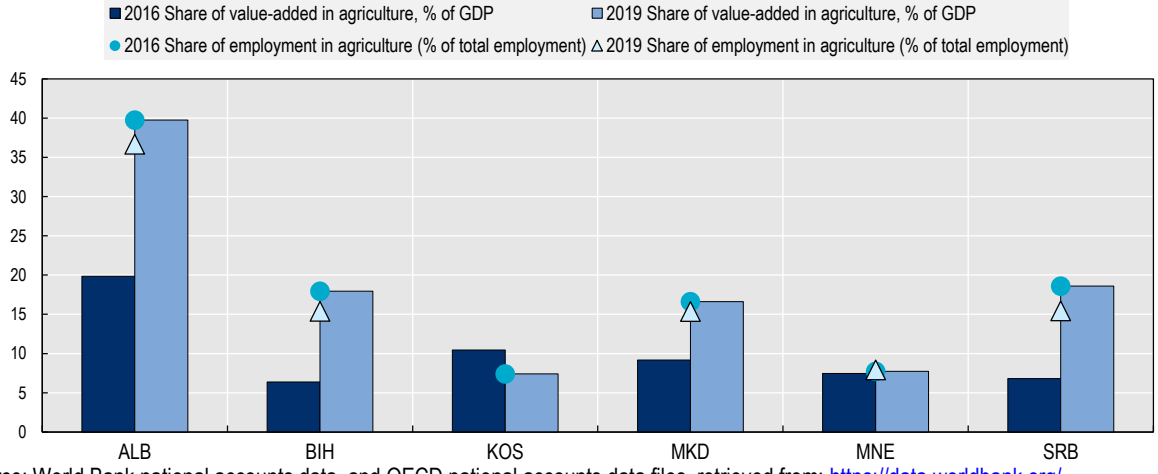

Note: The CEEC-11 are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.

Source: World Bank national accounts data, and OECD National Accounts data files, retrieved from: https://data.worldbank.org.

StatLink https://doi.org/10.1787/888934255038

As illustrated in Figure 17.5, agricultural productivity has increased between 2016 and 2019 in all WB6 economies. Montenegro had the highest relative agricultural labour productivity of the WB6 economies in 2019: its ratio of total agricultural employment to share of GDP was 1.22. In comparison, the figure was 3.40 on average for OECD countries, 2.60 for the EU and 3.33 for the CEEC.

### Figure 17.5. Productivity index for the Western Balkans economies (2016-19)




Source: World Bank national accounts data, and OECD national accounts data files, retrieved from: https://data.worldbank.org/.

StatLink https://doi.org/10.1787/888934255057

## Agro-food system capacity (Sub-dimension 14.1)

The agro-food system capacity sub-dimension focuses on 1) the role of rural infrastructure capacity; 2) irrigation policy framework; and 3) skills and education in facilitating productive, sustainable and competitive agriculture.

As Table 17.2 shows, the average score across all six economies is 2.8 with Bosnia and Herzegovina having made the least progress while Albania, Montenegro and North Macedonia have performed most strongly. All of the economies have prioritised irrigation and education, two areas critical to the competitiveness of the agriculture sector.

**Table 17.2. Scores for Sub-dimension 14.1: Agro-food system capacity**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 14.1 Agro-food system capacity | Rural infrastructure policy | 3.5 | 1.0 | 3.5 | 4.0 | 3.5 | 2.0 | 2.9 |
| | Irrigation policy framework | 3.0 | 2.0 | 2.0 | 2.8 | 3.5 | 3.0 | 2.7 |
| | Agricultural education system | 3.0 | 1.5 | 3.3 | 2.5 | 3.0 | 2.5 | 2.6 |
| **Sub-dimension average score** | | 3.2 | 1.5 | 2.9 | 3.1 | 3.3 | 2.5 | 2.8 |

### *A rural infrastructure policy framework is in place in all six economies*

As infrastructure connects the economic system which allows factors of production, goods and information to move across people and markets, it plays an important role in decisions about investment in economic activity.

The economies' agriculture and rural development strategies have been updated, setting comprehensive priorities for the rural infrastructure policy framework. Among the top priorities for rural infrastructure are the construction and rehabilitation of local roads, irrigation systems, and digitalisation as preconditions for increasing agricultural productivity and competitiveness. The digital transformation of agriculture and of the economies more broadly has significantly increased the amount of agricultural data of commercial significance. The enhanced ability of agri-food stakeholders to access, share and use agricultural data is reshaping competition in the sector. At the farm level, agricultural data can be analysed to generate information and actionable insights that support producers' decision making and help them to better manage their operations. This includes using agricultural inputs more precisely and adapting to pests, weather and climate. The increasing availability of data is also changing business models, fostering new types of vertical collaboration (for example, between machinery equipment and digital software providers), and providing increased opportunities to tailor products and services for farmers (Jouanjean et al., 2020[3])

All six economies recognise the digital transformation of agriculture as a prerequisite for its development. Kosovo is making great efforts to improve its digital infrastructure in rural areas. Under the Digital Economy Project (KODE) 2018-23, supported with USD 25 million from the World Bank, more than 200 villages (will get a broadband connection by 2023. Most of Kosovo's rural areas are therefore expected to benefit from broadband Internet access within the next five years. This will give farmers access to increased digitalisation opportunities (market information systems, weather/climate data for preventive measures, online promotion/sales, etc). In November 2020, Serbia started implementing its last-mile broadband project, aimed at rural households that were not targeted for network expansion by a commercial operator in the next three years. Funded by the European Bank for Reconstruction and Development (EBRD), the project will support the deployment of last-mile fibre broadband that will connect the existing fibre backbone to 600 schools located in white zones (without access to broadband) in rural areas. This will improve living conditions in rural areas by providing better access to information and know-how, improved education for students, and allow new farmers to improve their skills. The project is part of a larger initiative and is the first of two phases; the second phase, targeting approximately 900 schools, is planned for 2021/22 as a separate project.

### *Investment in irrigation is increasing but policy progress is limited*

Irrigation infrastructure is regarded as a high priority for boosting productivity and stabilising agricultural production in the six economies. However, only limited progress has been made in developing irrigation

policies to improve the efficiency and sustainability of irrigation, or instruments to measure soil erosion, drainage and soil moisture.

In 2018, Albania prepared a new irrigation and drainage strategy for 2019-31. Under this strategy, the Water Resource Management Agency was established, two river basin management plans were adopted in 2020 and three other plans are being prepared and should be finalised in early 2022. Montenegro is currently implementing its strategy for water management, including irrigation, for 2018-35. With the support of the Food and Agriculture Organization (FAO), North Macedonia is planning to prepare its irrigation and drainage strategy for 2021-31, which will set the future direction for the national irrigation system to increase water use on an efficient and rational basis.

Investment in new irrigation systems continues in all WB6 economies. North Macedonia continues to implement its Irrigation Project (2019), with EUR 80 million of funding from the German Development Bank KfW and EUR 7 million in EU funding through the Instrument for Pre Accession Assistance (IPA) projects. Investment in water management systems is being carried out in accordance with the Plan for Investment in Water Management Infrastructure for the Period 2015-25, which aims to increase the potential irrigated area by about 32 000 ha. In Bosnia and Herzegovina, the Irrigation Development Project 2013-20 has been financed by a World Bank loan of USD 40 million.

Water management remains an open question, as economies are still struggling to find the best irrigation water management model. Most of the water user organisations proposed as a model by the World Bank in the region have failed to assume the role intended for them. In North Macedonia, some of these organisations have been transformed into legally independent co-operatives, while in Albania and Kosovo, although irrigation water management has been transferred to the local level, the system continues to face considerable inefficiency and financial losses.

### *Agricultural education systems are not providing the skills the sector needs*

Agricultural education and training remain underfinanced and the number of agriculture students in the WB6 economies continues to fall. All of the economies' agriculture and rural development strategies see education and training as an important area for development, but few measures are envisaged. In addition, there is a lack of inter-sectoral co-operation between the agriculture and education ministries. The integration between vocational education and the training system is also weak and the curricula offer little scope to practise the skills learned, despite this being a crucial component of agricultural work. Montenegro has been the first to make efforts to improve the integration of vocational education. In December 2019 it prepared the Strategy for the Development of Vocational Education in Montenegro (2020-2024) with an action plan for 2020-22.

Although the agriculture sector largely employs the working poor and low-skilled workers, vocational education and training services do not reach rural areas, where education levels are generally lower than urban areas and where most of the population of the region currently resides.

Qualified and professional agricultural workers who are ready to meet the challenges of new production technologies are in constant demand. For this reason, all of the WB6 economies face a pressing need to reorganise their agriculture education system, using the resources available, and to create sustainable links between the education institutions and the labour market.

Too many people still work in agriculture in the WB6 economies. Further reforms towards making it a more skill- and capital-intensive sector will release a lot of workers. Their integration into the labour market will demand a number of policies (medium- and long-term measures) that will support the reallocation of the agricultural workforce into new sectors, possibly in diversified rural economies or green initiatives.

Most of the economies lack any monitoring and evaluation of their agriculture education systems. Serbia has been the first to begin developing an evaluation mechanism. In March 2020, the national system for

assessment of the education and its outcomes was established as an education management information system, based on the Strategy for Education Development in Serbia 2012-20. The first results are expected in 2021, and the information gathered will help the future planning and implementation of agricultural education programmes.

### *The way forward for agro-food system capacity*

- **Increase investment and improve the implementation of rural infrastructure policy**. Rural infrastructure policies are crucial to improving the competitiveness and productivity of the agriculture sector. There is a continuing need to improve rural infrastructure and increase the take up of current programmes. Support schemes need to be boosted by increasing the funds allocated and increasing support to the rural infrastructure projects implemented by local self-governments and other stakeholders.
- **Continue investing in irrigation infrastructure**. Irrigation and drainage are crucial to agriculture and can double, or even triple, yields for some crops. Current irrigation investment strategies need to be implemented as planned. Combined with the planned road infrastructure investment, this will improve the competitiveness of all six economies' agricultural products.
- **Improve irrigation water management**. Increasing funding for the maintenance of the existing irrigation network and the new areas being developed will be a priority. Without effective and efficient water management, the planned investments in irrigation will not be maintained and the system will not be sustainable. Economies could draw on the system implemented in the Emilia-Romagna region in Italy to optimise their irrigation water management (Box 17.1).
- **Ensure the skills taught in agricultural education meet labour market needs**. This will help students find practical work during their studies and after graduation. Accountability and certification mechanisms will need to improve to keep pace with labour market demand for the development of new know-how.

#### Box 17.1. Using information technology for agricultural water management in Emilia-Romagna, Italy

IRRINET is an irrigation IT system which advises farmers on efficient water management. The web service was developed with public funding by the Canale Emiliano Romagnolo (CER), a water consortium located in the Emilia-Romagna region

Emilia-Romagna is a leading Italian agricultural region with more than 84 000 farms, and about 1 million ha of farmland. About 33% of the farms have some irrigated land, making it increasingly important to use the water as efficiently as possible. Water scarcity and droughts are increasing in the region and climate change is expected to worsen the situation, reducing the amount of water available for agriculture. After the 2012 and 2013 drought events, the Emilia-Romagna regional authority put pressure on farmers to use water more efficiently, introducing new criteria for water resources governance and management and developing and adopting innovative techniques that can enable farmers to improve their overall economic and sustainable production, such as water scheduling.

IRRINET processes meteorological (rain and evapotranspiration), soil and crop information, to calculate the so-called water balance for individual crops, allowing farmers to know how much water is actually needed so they can reduce usage without reducing the quality of the crop. IRRINET is available free to farmers in Emilia-Romagna and currently provides more than 12 000 farms with daily irrigation scheduling via a web interface, text messaging or an app. This supports the efficient use of water resources in the sector. In 2017 it was estimated the service allowed about 90 million $m^3$ of water to be saved in the region each year – 20% of the total agricultural demand – without reducing yields. In the long term, IRRINET can optimise the use of water resources and sustain agricultural production, especially in dry years.

Source: (Climate ADAPT, 2019[4]), *IRRINET: IT irrigation system for agricultural water management in Emilia-Romagna, Italy*, https://climate-adapt.eea.europa.eu/metadata/case-studies/irrinet-it-irrigation-system-for-agricultural-water-management-in-emilia-romagna-italy.

## Agro-food system regulation (Sub-dimension 14.2)

The second sub-dimension assesses the regulations covering two main areas: natural resources such as land and water; and inputs, such as crops and fertiliser and pesticides. Regulations for natural resources are central to ensuring their long-term sustainable use, determining access to and use of land, water and biodiversity resources. Regulations for products and inputs aim to protect human, animal and plant health, and can also affect natural resource use.

Overall, the WB6 average score for this sub-dimension is 2.9 (Table 17.3). Serbia has the highest score, for natural resource regulations, at 3.6, with Albania and Montenegro close behind. Montenegro and North Macedonia have the highest score for regulations on products.

### Table 17.3. Scores for Sub-dimension 14.2: Agro-food system regulation

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 14.2: Agro-food system regulation | Natural resources regulations | 3.5 | 2.5 | 2.0 | 3.0 | 3.5 | 3.6 | 3.0 |
| | Product regulations | 2.5 | 2.0 | 2.6 | 3.5 | 3.5 | 3.0 | 2.9 |
| **Sub-dimension average score** | | 3.0 | 2.3 | 2.3 | 3.3 | 3.5 | 3.3 | 2.9 |

### *Natural resource regulations are hampered by limited land information systems*

Efforts to regulate natural resources have been limited, especially when it comes to creating effective measures that will stop the loss of agricultural land and improve the implementation of legislation by providing more efficient mechanisms of inspection/control. Inconsistent cadastral information and the lack of implementation of property rights legislation are holding most of the WB6 economies back from improving their natural resources regulations.

Land parcel identification systems (LPIS) are an important tool for planning, implementing and monitoring agricultural support. It is an element of the Farm register (FR) and works as a spatial representation of areas utilized by agricultural households. Serbia is prioritising land consolidation to improve agriculture competitiveness. As part of its Serbia 2025 programme, it is allocating an additional EUR 70 million to land consolidation processes based on the Strategy for Rural Development 2014-24.

### *Product regulations are harmonised with the EU, but better management of fertilisers and pesticides is needed*

The regulations on seeds and propagation material are aligned with EU directives and protocols, including consistent monitoring and evaluation on a quarterly basis following EU guidelines. The regulations cover

agricultural production, environmental protection and consumer health. Managing regulations for seeds and propagation material requires co-ordination between government agencies, as well as clear divisions of responsibilities and mandates. In 2018, Kosovo prepared a new Draft Law on Seeds as part of the Italian-Kosovo EU twinning project, but it is still awaiting further legal procedures for approval.

The use of fertilisers and pesticides requires proper management, inspection and control at all levels. The WB6 governments need to improve their efforts in this area. In Albania, the new Law on Fertiliser Products was approved in 2020 and harmonises the EU rules for production, registration, trade, import, export, use, quality control, traceability, information, advertising and inspection of activities related to fertiliser products, as well as the organisation and operation of the relevant structures.

### *The way forward for agro-food system regulation*

- **Enhance the land consolidation process**. The land consolidation process is crucial for improved productivity. Continued implementation of consolidation policies using different approaches to increase the average farm size will significantly boost productivity.
- **Enhance agricultural land management policies**. The full establishment of a functional and operational land parcel identification system (LPIS) is crucial. LPIS are one of the preconditions for the accreditation of new IPARD measures and offer strong tools for planning, implementing and monitoring agricultural support policy.
- **Ensure continuous improvement of the regulations on fertilisers and pesticides.** Appropriate management of fertilisers and pesticides will reduce their long-term negative impact on farming, and promote the sustainable use of natural resources. Box 17.2 provides an example from Denmark on how policies can achieve this.

#### Box 17.2. Managing the biodiversity impacts of fertiliser and pesticide use in Denmark

Major increases in the use of pesticides were leading to a serious decline in Denmark's farmland wildlife at the beginning of the 1980s. For example, wild plant diversity decreased by 60% between 1970 and 1990 (PAN Europe, 2005[5]). Denmark has a long history of implementing policies to reduce pesticide use, accompanied by quantitative targets. The first pesticide reduction plan was introduced in 1986 to protect groundwater that is consumed directly without any purification treatment. Since then, pesticides have been banned when it is proved that they have affected groundwater used for drinking (MIM and MFVM, 2013[6]). Consequently, only around 80 types of active substances are permitted in Denmark, compared to 3-400 in many other EU Member States (Coll and Wajnberg, 2017[7])

Along with tightening approval procedures, there are regulations requiring mandatory spraying certificates for professional users, mandatory spraying journals and mandatory buffer zones around water courses, lakes and public water supplies (Pedersen and Nielsen, 2017[8]). Under the Pesticide Leaching Assessment Programme, authorised pesticides are applied to six representative test fields followed by intensive monitoring to determine if there is evidence of the pesticides, or their metabolites, leaching into groundwater. As a result of this programme, a small number of previously authorised pesticides have had their authorisations withdrawn in Denmark, and in some other cases the conditions of use have been modified (EC, 2017[9]).

Source: (Sud, 2020[10]), "Managing the biodiversity impacts of fertiliser and pesticide use: Overview and insights from trends and policies across selected OECD countries", https://dx.doi.org/10.1787/63942249-en.

## Agricultural support system (Sub-dimension 14.3)

The third sub-dimension assesses the policies, instruments and organisation of agricultural support systems. The way in which economies provide support to farmers is arguably as important as the total level of that support. In that respect, this sub-dimension analyses the large portfolio of measures available to governments.

As Table 17.4 shows the average score for the WB6 economies in this sub-dimension is 2.7, which suggests limited progress. Montenegro and Serbia, the two economies that are already in the EU negotiation process, are the most advanced in the region. In contrast, Bosnia and Herzegovina and Kosovo are the only two economies whose IPARD support schemes are still not accredited and who therefore score the lowest.

### Table 17.4. Scores for Sub-dimension 14.3: Agricultural support system

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 14.3: Agricultural support system | Agricultural policy framework | 3.0 | 3.0 | 2.5 | 3.1 | 3.5 | 3.5 | 3.1 |
| | Domestic producer support | 3.0 | 2.0 | 2.0 | 2.2 | 3.5 | 3.0 | 2.6 |
| | Agricultural trade policy | 2.5 | 2.0 | 2.0 | 3.0 | 4.0 | 3.0 | 2.8 |
| | Agricultural tax regime | 2.5 | 1.5 | 2.0 | 1.4 | 3.5 | 3.0 | 2.3 |
| | Sanitary and phytosanitary measures | 3.0 | 2.0 | 2.0 | 1.4 | 3.0 | 4.0 | 2.6 |
| **Sub-dimension average score** | | 2.8 | 2.1 | 2.1 | 2.2 | 3.5 | 3.3 | 2.7 |

### *Agriculture policy frameworks are fairly well harmonised with EU policies*

The region's agriculture support policies are based on national strategies and programmes which are harmonised overall with the EU Common Agricultural Policy (CAP) and the seven-year period for its implementation. These documents outline the strategic interventions needed to develop the agriculture sector and rural areas so they can meet the challenges of the EU single market requirements. The planning processes in all six economies involve long consultation exercises and discussions using participatory mechanisms so that all types of stakeholders can help to define the measures. All of the strategies include performance indicators (such as real economic growth in the sector, increased labour productivity in agriculture and processing, full compliance of formal agriculture holdings with EU standards, increased average farm sizes, increased export to import ratios, and the creation of new jobs). However, monitoring and evaluation mechanisms are limited. The agriculture support policy framework mainly consists of IPARD and domestic support measures.

Even though it has not yet started the EU negotiation process, North Macedonia's agriculture policy framework is the best organised of the six economies. Its support system is both functional and in line with the procedures and support system envisaged in the CAP. Albania, Montenegro, North Macedonia and Serbia implement IPARD measures through an accredited payment agency. Bosnia and Herzegovina and Kosovo still lack the administration mechanisms that would make them eligible for IPARD funding.

### *Domestic producer support instruments are in line with IPARD, but the criteria are not harmonised*

All the economies provide direct payments to farmers. They are mainly based on land area, head of livestock and agricultural products sold and are the main income support instruments for agricultural producers. The support is based on income subsidies and non-production criteria. These income supplements largely determine the profitability of agriculture in most sub-sectors and represent a major element supporting the choice of agriculture as a profession.

Albania's domestic support instruments are aligned with IPARD support and funding measures and it has made substantial progress in natural disaster mitigation and preventative measures. Although no measures similar to the CAP agri-environmental indicators are in place yet, draft measures are being formulated. Domestic support to agriculture in Kosovo remains underfunded, reaching EUR 49.6 million in 2019, including direct payments and investments in rural development. While Kosovo's Ministry of Agriculture, Forestry and Rural Development (MAFRD) continued to subsidise farmers through direct crop payments based on the area cultivated, it has not introduced any cross-compliance measures.

Besides the fact that the criteria for domestic support measures are much easier to meet than for IPARD, there has been little monitoring to evaluate cross-compliance.

### *Trade policies follow EU principles, but tariff and non-tariff barriers remain significant in some economies*

Agricultural trade is quite liberal as most economies in the region are World Trade Organization (WTO) members, or at least largely comply with its policies. Most of the economies apply some preferential tariffs on agricultural products originating from the EU, the Central European Free Trade Agreement (CEFTA), the European Free Trade Association (EFTA) and Turkey. The regulations on customs tariffs are adopted on an annual basis. In 2019, Kosovo increased its tariffs on goods originating from Bosnia and Herzegovina and Serbia to 100%. In April 2020, the tariffs were lifted and replaced by gradual trade reciprocity measures, which were subsequently abolished by the new Government of Kosovo in June 2020. Such tariffs seriously jeopardise the position of consumers in Kosovo and provoke retaliatory tariff and non-tariff barriers for the few Kosovo agricultural exporters trying to penetrate the regional market (Gap Institute, 2019[11]).[2]

Laws on common market organisations (CMOs) is still pending in all economies in the region, even though CMOs are designed to manage production and trade in order to ensure steady incomes for farmers and a continued supply for consumers. CMOs represent the main pillar of the Common Agriculture Policy (CAP) and its framework for market support measures. This is a requirement for full alignment with the European Union (EU) *acquis*.

### *Farmers enjoy a highly preferential agricultural tax regime*

The taxation system in all economies remains unified and applies few taxes to farmers. In most cases, value-added tax (VAT) for agriculture products is levied at a reduced rate. This reduction covers agricultural machinery and inputs such as seeds and seedlings. In Bosnia and Herzegovina the specific agricultural products attracting a reduced rate are decided at the entity level. Both entities can choose to defer their tax regime rates annually based on analysis by their finance and agriculture ministries.

Taxes on agriculture land are paid by the hectare. There are some exclusions for farms planted with permanent crops. For example, in Albania, orchards and vineyards are exempt from tax for the first five years after planting.[3]

### *Sanitary and phytosanitary frameworks partly comply with EU and international standards*

All assistance to the agri-food sector requires the right interventions both in terms of specific measures and the overall government approach. To modernise the agri-food sector and foster rural development, while preparing the sector for the increasingly challenging environment posed by modern value chains, food safety standards and climate change, government policies and spending need to provide the right incentives for farmers and rural entrepreneurs. The sector must also be managed in alignment with EU policies, which requires significant changes in public sector support for agriculture, forestry, food security

and rural development. Perhaps the greatest issue is that both food safety and veterinary services continue to face capacity limitations in technical support, training and policy.

Even though Albania is a member of a number of international organisations for plant and animal health and has functional national contact points for each organisation, it has not transferred a lot of know-how and has made little progress in bringing its national SPS framework in line with international guidelines. It has a food safety, phytosanitary and veterinary network reference laboratory, but the law does not require the accreditation of tests. Only a limited number of food safety tests are internationally certified, preventing the recognition of these procedures abroad. Phytosanitary tests are partly recognised and a process for their recognition by CEFTA members is ongoing.

Most of the WB6 economies lack a comprehensive veterinary disease monitoring and control system that is in line with EU legislation and the World Organisation for Animal Health requirements. North Macedonia has made the most progress in these areas, followed by Serbia. However, there is a lack of in-service training and education programmes for field veterinarians in all six economies.

To improve the collection and disposal of animal by-products, Kosovo has been granted EU funding for a new, fully equipped rendering plant. Despite having been built two years ago, the plant is still not operational. The MAFRD was obliged to launch a call for tenders and select a management company for the plant. Collection will only be able to start in 2021.

A phytosanitary information system (PIS) for plant health and plant protection products contributes to better communication, co-ordination, transparency and more efficient functioning of all stakeholders involved in the phytosanitary sector. PISs are in the early phases of development in all the economies. The greatest progress has been made in North Macedonia where the Macedonian Phytosanitary Directorate within the Ministry of Agriculture, Forestry and Water Economy has designed, developed and implemented PIS administration and controls for plant health and pesticides. Currently, an official control module is being developed to upgrade the import, export, re-export and transit activities by including additional data for further risk analysis and the preparation of reports.

### *The way forward for the agricultural support system*

- **Meet the preconditions for and increase capacity to facilitate IPARD funding**. As part of the harmonisation with the EU CAP, the economies need to make further efforts to accelerate the process of accreditation of new IPARD measures.
- **Adopt and implement common market organisation legislation** as part of the introduction of cross-compliance measures, especially among those economies that have not prepared them.
- **Continue to upgrade SPS systems in line with EU requirements**. Further efforts to implement integrated food control systems should be a priority. All the WB6 economies still need to establish functioning rendering plants for the disposal of animal by-products in order to complete their animal monitoring and control systems. In the phytosanitary sector, establishing and further strengthening of technical plant protection services is a priority for the implementation of pest monitoring and integrated pest management.
- **Speed up the process of establishing reference laboratories**. The economies need to increase the accreditation of laboratory methods used in hygiene, veterinary and phytosanitary controls. The reference laboratories will improve overall food safety and phytosanitary controls, increasing the competitiveness of the agriculture sector overall.
- **Strengthen institutional co-ordination and harmonise standards and criteria for support measures.** Harmonising the criteria used for IPARD and domestic support measures will help farmers transform the region's agriculture towards integration with the EU.

## Agricultural innovation system (Sub-dimension 14.4)

The agricultural innovation framework spans public, private and higher education institutions, along with extension services, and creates the underlying knowledge needed for innovation in products, processes, marketing and organisation. Agricultural innovation priorities range from crops, livestock and fisheries to sustainable resource use and climate change. This sub-dimension assesses how well the agricultural innovation framework, supported by international co-operation, is helping the development of new knowledge in agriculture.

As Table 17.5 shows, almost all economies in the region face the same challenges of underfinanced innovation projects and extension services of limited efficiency. The average score is 2.6, with North Macedonia the most advanced, followed by Serbia and Montenegro. The other three economies are at early stages of development in this area.

### Table 17.5. Scores for Sub-dimension 14.4: Agricultural innovation system

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 14.4: Agricultural innovation system | Agricultural research and development framework | 2.0 | 2.0 | 2.5 | 3.1 | 2.5 | 3.0 | 2.5 |
| | Agricultural extension services framework | 2.0 | 2.0 | 2.5 | 3.2 | 3.5 | 3.0 | 2.7 |
| **Sub-dimension average score** | | 2.0 | 2.0 | 2.5 | 3.2 | 3.0 | 3.0 | 2.6 |

### *Research and innovation policy is underfinanced and limited in all economies*

All the WB6 economies continue to neglect agricultural science and research. In a context of digitalisation and global market trends, agricultural innovation systems are essential to increasing competitiveness in world markets. Currently, all the economies have strategic documents covering innovation and the application of science. The strategies identify some key points regarding agricultural research and aim to increase the number of applied projects between research institutes and farmers, improving production technology and producers' competitiveness. Despite this, public spending on research and innovation was still below 1% of GDP in 2019, compared to 2.19% on average in the EU, even though in most of the economies they are prioritised as part of the agriculture budget.

Apart from the work of public institutes, none of the economies in the region have dynamic applied science and research fields. Research is largely dependent on donor-funded projects, while the national budget for such projects is extremely limited, which restricts projects to an ad hoc basis only.

Montenegro and Serbia have seen the greatest increase in agricultural research budgets over the last three years. In Montenegro 16% of research projects funded by the national budget were in the agriculture sector, while in Serbia support for agriculture research rose by 8%.[4]

Overall innovation, with a stress on sustainability, is a priority of the Smart Specialisation Strategy, a concept associated with European cohesion policy. Montenegro is the first non-EU country to have adopted a Smart Specialisation Strategy, in 2019 (S3.me, 2019[12]). The strategy hopes to see Montenegro recognised for, among other things, agricultural innovation and sustainability, preservation of tradition in rural areas, and the development of a food value chain for authentic Montenegrin products.

### *Agriculture extension services lack human and financial resources*

Extension services are the main source of information, education and training for the majority of producers in the WB region. They either are organised as agencies with a special mandate from the government or as part of the relevant ministry.

The national, state-owned extension services have a long tradition of support of agriculture in all the WB6 economies, except for Albania,[5] where extension services were only introduced in the mid 1990s.

At present, the public agricultural extension services are strongly focused on production techniques, and only partly able to cover farm management, markets and marketing, regional rural development and the promotion of producer organisations. Extension services should be further diversified to meet market demand and farmers' needs.

Extension services in all WB6 economies are provided free of charge or at low cost, but each advisor serves a significant number of farmers which limits the scope and quality of the services they can provide. Almost all extension service agencies in the region lack the human and financial capacities to improve their performance in the field. Only in Kosovo are extension services widely available and very competitive due to the number of donor-supported projects and high awareness among farmers of their role. In 2019, 13 private companies were licensed to perform advisory activities. Approximately 300 agriculture and rural development advisors have been certified, and another 100 are expected to be certified by the end of 2020.

The introduction of private advisors into the extension network is a reform process in the WB6 economies. The smooth transformation of the existing state-owned system will take some effort and dedication. It will also require mechanisms for planning, standardisation, access, evaluation and continuing support for the development of services.

### *The way forward for the agricultural innovation system*

- **Increase funding for and implement national scientific research strategies.** Increase the investments in research, in line with market demand, and stimulate links between producers and researchers while supporting innovation projects in targeted agricultural sub-sectors.
- **The current extension services need to be further supported** by increasing advisors' know-how through continuing training.
- **Improve farmers' access to information, especially market information**. The current information systems should be reformed into functional and dynamic platforms for the collection and dissemination of information.

## Conclusion

Agriculture is a key pillar of the Western Balkan economy. The region's progress over the past two years has been notable in many areas, including improvements in rural infrastructure, irrigation, IPARD implementation and the regulation of natural resources. There is still room for improvements in education and training, innovation and research. All the WB6 economies are aligning their policies with those of the EU, but this process is very demanding and requires effort and dedication at all levels.

Given that they all share a similar background, it is not surprising that the problems and challenges the WB6 economies face are almost identical. Yet, although they could benefit from their shared experience, regional co-ordination and support mechanisms are lacking. The region would benefit from focusing on synergies and highlighting the most appropriate solutions in the process of harmonisation with the EU. The way forward for the Balkan economies will be to stabilise rural areas and provide a decent life for the rural population, which is only possible through sustainable and profitable agriculture. Agriculture remains the most labour-intensive sector in the region and investment in new technology, value-added production and the sustainable use of resources is the only way to improve rural living conditions.

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## Notes

[1] The 11 Central and Eastern European countries (CEEC) which have joined the European Union: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[2] The 100% tax does not resolve the non-tariff barriers faced by Kosovo businesses exporting to Serbia. Empirical studies show that these barriers can become greater obstacles than tariff barriers, which were annulled with the entry into force of CEFTA. The tariff may have significantly increased consumer prices of food, the main expenditure for Kosovar consumers. Taking this into consideration, maintaining this tax for a longer period may increase poverty (Gap Institute, 2019[11]).

[3] Article 23 of the Albania law no.9632 of 30.10.2006 On Local Taxes System.

[4] In 2020 the European Innovation Scoreboard ranked Serbia as a moderate innovator with an improvement in results of 13.3%. Almost 20% of all implemented research projects and success stories are in agriculture, focusing mainly on digitalisation, smart farming, modern technologies and sustainability (EC, 2020[29]).

[5] Albania now has five regional Agricultural Technology Transfer Centres with a mission of enabling the smooth transfer of agricultural technology according to the needs and regional priorities within their jurisdictions. The centres have 153 employees implementing an annual programme and offering training and educational material to farmers and agribusinesses.

# 18 Tourism policy (Dimension 15)

The Western Balkans is one of the fastest growing tourist regions in the world, with all six Western Balkan (WB6) economies seeing double-digit increases in tourist arrivals and overnight stays in recent years. The fast growth of tourist arrivals contributes to the growth of earnings, gross domestic product (GDP), exports and job creation, underlining the increasing importance of the sector for regional development. This chapter assesses the performance of the WB6 in developing competitive and sustainable tourism through an analysis of five tourism policy sub-dimensions. The first sub-dimension, governance structure and co-operation, explores the effectiveness of the institutional set up and the efficiency of co-operation among public and private stakeholders. The second sub-dimension, destination accessibility and tourism infrastructure, assesses the progress made in improving accessibility, accommodation capacity and quality assurance. The third sub-dimension, availability of a qualified workforce, examines how effectively economies address the needs of the tourism labour market through vocational education and training and higher education frameworks. The fourth sub-dimension, sustainable and competitive tourism, assesses the existence and efficiency of sustainable tourism policy frameworks to influence the development and operation of sustainable tourism. The fifth and final sub-dimension, tourism branding and marketing, assesses the effectiveness of tourism branding and marketing, including digital marketing.

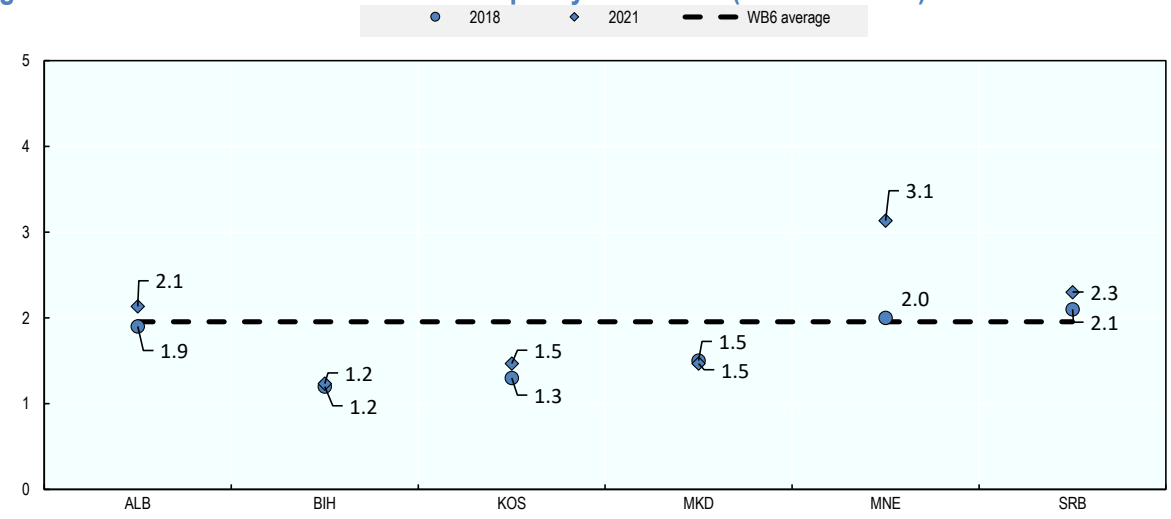
## Key findings

- **Four WB6 economies (Albania, Montenegro, North Macedonia and Serbia) have tourism development strategies and have committed to develop an efficient governance structure involving inter-ministerial co-ordination, vertical co-operation, and dialogue with private and other tourism stakeholders**. Albania, Montenegro and Serbia have made the most progress in this area.
- **Most WB6 economies (Albania, Kosovo, Montenegro and North Macedonia) have made some progress in developing a tourism data collection framework**. North Macedonia, Montenegro, and Bosnia and Herzegovina have started or plan to start preparing their first Tourism Satellite Account. The key challenge remains the reliability of the data collected.
- **All economies have made progress in boosting accommodation capacity and establishing an accommodation quality standards framework** based on international standards. All WB6 economies started categorising accommodation before this assessment, with the main progress in the last two years regarding the establishment of a register of accommodation facilities. Regular monitoring controls should be established.
- **Three WB6 economies (Albania, Kosovo and North Macedonia) have made sound progress in developing a vocational education and training (VET) framework. However, a qualified workforce is still lacking throughout the region, implying that the skills supply framework and higher education need improving**. Other key challenges are the lack of active engagement by private stakeholders in curricula development, weak monitoring and evaluation systems, and schools' insufficient budgets for equipment and staff training.
- **Comprehensive natural and cultural heritage enhancement frameworks for sustainable tourism development are still incipient**. The WB6 economies should focus on establishing effective inter-ministerial co-operation and introducing regular monitoring and evaluation of policy measures. Montenegro has made the most effort in this area.
- **Despite efforts to develop tourism investment policies in most economies, tourism innovation frameworks are not yet in place**. Challenges include monitoring and evaluation, investment procedures, urban planning, and awareness raising among private investors.
- **Despite significant progress, the competitiveness of tourism marketing and branding remains a challenge for most WB6 economies, but is needed to increase their visibility in international markets.** Digital marketing frameworks are incipient. Moreover, the absence of a common regional tourism brand and marketing activities lessens the visibility of the Western Balkans as an attractive tourist destination that offers a diversity of unique tourist experiences. Four economies (Albania, Montenegro, North Macedonia and Serbia) have established tourism brands. Only Montenegro, Serbia and Republika Srpska in Bosnia and Herzegovina have valid marketing strategies that have not yet expired. Marketing strategies are under development in all other economies.
- **The COVID-19 pandemic has hit the tourism sector very hard in all WB6 economies (most significantly in Montenegro), and has stopped the fast growth of tourism seen over the last decade.** The crisis revealed gaps in tourism development that will need to be addressed in the future. The main gaps and challenges in all WB6 economies are similar, therefore establishing regional co-operation to address these challenges could help each WB6 economy to overcome them more efficiently.

## Comparison with the 2018 assessment

Montenegro, where tourism contributes much more to GDP and employment than in the other economies, has the most developed tourism policy framework, followed by Serbia and Albania (Figure 18.1). Bosnia and Herzegovina, Kosovo and North Macedonia still have room to improve their tourism policy frameworks.

### Figure 18.1. Overall scores for the tourism policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition of new sub-dimensions and relevant qualitative indicators, and removal of some sub-dimensions and qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

The previous Competitiveness Outlook (CO) in 2018 made a number of recommendations for the WB6 economies to improve the tourism policy framework (Table 18.1) (OECD, 2018[1]). Progress in most issues has been moderate, with key challenges remaining including monitoring and evaluation of implemented policy measures and more efficient inter-ministerial co-operation to enhance cultural and natural heritage in tourism.

## Table 18.1. Implementation of CO 2018 policy recommendations: Tourism policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **CO 2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| Systematically implement a whole-of-government approach to tourism | • Specific tourism-related strategies/programmes were adopted in Albania, Montenegro, North Macedonia and Serbia.<br>• Tourism was included in other domestic strategies in Albania, Montenegro and Serbia.<br>• Regular co-operation among public officials in the ministries is formally established in all WB6 economies, except North Macedonia. | Moderate |
| Forge stronger links between natural and cultural resource strategies and tourism | • Links between natural and cultural resource strategies and tourism are formally established in all WB6 economies, except North Macedonia.<br>• However, the implementation of policy measures and actual co-operation among relevant ministries is still weak in all WB6 economies except Montenegro, which has developed a comprehensive natural and cultural enhancement framework. | Limited |
| Bring tourism infrastructure in line with internationally recognised standards | • Consistent accommodation quality standard frameworks based on international standards have been developed in all WB6 economies.<br>• Challenges remain regarding tourism monitoring and inspections due to a lack of human and financial resources in all WB6 economies. | Moderate |
| Further professionalise the tourism workforce and address the significant skills gaps in the sector | • Progress has been achieved, especially in improving the tourism VET framework, in all economies except in Bosnia and Herzegovina.<br>• However, higher education and skills supply frameworks still need to be improved in all WB6 economies. | Moderate |
| Develop tourism data and statistics in line with international standards and good practice | • North Macedonia has started preparing its first Tourism Satellite Account (TSA). Bosnia and Herzegovina and Montenegro are planning to implement a TSA in 2021.<br>• Serbia has launched an e-tourist information system. Montenegro is planning to implement e-tourism electronic guest registration in 2021. A platform for electronic data collection is under development in Kosovo. | Moderate |
| Improve co-ordination among institutions promoting tourism at central, regional and local levels | • All WB6 economies have established a public-private dialogue and co-operation framework at the economy level, which includes vertical co-operation with the local level.<br>• All WB6 economies have established formal bodies at the economy level that include representatives of the private sector, non-governmental organisations (NGOs), educational institutions and municipalities, in addition to relevant ministries.<br>• Except for North Macedonia, regular meetings of public and private tourism stakeholders have been undertaken since the previous assessment. | Moderate |
| Put in place independent monitoring and evaluation of tourism-related action plans and strategies | • Albania has started monitoring its tourism strategy, with the first progress report prepared for 2019.<br>• Montenegro began monitoring its tourism strategy in 2019. However, more measurable indicators should be included in the monitoring. | Limited |

## Introduction

Driven by a relatively strong global economy, a growing middle class in emerging economies, technological advances, new business models, affordable travel costs and visa facilitation, international tourist arrivals grew by 4% globally in 2019 compared to 2018, to reach USD 1.481 billion in total international receipts.[1] At the same time, export earnings generated by tourism grew to USD 1.7 trillion (UNWTO, 2021[2]). This makes the sector a true global force for economic growth and development, driving the creation of more and better jobs and serving as a catalyst for innovation and entrepreneurship (UNWTO, 2019[3]).

As emerging tourist destinations, the WB6 economies have all reported double-digit increases in tourist arrivals and overnight stays in recent years, making the region one of the fastest growing in the world. The fast growth of tourist arrivals creates jobs and contributes to the growth of earnings and consequently the

growth of travel and tourism as a share of GDP (Figure 18.5) and exports (Figure 18.6). This shows the growing importance of tourism for overall economic development in WB6 economies.

The containment measures adopted to prevent the spread of the COVID-19 virus have had a significant impact on the tourism industry in the Western Balkans. The number of tourist arrivals decreased in 2020 by around two-thirds compared to 2019,[2] which negatively affected jobs in the tourism industry (OECD, 2020[4]). WB6 governments need to ensure that they strengthen their tourism policy frameworks to effectively support the recovery of the tourism industry – especially small and medium sized-enterprises (SMEs) – and take the opportunity of increased demand for outdoor and nature adventure tourism products, for which the whole region has enormous potential.

This chapter considers the links between tourism and other policies, including potential trade-offs and complementarities. The following chapters of the Competitiveness Outlook are also particularly relevant for tourism:

- **Chapter 4. Investment policy and promotion** is important as public and private investments play an important role in promoting the attractiveness and competitiveness of a destination. Closer co-operation between the government bodies responsible for tourism and investment policies and promotion could allow them to better target opportunities, boost the level and quality of investment in the sector, and together address the obstacles that hinder investments in tourism.
- **Chapter 6. Access to finance** is important for ensuring sufficient investment in high-quality tourist products and infrastructure, especially for micro, small and medium sized enterprises (MSMEs), which are predominant in the tourism sector.
- **Chapter 10. Education policy** is relevant as the ability to provide enough qualified workers is essential for sustaining and enhancing competitiveness in tourism. To fully address labour and skills shortages, the government bodies in charge of tourism and education could co-operate to adopt and implement policy measures that will address tourism specific needs.
- **Chapter 11. Employment policy** and efficient labour market governance are key to ensure high-quality jobs and develop a flexible, inclusive and proactive labour market in tourism.
- **Chapter 12. Science, technology and innovation** are key to ensure competitiveness in tourism. Tourism is recognised as a sector where several innovations can be tested and implemented (e.g. renewable resources, energy efficiency solutions, green mobility solutions, single-use plastic reduction). This requires the inclusion of tourism in the overall science, technology and innovation strategy.
- **Chapter 13. Digital society** is important as tourism is one of the largest users of information and communication technology (ICT) and cannot survive without Internet access, broadband penetration and the use of e-commerce.
- **Chapter 14. Transport policy** that ensures capacity, efficiency and connectivity is vital for improving the accessibility of destinations and the movement of visitors within the region. It is therefore important that economy-level transport strategies consider investments in transport infrastructure that are vital for tourism development, especially in remote areas.
- **Chapter 16. Environment policy** is key to protect natural assets, control and manage the environmental impacts of tourism, and protect the region's competitive advantage. Environmental and tourism policies need to be aligned to promote sustainable growth and support domestic efforts to reconcile resource use and waste targets with tourism growth objectives.
- **Chapter 17. Agriculture policy** is key as the agro-food sector is a major supplier and one of the most important parts of the tourism value chain. It provides the basis for the creation of local and authentic culinary tourist products and experiences, which is one of the fastest growing tourism market segments.

## Assessment framework

### *Structure*

This chapter examines tourism policy frameworks in the WB6 by assessing five broad sub-dimensions:

1. **Sub-dimension 15.1: Governance and co-operation** focuses on the efficiency of economies' governance structures and institutional setups at economy and destination levels for managing the development and implementation of tourism strategies. It assesses inter-ministerial co-operation, government co-operation with municipalities and dialogue with non-governmental tourism stakeholders. It also assesses institutional support for the establishment of a comprehensive tourism data collection and sharing system.
2. **Sub-dimension 15.2: Destination accessibility and tourist infrastructure** focuses on how the economies facilitate destination accessibility and the flow of tourists across the region in terms of visa requirement policies and the implementation of other measures to ease border crossings. It also focuses on how efficiently the economies facilitate the quality of tourist accommodation based on international standards. The quality of information for tourists about destinations, accommodation and experiences is also assessed.
3. **Sub-dimension 15.3: Availability of a qualified workforce** focuses on how efficiently the economies bridge skills gaps in the tourism sector through established VET and higher education frameworks. It focuses on how well equipped schools are to deliver knowledge to their students, the effectiveness of the quality assurance framework in education and training, and to what extent private tourism stakeholders are involved in human resource development.
4. **Sub-dimension 15.4: Sustainable and competitive tourism** focuses on how efficiently the economies conserve, manage and use natural and cultural resources as one of the key drivers of tourism development and competitiveness. It also explores how efficiently tourism policy frameworks, which influence both tourism development and the operation of the tourism sector, make tourism more environmentally, socially and economically sustainable. Finally, it assesses how economies facilitate the investments and innovation in tourism that are vital for sustaining the competitiveness of the sector.
5. **Sub-dimension 15.5: Tourism branding and marketing** focuses on the effectiveness of tourism branding and marketing, how efficiently the economies facilitate the use of digital tools in tourism marketing, and the capacity of tourist stakeholders to use digital tools efficiently.

Figure 18.2 shows how the sub-dimensions and their indicators make up the tourism policy dimension assessment framework. The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as interviews undertaken with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information on the methodology see the Assessment methodology and process chapter.

## Figure 18.2. Tourism policy dimension assessment framework

**Tourism dimension**

**Outcome indicators:**
1. Growth of international tourist arrivals
2. Growth of overnight stays
3. Tourism contribution to the gross domestic product
4. Contribution of travel and tourism to employment and exports

| Sub-dimension 15.1 Governance and co-operation | Sub-dimension 15.2 Destination accessibility and tourism infrastructure | Sub-dimension 15.3 Availability of a qualified workforce | Sub-dimension 15.4 Sustainable and competitive tourism | Sub-dimension 15.5 Tourism branding and marketing |
|---|---|---|---|---|
| **Qualitative indicators**<br>1. Tourism governance and institutional set up<br>2. Partnerships with stakeholders<br>3. Vertical co-operation<br>4. Data collection and interpretation | **Qualitative indicators**<br>5. Connectivity framework<br>6. Accommodation capacity and quality of tourism offer<br>7. Information availability | **Qualitative indicators**<br>8. Skills supply framework<br>9. VET framework for tourism<br>10. Higher education framework for tourism | **Qualitative indicators**<br>11. Natural and cultural heritage enhancement framework<br>12. Promotion of sustainable development and operations within the tourism sector<br>13. Tourism investment and innovation policy framework | **Qualitative indicators**<br>14. Tourism branding and marketing strategy<br>15. Digital tourism marketing framework |
| **Quantitative indicators**<br>1. Budget allocated for tourism<br>2. Number of staff working on tourism strategy implementation | **Quantitative indicators**<br>3. Number of economies on visa-required list<br>4. Costs of obtaining visa<br>5. Number of economies with existing travel facilitation agreements<br>6. Number of beds in hotels<br>7. Number of beds in private accommodation | **Quantitative indicators**<br>8. Quality of the tourism labour force<br>9. Number of students in VET programmes for tourism and hospitality<br>10. Number of students in higher education programmes for tourism and hospitality<br>11. Number of certified VET programmes | **Quantitative indicators**<br>12. Share of national protected areas (national parks and nature reserves)<br>13. Budget for tourism investments<br>14. Budget for innovations and new products | **Quantitative indicators**<br>15. Average staff per tourism office<br>16. Effectiveness of marketing and branding to attract tourists<br>17. Economy brand strategy rating<br>18. Budget allocated for tourism promotion |

The leaders of the WB6 endorsed the Common Regional Market (CRM) 2021-2024 Action Plan at the Berlin Process Summit held on 10 November 2020 in Sofia. The plan is made up of targeted actions in four key areas: 1) a regional trade area; 2) a regional investment area; 3) a regional digital area; and 4) a regional industrial and innovation area.

In the regional industrial and innovation area, the WB6 economies commit to closely transform the industrial sectors, shape the value chains they belong to, and prepare them for the realities of today and the challenges of tomorrow. The findings of the tourism policy dimension can help to inform implementation of actions under this component (Box 18.1, Box 18.5 and Box 18.6).

### *Key methodological changes to the assessment framework*

Since the CO 2018 assessment, some methodological changes have been made to the framework to emphasise issues that are gaining importance for sustaining and improving the competitiveness of tourism in the region.

Three new sub-dimensions have been created:

- **Governance and co-operation** covers some indicators of the CO 2018 sub-dimension tourism prioritisation and promotion, complemented by new indicators for measuring how efficiently tourism strategies are implemented.
- **Sustainable and competitive tourism** supplements the CO 2018 sub-dimension cultural and natural resources, with indicators focusing on the promotion of sustainable tourism development, and the existence and efficiency of tourism investment and innovation policies.
- **Tourism branding and marketing** contains some indicators of the CO 2018 sub-dimension tourism prioritisation and promotion, accompanied by new indicators for measuring the effectiveness of tourism branding and marketing and the readiness of the tourism sector for digitalisation.

## Tourism policy performance and context in the WB6

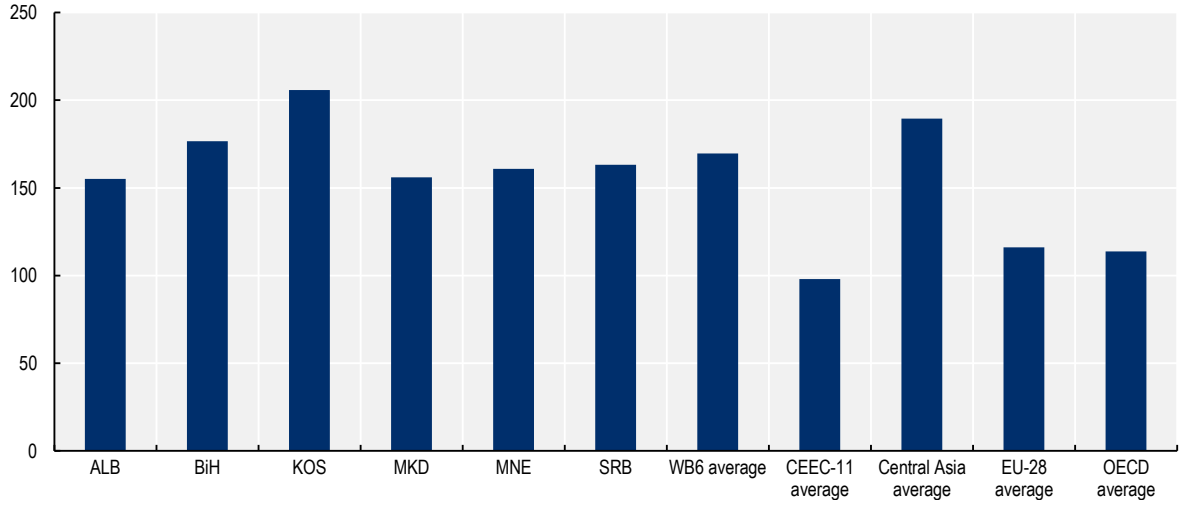
The Western Balkans is one of the world's fastest growing tourist regions. Its unique geographical position between the East and West, as well as its rich and diverse cultural heritage and pure nature that includes Europe's deepest canyons, glacial lakes and the last remaining virgin forests between the Danube River, Dinaric Alps and the Adriatic Sea, means that the Western Balkans is one of the Europe's most unique regions and can offer authentic nature adventures and cultural experiences to tourists. All WB6 economies have recognised tourism as an opportunity for economic development. By designing tourism policy frameworks they have provided a base for improving the competitiveness and visibility of their economies in the highly competitive tourism market. To consolidate the fragmented tourist offer and increase the visibility of the Western Balkans as a unique tourist destination, the economies have begun co-operating at the regional level through the development of joint and internationally competitive cultural and adventure tourist products – see Destination accessibility and tourism infrastructure (Sub-dimension 15.2).

Outcome indicators play a key role in examining the effects of policies and provide crucial information for policy makers to judge the effectiveness of existing policies and the need for new policies. The outcome indicators chosen for the tourism sub-dimension are designed to show the impact of tourism on the WB6 economies and its contribution to economic growth and job creation. They also show the importance of tourism in the WB6 economies in terms of its impact on overall development and progress compared to Central Asia,[3] another emerging tourist region, the European Union (EU), OECD and CEEC.[4]

In the last decade, tourist arrivals have grown significantly in the WB6 region (average annual growth rate 11.5% in the period 2010-2019), driven by the overall fast growth of international tourism and improvements in marketing. The region also became more connected due to the expansion of low-cost air carriers and the development of air route networks. The double-digit growth rates of international arrivals to the region in 2019 compared to 2015 was below the Central Asia average, except for Kosovo, but exceeded OECD, EU and CEEC averages (Figure 18.3).

## Figure 18.3. Growth of international tourist arrivals (2015-19)

WB economies, Central Asia, CEEC, EU and OECD. Index 2015=100




Note: The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

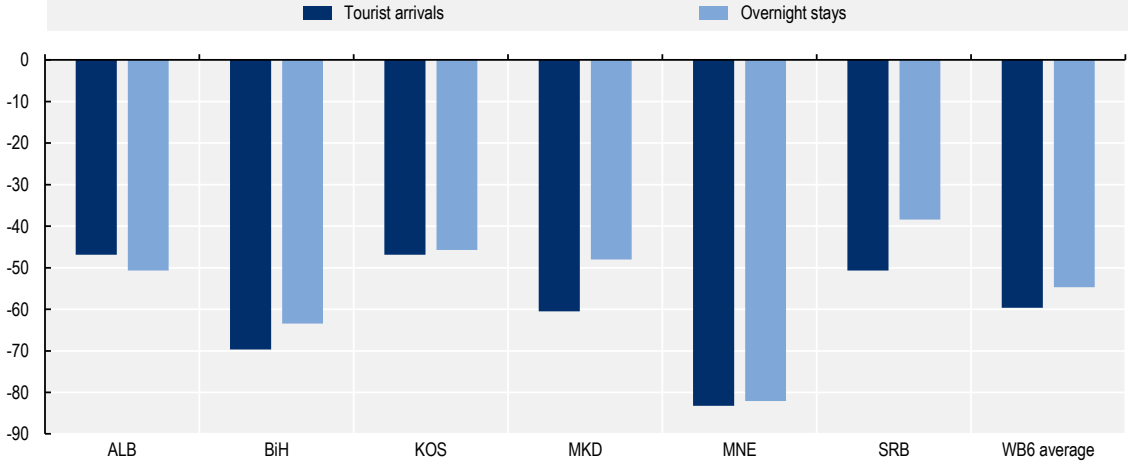
Source: (World Bank, 2021[5]), *International tourism, number of arrivals*, https://data.worldbank.org/indicator/ST.INT.ARVL; For Kosovo, (Kosovo Agency of Statistics, 2020[6]), *Hotel Statistics*, https://ask.rks-gov.net/media/5950/hoteleria-q4-2020.pdf.

StatLink https://doi.org/10.1787/888934255076

The COVID-19 crisis hit the tourism sector in the WB6 very hard and led to a significant drop in tourism growth in the region, with tourist arrivals decreasing by nearly 60% and overnight stays by 55% in 2020 compared to 2019. Montenegro faced the highest drop in the region (83.2% in tourist arrivals and 82.1% in overnight stays), followed by Bosnia and Herzegovina (nearly 70% in tourist arrivals and 63.4% in overnight stays). The fall in tourist arrivals and overnight stays in other economies was lower, but still significant (Figure 18.4).

## Figure 18.4. Tourist arrivals and overnight stays in the Western Balkans (2019-2020)

% change



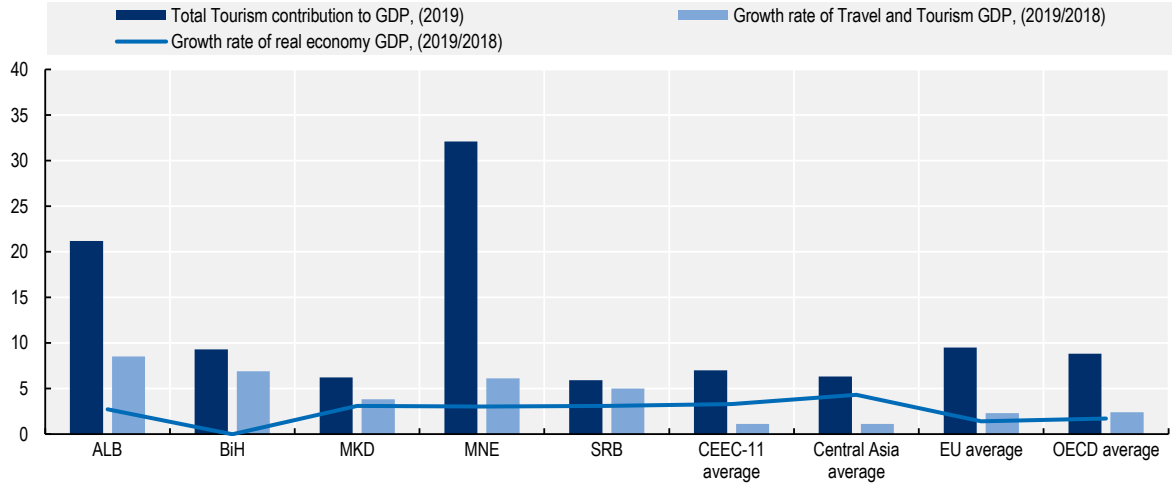

Source: Statistical Offices of WB6 economies.

StatLink https://doi.org/10.1787/888934255095

The fast growth of tourist arrivals before the COVID-19 crisis has contributed to a rise in earnings and consequently to the growth of travel and tourism as a share of GDP in WB economies. Given their location on the Adriatic Sea, the tourism sector in Montenegro and Albania contributes much more to GDP than in

the other WB economies, representing about one-third of GDP in Montenegro and one-fifth in Albania (Figure 18.5). In other WB economies, the contribution of tourism to GDP is below 10%, similar to Central Asia, EU, OECD and CEEC averages. Nevertheless, compared to 2018 the growth of tourism GDP was higher than overall GDP growth in all assessed economies, and much higher than Central Asia, EU, OECD and CEEC averages (Figure 18.5).

## Figure 18.5. Travel and tourism and GDP growth in the Western Balkans (2018-19)



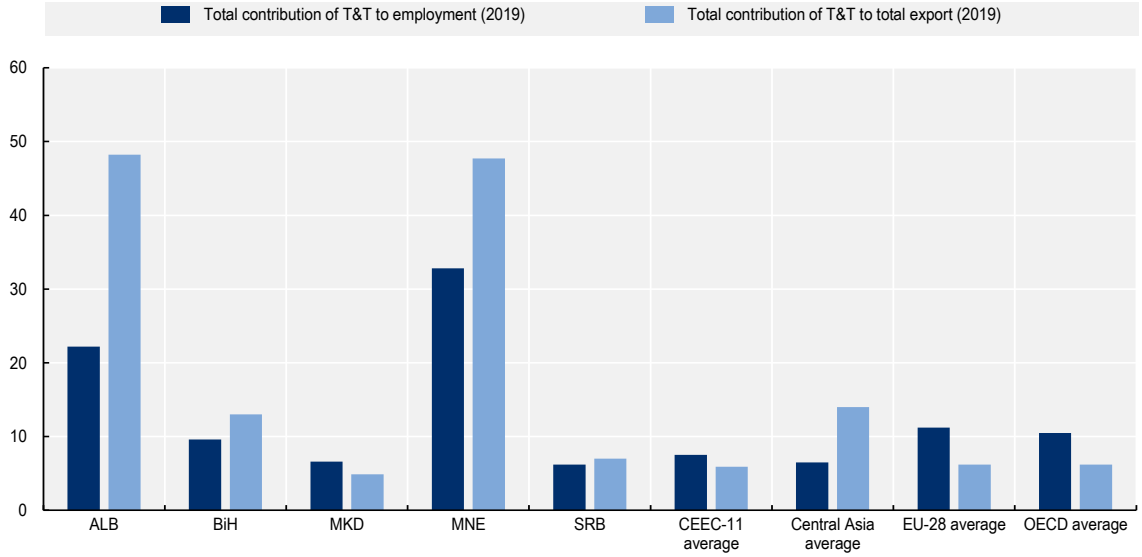

Note: EU includes all EU Member States in 2018-2019 period. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: (WTTC, 2020[7]), *Economic Impact Reports*, https://wttc.org/Research/Economic-Impact; For Kosovo, (Kosovo Agency of Statistics, 2020[6]), *Hotel Statistics*, https://ask.rks-gov.net/media/5950/hoteleria-q4-2020.pdf.

StatLink https://doi.org/10.1787/888934255114

The COVID-19 pandemic has lessened the contribution of travel and tourism to GDP across the region,[5] and will have severe economic and social consequences for all WB6 economies in terms of total exports and employment, particularly in Albania and Montenegro, where tourism contributes significantly to total exports and employment (OECD, 2021[8]). The contribution of tourism to total exports and employment in other WB6 economies is much lower. The contribution of travel and tourism to exports in the WB6 (except Albania and Montenegro) is lower than the Central Asia average, but higher than EU, OECD and CEEC averages (except for North Macedonia). The contribution of tourism to total employment in the WB6 economies is nearly the same as in Central Asia – except for Bosnia and Herzegovina where the contribution of tourism to total employment is higher – but below EU, OECD and CEEC averages (Figure 18.6).

## Figure 18.6. Contribution of travel and tourism to employment and exports (2019)

% contribution




Note: Data for Kosovo are not available. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

Source: (WTTC, 2020[7]), *Economic Impact Reports*, https://wttc.org/Research/Economic-Impact.

StatLink https://doi.org/10.1787/888934255133

The growth of tourism GDP in the WB6 before the COVID-19 crisis showed the increasing importance of this sector for the overall economic development of the region. Nevertheless, the pandemic has revealed the main gaps in tourism development, in particular the government and industry's preparedness and response capacity, the concentration of tourism in a small number of destinations, high seasonality, the low quality of tourist offers, and the lack of sustainable approaches to development.[6] Considering the significant similarities among opportunities and challenges for tourism sector development in each WB6 economy, strengthening regional co-operation to address the common challenges and opportunities may help each economy overcome gaps at the economy level more efficiently. Moreover, established regional co-operation is key for increasing the visibility of the Western Balkan as an attractive tourist destination and an opportunity to capture a more significant share of international tourism.

## Governance and co-operation (Sub-dimension 15.1)

An economy-level tourism strategy is a fundamental requirement to foster long-term growth in the tourism sector. It enables policy makers to assess the areas of greatest potential and capture economic and social benefits from tourism. The successful design and implementation of tourism policy requires an efficient governance structure and institutional set up at the economy and destination level. The cross-cutting nature of the sector requires a sophisticated set of horizontal co-ordination measures across government departments and agencies to ensure that all parts of government with either an interest in or influence over tourism can be fully involved in its planning and development (OECD, 2020[4]). Destination management organisations often play a leading role in developing tourism, working in collaboration with regional and local government, and increasingly have other related roles, such as inward investment promotion, and co-ordinating the management of all elements that make up a destination (OECD, 2020[4]). Moreover, there needs to be active co-operation and dialogue with the private sector and NGOs, and active involvement of local communities in the overall governance structure to ensure coherent tourism management in an economy (UNWTO, 2013[9]).

This section aims to assess the efficiency of tourism governance co-operation at the economy and destination level, and the progress made on developing a tourism data collection and sharing framework (Table 18.2).

Overall, Albania, Montenegro and Serbia have managed to establish the most effective governance and co-operation frameworks at economy and local levels (scoring from 2.4 to 3.8), while the frameworks in Bosnia and Herzegovina, Kosovo and North Macedonia still need significant improvement, especially in tourism governance and institutional set up and in vertical co-operation, where they score only between 1.0 and 1.5. Across all economies, the tourism data collection and sharing framework is the most advanced, reaching the highest average score overall (3.0) in this sub-dimension. However, the economies still need to work on this area intensively to provide consistent and reliable data for decision making.

**Table 18.2. Scores for Sub-dimension 15.1: Governance and co-operation**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 15.1: Governance and co-operation | Tourism governance and institutional set up | 2.0 | 1.0 | 1.0 | 1.0 | 4.0 | 3.0 | 2.0 |
| | Partnership with stakeholders | 3.5 | 1.0 | 2.0 | 1.0 | 4.0 | 3.0 | 2.4 |
| | Vertical co-operation | 2.0 | 1.0 | 1.0 | 1.5 | 3.0 | 3.0 | 1.9 |
| | Data collection and interpretation | 2.0 | 2.0 | 3.5 | 3.5 | 4.0 | 3.0 | 3.0 |
| **Sub-dimension average score** | | 2.4 | 1.3 | 1.9 | 1.8 | 3.8 | 3.0 | 2.3 |

### *Tourism governance still needs improving to implement policy measures effectively*

Clear tourism policies, effectively implemented by governance structures that embrace a range of stakeholder interests, are essential for sustainable tourism development and competitiveness. Albania, Montenegro, Serbia and Republika Srpska (RS) in Bosnia and Herzegovina[7] have committed to developing an efficient governance structure with well-established inter-ministerial co-ordination and the active involvement of private stakeholders, municipalities, educational institutions and NGOs in the planning and development of tourism. The tourism strategies in these economies and entity clearly define policy measures and actions to be implemented (by ministries responsible for tourism and other relevant ministries), as well as budget allocation and the timeframe for implementation. A multi-governmental approach that respects the cross-cutting nature of the tourism sector is confirmed by the adoption of specific tourism-related strategies/programmes and the inclusion of tourism in other strategies (Table 18.3). Regular co-operation among public officials in the ministries is formally established through bodies such as tourism councils and working groups (Table 18.4). In Kosovo, North Macedonia and the Federation of Bosnia and Herzegovina (FBiH), tourism governance is still weak. In North Macedonia, this is reflected in the fact that few policy measures defined in the tourism development strategy have been implemented. In the FBiH, a draft Tourism Strategy for 2008-2018 was prepared but never adopted, and the FBiH Law on Tourism was cancelled in 2014 and a new one has not yet been adopted. The tourism policy framework in Kosovo is in the early stages of development and the Tourism Development Strategy is currently being developed.

## Table 18.3. Tourism strategies and tourism-related strategic documents in WB6 economies

| Economy | Tourism strategies and tourism-related strategic documents | Key focus area |
|---|---|---|
| **ALB** | **Strategy for the Sustainable Development of Tourism 2019-2023** | **Overall tourism development** |
| | General National Territorial Plan 2015-2030 | Sustainable tourism based on natural resources |
| | Integrated Cross-Sectoral Plan for the Coast 2015-2030 | Coastline and urban tourism |
| | Sectorial Strategy of Transport and Action Plan 2016-2020 | Connectivity and accessibility |
| | Cross-Cutting Strategy Digital Agenda of Albania 2015-2020 | Development of connected tourism/e-tourism |
| | Cross-Sectoral Strategy for Rural and Agricultural Development 2014-2020 | Development of rural tourism and tourism related to culture, nature, mountains, etc. |
| | National Strategy for Culture 2019-2025 | Management of cultural heritage and cultural tourism |
| | Policy Document on Biodiversity and Law on Protected Areas | Management of natural heritage and nature adventure tourism |
| **BIH** | Tourism strategy is under jurisdiction of the entities | |
| | Strategy of Cultural Policy in Bosnia and Herzegovina (adopted in 2008) | Includes cultural tourism development |
| | Biodiversity Strategy and Action Plan for 2015-20 (adopted in 2016) | Includes natural heritage and nature adventure tourism |
| | **FBiH: Tourism strategies at the cantonal level** | **Overall tourism development** |
| | **RS: Tourism Strategy for the period 2010-2020** | **Overall tourism development** |
| **KOS** | **Tourism Strategy is under development** | |
| | National Strategy for Cultural Heritage 2017-2020. | Management of cultural heritage and cultural tourism |
| | Strategy and Action Plan for Biodiversity 2011-2020 | Management of natural heritage and nature adventure tourism |
| **MNE** | **Tourism Development Strategy 2020** | **Overall tourism development** |
| | Rural Tourism Development Programme and Action Plan 2019-2021 | Measures for development of tourism in rural areas |
| | Cultural Tourism Development Programme and Action Plan 2019-2021 | Cultural tourism products |
| | Health Tourism Development Programme and Action Plan 2021-2023 | Includes sustainable component of tourism development |
| | National Strategy for Sustainable Development by 2030 | Sustainable and health tourism |
| | Smart Specialisation Strategy of Montenegro (adopted in 2019) | Tourism and culture tourism |
| | Cultural Heritage Development Strategy for 2020-2025 | Cultural tourism products |
| | National Strategy of Preservation and Sustainable Use of Cultural Heritage | Protection of cultural heritage |
| | National Biodiversity Strategy and Action Plan for 2016-2020 | Integrating and developing biodiversity protection measures in the tourism sector. |
| | Montenegro Development Directions 2018-2021 | Includes measures for tourism |
| | Montenegro Economic Reform Programme 2020-2022 | Includes measures for tourism |
| | Strategy of Regional Development 2014-2020 | Includes measures for tourism |
| **MKD** | **National Tourism Development Strategy 2016-2021** | **Overall tourism development** |
| | **Tourism Development Strategy 2016-2025** | **Overall tourism development** |
| **SRB** | **The Tourism Development Strategy of the Republic of Serbia for the Period 2016-2025** | **Overall tourism development** |
| | The Strategic Marketing Plan for Tourism of the Republic of Serbia until 2025 (adopted in 2021) | Tourism marketing |
| | Agriculture and Rural Development Strategy for 2014-2024 | Includes tourism in rural development |
| | Strategy of Sustainable Urban Development until 2030 | Includes sustainable component of tourism development |
| | Culture Development Strategy 2020-2029 | The impact of tourism on cultural heritage and natural resources, and rules for cultural and natural heritage protection from the negative impacts of tourism |

Note: In Bosnia and Herzegovina, FBiH = Federation of Bosnia and Herzegovina, RS = Republika Srpska.
Source: Ministries responsible for tourism in WB6 economies; Tourism C0 2021 qualitative questionnaire.

Despite these relevant strategies, representatives of WB6 economy ministries responsible for tourism, except those in Albania and Montenegro, claimed that there is still significant room to improve inter-ministerial co-operation. The lack of monitoring of implemented policy measures in terms of outputs and outcomes hinders a more realistic assessment of progress, and limits the ability to adapt decisions and policy measures to monitoring results. Only Albania and Montenegro have made progress in introducing regular monitoring of implemented policy measures since the last assessment.

### *Public-private co-operation and dialogue is formally established, but not monitored or evaluated*

The private sector is key to the development and co-ordination of tourism policy, and its involvement ensures that policies address the key challenges of the sector. Accordingly, an effective partnership and dialogue framework is one of the key factors for ensuring coherent tourism development.

All WB6 economies have established a public-private dialogue and co-operation framework at the economy level, which also includes vertical co-operation with the local level. With the exception of North Macedonia, all WB6 economies have established formal bodies at the economy level, which besides relevant ministries include representatives of the private sector, NGOs, educational institutions and municipalities (Table 18.4). The members of the councils or working groups meet at least twice a year to discuss the design and implementation of tourism strategies and other tourism related issues. However, a more detailed assessment of the effectiveness of public-private co-operation could not be provided due to the lack of monitoring and evaluation.

**Table 18.4. Formal bodies for co-operation and dialogue with non-government tourism stakeholders in WB6**

| Economy | Name of formal tourism body | Members/representatives of institutions |
|---|---|---|
| **ALB** | Private Sector Advisory Committee of Tourism (chaired by the Minister for Tourism) | Associations of enterprises; higher education institutions; chambers of commerce; tourist associations or NGOs operating in the field of tourism; international institutions/donors. |
| **BIH** | Tourism Working Group (established by the Ministry of Foreign Trade and Economic Relations) | Ministries responsible for tourism in the entities of FBiH and RS; Brčko District; Foreign Trade Chamber of BiH. |
| **KOS** | The Kosovo Tourism Council | Ministry of Trade and Industry; Ministry of Environment and Spatial Planning; Ministry of Education, Science and Technology; Ministry of Culture, Youth and Sports; Association of Municipalities; tourism experts; representatives of NGOs. |
| **MKD** | Working group for the development of the tourism strategy (chaired by senior tourism official) | Chamber of Commerce; the eight regions; municipalities; educational institutions; NGOs; other associations (e.g. the Mountaineering Association). |
| **MNE** | Tourism Council (chaired by the Prime Minister), Co-ordination body (chaired by the Minister of Sustainable Development and Tourism) | Relevant ministries; stakeholders from the private sector (e.g. Chamber of Commerce and their associations); local communities and NGOs. |
| **SRB** | National Council for Tourism Development (chaired by The Minister of Trade, Tourism and Telecommunications) | Tourism Organization of Serbia; Association of Travel Agencies (YUTA); Business Association of Hotel and Restaurant Industry (HORES); Association of Tourist Guides; Spa Associations of Serbia; Air Serbia; universities; Belgrade municipality. |

Source: Ministries responsible for tourism in WB6 economies; Tourism CO2021 qualitative questionnaire.

### *Municipalities need systematic government support to develop tourism effectively*

Regional and local governments often play both a strategic and a delivery role in relation to tourism, which requires them to understand the challenges of their tourism sector and put in place plans to address these

challenges and develop tourism. They may also be involved in domestic promotion, while overseas and economy-wide promotion is usually the responsibility of economy-level tourism organisations. The administration of tourism therefore needs to be co-ordinated vertically, taking into account the roles and activities of regional and local jurisdictions (OECD, 2020[4]).

Vertical co-operation is established in all WB6 economies, while destination management still needs to be strengthened in most economies. Municipalities in all the economies are formally involved in overall tourism governance. Local tourism development strategies (where adopted) are mainly aligned with economy-level tourism strategies. Implementation remains a challenge, mostly due to weak human and financial resources in the municipal governments, lack of investment in infrastructure and limited co-operation with private stakeholders. Moreover, destination management organisations, which should play a leading role in developing tourism, are only established and functioning well in Serbia and Republika Srpska.[8] On a positive note, recent donor projects in Bosnia and Herzegovina[9] have helped to improve public-private co-operation at the destination level and can serve as a good model for all other main tourist destinations in the economy. In Kosovo, while tourism governance and destination management are relatively weak, most municipalities have established departments for tourism development and adopted tourism development strategies.[10]

### *Data collection has improved, but data need to be more reliable*

Improving the reliability, accessibility and transparency of statistics is vital to guide tourism development. The provision and measurement of good quality tourism data requires the active involvement and co-ordination of key players.

Since the last assessment, most WB6 economies have made some progress in this area. All WB6 economies have tourism data collection and sharing frameworks formally in place, defined in laws on statistics. Informal co-operation among the relevant institutions for data collection is also established (e.g. ministries responsible for tourism, central banks, custom offices).

North Macedonia started preparing its first Tourism Satellite Account (TSA)[11] in 2019, and BiH and Montenegro are planning TSA implementation for 2021. In Serbia, a central information system for hospitality and tourism (e-tourists) started to operate in 2020 with the aim of consolidating all data on accommodation providers. Kosovo and Montenegro plan to establish the e-tourism electronic guest registration in 2021.

The findings of this assessment are also relevant for the WB6 economies' implementation of the Common Regional Market Action Plan, which includes a component on tourism data and statistics (Box 18.1).

#### Box 18.1. Tourism governance and co-operation in the Common Regional Market

The regional industrial and innovation area of the CRM 2021-24 Action Plan includes a component on tourism data and statistics (Priority 8.8). The following key findings of the CO2021 governance and co-operation sub-dimension, and in particular the tourism data collection and interpretation indicator, can inform the implementation of actions under this component:

- All WB6 economies have a tourism data collection and sharing framework formally in place, as defined in laws on statistics.
- North Macedonia has begun the preparation of the first Tourism Satellite Account, and BIH and Montenegro are planning TSA implementation for 2021.
- Serbia has established a central information system for hospitality and tourism (e-tourists) to enable the more accurate statistical monitoring of domestic and foreign tourists and to improve the reliability of collected data.

### *The way forward for governance and co-operation*

- **Revise tourism strategies and adapt strategic goals and policy measures to focus on more sustainable and resilient models of tourism development**. COVID-19 has changed tourist behaviour, preferences and patterns. For example there is now a greater demand for short haul travel domestically or to neighbouring economies; a preference for travelling by rail or car rather than aeroplane; people are staying in self-catering and private accommodation rather than hotels; are visiting coastal, regional and rural areas rather than cities; and are participating in walking, cycling and other outdoor activities rather than spending time in enclosed spaces (OECD, 2020[10]). Revised tourism strategies should also include crisis management to better address the recovery and to be better prepared for the next crises.
- **Further strengthen the governance structure at the central level by establishing efficient inter-ministerial co-operation**. This will help to harmonise tourism policy priorities with the priorities of other sectoral policies and strengthen the capacity of public officials for managing tourism development. In particular, North Macedonia should establish a formal government body to improve the effectiveness of inter-ministerial co-operation.
- **Establish regular monitoring and introduce the independent evaluation of implemented policy measures** to assess their effectiveness, and make adjustments accordingly. This would contribute to the more prompt response and adaptation of tourism policy to the current market situation. This is valid for all WB6 economies, except Montenegro and Serbia, which already have such measures. All WB6 economies should include relevant indicators of the effectiveness of public-private co-operation and dialogue in the overall monitoring model to provide a reliable basis for improvements.
- **Strengthen dialogue and co-operation with private sector stakeholders, educational institutions and NGOs at all levels of government.** Involve private sector stakeholders more actively in the process of decision making to better address their needs and to understand expected government support in the implementation of development projects. The current crisis has confirmed that co-ordinated actions across governments at all levels, as well as with the private sector, is essential for mitigating the impacts of the crisis on tourism. Organising events such as tourism forums as an open space for the exchange of views on tourism development could contribute to the more active involvement of a wider range of tourism stakeholders and enable the better understanding of commonly set goals and objectives. This would provide conditions for more co-ordinated action in the tourism sector and could contribute to awareness raising among private stakeholders of the benefits of co-operation and dialogue for businesses development. The Days of Slovenian Tourism initiative might serve as inspiration (Box 18.2).
- **Empower local communities and tourist destinations to manage tourism development** by establishing tourism destination management organisations (particularly in Albania, Kosovo, North Macedonia and FBiH), providing sufficient budgets, and implementing sound capacity building programmes for local tourist organisations (LTOs). This will help the faster, more efficient and sustainable development of competitive tourism products. Post-COVID-19 recovery requires well-functioning destination management that will be able to facilitate the development of new bookable tourist products from MSMEs, and their connections to inbound tour operators and other marketing channels (OECD, 2021[11]). Sufficient resources should be allocated to destinations and to SMEs in tourism so that they can develop new and adapt existing tourist products, build new tourist infrastructure, and implement digital marketing campaigns effectively.[12] The following funds should be used for these purposes: an EU package of EUR 385 million to support socio-economic recovery in the Western Balkans and ensure the survival in the short term, and recovery in the medium term, of businesses in the private sector; a European Investment Bank (EIB) support package of EUR 1.7 billion for additional loans for public sector investments, as well as credit for enterprises, to help safeguard jobs for those working in the region's SMEs (EC, 2021[12]).

- **Improve the tourism data collection and sharing framework to empower policy makers with reliable information for decision making.** The introduction of electronic data collection methods (e-questionnaires, web surveys, etc.) in all economies would improve the reliability of tourism data collected. Establishing a formal co-ordination body among relevant institutions would help to increase the quality of tourism data collection. In all economies, updating and expanding survey evidence (such as visitor perceptions, spending, room occupancy, revenue per room, and details by statistical region) would provide a better basis for decision making in tourism. Albania, Kosovo and Serbia should first consider introducing a TSA. Albania, Bosnia and Herzegovina, and North Macedonia should introduce electronic data collection, drawing on best practice examples from other economies in the region.

### Box 18.2. Annual gathering of tourism stakeholders: Days of Slovenian Tourism

Since 1997, the Days of Slovenian Tourism (DST) annual event has been organised to strengthen co-operation in the development and marketing of Slovenian tourism among major institutions active in tourism in Slovenia. This is in line with the basic principle of all Slovenian Tourism Development Strategies since 2002 that public-private partnerships for sustainable tourism development should be encouraged.

The DST is organised by the Ministry of Economic Development and Technology, the Hospitality and Catering Chamber, the Chamber of Crafts and Entrepreneurship, and the Slovenian Tourist Board. It gathers the whole tourism community in one place, with the tourist destination changing each year.

The central part of the DST is the annual **Slovenian Tourism Forum**, where current issues, trends in tourism and new projects are presented and discussed. This is also an open space for discussion on the next steps and future development of Slovenian tourism. Other important sessions include the **plenary session** where the main tourism achievements of the previous year are discussed and the highest achievements in tourism awarded (e.g. best innovations in tourism, best business model, best investments, best worker, best destination). The **Catering and Tourism Assembly also takes place during the DST, as do assemblies of several other tourist organisations**. There is an exhibition where new technologies for catering, hospitality and other tourism related sectors are presented.

Note: DST 2020 was organised virtually.
Source: (Slovenian Tourist Board, 2019[13]), *Days of Slovenian Tourism 2019: Programme of events*, https://www.slovenia.info/22st-slovenian-tourism-forum.

## Destination accessibility and tourism infrastructure (Sub-dimension 15.2)

For most foreign tourists, access to information is a basic requirement when making decisions about a destination, accommodation, and visits to tourist sites and attractions. The most important information for visitors when deciding where to go is the accessibility of a destination and the availability of high-quality accommodation. While accessibility influences the flow of tourists to and within the destination, and has a considerable impact on tourists' first impressions, the availability of consistent high-quality accommodation ensures tourists are satisfied and choose to return in the future.

This section aims to assess improvements in destination accessibility, the existence and effectiveness of accommodation quality standards and an investment facilitation framework, and the quality of tourists' access to information.

Overall, the connectivity framework can still be improved considerably throughout the region (average score 1.5). Although some progress has been made, there is still room for improvement in establishing a consistent quality assurance framework, especially in Kosovo, Bosnia and Herzegovina and

North Macedonia. Montenegro (4.0), followed by Kosovo and Serbia (3.0), have managed to establish the best tourist information system so far; however, the quality of the system can still be improved in all WB6 economies (Table 18.5).

**Table 18.5. Scores for Sub-dimension 15.2: Destination accessibility and tourist infrastructure**

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 15.2: Destination accessibility and tourist infrastructure | Connectivity framework | 2.0 | 0.5 | 0.5 | 1.0 | 3.0 | 2.0 | 1.5 |
| | Accommodation capacity and quality | 3.0 | 2.0 | 1.0 | 2.0 | 3.5 | 3.0 | 2.4 |
| | Information availability | 2.5 | 2.0 | 3.0 | 2.0 | 4.0 | 3.0 | 2.8 |
| **Sub-dimension average score** | | 2.5 | 1.5 | 1.5 | 1.7 | 3.5 | 2.7 | 2.2 |

### *Easing border crossings is a key challenge for improving destination connectivity*

Overall, limited progress has been made in improving destination accessibility in the WB6 economies since the last assessment. Although Albania, Montenegro and Serbia have further reduced visa requirements, the other economies have made no progress on this matter. Montenegro has made progress in easing border crossings with the adoption of special regimes for tourists in the high season. Albania introduced e-visa applications in 2020.

The accessibility of destinations remains one of the key challenges to further developing tourism in the region. The poor experience of many tourists, tour guides and operators at border crossings is recorded as the most pressing issue in regional tourism (Kennell J., 2019[14]) and includes extremely long waits at crossings with no explanation provided; unexpected closures of crossings, again with no warning or information available; language barriers involving tourist-facing staff; refusals to let suitably credentialed tourists or guides cross, with no clear explanation available or avenues for recourse; and in some cases a perception of corruption or other non-transparent procedures taking place at border crossings. This affects the launch of the regional, and internationally competitive, cultural and adventure tourism products developed as part of the Regional Cooperation Council's (RCC) Tourism Development and Promotion project, which could contribute to branding the region as a desirable tourist destination[13] (Box 18.3).

### Box 18.3. Regional cultural and adventure tourism: The RCC's Tourism Development and Promotion project

The RCC's Tourism Development and Promotion project works to consolidate the fragmented tourism offer in the WB6 economies through the creation of joint and internationally competitive tourism offers in cultural and adventure tourism. Such offers will be promoted globally and contribute to branding the region as a desirable tourist destination. Regional (three or more WB6 economies) tourism routes have been developed and are ready to launch on the market. These should attract more international tourists, lengthen their stay in the region, increase revenue and contribute to employment in the industry. However, COVID-19 has slowed down the launch of these products. Two products developed under this project are explored below.

The **Western Balkans Crossroads of Civilisations** was conceived with the aim of defining the framework for the development of an overarching shared regional umbrella identity. There are three main aims of this product: 1) to promote the rich and diverse cultural heritage of the WB6 region; 2) to spearhead the repositioning of the region in the international travel market; and 3) to support the development of high-quality services, products and essential tourism infrastructure at tourist destinations. The concept identified core points of historic intertwining to justify the selection of sites that communicate the heritage of the Western Balkans. The 40 sites and locations throughout the WB region have been identified and represent the starting point for creating tourism products and itineraries. Storytelling, a brand development strategy, a brand labelling system and a marketing strategy with two-year action plans have been prepared. These documents represent a solid base for the development of regional cultural tourism itineraries and marketing them internationally.

The idea of **the Balkan Monumental Trail (BMT)** is to explore and highlight hidden or forgotten monuments in the Western Balkans, with an emphasis on World War II heritage. Related to this, the RCC's Triple P Tourism Project aims to create tourism infrastructure (tourism route, signage, marketing tools) and a network of partnerships that will serve as conduit for tourists to effectively engage with these monuments. Furthermore, as many of these monuments are located in areas far from normal tourist paths, the creation of the Balkan Monumental Trail will bring economic stimulation to areas currently underserved by tourism traffic and keep tourists in the region for a longer period of time. This concept encompasses the historical and cultural significance of monumental sites, visual impressiveness, and architectural and artistic appeal.

**Via Dinarica**, a 2 000 km hiking mega trail running along the Dinaric Alps, was extended from Slovenia, Croatia and Bosnia and Herzegovina to Albania, Kosovo and Serbia in 2019.

Note: Promotional videos for these products have been prepared and are being promoted at several tourism fairs, such as ITB Berlin and ITB Shanghai. Videos are available at: https://www.youtube.com/watch?v=Hvvlg33TRYg; https://www.youtube.com/watch?v=B-L2CYOKE7I; and https://www.youtube.com/watch?v=sXtFzY9TrnQ.
Source: (RCC, 2020[15]), *Tourism Development and Promotion Project*, https://www.rcc.int/priority_areas/40/tourism-development-and-promotion; (RCC, 2019[16]) *Via Dinarica extends throughout Western Balkans: RCC developing a marketing strategy for the trail*, https://www.rcc.int/events/1331/via-dinarica-extends-throughout-western-balkans-rcc-developing-a-marketing-strategy-for-the-trail.

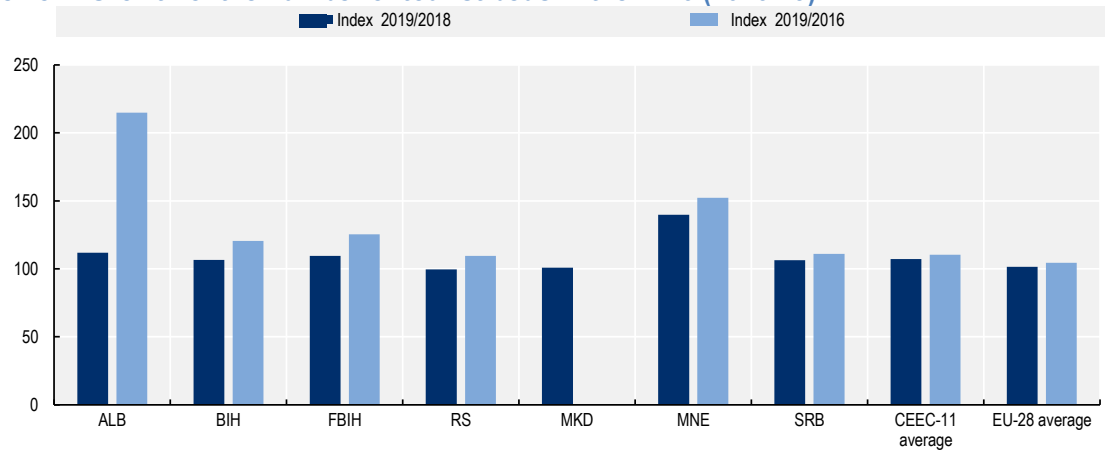
## *Accommodation quality has improved, but there is insufficient monitoring and control*

The availability and quality of accommodation facilities is one of the key success factors of the tourism sector. Therefore, it is important to design an accommodation facilitation framework that fosters the availability and quality improvements of all types of accommodation in an economy. Providing incentives for investment in private accommodation facilities, especially by MSMEs, can boost the availability of different types of high-quality accommodation adapted to the needs of tourists. An effective accommodation quality standards framework is necessary to sustain the consistent quality of

accommodation facilities. Accordingly, governments are looking to official certification schemes to denote the quality of facilities and services, and to support local businesses to improve their products and service quality (OECD, 2020[4]).

In the period 2016-19, five of the six economies (data for Kosovo are not available) increased the number of beds registered in private accommodation. Except for North Macedonia, the growth of the number of beds was higher than EU (4.5%) and CEEC (10.3%) averages. Albania recorded the highest growth (115%), followed by Montenegro (52.3%) and Bosnia and Herzegovina (20%) (Figure 18.7). The impact of COVID-19 on the availability and further growth of beds in the WB6 economies has not yet been monitored. However, it can be assumed that the pandemic has led to the reduction of accommodation facilities in WB6 economies.

## Figure 18.7. Growth of the number of tourist beds in the WB6 (2016-19)




Note: For North Macedonia only Index 2018/2019 is calculated as the data for 2016 and 2017 are not available. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: For EU and CEEC: (Eurostat, 2021[17]), *Number of establishments, bedrooms and bed-places (database)*, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=tour_cap_nat&lang=en; for Albania: (INSTAT, 2019[18]), *Tourism Survey "Accommodation establishments"*, http://www.instat.gov.al/media/7332/tourism-survey-accommodation-establishments-2019.pdf; for other economies data were provided by the statistical offices through the quantitative questionnaire.

StatLink https://doi.org/10.1787/888934255152

In most WB6 economies (Albania, Bosnia and Herzegovina, Montenegro and Serbia), several incentives (subsidies and/or loans) are available for private and public investors in high-quality accommodation. In North Macedonia and Kosovo, incentives are rather limited and there has been no major investment in accommodation.[14]

Despite the recent relatively high growth of accommodation capacity in the region (which might have fallen in 2020), there is still room for improvement. Except for Montenegro, all other economies have yet to establish regular monitoring and evaluation of policy measures to facilitate investment in accommodation facilities, which would ensure the most efficient allocation of limited financial resources. Moreover, the lack of clearly defined property rights (in Albania), lengthy spatial plan preparation procedures and weak co-operation with private investors in strategic planning at the destination level, along with other cross-cutting challenges in the business environment, hamper investment in accommodation and other tourist infrastructure in all WB6 economies.

Since the last assessment, all WB6 economies have been developing consistent accommodation quality standard frameworks based on international standards, have begun the process of categorising accommodation structures and have established a register of accommodation facilities. Every type of accommodation must be categorised in all economies except Kosovo. However, the development of a consistent accommodation quality standard framework is still in the early stages, and needs the further

engagement of responsible ministries to ensure that it is efficient. The key challenge in this regard is to empower responsible inspectorates with sufficient human and financial resources to monitor and control the categorisation of accommodation.

### *Tourism information systems require better management and co-ordination, and regular monitoring and evaluation*

The WB6 economies have established systems that provide information on the accommodation, attractiveness and services available at tourist destinations. Information is provided in multiple languages via websites, road signage and tourist information centres. Tourism information is reported to be updated regularly in all WB6 economies.

Montenegro, Serbia and Republika Srpska have a well-established system for co-ordinating tourist information between the central and local destination levels, while the other economies still need to strengthen co-ordination among different stakeholders to establish a comprehensive information database. The main area for improvement overall is establishing tourism information system frameworks that will include the regular monitoring and evaluation of tourist information. Currently, only Montenegro monitors the quality of tourism information by conducting regular visitor surveys, and even here an independent evaluation of the tourist information system is recommended to identify potential weaknesses not detected in the surveys. Providing real-time information to tourists is becoming a key way of gaining competitive advantages in tourism, and using digitalisation to improve tourist information systems should be considered in all WB6 economies.

### *The way forward for destination accessibility and tourist infrastructure*

- **Improve destination accessibility by further reducing visa requirements and easing border crossings.** WB6 economies could adopt special regimes to speed up border crossings, especially during peak seasons. Eliminating barriers identified in this area would ease tourism flows within the WB6 economies, helping to increase the attractiveness of the region in the global tourism market. A tourism ambassador programme for key tourist border crossing points could be a good solution as this would not require a systematic review of border arrangements and resourcing and is achievable in the short term (Box 18.4).
- **Establish the monitoring and evaluation of policy actions to facilitate investment in accommodation facilities.** Monitoring and evaluation should focus on how policy measures raise the overall quality of accommodation. The timely adaptation and upgrading of measures based on perceived weaknesses will improve the efficient use of scarce (available) financial resources.
- **Empower tourism inspectorates to effectively monitor and control the categorisation of accommodation facilities.** An effectively designed quality assurance framework will motivate private stakeholders to register and categorise their accommodation. Mechanisms used for this purpose include awareness-raising campaigns, training, and advice for private stakeholders on how to improve accommodation quality and why it is important.
- **Further strengthen the tourism information system by monitoring and evaluating the quality of tourist information** and ensuring that online sources of information are user friendly. Providing accurate and comprehensive information about destinations is key for attracting tourists. The benchmarking of online tourist information with competitors in terms of attractiveness, time spent to find comprehensive information and response time for the provision of requested information to tourists is one of the mechanisms to improve the effectiveness of tourist information systems. Regular surveys can also be implemented among visitors to better understand what information they perceive as the most important and what they might miss in this regard.

### Box 18.4. The tourism ambassador programme

Tourism ambassadors have frequently been used in temporary situations such as when a destination is hosting a large special event where an increase in visitor numbers is identified as a potential danger to the quality of the tourism experience. Tourism ambassadors are often specially trained volunteers or students on placement programmes who can be brought in and out of the workforce during spikes in tourist arrivals. They can also be employed on a more permanent basis, often through the creation of a specialist team within the police or a local authority. This is particularly effective when it is likely that tourists will be unfamiliar with the destination and/or suffer significant accessibility barriers due to language or culture.

In Korea and Thailand, where international tourist arrivals have risen dramatically over the last decade (in Korea by nearly 99% and in Thailand by 150% in the period 2010-2019), the decision was taken to create specialist tourist police. More locally, the Serbian and Chinese police forces have partnered to deploy Chinese police in Belgrade to support the growing numbers of Chinese tourists. Tourism ambassadors should be trained by the local destination management organisation or national tourist organisation and deployed in highly visible ways at key tourist border crossings during peak periods. They would work solely on one side of the border crossing and provide information and assistance to tourists. They should also be able to mediate in local languages in the case of disputes.

Source: (Kennell J., 2019[14]), *Western Balkans Tourism Policy Assessment and Recommendations*, https://rcc.int/download/docs/Ref%201_Tourism%20Policy%20Assessment%20with%20Recommendations.pdf/fb7c2c820b58ee138933888458ea4096.pdf.

## Availability of a qualified workforce (Sub-dimension 15.3)

Tourism is an important job creator, and the sector is highly dependent on quality human resources to develop and deliver a competitive tourism offering. However, finding and retaining the right calibre of staff remains a challenge in the sector, and is compounded in some economies by demographic trends and other influences that reduce the available talent pool. Tourism-related education and training are a principal area of government intervention in many economies to develop the required quantity and quality of skilled workers (OECD, 2020[4]). Due to COVID-19, skills shortages in the tourism sector may be exacerbated as many jobs have been lost and workers are moving to different sectors (OECD, 2020[10]). This means that there should be an even greater focus by governments to adopt policy measures to increase people's interest in studying and working in tourism.

This section assesses the existence and scope of human resource (HR) policy and action plans for tourism. It focuses on how efficiently the WB6 economies address skills gaps and training needs, and how the private sector is involved in the development of curricula and training programmes. Moreover, it assesses the overall capacity of schools to deliver high quality education and training, and the efficiency of the quality assurance and accreditation framework in terms of human and financial resources.

On average, the WB6 economies achieved a score of 1.8 for the availability of qualified workforce sub-dimension (Table 18.6), signifying that the availability of a qualified workforce could be improved considerably throughout the region. Although the WB6 economies have made moderate progress, especially in improving the VET framework in tourism, the higher education and skills supply framework still needs improvements. Montenegro has the highest average score (2.3) due to the high importance of tourism in the economy. Albania, Kosovo and North Macedonia have made significant progress regarding VET framework improvement, but no progress in the skills supply and higher education framework (Table 18.6).

### Table 18.6. Scores for Sub-dimension 15.3: Availability of a qualified workforce

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 15.3: Availability of a qualified workforce | Skills supply framework | 2.0 | 0.5 | 1.5 | 1.5 | 2.0 | 1.0 | 1.4 |
| | VET framework for tourism | 2.0 | 2.0 | 2.5 | 1.5 | 2.5 | 3.0 | 2.3 |
| | Higher education framework for tourism | 1.5 | 1.5 | 1.5 | 2.0 | 2.5 | 2.0 | 1.8 |
| **Sub-dimension average score** | | 1.8 | 1.3 | 1.8 | 1.7 | 2.3 | 2.0 | 1.8 |

### *Skills supply frameworks need improving to meet the needs of the tourism industry*

All WB6 economies have established strategic goals in their tourism development strategies to improve HR development. However, these ambitions to ensure favourable conditions in the tourism labour market are not always reflected in clear policy measures, or in implementation. The strategies mostly only give recommendations for improving the attractiveness of tourism studies among students, and there are no concrete policy measures.

In Montenegro, the skills supply framework is defined in the Strategy for Human Resources Development in the Tourism Sector, which provides an assessment of skills gaps and training needs, and defines a list of policy measures for human resources development and governance structure. In the other WB6 economies an assessment of skills gaps and training needs is only planned.

The key challenge for all WB6 economies is to encourage more young people into formal tourism education. The regional project, Towards regionally-based occupational standards (TO REGOS), implemented by the Education Reform Initiative of South Eastern Europe within the Western Balkans Alliance for Work-based Learning, aims to develop common qualifications standards in tourism in the Western Balkans. This represents an opportunity to improve the skills supply framework in the region (ERI SEE, 2018[19]).

This indicator is also relevant for the implementation of the Common Regional Market agenda, which includes a component on the development of common occupational standards for tourism (Box 18.5).

#### Box 18.5. Availability of a qualified workforce in the Common Regional Market

The regional industrial and innovation area of the CRM 2021-24 Action Plan includes a component on developing common occupational standards for tourism (Priority 8.8). The following key findings of the CO 2021 sub-dimension on availability of a qualified workforce, and in particular the skills supply indicator, can inform the implementation of actions under this component:

- All economies have established strategic goals for improving HR development in tourism development strategies. However, ambitions to strengthen overall HR policy frameworks are not always reflected in clear policy measures, nor in the implementation of these measures.
- In Montenegro, 34 occupational frameworks in the tourism sector have been updated and harmonised with market needs. In all other WB6 economies the assessment of skills gaps and training needs is only planned.

### *Most economies have made good progress in developing a VET tourism framework*

In many economies, tourism-related education and training is a principal area of government intervention to ensure that there is the required quantity of skilled workers to deliver and maintain high-quality service standards. Policy making for the VET framework for tourism is undertaken through the quality assurance and accreditation of VET programmes. An agency for quality assurance and accreditation should be established, staffed and funded, and operate with political support. It should also have links to both the

public and the private sector to ensure that education and training programmes are in line with the current and, more importantly, future needs of the tourism industry (OECD, 2020[4]).

Nearly all WB6 economies have a tourism VET framework in place (except for Bosnia and Herzegovina, although an overall state-level VET strategy is under development), and most have made sound progress since the last assessment. Albania, Kosovo, Montenegro, North Macedonia and Serbia have established quality assurance agencies that involve private sector stakeholders in the development of VET curricula, and practical training is mandatory within VET programmes. However, in general the monitoring and evaluation of the VET framework still needs improvement to enable it to better assess the efficiency of VET and the effectiveness of private-public co-operation in this area.[15] This is particularly relevant for Bosnia and Herzegovina, which has made less progress in this regard. It still lacks a formal accreditation process for VET programmes and private sector stakeholders are not actively involved (especially in the FBiH).

### *The higher education framework for tourism still needs considerable improvement*

Progress in the higher education framework for tourism has been rather limited since the last assessment. With the exception of Montenegro, where tourism is a high priority due to its contribution to overall economic performance, none of the other WB6 economies have a two-year higher education framework dedicated to tourism, although tourism studies are included in university higher education programmes.

### *The way forward for a qualified workforce*

- **Develop a tourism-specific human resource policy to address key challenges to the availability and quality of the workforce**. This is crucial for the provision of high-quality tourist products and offers, which is the core vision of all WB6 economies. The strategy should include a comprehensive skills gap assessment that covers the consequences of COVID-19; a programme for strengthening the tourism educational system in close co-operation with tourism industry representatives; policy actions to increase the attractiveness of tourism studies and professions, especially among the young population; and policy actions to increase the attractiveness of tourism education for lecturers.
- **Strengthen VET and higher education frameworks further to develop the required quantity and quality of skilled workers.** The more active involvement of the tourism industry in updating and developing new curricula will ensure that newly developed education and training programmes meet the needs of the tourism industry now and in the future. Mandating the involvement of businesses in the quality assurance process for qualification development could be a first step. Introducing the regular monitoring and evaluation of the VET framework will provide an accurate and more reliable assessment of its efficiency and enable the prompt correction of weak areas.
- **Provide sufficient budgets for new technologies and modern equipment in educational institutions, and training for teachers to keep up with technological advances in tourism.** The tourism industry is one the greatest users of modern ICT. Fast developments in this field demand constant re-learning for stakeholders to sustain their competitive position in the market. Training should therefore be provided for tourism sector stakeholders and for teachers. Schools also need the appropriate equipment to be able to deliver practical as well as theoretical knowledge and skills to students.
- **Strengthen regional co-operation in the VET and higher education frameworks for tourism.** The TO REGOS project is a good starting point for strengthening regional co-operation in HR development. The first occupational standard for hotel and restaurant technicians was developed in 2020 (ERI SEE, 2018[19]). Developing new regional VET programmes and training in tourism could be the next step.

## Sustainable and competitive tourism (Sub-dimension 15.4)

Sustainable tourism development considers current and future economic, social and environmental impacts, and addresses the needs of visitors, the industry, the environment and host communities (OECD, 2018[20]). Sustainable tourism can also raise awareness of cultural and environmental values, help finance the protection and management of protected areas, and increase their economic value and importance. Governments are increasingly developing policies that seek to maximise the economic, environmental and social benefits that tourism can bring, while reducing the pressures that arise when growth in this area is unplanned and unmanaged. Policy measures to address these concerns have become a priority, and governments have made efforts to deal effectively with overcrowding at popular destinations; spread economic and other benefits to areas that attract fewer visitors; develop new products to expand the season; and encourage increased productivity, better resource use and more stable employment (OECD, 2020[4]). The COVID-19 crisis is an opportunity to rethink tourism for the future. Governments need to consider the longer-term implications of the crisis, while capitalising on digitalisation, supporting the low carbon transition, and promoting the structural transformation needed to build a stronger, more sustainable and resilient tourism economy (OECD, 2021[21]).

A coherent and consistent policy framework is needed to provide an enabling environment for sustainable tourism investment. This involves co-ordinating actions across different policy areas, including tourism, environment and innovation, and across different levels of government to encourage sustainable and responsible business practices and to attract private investors to invest in a sustainable manner. Private investment is essential to deliver sustainable and inclusive tourism growth (OECD, 2018[20]).

This section assesses the existence and efficiency of sustainable tourism policy frameworks that influence both the development and the operation of the tourism sector to make it more sustainable.

Overall, Montenegro has managed to develop the most comprehensive framework for sustainable and competitive tourism development so far, having the highest average score in this sub-dimension (3.0), which is significantly above the other WB6 economies. The regional averages for natural and cultural enhancement framework, promotion of sustainable development and operations within the tourism sector, and tourism investment and innovation policy show similar levels of development (between 1.4 and 1.7), and indicate the need for further improvements. In particular, a tourism innovation framework should be a focus for economies in the future, as only Montenegro has made progress in this regard (Table 18.7).

### Table 18.7. Scores for Sub-dimension 15.4: Sustainable and competitive tourism

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 15.4: Sustainable and competitive tourism | Natural and cultural heritage enhancement framework | 1.5 | 1.5 | 2.0 | 1.0 | 3.0 | 1.0 | 1.7 |
| | Promotion of sustainable development and operations within the tourism sector | 1.0 | 1.0 | 1.0 | 0.5 | 3.0 | 2.0 | 1.4 |
| | Tourism investment and innovation policy framework | 1.5 | 1.5 | 0.5 | 1.0 | 3.0 | 2.0 | 1.6 |
| **Sub-dimension average score** | | 1.3 | 1.3 | 1.2 | 0.8 | 3.0 | 1.7 | 1.6 |

### *Natural and cultural enhancement frameworks need further development*

Natural and cultural heritage is one of the key drivers of tourism development. Destinations that can offer travellers access to a unique experience through nature, local culture and history have (and will increase) a competitive advantage over other destinations post COVID-19. Tourism policies and strategies should underline the importance of natural and cultural heritage to tourism and contain specific sections relating to their conservation and sustainable use as a key tourism resource. There needs to be a close working

relationship between tourism ministries and those responsible for the environment, natural resources and culture to enhance natural and cultural heritage in tourism.

Although all WB6 economies have made efforts since the last assessment,[16] comprehensive natural and cultural heritage enhancement frameworks in tourism are, except in Montenegro,[17] mainly in the early stages of development and need improving. Natural and cultural heritage are included in economy-level tourism strategies (Kosovo's will be included soon) as a source for the development of nature-related and thematic cultural tourism products. The economies have also adopted culture development strategies (except in North Macedonia where the strategy is being developed) that include policy measures for the protection, management and enhancement of cultural heritage in tourism. The protection, management and enhancement of natural heritage in tourism is mainly included in biodiversity strategies and laws on protected areas (Table 18.3).

There is reportedly co-operation among responsible ministries to co-ordinate policy measures and activities in the field of natural and cultural heritage. However, the effectiveness of such co-operation can only be assessed in Montenegro and Serbia,[18] as the other economies do not monitor or evaluate implemented policy measures and their impact on tourism development. Establishing effective inter-ministerial co-operation and introducing the regular monitoring and evaluation of implemented policy measures and actions in terms of their impact on tourism development would strengthen the enhancement of natural and cultural heritage in tourism in the region.

### *Comprehensive policy frameworks to promote sustainable tourism development need strengthening*

WB6 economies need an appropriate policy framework to address sustainable tourism development. The sustainability of tourism development and operations can be addressed through regulations and be influenced by other instruments such as financial incentives, labelling, guidance and capacity building. Many governments around the world have made recent progress by taking steps to embed sustainability principles in tourism policies and related strategies. However, an ongoing challenge in many economies, including WB6 economies, is the implementation of these strategies to deliver on the agreed actions and aspirations (OECD, 2018[20]).

In Montenegro and Serbia there are policy frameworks for the promotion of sustainable tourism and operations within the tourism sector, and both economies have made sound progress in promoting sustainable tourism development. The principles of sustainable tourism development are defined in their tourism development strategies, which include measures to support tourism stakeholders to develop sustainably.

In other WB6 economies, progress has been limited, although they are all planning to integrate sustainable tourism policies in their tourism development strategies. Through donor support, several projects and programmes have been launched to improve sustainable tourism development in the WB6 economies.[19] These projects and programmes are a good opportunity for the economies to start developing comprehensive sustainable tourism development frameworks. To ensure the long-term impact of projects, WB6 governments should introduce appropriate policy measures and actions (financial and institutional) to ensure the sustainability and scale up of implemented project activities once funding ends.

### *Most economies have developed a tourism investment policy framework, but not an innovation framework*

Public and private investment in tourism is essential to build a competitive and sustainable tourism sector, and new innovative tourism products are vital for sustaining the sector's competitiveness. Government measures to boost innovation in tourism can contribute in this regard. Reduced investments due to COVID-19 will require even more active policies to intensify and restore investments in the tourism sector,

and thus maintain the quality of the tourism offer and promote sustainable recovery and development (OECD, 2020[10]).

Most WB6 economies are taking actions to stimulate investment in tourism. Montenegro and Serbia take the lead, although all other economies, except for Kosovo, have also made efforts to develop a tourism investment policy framework, with the promotion of investment in tourism part of their tourism strategies and several forms of incentive available for investors (e.g. grants, value-added tax reduction). Policy measures promoting investment in tourism are also explicitly reflected in policies for the promotion of trade and investment.[20] Kosovo does not yet have a tourism investment policy framework, although one is planned as part of its new Tourism Development Strategy.

Despite the clear indication that the promotion of investment and innovation in tourism is a priority for tourism development in the WB6 economies, the efficiency of implemented policy measures could not be assessed as there is no evidence of any monitoring or evaluation. Private sector stakeholders identified long and non-transparent procedures for obtaining building permits, a lack of knowledge among investors of tourism infrastructure, and inadequate spatial planning, which indicate that implemented investments are not in line with sustainable development principles.[21] These issues should be addressed to ensure successful and sustainable tourism in the region.

Tourism innovation frameworks are not yet in place in the WB6 economies. Montenegro is the only economy in the region that has explicitly committed to promoting innovation in tourism with the inclusion of tourism in its Smart Specialisation Strategy (Table 18.3), adopted in 2019. This is unsurprising given the high importance of tourism in the economy. In other economies, where tourism is not yet recognised as high-priority sector, other ways of facilitating innovation in tourism should be considered and established.

The findings of this assessment are also relevant for the WB6 economies' implementation of the Common Regional Market Action Plan, which includes a component on sustainable and competitive tourism (Box 18.6).

### Box 18.6. Towards sustainable and competitive tourism in the Common Regional Market

The regional industrial and innovation area of the CRM 2021-24 AP includes a component on sustainable tourism (Priority 8.8). The following key findings of the CO2021 sustainable and competitive tourism sub-dimension can inform the implementation of actions under this component:

- WB6 economies have mainly embedded sustainability principles in tourism policies and related culture development and biodiversity strategies. However, ongoing challenges include implementing these strategies, inter-ministerial co-operation, and the regular monitoring and evaluation of the impact of implemented policy measures and actions on tourism development.
- Montenegro has made the greatest progress in promoting sustainable tourism development, and Serbia has a policy framework for sustainable tourism and operations within the tourism sector in place. Capacity building is provided and promoted to tourism businesses in these economies, which enhances the sustainability of their projects and operations. Both economies have introduced internationally recognised eco-certificates (Eco Label and Blue Flag in Montenegro, and Green Key and Blue Flag in Serbia).
- All other economies are planning to integrate sustainable tourism policies in their tourism development strategies. Through donor support, several projects and programmes have been launched to improve sustainable tourism development in the WB6 economies.
- Tourism innovation policies, including actions for strengthening the digital capacity of the tourism industry, are only in place in Montenegro, where tourism is part of the Smart Specialisation Strategy.

- WB6 economies have established co-operation for the development of joint regional cultural and adventure tourism products through the RCC's Tourism Development and Promotion project, funded by the EU. In 2019, a common regional identity brand for cultural tourism and the Balkan monumental trail were developed. The regional co-ordination structure extended into Albania, Kosovo and Serbia for the Via Dinarica hiking mega trail (Box 18.3).

### *The way forward for sustainable and competitive tourism*

- **Strengthen further the natural and cultural heritage enhancement framework in tourism**. This framework should focus on establishing effective inter-ministerial co-operation and introducing the regular monitoring and evaluation of how policy measures and actions impact tourism development. This is particularly valid for Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia. North Macedonia should also accelerate the adoption of a culture development strategy.
- **Make the consideration of sustainability criteria mandatory for all tourism infrastructure investment**. This should be supported by public incentives and awareness raising and training for tourism sector stakeholders on how to develop their businesses sustainably. Using best practices from other economies, such as the Green Scheme of Slovenian Tourism (Box 18.7), would mean that WB6 economies do not need to start from scratch.
- **Promote and mainstream investment and financing for sustainable tourism development.** Build on key policy considerations defined in the OECD Tourism Trends and Policies 2018 report (OECD, 2018[20]), which recommends promoting access to finance for sustainable tourism investment projects of all sizes. Direct public intervention includes grants and subsidised loans with environmental criteria to support tourism firms with sustainable project proposals in the start-up and early stages, as well as businesses willing to incorporate sustainable practices into their daily operations. Encourage the uptake of green financing instruments for tourism projects. Tailored support for small tourism businesses may be warranted where such intervention aids environmental and sustainability objectives. However, care should be taken to avoid crowding out the private sector. Indirect finance instruments (public credit guarantees) can be used to overcome the lack of collateral related to the production of service-based intangibles and to help the transition to greener processes. Consider promoting public-private partnerships to finance sustainable infrastructure investment and renovations. It may also be helpful to devise risk-sharing mechanisms to foster private sector participation in the financing of sustainable tourism development.
- **Strengthen regional co-operation further to support sustainable tourism growth**. This will be an effective way to address common challenges in all WB6 economies. The economies should build on the work undertaken through implemented regional projects, such as the RCC's Tourism Development and Promotion project (Box 18.3) that aims to develop joint regional cultural and adventure tourism products. To establish more structured regional co-operation in tourism development for areas of common interest, the example of the Nordic tourism co-operation plan could be followed (Box 18.8).

### Box 18.7. Slovenia's green tourism scheme: A comprehensive model for promoting sustainable tourism

Slovenia's green tourism scheme is a good example of how tourism companies can be encouraged to develop sustainable business models. Launched in 2015 by the Slovenian Tourist Board (STO) and supported by the Ministry of Economic Development and Technology, it provides a comprehensive framework for sustainable development in tourism. The core of the scheme is a certification programme that provides guidelines for tourist destinations and companies (accommodation providers, travel agencies and tourist attractions) and tools for monitoring progress on sustainability. Destinations and companies meeting the criteria are given a green label ("green destination", "green accommodation", "green travel agency", "green park", "green tourist attraction") and marketing support from the STO under the umbrella brand Slovenia Green, which raises their profile and makes them more competitive on the global market. The certification scheme is based on the European tourism indicators system for sustainable destination management and the green destination standards (GDS), thus ensuring international comparability. It provides an awareness-raising and capacity building tool for tourism sector stakeholders.

The green tourism scheme is recognised worldwide as a unique comprehensive national scheme that promotes the development of quality and innovative tourism products with high added value.

Source: (Slovenian Tourist Board, 2021[22]), *Green Scheme of Slovenian Tourism*, https://www.slovenia.info/en/business/green-scheme-of-slovenian-tourism.

### Box 18.8. Structured regional co-operation through the Nordic Tourism Co-operation Plan

Denmark, Finland, Iceland, Norway and Sweden have a long tradition of co-operating in various fields under the auspices of the Nordic Council of Ministers. In recent years, tourism has been actively placed on the agenda, leading to the development of the Nordic Tourism Co-operation Plan 2019-23 within the framework of the Nordic Co-operation Programme for Business and Innovation Policy 2018-21. The plan is intended to strengthen Nordic tourism co-operation to support sustainable tourism growth in the region, in alignment with the 2030 United Nations' Sustainable Development Goals. It identifies strategic areas of collaboration and establishes structured co-operation between policy makers and organisations in the Nordic economies to develop and implement tourism-related policies and projects.

The plan sets out four main objectives:

- Increase the competitiveness of the tourism sector through better regulation, comparable data provision and dialogue with the tourism industry.
- Develop the Nordics as an innovative and smart destination by strengthening the digital capacity of small and medium-sized enterprises and destinations, promoting innovation, and developing smart destinations.
- Support sustainable development and growth with the development of a voluntary Nordic roadmap for sustainable tourism and through gathering best practices.
- Make the Nordics a more attractive and competitive destination by investigating market possibilities in long-haul markets and strengthening the Nordic branding.

Source: (OECD, 2020[4]), *OECD Trends and Policies 2020*, https://doi.org/10.1787/6b47b985-en.

## Tourism branding and marketing (Sub-dimension 15.5)

The development and promotion of an economy's brand image and range of products that meet the needs of the market are vital for the competitiveness of its tourism sector. The public sector has traditionally played a lead role in destination marketing and promotion activities, as the fragmented nature of the sector and the small size of many tourism businesses makes it difficult for individual businesses to be visible to, and attract visitors from, remote tourism markets. More recently, economies have been exploring different tourism marketing models that draw on new funding sources, partnership opportunities and governance arrangements, as well as developing digital strategies (OECD, 2017[23]). Embracing digitalisation throughout the tourism ecosystem will help to drive the ability of business to build resilience in a post-COVID-19 era. This will include exploiting the opportunities digitalisation opens up for marketing, product and destination development, as well as investing in human capital and skills to retain and develop a skilled workforce. (OECD, 2021[24])

This section assesses the existence and quality/competitiveness of tourism brand images and marketing strategies in the WB6 economies. It also assesses the extent and efficiency of the use of digital tools in tourism marketing and the capacity of tourist stakeholders to use such tools effectively.

On average, the WB6 economies achieved a score of 1.6 for the tourism branding and marketing sub-dimension, signifying that considerable improvements are needed to boost their visibility in the international market. Albania, Montenegro and Republika Srpska[22] have established the most comprehensive tourism branding and marketing framework so far, with the other economies lagging behind. Albania leads the way in developing a digital tourism marketing framework with a score of 3.0, which is significantly above the other economies that are still in the early stages of development (Table 18.8).

### Table 18.8. Scores for Sub-dimension 15.5: Tourism branding and marketing

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 15.5: Tourism branding and marketing | Tourism branding and marketing strategy | 2.5 | 0.5 | 0.5 | 1.5 | 4.0 | 2.0 | 1.8 |
| | Digital tourism marketing framework | 3.0 | 0.5 | 0.5 | 1.0 | 1.5 | 1.5 | 1.3 |
| **Sub-dimension average score** | | 2.8 | 0.5 | 0.5 | 1.3 | 2.8 | 1.8 | 1.6 |

### *Despite significant progress, tourism marketing and branding remain a challenge*

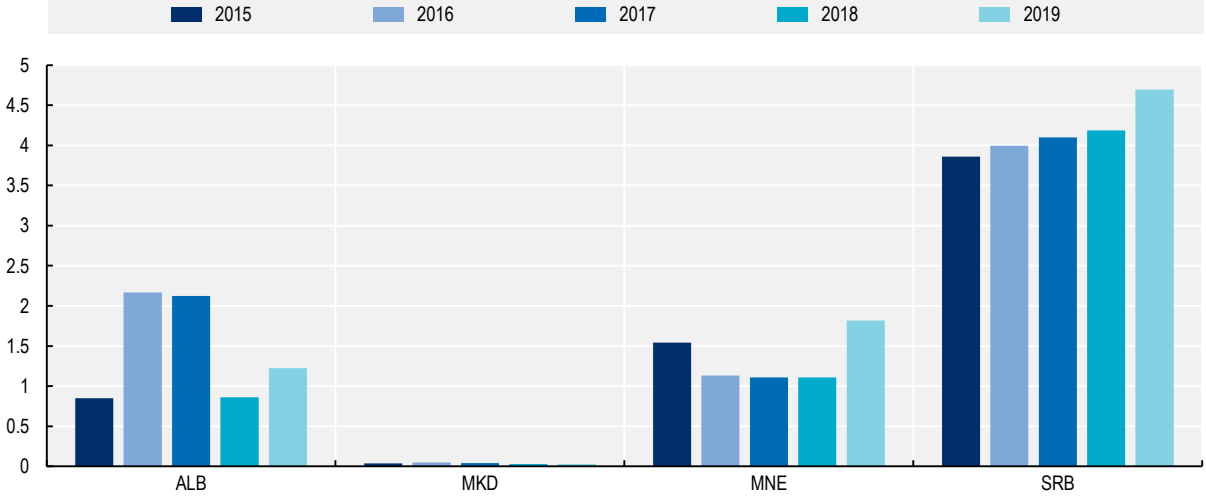
A well-developed marketing plan should be a key component of an economy's tourism strategy and should stem from the careful selection of target markets based on product strengths, current performance and global trends. A national tourism organisation (NTO) or equivalent body may be seen as the main vehicle for implementing a marketing plan. However, it is important that there is strong support and participation by private sector associations, individual businesses and other relevant tourism stakeholders. Encouraging co-operation and co-ordination among NTOs, state/provincial tourism organisations and destination management organisations is critical to the success of marketing tourism (UNWTO, 2013[9]).

All WB6 economies have established a tourism branding and marketing framework. NTOs are established and responsible for tourism branding and marketing in all economies except Kosovo and Bosnia and Herzegovina, where tourism is under the jurisdiction of the entities.[23] Currently, Albania, Montenegro, North Macedonia and Republika Srpska have established a tourism brand identity. However, only Montenegro, Serbia and Republika Srpska have valid marketing strategies. In Albania, a new marketing strategy is under development. In North Macedonia, the Agency for Promotion and Support of Tourism works on the basis of an annual programme for tourism promotion adopted by the government. All of these economies have established co-operation with the private sector and with local tourist organisations. All NTOs reported having sufficient budget and staff to implement marketing activities. However, except for Montenegro and Serbia, which have increased the budget and/or number of employees, the budget for

tourism marketing has decreased since 2015, which could have a negative impact on tourism development in the future (Figure 18.8).

### Figure 18.8. Budget for tourism marketing in WB6 economies (2016-19)

Million euros




Note: Data for Bosnia and Herzegovina and Kosovo are not available.
Source: Ministries responsible for tourism; CO 2021 Quantitative questionnaire.

StatLink https://doi.org/10.1787/888934255171

Kosovo lacks a tourism branding and marketing framework. Marketing and promotion are formally established at the ministry level; however, marketing is implemented mainly by tourism stakeholders in an uncoordinated manner.[24]

Albania, Montenegro and Serbia have significantly improved their ranking in the World Economic Forum's Travel and Tourism Competitiveness Index for the indicator measuring the effectiveness of marketing and branding to attract tourists (Table 18.9). However, the overall ranking shows that there is still significant room for improvement in tourism branding and marketing, starting with the accurate adoption of strategic marketing plans in the economies where they have not yet been adopted. The WB6 economies should also focus on establishing regular monitoring and evaluation of their brand image and marketing strategy framework (WEF, 2019[25]).

### Table 18.9. WB6 economies in the WEF Travel and Tourism Competitiveness Index (2017 and 2019)

Effectiveness of marketing and branding indicator

| Economy | Ranking | | |
|---|---|---|---|
| | 2017 | 2019 | Change |
| ALB | 71 | 48 | +23 |
| BIH | 114 | 118 | -4 |
| MKD | 41 | 124 | -83 |
| MNE | 53 | 34 | +19 |
| SRB | 107 | 78 | +29 |

Note: Data for Kosovo are not available.
Source: (WEF, 2019[25]), *Travel and Tourism Competitiveness Index 2019*, https://www.weforum.org/reports/the-travel-tourism-competitiveness-report-2019.

### *Digital tourism marketing frameworks are in the early stages of development*

Digitalisation has opened up new opportunities for tourism businesses to compete in global markets, bringing tourist offers directly to tourists' homes via the Internet. Governments play an important role in

creating the right framework conditions for the digital transformation of tourism business models and the wider tourism ecosystem. The right policy considerations can foster digital technology uptake and use by tourism SMEs (OECD, 2020[4]).

Digital tourism marketing frameworks are in the early phase of development in all WB6 economies. In Montenegro, the first draft of the Digital Marketing Programme (2021-2023) is under preparation, and in Republika Srpska digital marketing is included in the entity's marketing strategy. The other WB6 economies have not yet established a digital marketing framework, although Albania, Serbia and the FBiH implemented some digital marketing activities in 2019.

### *The way forward for tourism branding and marketing*

- **Accelerate the preparation (or adaptation for Montenegro, Serbia and Republika Srpska) of marketing strategies to meet new market circumstances and new trends in tourism demand post COVID-19**. All economies should ensure that marketing strategies include digital marketing and are adopted quickly with sufficient budgets for implementation (OECD, 2021[24]). Marketing strategies should clearly define target markets and target groups of visitors for the main tourist products (as defined in tourism strategies), as well as the most effective marketing tools and channels to reach target audiences. Targeting the right audiences means that less budget is needed for marketing activities in a context of reduced government budgets for tourism marketing. Other options to ensure sufficient budget include reconsidering existing tourist taxes and fees, involving the private sector in financing marketing activities, and allocating gaming taxes to finance tourism marketing activities (OECD, 2017[23]). Digital marketing can reach a much wider audience with the same budget, as described in the case of Portugal (Box 18.9).
- **Define (FBiH, Kosovo) or evaluate and revise (Albania, Montenegro, North Macedonia, Serbia) tourism brand and branding strategies** to ensure the brand sufficiently highlights their main advantages and differentiates destinations in a changing tourism market. COVID-19 has changed tourism demand tremendously, and there has been a move from mass tourism to individual tourist experiences, an emphasis on health and safety standards, and an orientation to domestic and neighbouring markets (OECD, 2020[10]). Existing tourist products and target markets, and their adaptation to new tourist demands, therefore need to be rethought across the region. All WB6 economies should adapt their tourism brand and branding strategy to improve visibility in the new target markets and to increase or at least sustain their destinations' competitiveness.
- **Strengthen co-operation and skills for implementing marketing activities at all levels, from state to destination.** A well-resourced and co-ordinated programme of promotional activities among key tourism stakeholders increases efficiency and contributes to their effectiveness. Marketing strategies should therefore be prepared in co-operation with key private stakeholders and local tourist destinations, and there should be regular communication with these stakeholders and destinations on implemented and planned marketing activities. To ensure efficient and effective tourism marketing it will be important to build the capacity of staff in destinations and private stakeholders, especially MSMEs, to design and implement digital marketing campaigns.
- **Strengthen regional co-operation in tourism marketing to increase the visibility of the Western Balkans as a tourist destination in international markets**. The Western Balkans is an emerging tourist destination with a rich natural and cultural heritage. The development of a joint regional cultural and nature adventure tourist experience offers an opportunity to make the whole region attractive for tourists from neighbouring and regional economies, as well as for long-haul tourists. The WB6 economies should build on the joint regional cultural and nature adventure tourist products (Box 18.3) and establish a common marketing framework for launching joint tourist products in the market. A first step could be the establishment of a regional marketing working group with representatives of NTOs as members. A first marketing plan with identified target markets and target audiences for marketing the joint products should also be developed.

### Box 18.9. Turismo de Portugal's 100% digital marketing strategy

Turismo de Portugal (the government tourism authority) is responsible for the international promotion of Portugal as a tourist destination. In 2011, its budget was cut by more than 30%, leading it to shift to a 100% digital approach to marketing to improve segmentation and targeting, reach and efficiency, measurement, and storytelling and engagement with consumers. The organisation believed that although this approach cost less than traditional marketing methods it would still deliver a similar return on investment.

A digital approach to marketing democratises access for the consumer and allows smaller markets and budgets to develop scale. In Turismo de Portugal's case, a digital marketing approach meant that it could scale-up impact despite a reduced budget. It created a strong social media presence on several social platforms, YouTube, Facebook, Instagram, Pinterest, Twitter and Weibo (in 12 different languages), to engage in social conversations.

One of the advantages of digital marketing is the ability to directly measure the return on investment. In 2015, investment in marketing in Portugal was about 50% lower than in 2011, but Turismo de Portugal still managed to achieve greater exposure of all Visit Portugal platforms. There has been a direct correlation between investment in digital platforms and an increase in reach and revenue. For instance, Facebook fans increased from 160 000 to over in 1.2 million in 2015. In the first year of the strategy, visits to the Visit Portugal website increased 92.5%, almost doubling the number of daily visitors, and YouTube views more than doubled in the first year. Between 2011 and 2015, overnight stays increased by 24.1% and revenue by 39.5%.

Source: (OECD, 2017[23]), *A review of the policy framework for tourism marketing and promotion*, http://dx.doi.org/10.1787/096d0ace-en.

## Conclusion

WB6 economies have made some progress in enhancing the overall tourism policy framework by improving the governance structure and co-operation with the private sector. Progress has been made in accommodation capacity and the quality assurance framework, and in providing incentives for investment in accommodation and other tourist infrastructure. Progress has also been made in tourist information availability and tourism data collection. Montenegro and Albania have made the greatest progress, while the other economies still need to make considerable improvements in all sub-dimensions.

The COVID-19 crisis has had a severe negative impact on the tourism sector in all WB6 economies. A huge fall in tourist arrivals (nearly 60% on average) and overnight stays (54.7% on average) in 2020 reduced tourism revenue and exports, lessened the contribution of tourism to total GDP, and endangered many jobs in SMEs in all WB6 economies. The outlook for the tourism sector remains highly uncertain, and most tourism experts do not expect international tourism to return to pre-COVID levels before 2023 (UNWTO, 2021[26]). Accordingly, the tourism sector needs significant and well-coordinated support to ensure survival in the short term and recovery in the medium term of businesses in the private sector. The EU support package for socio-economic recovery in the Western Balkans, which focuses on SMEs, start-ups and innovative companies in tourism, is an opportunity for all WB6 economies to ensure a successful recovery.

COVID-19 has revealed several gaps in tourism in the WB6 economies, and several challenges remain to improve the competitiveness of tourism in the region, such as the relatively inefficient tourism governance structure where few policy measures have been implemented and the lack of monitoring and evaluation systems to provide more relevant information for decision makers. Although inter-ministerial co-operation

is formally established, efforts are still needed to promote sustainable development and enhance natural and cultural heritage in tourism.

However, the crisis offers an opportunity for WB6 economies to re-think future tourism development, establish strong governance and partnerships with the private sector and destinations, prepare new tourism strategies adapted to the new market circumstances, and develop more sustainable and resilient tourism.

The region has a rich cultural and natural heritage, and great potential to become one of the most attractive tourist destinations in Europe. In this regard, the WB6 economies should continue to strengthen regional co-operation as they share common challenges (such as accessibility, availability of qualified workforce, quality of tourism offer) that could be addressed efficiently at the regional level. The establishment of more structured regional co-operation in tourism development through the creation of joint regional cultural and nature adventure tourist products (that show the uniqueness of the region in terms of culture and nature) and by developing a common regional tourism brand will make the Western Balkans attractive to international tourists, thus bringing benefits to each WB6 economy.

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## Notes

[1] International receipts is a value of tourism receipts resulting from expenditures made by visitors from abroad and earned by a destination country from inbound tourism.

[2] This is a rough estimation based on available data for each WB6 economy.

[3] The Central Asia region includes Azerbaijan, Kyrgyzstan, Kazakhstan, Tajikistan and Uzbekistan. Data for Turkmenistan are not available.

[4] The Central and Eastern European Countries (CEEC) are Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

[5] According to the World Bank Group's Western Balkan Outlook, in the baseline scenario Albania, Kosovo, and Montenegro experienced a 20-35% fall in tourism receipts in 2020, which subtracts significantly from their 2020 GDP growth (World Bank, 2020[28])

[6] The key challenges of each economy are presented in more detail in the economy profile reports.

[7] In Bosnia and Herzegovina, tourism is under jurisdiction of the two entities: Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH). Accordingly, the entities are responsible for the adoption of their own tourism strategies and the establishment of the governance structure and institutional set up, which differ in each entity. While the tourism governance framework in RS is similar to the most commonly established governance frameworks in other economies, the governance structure in the FBiH is much more complex, with tourism governance divided among the Federal Ministry of Environment and Tourism and the ministries of the cantons responsible for tourism, which have also adopted their own legislation and regulation. At the state level, the Tourism Working Group was established by the Ministry of Foreign Trade and Economic Relations to co-ordinate tourism activities among the entities and Brćko District (which officially belongs to both, but is governed by neither).

[8] More information is provided in the economy profile reports.

[9] The tourist cluster of Una Sana seems to be a good practice case of public-private co-operation at the destination level. The cluster was developed with the support of the Swedish Agency for International Development and Cooperation of Sida and implemented by the World Wildlife Fund. More information is available at https://www.unasana.ba/en/turisticki-klaster-una/. Another good example is the tourist cluster of Herzegovina, which is established as a public-private organisation for the promotion of tourism in Herzegovina. More information is available at: http://www.tkh.ba/?lang=en.

[10] In the western region of Kosovo, a destination management organisation is established as an NGO. These organisations provide support to the development and promotion of sustainable tourism in the region through joint work with local authorities, businesses and public agencies, as well as strategic partnerships with relevant stakeholders.

[11] The Tourism Satellite Account is the second international standard on tourism statistics (Tourism Satellite Account: Recommended Methodological Framework 2008 –TSA:RMF 2008). It has been developed to present economic data relative to tourism within a framework of internal and external consistency with the rest of the statistical system through its link to the System of National Accounts. It is the basic reconciliation framework of tourism statistics. As a statistical tool for the economic accounting of tourism, the TSA can be seen as a set of 10 summary tables, each with their underlying data and representing a different aspect of the economic data relative to tourism: inbound, domestic tourism and outbound tourism expenditure, internal tourism expenditure, production accounts of tourism industries, gross value added (GVA) and GDP attributable to tourism demand, employment, investment, government consumption, and non-monetary indicators (UNWTO, 2021[27]).

[12] Due to the significant decrease of tourist arrivals in 2020, destinations lost most of their main financial resources (tourist tax or similar financial contributions) for supporting tourism promotion, new tourism product development and investment in public tourist infrastructure. Accordingly, destinations need new financial resources and support to help their recovery after the pandemic.

[13] For more information see https://www.rcc.int/tourism.

[14] For more information about incentives see the economy profile reports.

[15] For more information see Sub-dimension 7.3: Vocational education and training, in the Education policy chapter.

[16] For more detailed information see the economy profiles.

[17] Montenegro has developed a comprehensive natural and cultural enhancement framework for tourism under the Cultural Heritage Development Strategy for 2020-2025 and the National Strategy of Preservation and Sustainable Use of Cultural Heritage, both supported by UNESCO. The Ministry of Culture has also developed four long-term management plans for cultural heritage.

[18] The Environment Report in the Republic of Serbia, prepared by the Environmental Protection Agency (Ministry of Environmental Protection) includes monitoring of the impacts of tourism on the environment. In Montenegro, the Administration for the Protection of Cultural Properties regularly monitors the state and value enhancement of cultural properties. Other mechanisms prescribed by the law, such as studies of the cultural heritage protection, management plans and heritage impact assessment have been adopted upon proposal of the administration body in charge of culture-related matters.

[19] For more information see the economy profiles.

[20] For more information see the economy profiles.

[21] This assessment is provided based on interviews with representatives of private sector associations in all WB6 economies. The challenges presented in this report were reported most often in all WB6 economies. It is therefore assumed that these are the common challenges for the whole region.

[22] As the scores are provided at the economy level the progress of Republika Srpska is not visible; however, it influences the overall score for Bosnia and Herzegovina, which would be much lower otherwise.

[23] Republika Srpska has established the Tourism Organisation of Republika Srpska, which is responsible for tourism promotion and marketing and branding at the entity level. The FBiH has no tourist organisation at the entity level, instead tourism promotion and marketing are implemented by the tourist boards of cantons and destinations.

[24] Some tourism promotion is implemented by the Kosovo Investment and Enterprise Support Agency (KIESA), which organises participation in the most attractive international tourism events, such as ITB Berlin. However, this is not a comprehensive tourism and marketing framework.

# 19 Anti-corruption policy (Dimension 16)

Controlling corruption is a key condition for strong competitiveness. This chapter on anti-corruption policy assesses the policy strategies, regulations, processes and institutions in the six Western Balkan economies (WB6). It starts with a brief overview of trends and performance in the fight against corruption, including the economies' performance against international anti-corruption indicators. The chapter then focuses on five essential sub-dimensions. The first, anti-corruption policy framework, examines anti-corruption policies: how they are planned, monitored and co-ordinated, including civil society involvement. The second, prevention of corruption, assesses corruption prevention bodies and key policy areas – conflicts of interest, asset and interest disclosure, and protection of whistle-blowers. The third, independence of the judiciary, covers laws, institutions and practices that safeguard the judiciary against undue interference. The fourth, business integrity and corporate liability, considers how private sector actors can be discouraged from corrupt actions and helped to tackle corruption challenges. Finally, the investigation and prosecution sub-dimension considers the readiness and track record of the economies in investigating, prosecuting and adjudicating high-level corruption, including whether there are independent and effective investigation and prosecutorial bodies. The chapter includes suggestions for enhancing policies to tackle corruption in each of these sub-dimensions, which in turn will help foster greater competitiveness.

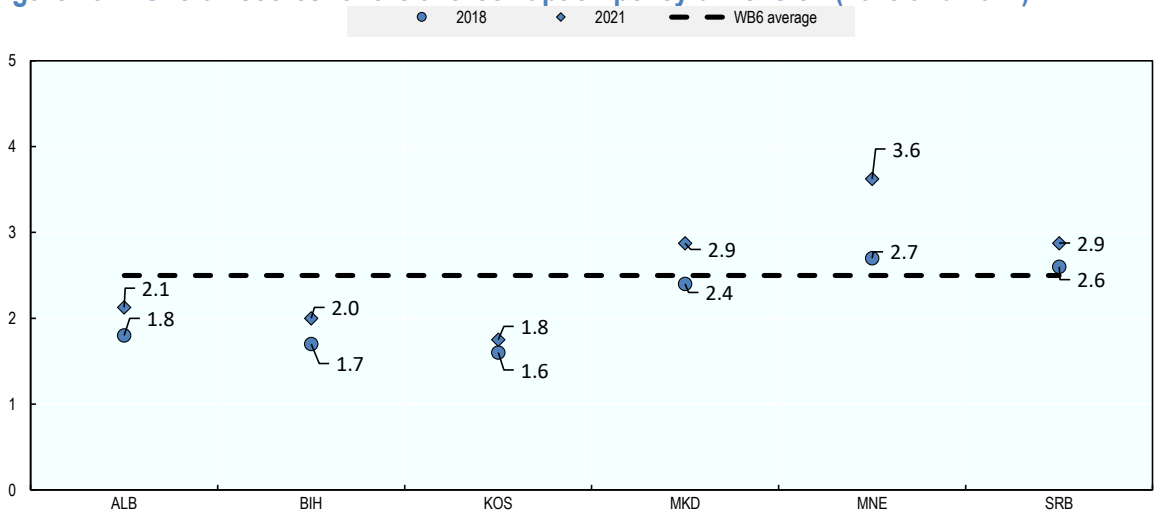
## Key findings

- **The general corruption situation in the WB6 region remains as poor as during the Competitiveness Outlook 2018 assessment.** The assessment did find minor but consistent signs of improvement in Montenegro based on several indices and surveys.
- **All WB6 economies have anti-corruption strategies and/or plans, and all of the economies have mechanisms for monitoring the implementation of these policy documents although with different degrees of analytical sophistication.** As of the end of 2020, several of the economies had prepared but not adopted replacements for strategies that had expired.
- **The authorities involve civil society in the preparation of anti-corruption strategies and plans** by holding consultations or including civil-society stakeholders in working groups, but some non-government organisations (NGOs) remain concerned about the lack of responsiveness to their proposals.
- **Most WB6 economies have multi-functional corruption prevention bodies**, which mostly have safeguards of their independence and observe due public accountability, although some struggle to implement their mandate due to limited resources.
- **Most of the WB6 economies fund awareness-raising and education activities from their national budgets**, a sign that they are prioritising this area of work.
- **None of the WB6 economies have yet achieved a sound and sustainable independent judiciary**. However, several of the economies have implemented reforms including setting up judiciary councils with sufficient legal guarantees of independence, introducing competitive procedures for the selection and promotion for judicial positions, and strengthening the mechanisms of disciplinary liability.
- **Concrete business integrity practices or incentives for companies to improve the integrity of their operations are scarce**.
- **Most WB6 economies have recent laws on the registration of beneficial owners of legal entities** which envisage access to the data by any member of the general public.
- **All WB6 economies envisage the liability of legal persons for all criminal offences**. In Albania, Kosovo, North Macedonia and Serbia, the maximum fines are low considering the possible scale of large corruption transactions.
- **Most WB6 economies have had at least some convictions in prominent corruption cases**. However, in Albania, Montenegro, North Macedonia, and Serbia, despite large numbers of investigations into high-level corruption, there are few final convictions.

## Comparison with the 2018 assessment

The WB6 average scores have improved for all scored indicators of the 2021 assessment (Figure 19.1). The strongest increase has been for anti-corruption public awareness and education, by one point. For the other indicators, the average improvement is around 0.5 points.

### Figure 19.1. Overall scores for the anti-corruption policy dimension (2018 and 2021)




Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators and re-structuring of sub-dimensions. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

## Implementation of the Competitiveness Outlook 2018 recommendations

The implementation of the CO2018 policy recommendations has been limited. The strongest general progress has been in making public awareness-raising activities more sustainable through national funding. Otherwise, individual economies have implemented a few actions that correspond to the recommendations, as shown in Table 19.1, without amounting to broader regional trends.

### Table 19.1. Implementation of the CO 2018 policy recommendations: Anti-corruption policy

| Competitiveness Outlook 2021 | | |
|---|---|---|
| **2018 policy recommendations** | **Main developments during the assessment period** | **Regional progress status** |
| Improve the involvement of civil society in policy development and preparing draft legislation. | • The involvement of civil society generally continues as before.<br>• Most of the economies do not provide public overviews of received, accepted and rejected proposals.<br>• In some economies, NGOs still criticise the responsiveness of the authorities. | Limited |
| Ensure more systematic and comprehensive corruption proofing of legislation. | • The practice remains limited, especially in Albania, Bosnia and Herzegovina, and Kosovo.<br>• The legal competence of prevention bodies to carry out corruption proofing has been reconfirmed in new laws in North Macedonia and Serbia. | Limited |
| Make public awareness-raising activities more sustainable. | • Funding of awareness-raising and education activities from national budgets has been ensured in most WB6 economies. | Moderate |
| Some multi-stakeholder co - ordination institutions should do more to demonstrate their | • Multi-stakeholder co-ordination institutions have been reformed or new ones set up in Albania and Montenegro.<br>• No evidence that the existing co-ordination institutions have | Limited |

| | | |
|---|---|---|
| effectiveness. | become more effective. | |
| Implement the whistle-blower protection laws. | • Kosovo has adopted a new whistle-blowing law.<br>• Montenegro and Serbia have had relatively high whistle-blower activity.<br>• The evidence on whistle-blower protection is mixed, with some anecdotal evidence of retaliations against whistle-blowers. | Limited |
| Provide better safeguards to protect anti-corruption investigation units. | • Only Albania has established a new independent anti-corruption investigation body. | Limited |

## Introduction

Anti-corruption policy encompasses both the formal policy framework and the concrete actions for containing and eventually reducing corruption. All the WB6 economies have persistently high corruption levels and suffer continuous attempts by patronage networks to establish state capture (Bak, 2019[1]). Corruption has been a major challenge to the economies' progress towards EU accession (European Commission, 2020[2]). Weak anti-corruption actions have been a persistent obstacle to economic competitiveness in the region (OECD, 2020[3]).

In recent decades, the negative impact of corruption on growth has been extensively examined (see for example (Hoinaru et al., 2020[4]; Mauro, 1995[5]; Tanzi and Davoodi, 1997[6])). Corruption has been shown to reduce incentives for innovation and productive labour and damage government services (OECD, 2015[7]). There is a strong negative correlation between confidence in government and perceptions of government corruption (OECD, 2020[3]).

Various strategies, including decentralisation, institutional and community monitoring, and open procurement auctions, have been shown to reduce the capture of public funds and resources (Hanna et al., 2011). At least in some contexts, anti-corruption policies have had positive effects on integrity and impartiality in the public sector (Kalniņš, 2015[8]; Min, 2019[9]).

Anti-corruption policy benefits most of the policy areas covered in this publication. However, effective control of corruption is particularly relevant to the following chapters:

- **Chapter 4. Investment policy.** Economies with less corruption generally provide a better investment climate and therefore attract more investment. In contexts with limited corruption, companies can invest resources that would otherwise be spent as bribes. The benefits also work in the opposite direction: a transparent and fair investment policy reduces incentives to engage in corruption, including by making investments in productivity more profitable than spending resources on corruption.
- **Chapter 7. Tax policy.** Tax collection is hampered by corruption, which has a significant negative impact on tax revenue. In certain contexts, more than half of tax revenues could be lost due to corruption (Nawaz, 2010[10]). A clear tax policy can reduce risks of corruption by limiting opportunities for officials to abuse their taxation powers.
- **Chapter 9. State-owned enterprises (SOEs).** Management of SOEs depends on anti-corruption policies due to threats of corruption and irregular practices in and around SOEs. Due to the tendency of political officials to abuse SOEs' resources for political or personal gains, relations with the government represent one of the greatest obstacles to the integrity of SOEs. SOEs with public policy objectives have especially high risks of corruption (OECD, 2018[11]). The implementation of good corporate governance principles in the SOE sector reduces the risk of corruption. These include strengthening merit-based personnel appointment, ensuring the accountability of enterprises' management and proper public reporting, and making enterprises more effectiveness at achieving their economic and public policy objectives.

- **Chapter 10. Education policy.** Education can be severely affected in corrupt environments. Corruption degrades learning outcomes, helping individuals to succeed who do not merit it, while excluding socially disadvantaged groups who cannot afford the cost of corruption. Corruption in education particularly affects the values formed by young people (Transparency International, 2013[12]).

## Assessment framework

### *Structure*

This chapter assesses anticorruption policies in WB6 economies by assessing five broad sub-dimensions:

1. **Sub-dimension 16.1: Anti-corruption policy framework** focuses on how the economies plan, monitor and co-ordinate their anti-corruption efforts. The analysis also focuses specifically on the way the authorities assess factors that may facilitate or encourage corruption and cause corruption risks in the operation of public bodies and legislation.
2. **Sub-dimension 16.2: Prevention of corruption** focuses on institutions (corruption prevention bodies) and three key areas of policy (conflicts of interest, asset and interest disclosure, and the protection of whistle-blowers) that act as pre-emptive safeguards against corruption. This sub-dimension also reviews how the economies raise awareness and educate the general public and public officials on corruption-related topics.
3. **Sub-dimension 16.3: Independence of the judiciary** focuses on the laws, institutions and practices that protect the judiciary against undue interference. The analysis also considers mechanisms and practices that ensure the accountability and transparency of the judiciary.
4. **Sub-dimension 16.4: Business integrity and corporate liability** focuses on how the economies prevent the use of business entities for corrupt purposes, encourage integrity in business processes and help businesses withstand corrupt demands. It also reviews the provisions of liability of legal persons for corruption offences and their application in practice.
5. **Sub-dimension 16.5: Investigation and prosecution** focuses on the readiness and track record of the economies in investigating, prosecuting, and adjudicating high-level corruption. The analysis specifically reviews the institutional setup, capacities and guarantees of independence of specialised anti-corruption investigative and prosecutorial bodies.

## Figure 19.2. Anti-corruption policy dimension assessment framework

**Anti-corruption policy dimension**

**Outcome indicators**
1. Corruption Perceptions Index
2. Experience of corruption pressure
3. Opinion about the effectiveness of the government in fighting corruption

| **Sub-dimension 16.1** Anti-corruption policy framework | **Sub-dimension 16.2** Prevention of corruption | **Sub-dimension 16.3** Independence of the judiciary | **Sub-dimension 16.4** Business integrity and corporate liability | **Sub-dimension 16.5** Investigation and prosecution |
|---|---|---|---|---|
| **Qualitative indicators**<br>1. Policy documents, co-ordination and implementation[1]<br>2. Corruption risk assessment<br>3. Corruption proofing of legislation | **Qualitative indicators**<br>4. Corruption prevention bodies[1]<br>5. Conflicts of interest[1]<br>6. Asset and interest disclosure[1]<br>7. Protection of whistle-blowers[1]<br>8. Anti-corruption public awareness and education | **Qualitative indicators**<br>9. Independence of judiciary[1] | **Qualitative indicators**<br>10. Business integrity[1]<br>11. Enforcement of liability of legal persons[1] | **Qualitative indicators**<br>12. Investigation and prosecution of high-level corruption[1]<br>13. Specialised anti-corruption investigative bodies[2]<br>14. Specialised anti-corruption prosecutorial and judicial bodies[2] |
| **Quantitative indicators**<br>n.a | **Quantitative indicators**<br>1. Number of sanctions for violations related to conflicts of interest<br>2. Number of whistle-blower reports and requests for protection | **Quantitative indicators**<br>3. Independence of judiciary index | **Quantitative indicators**<br>n.a | **Quantitative indicators**<br>4. Number of final convictions for high-level corruption |
| **OECD Instruments**<br>OECD Recommendation on Public Integrity | **OECD Instruments**<br>OECD Recommendation on Public Integrity<br>OECD Guidelines for Managing Conflict of Interest in the Public Service<br>Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions | | **OECD Instruments**<br>OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and related instruments | **OECD Instruments**<br>OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and related instruments |

1: Non-scored qualitative indicator.
2: These are scored together under the Anti-corruption law enforcement bodies indicator.

Figure 19.2 shows how the sub-dimensions, and their indicators, make up the anti-corruption policy dimension framework. Note that for comparability with the previous assessment, not all of the qualitative indicators in each sub-dimension are scored.

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by public authorities, written comments provided by relevant non-government stakeholders, online consultations with the authorities, and complementary desk research. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. For more information, see the Assessment methodology and process chapter.

### *Key methodological changes to the assessment framework*

Three sub-dimensions in the 2018 assessment (anti-corruption public awareness and education, corruption prevention and co-ordination institutions, and preventing and managing conflicts of interest and whistle-blower protection) have been merged into the new sub-dimension Prevention of corruption (Sub-dimension 16.2). This change reflects the unity of the prevention framework and the addition of a new qualitative indicator (asset and interest disclosure), which has become a universally accepted part of corruption prevention frameworks.

The new sub-dimension Independence of the judiciary (Sub-dimension 16.3) reflects the recognition that the courts make the final decisions relevant to combatting corruption and ensure the maintenance of the rule of law in general, which is a fundamental precondition for the effective control of corruption.

The new sub-dimension Business integrity and corporate liability (Sub-dimension 16.4) has been added in recognition of the role that businesses have in preventing corrupt practices and the importance of holding them accountable for acts of corruption.

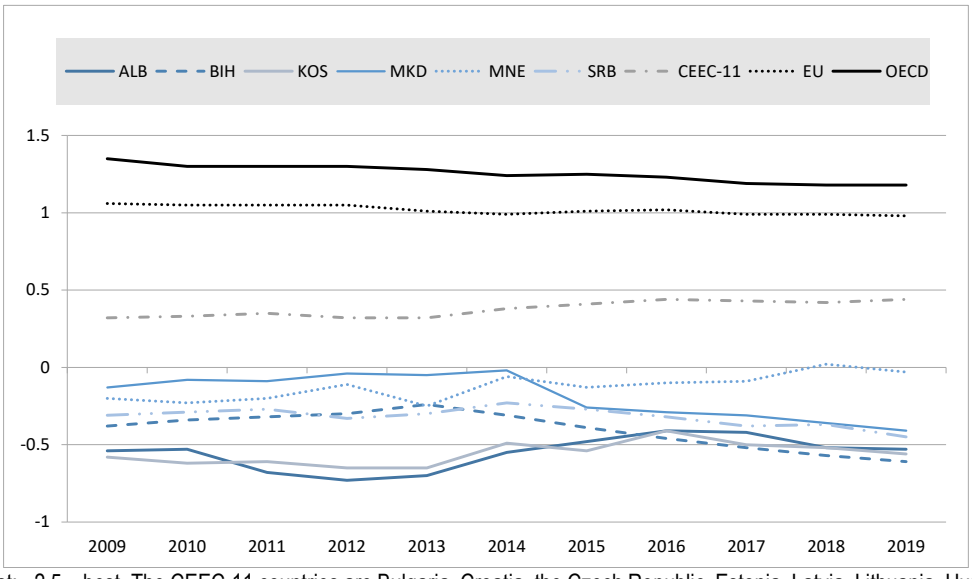
Investigation and prosecution (Sub-dimension 16.5) contains a new qualitative indicator, investigation and prosecution of high-level corruption, an area often seen as a key indicator for the credibility of anti-corruption efforts. Considering the need to limit the overall amount of analysis, this sub-dimension no longer contains the qualitative indicator of regional co-operation and mutual legal assistance.

## Anti-corruption policy performance and context in the WB6

In recent years, the WB6 economies have failed to reduce perceptions of their corruption.

On a scale from -2.5 (worst) to +2.5 (best), the WB6 economies' average scores in the World Bank's Control of Corruption indicator deteriorated from -0.36 in 2009 to -0.43 in 2019 (Figure 19.3). Montenegro had the highest score (-0.03) and Bosnia and Herzegovina the lowest (-0.61) in 2019, compared to an average of 1.18 for OECD member states. Over the period 2016-19, the scores fell slightly for all WB6 economies except Montenegro, which had a minor improvement.

## Figure 19.3. Control of Corruption Indicator (2009-19)

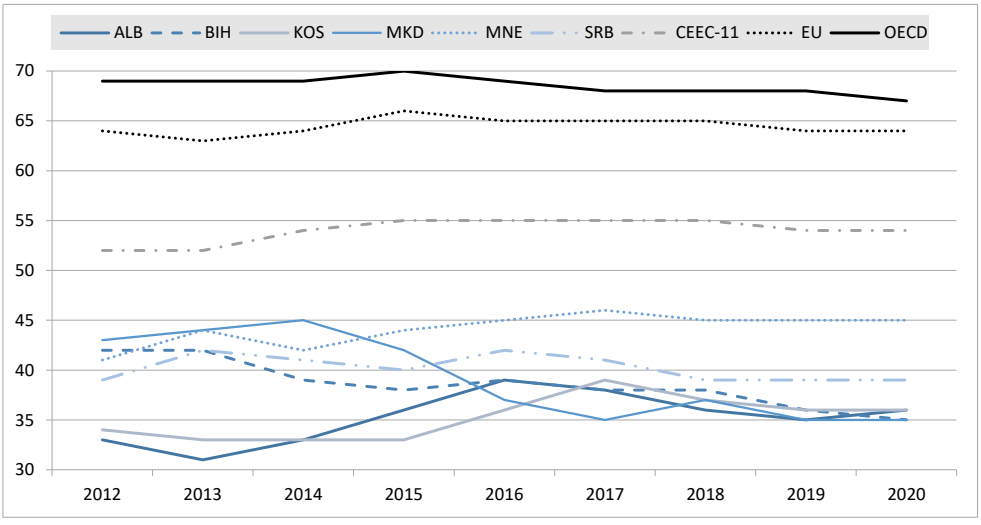



Note: -2.5 – worst; +2.5 – best. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (World Bank, n.d.[13]), *Worldwide Governance Indicators*, https://info.worldbank.org/governance/wgi/.

StatLink https://doi.org/10.1787/888934255190

The Transparency International's Corruption Perceptions Index reflects a similar dynamic. On a scale from 0 (highly corrupt) to 100 (very clean), the average scores among the WB6 economies deteriorated from 40 in 2016 to 37.5 in 2020 (Figure 19.4). This compares to an average score of 67 for OECD member states in 2020. The scores of most WB6 economies fell; at best, for two economies (Kosovo and Montenegro), they remained the same. In 2020, Montenegro had the highest score (45) and Bosnia and Herzegovina, and North Macedonia had the lowest (35).

## Figure 19.4. Corruption Perceptions Index (2012-20)

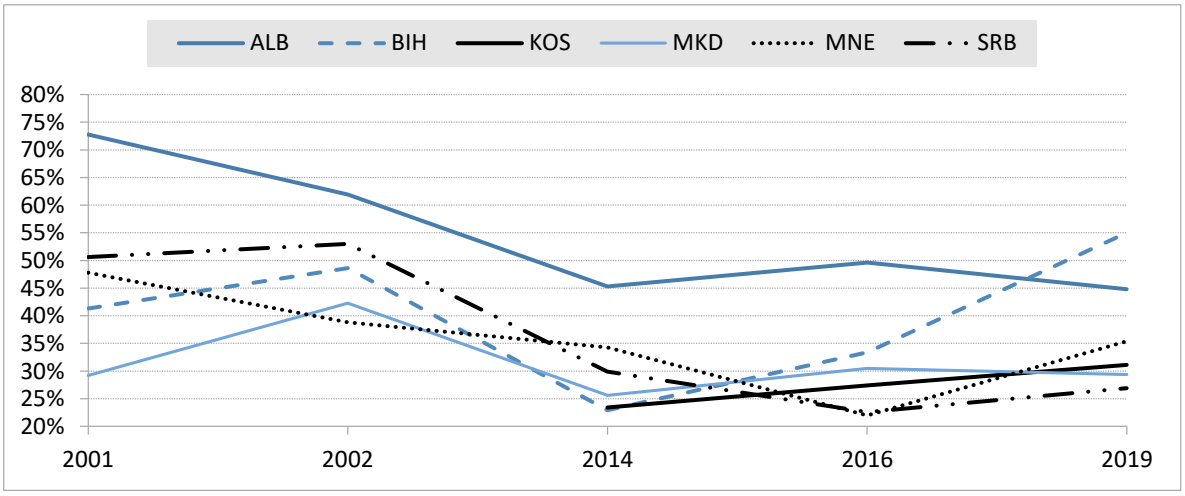



Note: 1 – highly corrupt; 100 – very clean. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Transparency International, 2021[14]), *Corruption Perceptions Index 2020*, https://www.transparency.org/en/cpi/2020/index/nzl.

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Indicators of perceptions of corruption may reflect opinions affected by various external factors such as the media agenda or more general social grievances, and therefore their reliability is sometimes questioned. Surveys of the regional Corruption Monitoring System of the Southeast Europe Leadership for Development and Integrity (SELDI) coalition measure not only perceptions but also the attitudes and experiences of respondents. In 2016-19, the corruption pressure indicator (the share of respondents who have been expected to provide cash, gifts, or favours to public officials) worsened in Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia, improved insignificantly in North Macedonia and considerably in Albania. Despite fluctuations on the level of individual economies, the overall trend since 2014 is stagnating with major deterioration in Bosnia and Herzegovina (Figure 19.5).

## Figure 19.5. Experience of corruption pressure (2001-19)

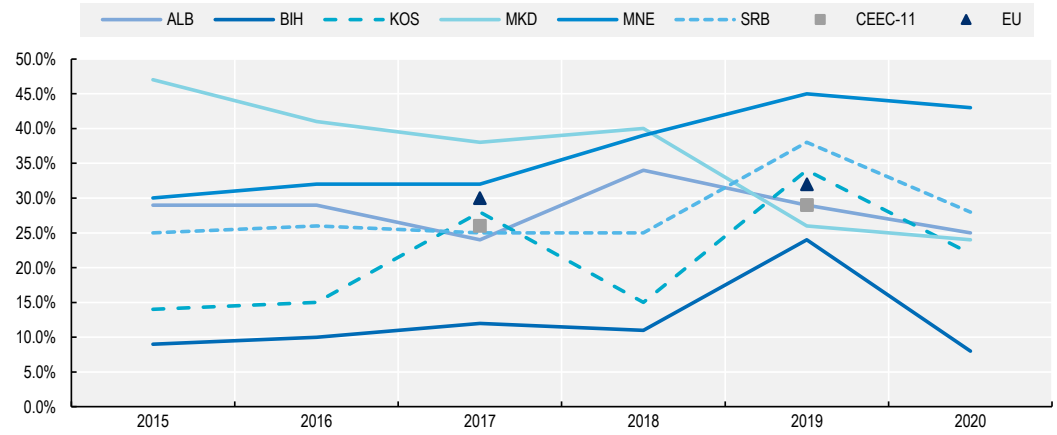



Source: (SELDI, 2020[15]), Experience based corruption indexes, https://seldi.net/cms-data/experience-based-corruption-indexes/.

StatLink https://doi.org/10.1787/888934255228

The potential for improvement is strongly related to the anti-corruption efforts of the public authorities, which have varied degrees of credibility in the eyes of citizens. According to the Balkan Barometer, only a minority of people in all of the WB6 economies agree that the government fights corruption successfully (Figure 19.6). Montenegro stands out with the largest share (43% in 2020) of respondents who believe this to be the case, while Bosnia and Herzegovina has the lowest (8%). On this measure, the general situation in the WB6 economies is similar to the average findings for the European Union. This indicator apparently reflects not only the perceived ability of the government to contain corruption but also broader satisfaction or grievances with its performance.

### Figure 19.6. Perceptions of the effectiveness of government anti-corruption efforts (2001-19)




Note: The relevant question was only included in the Eurobarometer survey for EU countries in 2017 and 2019. EU average is EU-28 for 2017 and 2019. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia. Note that the data from the WB6 economies come from the Balkan Barometer, which is a different survey but uses the same question.

Source: (RCC, 2015[16]), Balkan Barometer (2015-20), https://www.rcc.int/balkanbarometer/publications; EU (2020, 2017), Special Eurobarometer 502, 470, https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm.

StatLink https://doi.org/10.1787/888934255247

## Anti-corruption policy framework (Sub-dimension 16.1)

Tackling corruption requires effective and co-ordinated anti-corruption policies, which, among other things, promote the participation of civil society (UN, 2004). Comprehensive strategies and action plans, which define objectives and goals, allocate responsibilities for particular tasks, set deadlines, and, in some cases, also determine necessary funds, are widely recognised to be the optimal way to frame anti-corruption policies.

This sub-dimension contains two scored indicators: corruption risk assessment and the corruption proofing of legislation. Montenegro and North Macedonia have significantly strengthened their corruption risk assessment frameworks and practice since 2018, while the WB6 economies' performance regarding both indicators remains widely disparate (Table 19.2).

### Table 19.2. Scores for Sub-dimension 16.1: Anti-corruption policy framework

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 16.1: Anti-corruption policy framework | Corruption risk assessment | 1.0 | 2.0 | 1.0 | 3.0 | 4.5 | 3.0 | 2.4 |
| | Corruption proofing of legislation | 1.0 | 1.0 | 1.0 | 2.5 | 2.5 | 2.5 | 1.8 |
| **Sub-dimension average score** | | 1.0 | 1.5 | 1.0 | 2.8 | 3.5 | 2.8 | 2.1 |

### *Corruption risk assessments are carried out in most economies but their quality and impact are disputed*

The corruption risk assessment (CRA) indicator reflects whether the legal and methodological framework for CRA has been adopted and how regularly it is implemented in public institutions. The indicator takes into account whether the practice has become an integral part of organisational activities, and whether the competent authorities ensure sufficient support and monitoring for it.

Although all the WB6 economies have made some steps towards the implementation of CRAs, their performance varies widely. In Albania, Bosnia and Herzegovina, and Kosovo, public institutions are only required to carry out CRAs by policy documents rather than laws. However, although not required by law,

the practice of CRA is relatively widespread in Bosnia and Herzegovina. A substantial number of municipal and central-level institutions have also implemented CRAs in Kosovo.

In most WB6 economies, CRA is seen as a stage in the elaboration of internal anti-corruption plans of public institutions (called integrity plans). In Montenegro and Serbia, all institutions must carry out CRAs by virtue of the legal obligation to prepare and adopt integrity plans, and almost all public bodies have to comply. In North Macedonia, CRAs and management of risks generally take place within the framework of internal financial control. The State Commission for Prevention of Corruption (SCPC) is competent to prepare CRAs for different sectors.

Montenegro has the most advanced system of support and monitoring of integrity plans. Public bodies must submit integrity plans and annual implementation reports to the Agency for Prevention of Corruption (APC MNE) as well as assess the efficiency and effectiveness of the plans every second year. In 2018, the APC MNE launched an online application, with three modules: 1) a register of corruption risks, which allows for various kinds of analysis and monitoring of risk trends; 2) a reporting tool on the implementation of measures envisaged in integrity plans; and 3) a module for assessing the effectiveness and efficiency of integrity plans. In Serbia, integrity plans are to be revised/drafted every three years, and the Agency for Prevention of Corruption (APC SRB) supervises their development and implementation. According to the authorities, the Republika Srpska (RS) launched an online application for integrity plans in 2020. The quality of CRAs and integrity plans is a matter of dispute in all WB6 economies, and there seems to be a significant gap between the volume of activity and its impact.

### *Systematic and comprehensive corruption proofing of all relevant legislation has not been established in any WB6 economy*

The corruption proofing of legislation indicator reflects whether the authorities have established a formal process to subject draft and adopted legislation to corruption proofing. The indicator also takes note of ad hoc corruption-proofing activity but focuses particularly on whether the practice is systematic and whether recommendations from the process lead to changes in legislation.

The degree of implementation of corruption proofing of legislation varies among the WB6 economies, but generally remains limited. There is no law envisaging corruption proofing of legislation in Albania, Bosnia and Herzegovina, and Kosovo. At the state level, in Bosnia and Herzegovina the Unified Rules for Legislative Drafting in the Institutions of Bosnia and Herzegovina prescribe the mandatory methodology for assessing the impact of regulations (including on corruption and conflict of interest). Even without a formalised corruption-proofing process, corruption prevention agencies participate ad hoc in the preparation of draft laws and regulations, for example in Kosovo.

Montenegro, North Macedonia, and Serbia have the legal basis and methodologies for corruption proofing legislation. In these economies, corruption prevention bodies have the power to carry out such proofing. The APC MNE has issued 17 opinions with recommendations for the improvement of regulations and, according to the agency, its recommendations have been incorporated into five laws. However, the level of activity in this area has diminished since 2017. The Anti-Corruption Agency of Serbia has published more than 100 assessments since 2013 but its recent activity also appears somewhat diminished compared with the period up to 2018 (Anti-Corruption Agency, n.d.[17]). Even so, in 2019, the agency issued 18 opinions on proposals and drafts of regulations (Anti-Corruption Agency, 2020[18]). In North Macedonia, the SCPC published 15 corruption-proofing reports on laws and draft laws on its website. Very little evidence is generally available about the implementation of recommendations that resulted from the proofing.

### *All the economies have anti-corruption policies, drawn up in consultation with civil society*

All the WB6 economies have anti-corruption policy documents, co-ordination, and implementation arrangements. Their approaches to domestic anti-corruption policy planning can be divided into two groups: the adoption of separate anti-corruption strategies and action plans (Albania, Bosnia and Herzegovina, Kosovo, and North Macedonia) or tying the planning of anti-corruption policy with the process of accession to the European Union (Montenegro and Serbia have plans linked to Chapter 23 on Judiciary and Fundamental Rights of their accession negotiations). The anti-corruption strategies of Bosnia and Herzegovina (at the state level), Kosovo, and North Macedonia had all expired by the end of 2020; their replacements have been prepared but not adopted, which may interrupt their implementation.

Some national anti-corruption policy documents include assessments of funding needs for particular activities with greater or lesser degrees of detail (Albania, Montenegro, and Serbia). In other economies, the planning of funding has been rather ambiguous, based on assumptions that additional funds would not be required for most activities, leaving the determination of funding at the discretion of implementing bodies, or not envisaging the amounts and sources of funding at all. This increases the risk of not implementing the planned measures due to lack of resources.

All the WB6 economies monitor the implementation of their policy documents although with different degrees of analytical sophistication. The usual organisational arrangement comprises contact persons or focal points in implementing agencies who submit information about the progress of implementation to the corruption prevention body (in North Macedonia), to co-ordinators in a working group (in Montenegro), or to another kind of central unit such as the Minister of Justice in Albania. Albania and Bosnia and Herzegovina have also commissioned ad hoc evaluations of implementation progress, while other economies have had civil society organisations preparing independent assessments. The WB6 economies mostly tend to monitor the outputs of anti-corruption policies while concentrating less on outcomes or impact; Albania has the most comprehensive monitoring of outputs and outcomes.

Although it is generally accepted that information on the implementation of anti-corruption policies should be accessible to the public, it is not always fully observed in practice. In Bosnia and Herzegovina, the latest monitoring report of the implementation of the state-level strategy and action plan has not been made publicly available. In Montenegro and Serbia, the public authorities used to publish semi-annual reports on the implementation of the action plans for Chapter 23 but stopped the practice in 2019-20 (Government of Montenegro, 2019; Министарство правде, 2018).

Consultations with civil society are a standard practice across the WB6 region, although some civil society stakeholders complain that the responses to their proposals are insufficient. For instance, in Montenegro in 2016 the draft anti-corruption operating document was submitted to a public debate, and the official report of the consultations shows which proposals of civil society representatives were incorporated or why they were rejected (Ministarstvo pravde, 2016). Nevertheless, some NGOs claim that most proposals by the civil society were ignored. In Albania, repeated online consultations and in-person discussions took place regarding drafts of the action plan 2020-23 for the implementation of the Inter-Sectoral Anti-Corruption Strategy but reportedly feedback was not provided systematically (EC, 2020b). Albania has started to publish reports of consultations on the monitoring reports of its strategy. Meanwhile, most WB6 economies still do not provide public overviews of the proposals they received, accepted or rejected on their anti-corruption policy documents, which makes it harder to assess the impact of the consultations. This assessment cannot independently verify the validity of the critical claims of the stakeholders in some of the economies, and only takes notice of the controversy surrounding the consultations.

The COVID-19 pandemic prompted emergency measures and policies, which can create new corruption risks and require new prevention actions. As the pandemic continues, this situation is rapidly evolving and hence not fully assessed here. In some of the economies, the relevant agencies quickly reacted to the

potential new challenges. For example, Bosnia and Herzegovina developed a framework action plan for prevention of corruption during the pandemic, while North Macedonia introduced measures to increase transparency in the allocation of relief funds and implemented other measures.

Most WB6 economies are parties to several international anti-corruption legal instruments such as the United Nations Convention against Corruption, and participate in international mechanisms such as the Group of States against Corruption (GRECO) and the OECD Anti-Corruption Network for Eastern Europe and Central Asia.

### *The way forward for anti-corruption policy framework*

- **Albania, Bosnia and Herzegovina, and Kosovo should systematically corruption proof their legislation** and make such proofing mandatory for most relevant legislation.
- **Introduce transparent and detailed planning of funding for anti-corruption activities** where exact budget requirements are not included in anti-corruption strategies and action plans.
- **Explore how to strengthen the monitoring of outcomes and impact** of anti-corruption policies.
- **Develop standards of good practice for the involvement of civil society** preferably based on broad consensus between the authorities and civil society groups.

## Prevention of corruption (Sub-dimension 16.2)

Successful prevention of corruption safeguards public integrity and ensures that laws and policies are fairly designed and implemented without undue influence. It prevents harmful impacts from corruption from occurring in the first place, and reduces the need for complicated and costly repressive measures. Preventing corrupt acts before they take place is the most effective way to promote public trust and the efficient use of public resources.

The only scored indicator for this sub-dimension shows that most WB6 economies have strengthened anti-corruption awareness and education activities, and disparities between the economies in this area have decreased since 2018 (Table 19.3).

### Table 19.3. Scores for Sub-dimension 16.2: Prevention of corruption

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 16.2: Prevention of corruption | Anti-corruption public awareness and education | 4.0 | 3.0 | 2.5 | 3.0 | 4.0 | 3.0 | 3.3 |
| **Sub-dimension average score** | | 4.0 | 3.0 | 2.5 | 3.0 | 4.0 | 3.0 | 3.3 |

### *All the WB6 economies conduct awareness-raising activities*

The anti-corruption public awareness and education indicator assesses the extent of government engagement in awareness-raising and education activities. It considers whether the government engages in general campaigns on corruption; produces easily accessible information materials; organises conferences and seminars for target audiences; supports, develops and delivers education programmes for public officials, students and other groups; allocates specific funding; and monitors the effectiveness of awareness-raising activities and adjusts them accordingly.

The public authorities in all the WB6 economies engage in anti-corruption awareness raising and education. Such activities have been especially extensive in Albania (public outreach events, consultative forums) and Montenegro (fliers, brochures, a billboard, TV spots). Other examples include competitions for art and literary works by school students on anti-corruption topics (Bosnia and Herzegovina) and a campaign for reporting corruption by the Customs Administration of North Macedonia. The public

authorities have engaged in relatively little general awareness-raising in Kosovo since 2016 and Serbia since 2018.

Assessment of the effectiveness of awareness-raising activities remains rare. A notable exception is Montenegro where effectiveness is measured through an annual poll, which measures the share of citizens who would report corruption, claim to know what the APC MNE does, and who believe that the agency has contributed to the overall fight against corruption and that its campaigns encourage citizens to fight corruption, etc. (ASK and Defacto Consultancy, 2019[19]). According to the APC MNE, the survey findings have been used to target communication activities.

The main target groups for education and training activities are public sector officials and employees in all the WB6 economies as well as students at different levels of the education system (in Bosnia and Herzegovina, Montenegro, North Macedonia, and Serbia). While the need to educate officials is obvious, the choice to focus on students also appears strategically sound, by aiming to achieve the greatest impact on the attitudes of the broader society through younger generations. Training for public officials is provided by corruption prevention bodies in all the WB6 economies, as well as schools of public administration or the judiciary (Albania, Kosovo, North Macedonia and Serbia), ministries of justice (Albania, the RS), civil-service bodies (Bosnia and Herzegovina at both state and entity level), etc. Online training has been relatively rare; as of mid-2020, there was evidence of online training only in Bosnia and Herzegovina and Serbia. The COVID-19 pandemic is likely to have contributed to the wider use of online training.

A reassuring trend is the evidence of systematic funding of awareness-raising and education activities from national budgets in most WB6 economies even where contributions from international donors remain relevant. Funding from national budgets sends signals that the public authorities appreciate the significance of awareness raising and education.

### *Corruption prevention bodies enjoy varying degrees of independence and resources across the WB6 economies*

Corruption prevention bodies operate in all the WB6 economies. In all the economies except Albania and the entities of Bosnia and Herzegovina, the main prevention bodies have comprehensive mandates to plan anti-corruption policies, oversee the management of conflicts of interest, implement asset and interest disclosure systems, and engage in awareness raising and education. In some economies they also carry out preliminary administrative probes in suspected corruption cases, etc. Albania has a multitude of prevention bodies and institutional arrangements. Its most prominent body – the High Inspectorate for the Declaration and Audit of Assets and Conflicts of Interest (HIDAACI) – is specifically responsible for the areas defined in its title. The Agency for Prevention of Corruption and Co-ordination of the Fight against Corruption of Bosnia and Herzegovina (APC BIH) has comparatively limited direct powers due to the constitutionally determined division of responsibilities between the state and autonomous entities.

The corruption prevention bodies mostly have adequate independence safeguards and mechanisms of public accountability. These include the competitive selection of candidates for leadership posts, the involvement of several stakeholders and institutions in the selection and appointment processes, collective management structures for some of the agencies, safeguards against the discretionary removal of managers, the publication of decisions made by the bodies, and at least some guarantees of funding.

In Albania, the main policy planning and administrative co-ordination unit (the Directorate of Programmes and Projects in the Anti-Corruption Field in the Ministry of Justice) as well as two institutions with administrative oversight responsibilities (the Inter-Institutional Anti-Corruption Task Force and the Special Anti-Corruption and Anti-Evasion Unit) are under direct or indirect control of political leadership and have no special independence safeguards. The APC BIH has a Selection and Monitoring Committee, which nominates the agency's director and receives reports on its operations. In practice, the committee's mandate expired in 2018, and, as of end 2020, there was no evidence of renewed activity except for the

news of the appointment to the committee of a person included in the US sanctions list for corruption (Transparency International BiH, 2020[20]).

The capacity of the prevention bodies varies, and at least some of them have struggled to maintain sufficient human resources. The institutions in Bosnia and Herzegovina, Kosovo, and North Macedonia are the smallest in the Western Balkan region (SELDI, 2019[21]), and this is particularly challenging for the latter two due to their broad mandates.

### *The legal frameworks and oversight bodies needed to manage conflicts of interest are mostly in place*

Most of the WB6 economies have advanced legal frameworks to manage conflicts of interest. Dedicated laws on prevention of conflicts of interest and/or corruption, combined with civil service and other laws, form frameworks which apply to a generally comprehensive range of officials. The laws mostly comply with international standards. In Albania, Kosovo and Serbia, they cover all three main internationally recognised forms of conflicts of interest – actual, potential, and apparent – at least in principle. All the laws require public officials to be aware of their conflicts of interest and take steps to resolve them. Albania's law provides the most detailed description of the steps that officials and their superiors should take to prevent and resolve conflicts of interest.

Detailed reviews have identified areas where some provisions of the laws could be improved. For example, international experts have identified ambiguity regarding the ad hoc disclosure and management of conflicts of interest in North Macedonia (GRECO, 2019[22]). Since then, North Macedonia has attempted to clarify the procedures by adopting a new code of ethics and a guide as well as relying on designated persons in government institutions to advise on integrity matters. GRECO found that Serbia's Law on Corruption Prevention lacked criteria for restricting public officials from performing business activities or allowing them to do so (GRECO, 2020[23]). The legal framework in Bosnia and Herzegovina contains several laws, including the non-operational law of the FBiH, and is not compliant with the GRECO recommendations to harmonise "the legislation on conflicts of interest throughout the national territory" (GRECO, 2018[24]). In January 2021, the House of Representatives of Bosnia and Herzegovina adopted a new law on conflicts of interest. Guides on conflicts of interest have been adopted in most WB6 economies.

The oversight bodies have different means of responding to non-compliance in the different economies. These include requests to resolve conflicts of interest, notifying the authorities where the officials concerned perform their functions, recommending dismissal, issuing warnings, and initiating actions to render actions void if they were made in circumstances where there was a conflict of interest. Some of the economies also envisage criminal sanctions for offences related to conflicts of interest. There are two main ways that the central oversight body can apply sanctions. In Albania, Bosnia and Herzegovina, and North Macedonia, the oversight bodies have the power to apply administrative sanctions directly, whereas in Kosovo, Montenegro and Serbia, they establish violations and then forward cases to courts or other bodies to issue sanctions or other consequences. Table 19.4 gives the data on recent sanctions and investigations.

The oversight institutions in the RS (Commission for Determining Conflicts of Interest in Public Bodies) and especially at the state level in Bosnia and Herzegovina (Commission for Deciding on Conflicts of Interest, CDCI) have weak safeguards against undue political interference. Moreover, the mandate of the CDCI expired in 2018, and it only resumed activity in mid-2020.

### Table 19.4. Sanctions for violations related to conflicts of interest (2017-19)

| Year | ALB | KOS | MKD | MNE | SRB |
|---|---|---|---|---|---|
| 2017 | 436 fines | < 5 cases submitted for minor offence procedures; < 5 cases sent for criminal investigation | 7 reprimands | 26 | 125 (for conflicts of interest)<br>153 (for incompatibilities) |
| 2018 | 112 fines | < 5 cases submitted for minor offence procedures; 10 cases sent for criminal investigation | 1 reprimand | 20 | 113 (for conflicts of interest)<br>125 (for incompatibilities) |
| 2019 | 54 fines | 2 cases submitted to the prosecutor's office; 2 requests for dismissal/ minor offence procedures. | 2 reprimands; 1 fine | 32 | 82 (for conflicts of interest)<br>117 (for incompatibilities) |

Note: Data on Albania include non-declaration of private interests, conflicts of interest and violations of the law on whistle-blowing. Data on Montenegro include sanctions for conflicts of interest and violations of restrictions.
Source: Information provided by public authorities; (AKK, 2020[25]), Annual Work Report. 1 January – 31 December 2019, https://www.akk-ks.org/assets/cms/uploads/files/Publikimet/Raporte/03.%20Raporti_Vjetor_i_Punes_AKK_viti_2019_ver_final_ENG_AKK_Mars_2020.pdf; (European Commission, 2018[26]), Kosovo* 2018 Report, Commission Staff Working Document, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-kosovo-report.pdf; (European Commission, 2019[27]), Kosovo* 2019 Report, Commission Staff Working Document, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-kosovo-report.pdf.

### *Asset and interest disclosure requirements apply to most high/mid-level public officials, but verification remains a problem*

Asset and interest disclosure apply to most high/mid-level officials in the majority of the WB6 economies (Albania, Kosovo, Montenegro, and Serbia). The range of officials covered is relatively narrow in North Macedonia, while Bosnia and Herzegovina is yet to establish a comprehensive and fully functional framework for asset and interest disclosure.

Analysis reveals some gaps in the information required to monitor the economic situation and interests of public officials. The most common gaps are beneficial ownership, when not based on formal ownership, and virtual assets such as cryptocurrencies. In some systems, the omissions also include trusts, cash avings, major transactions (expenses), salary payments for performing official functions and unpaid outside posts.

Kosovo and Montenegro publish the declarations, except for some limited personal data. Public access to the information in Albania is on request, but routine publication is expected to start in 2021. In Serbia, broad categories of data are exempt from public disclosure, such as the sources and amounts of income from non-public sources, amounts of savings, and ownership of financial instruments. In North Macedonia, the implementation of the whole system of declaration in line with the law of 2019 was delayed as of November 2020 due to software development delays.

Data on the effectiveness of the declaration systems for detecting illicit income are limited. In some of the economies, for example Kosovo, verification focuses on comparison with data held by other institutions rather than any analytical assessment of the plausibility of officials' declared economic conditions. Few of the probes into inexplicable wealth have resulted in any irregularities being found in Montenegro. In North Macedonia, in cases of suspected unjustified increase of property, an initiative to verify undeclared and untaxed assets can be submitted to the Public Revenue Office. However, since 2016, no personal income tax debt settlement decisions have followed the verifications. In Kosovo, Montenegro and Serbia, limited access to bank information, whether for legal or practical reasons, is an obstacle to exhaustive verification. Auditing of income and assets has been a significant element in the vetting of judges in Albania and a cause of grievances concerning alleged violations of human rights, although the European Court of Human Rights dismissed this in a landmark judgment (Box 19.1).

In a pioneering effort, on 19 March 2021, Montenegro, North Macedonia and Serbia signed the International Treaty on Exchange of Data for the Verification of Asset Declarations to provide direct administrative exchange of information among them (RAI, 2021[28]). The treaty sets legal grounds for

access to information located abroad in the course of administrative proceedings, which is one of the most acute challenges to asset verification.

### *Protection of whistle-blowers has been strengthened but still does not meet international standards*

The WB6 economies have been strengthening the protection of whistle-blowers, although the maturity of their legal frameworks, levels of whistle-blower activity and reliability of protection vary. In the last five years, new whistle-blower protection laws have been adopted in Albania (2016), the RS (2017), and Kosovo (2018). There is no whistle-blower protection law in the FBiH. Montenegro and Serbia have had high levels of whistle-blower activity (Table 19.5).

Most of the laws extend protection to whistle-blowers in both the public and private sectors and provide protection against varied and non-exhaustively listed types of retaliation. Deviations from the EU Directive 2019/1937 on whistle-blowing are commonplace. For example, only corruption-related matters can be the subject of whistle-blowing in Albania and Montenegro. External whistle-blowing to competent authorities is subject to at least some conditions, such as having reasons to doubt the integrity of an internal review of a whistle-blower report in Albania, the state level of Bosnia and Herzegovina, Kosovo, and North Macedonia. Several economies either deny protection in case of public disclosure to the media or public associations (Albania and Montenegro) or subject such disclosure to excessively limiting conditions (North Macedonia and Serbia). Some laws do not envisage protection for persons connected with the whistle-blower (Albania and Bosnia and Herzegovina).

**Table 19.5. Numbers of whistle-blower reports and requests for protection (2016-20)**

| Year | ALB | | MKD | | MNE | | SRB |
|---|---|---|---|---|---|---|---|
| | Reports | Requests for protection | Reports | Requests for protection | Reports | Requests for protection | |
| 2016 | | | | | 56 | 8 | 774 whistle-blower protection cases received in courts during June 2015 - December 2019 |
| 2017 | 8 | 1 | | | 69 | 2 | |
| 2018 | 16 | 3 | | | 110 | 1 | |
| 2019 | 14 | 1 | 19 | 2 | 110 | 3 | |
| 2020 | 9 | 1 | 6 | | 75 | 3 | |

Note: Data only refer to reports to central bodies in Albania, Montenegro, and North Macedonia.
Source: Information provided by the public authorities; Montenegro also: (European Commission, 2019[29]), *Montenegro 2019 Report, Commission Staff Working Document*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-montenegro-report.pdf; (European Commission, 2020[30]), *Montenegro 2020 Report, Commission Staff Working Document*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/montenegro_report_2020.pdf; (ASK, 2020[31]) *Report on the work of the Prevention Agency*, https://www.antikorupcija.me/media/documents/Izvje%C5%A1taj_o_radu_ASK_u_2020.pdf; (Ministry of Justice, 2020[32]), *Revised Action Plan for Chapter 23 and Judicial Development Strategy for the Period 2020-2025 (22.07.2020)*, https://www.mpravde.gov.rs/tekst/30402/revidirani-akcioni-plan-za-poglavlje-23-i-strategija-razvoja-pravosudja-za-period-2020-2025-22072020.php.

In most of the region, the share of whistle-blower reports which result in the sanctioning or prosecution of perpetrators of corrupt acts is low. Anecdotal evidence of retaliation against whistle-blowers recurs in the media, and studies have identified various cultural and institutional barriers to whistle-blowing in several WB6 economies - see, for example: (Komiteti Shqiptar i Helsinkit, 2020[33]).

### *The way forward for prevention of corruption*

- **Measure the effectiveness of awareness-raising activities**, for example by using public opinion surveys, and use the results of such monitoring to adjust future activities.
- **Introduce or develop cost-effective online anti-corruption courses** to increase the reach of anti-corruption training.

- **Review the requirements for asset declarations** to ensure that the disclosed information gives a comprehensive picture of the economic situation of declarants, including beneficial ownership, virtual assets and cash savings. Strengthen comprehensive financial analysis of asset declarations in addition to their formal verification.
- **Further develop legislation for protection of whistle-blowers in line with international standards**, continue disseminating information to promote whistle-blowing and increase the usefulness of reports for follow-up by relevant authorities, and reduce the obstacles that whistle-blowers face, especially by making it is easy find out when, where and how to apply for protection.

### Box 19.1. The European Court of Human Rights (ECHR) hands a judgment consequential for the maintenance of public officials' integrity

This box illustrates the conformity of important aspects of the judiciary vetting process in Albania and verification of assets with the standards of human rights. In the case of Xhoxhaj v. Albania, the ECHR came to conclusions significant for the audit of public officials' assets and consequences of such audit. The court assessed several cornerstones of the audit of assets of public officials and found them compliant with the European Convention on Human Rights. The findings will be relevant not only for Albania but also other European countries in developing and reforming systems to oversee the legality of officials' wealth.

The application to the ECHR was brought by a former judge of the Constitutional Court of Albania who was dismissed based on the findings of the vetting of judges. In the vetting process, the competent bodies found that the judge and her partner had not had sufficient lawful income to acquire a flat, the judge had not convincingly explained the lawful source of monetary assets and attempted to conceal and present the liquid assets inaccurately. She and her partner had not justified the lawfulness of the income for these monetary amounts. It was found that the judge's partner had not disclosed a cash amount, and the judge had not disclosed foreign bank accounts in declarations of assets as required by law.

The ECHR found no violations of the European Convention of Human Rights. Beyond findings regarding the independence and impartiality of the vetting bodies, fairness of the proceedings, and proportionality of the applicant's dismissal, several conclusions have long-term significance for the oversight of public officials' assets:

- Regarding shifting of the burden of proof: "The Court further reiterates that it is not per se arbitrary […] that the burden of proof shifted onto the applicant in the vetting proceedings after the [Independent Qualification Commission] had made available the preliminary findings resulting from the conclusion of the investigation and had given access to the evidence in the case file […]."
- Methodology: The ECHR notes as a reason for rejecting the claim of violation that the judge "was granted access … to the methodology used to calculate expenses ...".
- Regarding limitation periods: "Given that personal or family assets are normally accumulated over the course of working life, placing strict temporal limits for the evaluation of assets would greatly restrict and impinge on the authorities' ability to evaluate the lawfulness of the total assets acquired [...]."

- Regarding the audit of assets and private life: "While acquisition or creation of assets could be considered to be an aspect of private life, it is not the number or size of assets or an individual's lifestyle as such that could give rise to disciplinary liability, but the individual's inability to justify the lawfulness of the source used for their acquisition or creation and to ensure public trust in his or her integrity. In any event, the Court considers that an audit of assets does not involve an intimate aspect of private conduct that is itself treated as an ethical breach […]."

Source: *Xhoxhaj v. Albania*, no. 15227/19, 9 February 2021.

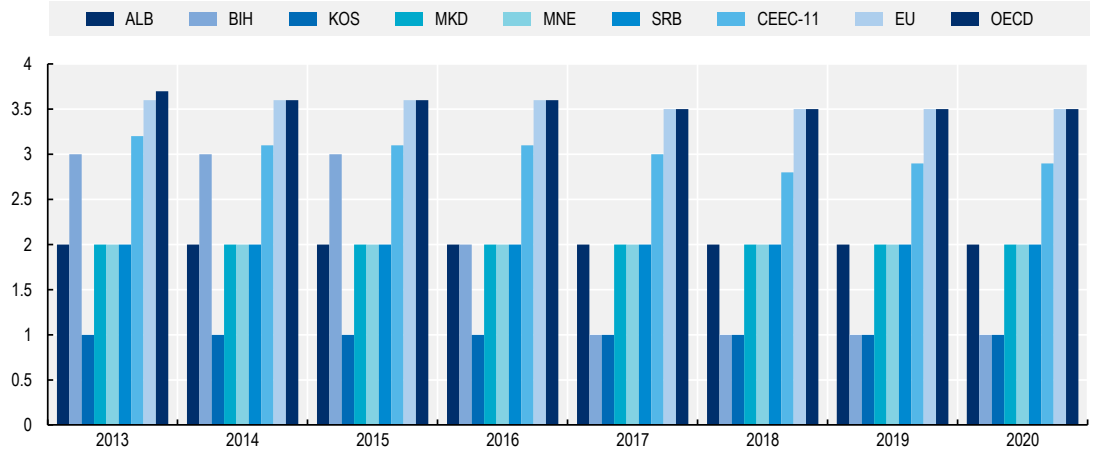
## Independence of the judiciary (Sub-dimension 16.3)

Independence of the judiciary is a fundamental principle of the rule of law enshrined in international standards and the EU treaties. One of the key principles of the fight against corruption is ensuring that those in charge of the prevention, investigation, prosecution and adjudication of corruption enjoy the independence and autonomy appropriate to their functions (Council of Europe, 1997). There are no scored indicators for this sub-dimension.

### *Despite recent progress, none of the WB6 economies have yet achieved firm and sustainable judicial independence*

Since 2013, the Freedom in the World report has consistently found that the degree of independence of the judiciary in the WB6 economies is considerably below the average levels of the EU and OECD member states (Figure 19.7).

### Figure 19.7. Independence of the judiciary (2013-20)




Note: 0 – the smallest degree of independence; 4 – the greatest degree of independence. The CEEC-11 countries are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, the Slovak Republic and Slovenia.
Source: (Freedom House, 2013[34]), Freedom in the World (2013-2020), https://freedomhouse.org/report/freedom-world.

StatLink https://doi.org/10.1787/888934255266

The constitutions and relevant laws of all the WB6 economies provide certain guarantees of independence of the judiciary. Aside from general legal principles, common safeguards include the appointment of judges by judicial bodies and their life tenure without probation periods in Albania, Bosnia and Herzegovina, Montenegro, and North Macedonia. However, in Kosovo, judges are appointed by the President, while in Serbia appointments are made by the National Assembly.

Competitive procedures for the selection of candidates for judicial office and court chairmanship have become widely adopted in the region, as publication of vacancies and the winners of different stages of

selection. However, the implementation of the procedures is not universally satisfactory. For example, in Bosnia and Herzegovina appointment proceedings are reportedly fraught with flaws such as deviations from the rankings of candidates, insufficient transparency, insufficient reasoning about appointment decisions, excessive weight given to ethnic criteria, and the annulment by court of the criteria on performance appraisal for judges and prosecutors in May 2020 (European Commission, 2020[35]).

The institutional setup of the governance of the judiciary is adequate for upholding judicial independence in several WB6 economies. In Albania, Kosovo and North Macedonia, the majority of the membership of judicial councils are judges who have been elected by other judges. In contrast, judges elected by their peers are a minority in the councils of Bosnia and Herzegovina and Montenegro. Moreover, the High Judicial and Prosecutorial Council (HJPC) of Bosnia and Herzegovina lacks explicit constitutional status. The *ex officio* membership of ministers of justice in the judicial councils of Montenegro, North Macedonia, and Serbia can be seen as a restriction of judicial independence. Serbia has the weakest guarantees of the independence of judiciary in its institutional set up. The National Assembly directly or indirectly appoints members of the High Judicial Council (Venice Commission, 2007[36]). Completing the procedure of amending the Constitution is a key task in Serbia's Judicial Development Strategy for the period of 2020–25 (Government of the Republic of Serbia, 2020[37]). This will include, among other things, strengthening the independence of the courts.

Anecdotal evidence of threats to the independence of judiciary remains common across the WB6 region. For example, there have been public comments by government officials on court proceedings in Serbia, and discretionary state-sponsored benefits as well as temporary salary reductions for some judges due to the COVID-19 pandemic in Montenegro (European Commission, 2020[38]; European Commission, 2020[30]; Građanska alijansa, 2019[39]). These and other observations show that firm and sustainable independence of judiciary has not yet been achieved in any of the WB6 economies.

The most ambitious reform process of recent years has been in Albania, which started a vetting process in 2016 for all judges and prosecutors as a single extraordinary measure under the oversight of the International Monitoring Operation. Processing of more than 286 dossiers resulted in 62% dismissals (European Commission, 2020[40]). However, the vetting has also created a strain on the judiciary due to the increased number of vacancies. At one point, the High Court and the Constitutional Court became practically dysfunctional (Venice Commission, 2020). In contrast, the appraisal of judges in Kosovo has been perceived as unrealistically lenient. In 2019, 99% of judges with permanent mandates who were subject to evaluation were rated "good" or "very good", in stark contrast to common perceptions about judges' professionalism (European Commission, 2020[41]).

Several WB6 economies have taken steps to strengthen the disciplinary liability of judges through reforms such as the introduction of the High Justice Inspector responsible for initiation of disciplinary proceedings in Albania and clearer disciplinary mechanisms based on the new Law on the Disciplinary Liability of Judges and Prosecutors (2018) in Kosovo. In Serbia, disciplinary and ethics rules are being revised to improve the definitions of offences, among other aims. In Montenegro, however, the lack of publication of decisions on disciplinary proceedings against judges limits public accountability. In Bosnia and Herzegovina, concerns have been raised about excessive dominance of the HJPC members in disciplinary commissions, obstacles to disciplinary liability of members of the HJPC themselves, alleged inconsistencies in decisions, lenient sanctioning policy, etc. (Delegation of the European Union to Bosnia and Herzegovina / EUSR, 2019[42]; Omerović, 2020[43]; Transparency International BiH, 2020[44]).

### *The way forward for independence of the judiciary*

- **Ensure that the majority of members of judiciary councils are judges elected by other judges** in economies where that is not the case (Bosnia and Herzegovina, Montenegro, and Serbia). In Bosnia and Herzegovina this may require the separation of the institution into judiciary and prosecutorial councils.

- **Serbia should continue to debate and eventually amend the relevant legal provisions to firmly safeguard judicial independence** including by reducing the role of political bodies in judicial careers.
- **Shield the judiciary from specific threats relevant to the individual economies,** such as hostile communication from government members, arbitrary advantages or disadvantages handed by the government to individual judges, and tolerance of inexplicable wealth among judges.

## Business integrity and corporate liability (Sub-dimension 16.4)

Business integrity is essential for both the public interest (reducing the supply of bribes from the business sector, for instance) and private interests (such as safeguarding investment value). The sustainable containment of corruption is more likely when public sector and private sector actors co-operate and complement their mutual efforts against abuse. There are no scored indicators for this sub-dimension.

### *There are few business integrity requirements on companies but disclosure of beneficial owners is being introduced*

There are few concrete business integrity practices or incentives for companies to improve the integrity of their operations in the WB6 economies (for an example of good practice, see Box 19.2). Company laws do not explicitly envisage the responsibility of boards of directors to oversee the management of corruption risks apart from general fiduciary duties. Business chambers and associations have undertaken some activities such as adopting the Business Ethics Code and establishing the Court of Honour (Montenegro) and developing principles of business ethics (North Macedonia).

There are few designated institutions such as business ombudsmen responsible for receiving complaints from companies about corruption-related matters. According to the Minister of State for Protection of Entrepreneurship of Albania, the minister addresses complaints by entrepreneurs from an administrative perspective, including corruption-related matters.

The introduction of disclosure of beneficial owners is at different stages in the different economies. Most of the WB6 economies have recent laws, which comply with the EU's 5th Anti-Money Laundering Directive (2018/843) regarding the requirement to provide access to data on beneficial owners to any member of the general public. Only in the FBiH and Kosovo does the law not require disclosure of beneficial owners. The legal definitions of beneficial owners are mostly modelled along the lines of the definition in the EU directives. As of end 2020, Albania and Montenegro had not launched the relevant registers; North Macedonia made its register operational in January 2021.

### Box 19.2. Helping businesses to avoid bribery in the United Kingdom

Public authorities can effectively incentivise and assist private companies to prevent, detect and report bribery. Even when shareholders, management and other employees want to avoid corruption in business proceedings, they may not be aware of the full extent and kinds of corruption risks and all the available tools that could be used to mitigate them. Therefore, guidance and clear communication about the mandatory and recommended anti-corruption compliance measures can be essential support for companies.

The United Kingdom is an example of good practice in this regard, based on, among other things, the provisions of the 2010 Bribery Act regarding liability of legal persons, including for failing to prevent bribery unless they prove that they "had in place adequate procedures designed to prevent" bribery by persons associated with them. In 2011, the Ministry of Justice published the Guidance to Commercial Organisations, which explains how to prevent bribery by way of applying anti-bribery procedures, demonstrating top-level commitment, assessing risks, applying due diligence procedures in respect of persons who perform services for or on behalf of the organisation, communicating the prevention policies internally and externally, and monitoring, reviewing and improving procedures as necessary.

Other authorities have also provided guidance. The Financial Conduct Authority (financial regulatory body) published the Financial Crime Guide and the results of its thematic reviews. The City of London Police developed films for commercial organisations and law enforcement around the world to raise awareness.

The UK government has published a set of resources accessible through a web portal for businesses (www.great.gov.uk) containing:

- tailored guidance on compliance, prevention, and collective action for [small and medium-sized enterprises] SMEs
- links to the Transparency International's Global Anti-Bribery Guidance and the Anti-Corruption Toolkit for SMEs from the G20 and B20
- information on UK legislation and how it relates to businesses operating abroad
- a guidance pack and a quick start guide to the Bribery Act 2010 ...
- information and links to guidance on anti-corruption legislation around the world, e.g. the US Foreign Corrupt Practice Act
- detailed information on Know Your Customer procedures which highlights the importance of identifying foreign bribery, conducting due diligence checks and supply chain mapping.

Although the OECD Working Group on Bribery in International Business Transactions has found some room for the further improvement of the policy, the adoption of anti-corruption corporate compliance measures by companies in the United Kingdom is overall well advanced.

Source: (OECD, 2019[45]), *Implementing the OECD Anti-Bribery Convention: Phase 4 Two-Year Follow-Up Report: United Kingdom*, www.oecd.org/corruption/United-Kingdom-phase-4-follow-up-report-ENG.pdf; (Ministry of Justice, 2011[46]), *The Bribery Act 2010*, guidance, www.gov.uk/government/uploads/system/uploads/attachment_data/file/181762/bribery-act-2010-guidance.pdf; (OECD, 2017[47]), *Implementing the OECD Anti-Bribery Convention, Phase 4 Report: United Kingdom*, https://www.oecd.org/corruption/anti-bribery/UK-Phase-4-Report-ENG.pdf.

### *The main elements of liability of legal persons are in place but evidence of enforcement is scarce*

Liability of legal persons in all WB6 economies is general, meaning it is applicable for all criminal offences, and mostly autonomous, meaning it can be applied even when a natural person is not sentenced for the perpetrated criminal offence. The liability of legal persons in the region generally follows the expanded identification model where the liability of the legal person can be triggered by an offence committed by a person belonging to the entity's management or having representative powers (responsible person) or by such person's failure to supervise employees (OECD ACN, 2015[48]). In Bosnia and Herzegovina and North Macedonia, a legal person can also be held liable when they benefit from gains acquired through criminal offences. Thus, the main elements of liability of legal persons generally comply with international standards.

One issue of concern is the low level of fines applicable in several of the economies. The upper limit of fines for active corruption offences is around EUR 45 000 in Albania and around EUR 42 500 in Serbia. In Kosovo, the maximum limit for the gravest crimes is EUR 100 000. In North Macedonia, the general upper limit of fines is around EUR 485 000, but the law envisages much lower amounts for lesser crimes, to which certain corruption offences belong. Even when illicitly gained benefits can be confiscated, fines appear low relative to the possible scale of large corruption transactions.

The legal rules differ regarding the effects of compliance on sentencing and its enforcement. Compliance in the form of eliminating the organisational shortcomings which led to the criminal offence, is recognised as a mitigating circumstance in Albania. Montenegro envisages the possibility of exemption from punishment and Serbia permits suspended sentencing when the relevant entities have implemented compliance measures. The laws of Bosnia and Herzegovina, Kosovo, and North Macedonia do not envisage due diligence (compliance) as grounds to exempt legal persons from liability, mitigate or defer sanctions. These economies do not appear to have exhausted all legislative possibilities to incentivise anti-corruption compliance in companies.

Data are scarce about the application of liability of legal persons in corruption cases. In Albania, one sanction was applied in 2016, two in 2017, and two in 2018. In North Macedonia, no sanction was applied in 2017-2018, four sanctions were applied in 2019. The track record appears strongest in Montenegro where, in 2019, 33 legal entities were prosecuted for offences of the category 'offences against service obligations' (Tužilački savjet, 2020[49]).

### *The way forward for business integrity and corporate liability*

- **Develop standards and guidance on the internal corruption risk management and anti-corruption compliance in companies**. See Box 19.2 for an example of guidance from the United Kingdom.
- **Strengthen corporate liability** by ensuring that fines for all corruption offences conform with the standard of effective, proportionate, and dissuasive sanctions.
- **Explore the benefits of envisaging due diligence (compliance) as grounds to mitigate or defer sanctions** in those economies where it is not available (Bosnia and Herzegovina, Kosovo and North Macedonia).

## Investigation and prosecution (Sub-dimension 16.5)

Investigation and prosecution are key to the repression of corruption. A fundamental precondition for the impartial and effective repression of corruption is the protection of the relevant enforcement and prosecution bodies from undue influence. Combatting corruption requires a complex combination of

expertise, knowledge and skills. Therefore, a degree of specialisation is needed within anti-corruption law enforcement bodies in the anti-corruption field.

The only scored indicator for this sub-dimension shows that most WB6 economies have modestly strengthened the capacity of their anti-corruption law enforcement bodies, but few have made further steps to strengthen their independence. Some WB6 economies have slightly improved their track record of repressing corruption (Table 19.6).

### Table 19.6. Scores for Sub-dimension 16.5: Investigation and prosecution

| Sub-dimension | Qualitative indicator | ALB | BIH | KOS | MKD | MNE | SRB | WB6 average |
|---|---|---|---|---|---|---|---|---|
| Sub-dimension 16.5: Investigation and prosecution | Anti-corruption law enforcement bodies | 2.5 | 2.0 | 2.5 | 3.0 | 3.5 | 3.0 | 2.8 |
| **Sub-dimension average score** | | 2.5 | 2.0 | 2.5 | 3.0 | 3.5 | 3.0 | 2.8 |

### *The WB6 economies have specialised anti-corruption investigative and prosecutorial units and bodies with varying degrees of independence and capacity*

The anti-corruption law enforcement bodies indicator assesses the existence and operation of specialised anti-corruption law enforcement bodies. It considers whether they have adequate capacity (staff, training, expertise, funds, etc.) and whether their financial and operational independence from undue influence is ensured. The indicator also considers evidence regarding the investigation and prosecution of high-level corruption as a proxy indicator for the capacity and independence of the institutions.

The United Nations Convention against Corruption requires public authorities to ensure the existence of a body or bodies or persons specialised in combatting corruption through law enforcement. They should be granted the necessary independence to be able to carry out their functions effectively and without any undue influence. They should also have the appropriate training and resources to carry out their tasks (United Nations, 2004[50]).

The WB6 economies have mostly designated specialised anti-corruption investigative and prosecutorial units and/or bodies. Albania has nearly completed the most extensive institutional reforms in the region since the 2018 assessment. Based on a law adopted in 2016, it is creating a special anti-corruption structure (SPAK). The SPAK consists of the Special Prosecutor's Office (SPO), which is independent from the Prosecutor General, and the National Bureau of Investigation (NBI), which is subordinate to the SPO. The establishment of these bodies has been slow; the SPO was established in 2019 and the staffing of the NBI was close to completion as of January 2021. The legal framework contains safeguards for the independence of the SPO and the NBI, including competitive selection of the leadership and appointments by an independent institution (the High Prosecutorial Council).

Specialised prosecutor's offices – under a variety of titles – are the most widely implemented form of anti-corruption law enforcement among the WB6 economies. However, Bosnia and Herzegovina has only internal specialised sections and departments of prosecutor's offices. Corruption crimes may be just one of several categories of crime these bodies are responsible for. The offices have certain safeguards of their independence, although their strength varies. For example, in Montenegro, North Macedonia and Serbia, candidates for chief prosecutor are selected by public competition and they are appointed by prosecutorial councils rather than political bodies in Kosovo, Montenegro, and North Macedonia. The prosecutorial councils also have powers over their dismissal. Safeguards for operational independence vary; for example, the autonomy of the Special State Prosecutor's Office (SSPO) of Montenegro is limited in that the Supreme State Prosecutor may directly undertake actions for which the head of the SSPO is responsible. In contrast, in North Macedonia, the Public Prosecutor of the Republic cannot act in or transfer matters for which the Prosecutor's Office for Organized Crime and Corruption (POOCC) is competent without the consent of the Chief Public Prosecutor of the POOCC.

The specialised prosecutor's offices all have limited capacity in the WB6 economies although the degree of capacity constraint varies. Serbia has made significant investment in the capacity of specialised prosecution with 21 prosecutors and 27 staff members within the Prosecutor's Office for Organized Crime (POOC) and 45 deputy public prosecutors in the anti-corruption departments of four higher public prosecutor's offices. Six task forces have been established in the prosecutorial bodies, which include representatives of various relevant agencies (European Commission, 2020[38]; European Commission, 2019[51]). On the other hand, in Kosovo and the RS, the broad responsibilities of the specialised units have reportedly led to overstretched capacity (European Commission, 2020[41]; OSCE Mission to BiH, 2019[52]).

Apart from Albania and to some extent Bosnia and Herzegovina (at the state level), none of the WB6 economies have criminal investigation bodies specialising in anti-corruption. There are specialised units within police bodies or ministries of interior in Kosovo, Montenegro, North Macedonia, the RS, and Serbia. For the most part there are no additional safeguards of the independence of these units other than those for police entities in general. The Special Police Division of Montenegro is partially outside the police hierarchy and lines of accountability are subject to the instructions of special prosecutors. At the state level, Bosnia and Herzegovina has the institutionally separate State Investigation and Protection Agency (SIPA) for combating several categories of serious crime including corruption, which has certain special independence guarantees. For example, an independent board is involved in the nomination and dismissal process of its leadership. Most WB6 economies have taken steps to strengthen the capacity of their specialised anti-corruption investigative entities, but this trend needs to continue to secure optimal results. For comparison with a good-practice example, see the multi-purpose anti-corruption body in Lithuania, whose competence includes criminal investigation (Box 19.3).

### Box 19.3. Multi-purpose anti-corruption agencies and the Special Investigation Service of Lithuania

Criminal investigation of corruption offences requires specialised knowledge and skills. It is also essential to protect this activity from undue political interference. Considering this and the fact that effective anti-corruption policies require a combination of preventive and repressive efforts, a few economies in Europe have established multi-purpose anti-corruption agencies, which combine police investigation powers with competencies to raise awareness, educate, assess risks, develop and co-ordinate policies, etc. This institutional model has been implemented in Latvia, Lithuania and Poland, and could be considered as an option in potential future institutional reforms in the WB6 region.

The model has both potential advantages and disadvantages but among its strengths are:

- clear and broad responsibility for the anti-corruption policy
- strength of mandate and ability to counter corruption from different angles
- facilitated co-ordination of varied tasks
- synergies and mutual support between prevention and enforcement functions
- single top-level management, which results in less bureaucracy and a simpler system.

Potential risks include the fact that, when such an agency fails, almost the whole of the country's anti-corruption effort fails. In addition, a multi-purpose agency is internally complicated and can find it hard to focus on all tasks, its resources can be overstretched, the agency may not be politically tolerated and it may provide corrupt politicians a single target to attack at all costs.

A successful example of such agency is the Special Investigation Service (SIS) of Lithuania, which combines policy co-ordination and preventive competencies with investigative powers. An OECD assessment in 2017 commended the service's proactivity in opening bribery investigations and Lithuania's efforts to safeguard its ability to investigate corruption free from undue political influence. The SIS is accountable to the President and the parliament of Lithuania. Based on procedures and conditions established by law, the President appoints and dismisses the Director of the SIS by and with the consent of the parliament.

The OECD report also took notice of the SIS's advertising strategy and its lead role in awareness-raising efforts; participation in numerous anti-corruption research activities; regular contacts with other government bodies, private sector and civil society representatives; and its responsibility for oversight of the National Anti-Corruption Programme. Although the limited resources of the SIS used to be a source of concern, in 2019 the OECD found this challenge had been resolved and noted an increase in the agency's budget and capabilities.

Source: (Kalniņš, 2019[53]), *Multi-purpose and Multiple Anti-Corruption Agencies: Considerations for Institutional Design*, https://hkdepo.am/en/news/multi-purpose-and-multiple-anti-corruption-agencies-considerations-for-institutional-design-drafted-by-dr-valts-kalni-
(OECD, 2019[54]), *Implementing the OECD Anti-Bribery Convention, Phase 2 Two-Year Follow-Up Report: Lithuania*, https://www.oecd.org/corruption/anti-bribery/Lithuania-phase-2-follow-up-report-ENG.pdf
(OECD, 2017[55]), *Lithuania Phase 2 Report*, Working Group on Bribery in International Business Transactions, http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/WGB(2017)70/FINAL&docLanguage=En.

### *Several WB6 economies have intensified the investigation and prosecution of high-level corruption, but the numbers of final convictions are generally low*

Several WB6 economies have been building up their track record of investigating and prosecuting high-level corruption, but widespread significant challenges remain. The WB6 economies define high-level corruption differently, and the formats of statistical data vary so the national level data are not directly comparable. There is evidence of relatively high levels of investigation and prosecutorial activity regarding high-level corruption in Albania, Montenegro, North Macedonia and Serbia, but the numbers of final convictions are generally low (Table 19.7).

**Table 19.7. Number of final convictions for high-level corruption (2014-19)**

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| **ALB** | 0 | 6 | 3 | 5 | 3 | .. |
| **MKD** | 7 | 1 | 4 | 0 | 0 | 3 |
| **MNE** | 1 | 3 | 3 | .. | 1 | .. |

Note: No data provided by Bosnia and Herzegovina, Kosovo and Serbia
Source: Data provided by the governments.

A few economies have taken organisational steps to better target efforts to investigate and prosecute high-level corruption. For instance, in Bosnia and Herzegovina, the HJPC now requires mandatory financial investigation in all corruption cases. Kosovo has established a joint team of representatives of law enforcement institutions to select and target serious crimes and created a database of so-called targeted cases of organised crime and high-level corruption.

Scepticism about the authorities' ability to effectively investigate, prosecute, and adjudicate high-level corruption cases is still common throughout the region, while the relevant law enforcement, prosecutorial and judicial institutions are widely perceived to lack independence or capacity. The specific challenges vary in the different economies. For example, in Albania, investigation activity into high-level corruption has by far exceeded the levels of indictment and conviction (European Commission, 2020[40]; European

Commission, 2019[56]). Conviction rates in court cases for high-level corruption have been low and sanctions generally lenient in Bosnia and Herzegovina and Kosovo (European Commission, 2020[35]; European Commission, 2020[41]; Musliu and Zekaj, 2019[57]; OSCE Mission to BiH, 2019[52]).

On the other hand, there have been some prominent convictions. For example, an Appeals Court judge was convicted for bribery in Albania (confirmed after appeal in 2019) and the former Minister of Agriculture, Water Management and Forestry of the FBiH was convicted in 2019. In Kosovo, the Supreme Court convicted three defendants including a former Member of Parliament in 2020 in the so-called "Pronto" case associated with illegal employment in senior public enterprise positions (Bugaqku, 2020[58]; Himaj, 2020[59]). In North Macedonia, prominent convictions include a prison sentence for a former minister of the interior and a first-instance conviction of the former Chief Special Prosecutor in 2020 (European Commission, 2020[60]). Borrowing the formulation of the European Commission assessments, most WB6 economies have some level of preparedness in the fight against high-level corruption, but the sustainability of these efforts remains to be seen. The level of detected and confiscated corruption proceeds remains low, and financial probes are pursued unsystematically in corruption cases in most of the region.

### *The way forward for investigation and prosecution*

- **Continue efforts to ensure institutional autonomy as a key success factor in anti-corruption enforcement**. In particular, in those economies where corruption investigation bodies are located within the regular hierarchies of the police or the ministry of interior, they should consider ways to strengthen their institutional autonomy.
- **Strengthen the capacity of specialised prosecutors**, especially in Bosnia and Herzegovina and Kosovo.
- **Monitor and analyse proceedings in high-level corruption cases** to identify and mitigate major unjustified discrepancies between the number of investigations, prosecutions, and convictions as well as failures to ensure effective, proportionate and dissuasive sanctioning.
- **Strengthen the practice of financial probes alongside corruption investigations** to increase the amounts of corruption proceeds detected and confiscated, especially those located abroad.

## Conclusion

The WB6 economies continue their efforts to develop and implement comprehensive anti-corruption policies. Civil society is contributing to these efforts with extensive monitoring, critical appraisal of the government actions, and advocacy for policy changes. Most of the economies have set up dedicated prevention and co-ordination bodies, and several of them are actively pursuing further reforms of these institutions. There is a shared recognition of the need to raise public awareness of anti-corruption issues and train public officials. The award of public budget funds for these goals is indicates that they are being duly prioritised.

Nevertheless, the level of corruption has remained high across the region in recent years. Despite efforts to strengthen the rule of law, the independence of judiciary still faces challenges in all the WB6 economies. Persistent safeguarding of the institutional autonomy of specialised anti-corruption investigation and prosecutorial bodies, and strengthening their capacity, will be a key factor determining the future success of anti-corruption policies. Continued efforts to facilitate the cross-border exchange of information in administrative and criminal proceedings among the WB6 economies as well as fighting cross-border corruption will be instrumental in strengthening the anti-corruption efforts of the region as a whole.

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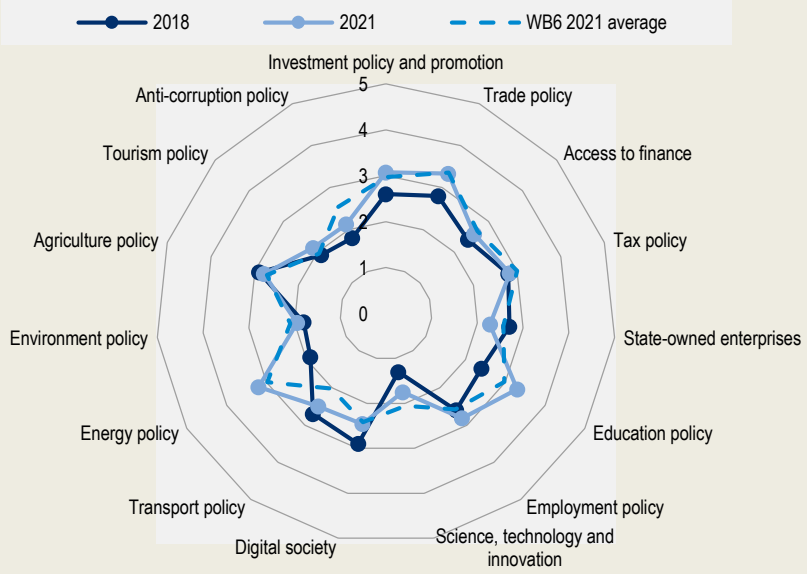
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# Part II Competitiveness Outlook assessment: Western Balkan profiles

# 20 Albania profile

# Key findings

## Figure 20.1. Scores for Albania (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Dimension scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Scoring approach section for information on the assessment methodology. Scores for Dimension 5 Competition Policy are not included in the figure due to different scoring methodology. See the Scoring approach for more information.

Albania has improved its performance since the publication of the Competitiveness Outlook 2018 report in 10 out of the 15 dimensions[1] scored in the assessment (Figure 20.1). Although this clearly indicates progress in the setting up of polices to enhance its competitiveness – at least in about two-thirds of the policy dimensions covered in this assessment – if they are to have a lasting impact then the effective and continuous implementation, monitoring and upgrading of those policies should remain a key priority. Albania achieves its highest average scores in the trade policy, education policy, energy policy, tax policy, investment policy and promotion, and employment policy dimensions. The following are some of Albania's major achievements in these areas:

- **Investment promotion and facilitation has seen notable progress**. A new strategy for investment promotion is underway which is expected to include the internationalisation of Albanian investments, outreach campaigns, aftercare programmes and strategies for attracting foreign direct investment (FDI) and the manufacturing of products in Albania. The Albanian Investment Promotion Agency (AIDA) has a broad mandate that is crucial for investment promotion, facilitation and retention and has started reinforcing its investor targeting actions. A wide range of incentives are provided for investors which can all be found on AIDA's website. Albania is also reinforcing its investment facilitation activities by accelerating the digitalisation of its public services. As of January 2020, 73% of all public services were available on line to citizens and businesses through the E-Albania Portal. Key improvements to investment procedures include the introduction of e-registration and electronic notification of balance sheets and financial reports.
- **The trade policy framework has been strengthened significantly**. The conclusion of Additional Protocol 6 on Trade in Services to the Central European Free Trade Agreement (CEFTA) in December 2019 created an important stimulus for reducing restrictions on services between parties

and for making services markets more attractive to third-country investors. Regulatory transparency has improved, as have public consultations on trade policy. Albania has reinforced its inter-institutional policy co-ordination by adopting new rules and procedures for the National Trade Facilitation Committee (NTFC). It has also established two working groups to explore reducing or eliminating import and export fees and charges. Dialogue with local stakeholders is now required at all stages of trade policy making. All draft laws are published electronically.

- **The education system is improving at a rapid pace.** Albania is one of the fastest-improving participants in the OECD Programme for International Student Assessment (PISA), although it still scores significantly below the European Union (EU) and OECD averages. Its mean score for student performance in mathematics increased by around 24 points between 2015 and 2018, compared to the OECD average 2-point increase. The gap between the highest and lowest-achieving students has also narrowed. Participation rates in school education are high: in 2019, net enrolment in primary education was 98%, and 96% in lower secondary education. The government has also introduced important policy reforms, such as a competency-based curriculum framework, decentralised school governance and a modernised vocational education and training (VET) sector.
- **Employment conditions have been broadly improved.** Advances have been made in tracing the employability of young people after they complete their education and Albania also conducts skills need surveys. It has seen significant progress in increasing women's employment rates, which have risen by 9 pecentage points since 2015 to reach 54% in 2019, the highest in the region. Its public employment service (PES) has begun to modernise the delivery of its employment services, including a new information technology (IT) system, individual counselling and individual action plans, as well as the systematic introduction of employer services.
- **Alignment with EU standards has improved in the energy sector.** Albania has made significant progress transposing the Third Energy Package. It is well on track to establish and operate a competitive energy market – it has a strong independent regulator, is currently finalising the operational deployment of a power exchange and is unbundling the distribution system operator for electricity.
- **Tax policy has seen greater international co-operation and greater alignment with recent international tax trends.** In August 2019, Albania became a member of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), leading to several other initiatives. Its tax system alignment with the Action 5 minimum standard is currently under review by the Harmful Practices Secretariat. In September 2020, Albania ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS and work on treaty abuse and mutual agreement procedures has been scheduled. The OECD Global Forum Assessment team carried out a peer review of Albania and found it was "largely compliant" on the exchange of information on request (EOIR). Albania introduced a law in February 2020 on the automatic exchange of information (AEOI); the first exchanges should occur in the near future. Finally, Albania has transfer pricing legislation in force and its legislation is in line with the OECD Guidelines on Transfer Pricing.

### Priority areas

Although Albania has made significant progress, it needs to make more efforts in several areas. It scores below the WB6 average in the access to finance; science, technology and innovation; environment policy; and anti-corruption policy dimensions. Although in line with the WB6 average, Albania's performance in the state-owned enterprises and digital society policy dimensions has worsened since the last assessment (Figure 20.1). To improve its performance in these priority areas, Albania should consider the following:

- **Increase efforts to diversify access to finance.** Alternative financing sources remain very limited in Albania. Although factoring and leasing are available and backed by well-developed legal

frameworks, crowdfunding, venture capital and business angel networks are non-existent. Giving firms access to funding beyond traditional lending schemes, and meeting their needs at all stages of their development, would help to diversify Albania's currently bank-dominated financial sector.

- **Strengthen the institutional arrangements for state ownership.** Ownership of state-owned enterprises (SOEs) is spread across central government in Albania, being exercised by several other line ministries and central government bodies as well as the Ministry of Finance and Economy. These dispersed ownership responsibilities are not guided by a common ownership policy. This has led to a lack of clear performance expectations from the state, contributing to corporate inefficiencies. The authorities should move forward with their initiative to establish a central state ownership agency – or, if this is not possible, a co-ordination entity – to further harmonise state ownership practices and fully separate ownership and regulatory roles.
- **Strengthen science, technology and innovation through investment in public sector research and business-academia collaboration.** Albania's public scientific research sector remains systemically underfunded, with public spending in research amounting to only 0.06% of GDP in 2018. This may jeopardise its goal to increase investment in research to 1% of GDP by 2022. To achieve this goal, the government should consider expanding the range of financial incentives for collaboration between businesses and academia. Investment in the scientific research system would make the profession more attractive, leading to higher-quality research outputs in the medium to long term. Albania could also reintroduce innovation vouchers to create financial incentives for innovation.
- **Enhance the digital society by investing in digital skills and upgrading information and communication technology (ICT) in schools.** The development of digital skills for adults is not yet fully integrated into VET systems or lifelong learning programmes, despite the lack of digital skills in the economy. IT curricula should be designed with the support of the ICT sector to improve digital skill levels. Training programmes and lifelong learning policy frameworks should be guided by the need to address the digital skills gap in the labour market. Albania also needs to ensure that all schools and students have access to broadband, functioning computers and digital education aids. In 2020, only around 25% of schools had Internet connections at speeds above 10 Mbps, which is below the WB6 average.
- **Protect the environment through comprehensive land-use policies and improved wastewater treatment.** Albania is one of the economies in Europe most at risk for multiple natural hazards, as illustrated by damage wreaked by the 2019 earthquake. The government lacks an all-inclusive land-use policy framework to provide clear direction, focusing on modernising building codes, updating seismic hazard maps and combatting unregulated and illegal building. Meanwhile, wastewater treatment plants cater for only about 15% of Albania's population, and the system faces key concerns such as the lack of licensing and tariffs for wastewater treatment, insufficient operation budget and maintenance, and the negative impact on the environment from underdeveloped networks and connections. A clear mapping of the situation is needed to identify key investment priorities. The government should try to finance these projects as much as possible from the domestic budget and higher water tariffs.
- **Intensify anti-corruption efforts by improving whistle-blower protection and strengthening high-level corruption cases.** Analysis is needed to identify and tackle the factors behind the discrepancy between the large number of investigations and the small number of convictions (of the 90 cases against high-level officials sent for prosecution in 2019, only 5 people were indicted). A fair and transparent assessment should be carried out to identify the obstacles preventing indictment and to increase the effectiveness of the fight against high-level corruption. Albania's whistle-blower protection legislation lacks several important elements found in the EU Directive on whistle-blower protection, such as protection for whistle-blowers who resort to public disclosure.

Albania should provide protection for public disclosure and for people connected with the whistle-blower, remove conditions preventing external reporting to the High Inspectorate for the Declaration and Audit of Assets and Conflicts of Interest (HIDAACI), and establish the right to protection in cases of mistaken identity.

1: Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses different scoring model (Scoring approach).

## Economic context

### *Key economic features*

Albania is a small service-oriented economy with a sizable tourism sector, but also a large agricultural sector. Services, dominated by wholesale and retail trade, real estate, transport, and storage services, account for 48.6% of gross domestic product (GDP) and 43.4% of employment (INSTAT, 2021[1]; World Bank, 2021[2]). Industry, including construction, contributes 20.2% to GDP, with the highest contribution coming from the construction sector (10.8% of GDP) (INSTAT, 2021[1]). Meanwhile, the manufacturing sector is very small, contributing just 6.3% to Albania's GDP. Despite a significant decline over the past decade, agriculture, forestry and fishing remains a very important sector in Albania, accounting for 18.5% of GDP, 36.4% of formal employment and a significant share of informal employment (World Bank, 2021[2]). These contributions are well above the contributions in neighbouring economies, both in terms of value added and employment.

Albania's growth over the past decade has been moderated compared to the period prior to the global financial crisis (Table 20.1), and even though macroeconomic stability has since improved, significant imbalances still persist. The economy is still mainly consumption-driven and investment, including foreign direct investment (FDI), remains concentrated in a few key energy projects and in the real estate sector, which have limited productivity-enhancing potential. In this context, the growth of the tradable sector has been limited. At 31.6% of GDP, the contribution of exports was lower than regional leaders in 2019 (e.g. 62.1% of GDP in North Macedonia) even prior to the impact of the COVID-19 pandemic. Exports consist of goods and services with limited technological content and value added, including tourism, textiles and apparel, electricity, as well as metals and metal-based products (INSTAT, 2021[1]). Moreover, due to the importance of the electricity sector, exports and their contribution to GDP have also been relatively volatile as they depend on hydrologic conditions. Meanwhile the impact of the COVID-19 pandemic has been amplified by the high dependence on tourism exports (see  section). In the context of highly import-dependent consumption (imports represented 45.4% of GDP in 2019), the trade and current account deficits have remained relatively large at 13.8% and 8.9% of GDP respectively (World Bank, 2021[2]; European Commission, 2020[3]).

This economic model has not been conducive to productivity growth. Over the past decade, growth has been mainly driven by labour and capital accumulation, while total factor productivity growth has either been low or negative (World Bank, 2019[4]). Labour productivity growth saw a marked decline in the post-crisis period due to more limited gains from labour reallocation between sectors, as well as weaker gains from within-sector productivity growth. As a result, labour productivity across all sectors remains very low, at less than a quarter of the EU average (World Bank, 2021[2]). And even though employment in Albania is higher than in most economies in the region, at 53%, most jobs are low-skilled and low-waged, including a high share of employment in subsistence agriculture (World Bank, 2019[4]; World Bank, 2021[2]).

Other labour market indicators point to notable outstanding challenges. Despite significant declines over the past decade, the unemployment rate remains elevated at 12.2% (Table 20.1). Moreover, the share of those who have been unemployed for one year or more was 64.3% in 2019, well above the OECD average

of 25.8% and the EU average of 40.4% (WIIW, 2019[5]; World Bank, 2021[2]). Meanwhile, the share of youth not in employment, education or training is also high at 25.8%, which is nearly double the OECD average of 13.6% and the EU average of 10% (World Bank, 2021[2]).

Albania's growth prospects over the coming decade and beyond will strongly depend on the strength of its reform efforts to upgrade human capital, boost investment and expand, diversify and upgrade its exports and modernise the agricultural sector. This will entail improving the quality and relevance of education at all levels, improving the business environment by tackling corruption and informality, strengthening contract enforcement and strengthening property rights, bridging the infrastructure gaps, and improving SMEs' access to finance.

### Table 20.1. Albania: Main macroeconomic indicators (2015-20)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 2.2 | 3.3 | 3.8 | 4.1 | 2.2 | -3.3 |
| GDP per capita[2] | Current international $ | 11 659 | 12. 079 | 12 771 | 13 546 | 14 231 | 13 818 |
| National GDP[2] | USD billion | 11.4 | 11.9 | 13.0 | 15.1 | 15.3 | 14.8 |
| Inflation[1] | Consumer price index, annual % change | 1.9 | 1.3 | 2.0 | 2.0 | 1.4 | 1.6 |
| Current account balance[1] | % of GDP | -8.6 | -7.6 | -7.5 | -6.8 | -8.0 | -8.9 |
| Exports of goods and services[1] | % of GDP | 27.3 | 29.0 | 31.6 | 31.7 | 31.6 | 23.3 |
| Imports of goods and services[1] | % of GDP | 44.5 | 45.9 | 46.7 | 45.4 | 45.4 | 38.1 |
| Net FDI[1] | % of GDP | 8.0 | 8.8 | 7.8 | 7.9 | 7.9 | 7.3 |
| Public and publicly guaranteed debt[3] | % of GDP | 72.7 | 72.3 | 71.9 | 69.5 | 67.9 | 77.4* |
| External debt[4] | % of GDP | 72.9 | 70.0 | 72.1 | 62.8 | 60.1 | … |
| Unemployment[1] | % | 17.5 | 15.6 | 14.1 | 12.8 | 12.0 | 12.2 |
| Youth unemployment[2] | % of total labour force ages 15-24 | 39.6 | 35.6 | 30.9 | 28.2 | 27.0 | … |
| International reserves[1] | In months of imports of G&S | 7.6 | 7.2 | 6.7 | 7.0 | 6.5 | 9.6 |
| Exchange rate (if applicable local currency/euro) [1] | Value | 139.7 | 137.4 | 134.1 | 127.6 | 123.0 | 123.8 |
| Remittance inflows[2] | % of GDP | 11.3 | 11.0 | 10.1 | 9.6 | 9.6 | 9.9 |
| Lending interest rate[5] | % annual average | 7.88 | 6.73 | 6.22 | 5.93 | 6.28 | 6.12 |
| Stock markets (if applicable) [1] | Average index | n.a | n.a | n.a | n.a | n.a | n.a. |

Note: G&S = goods and services; *estimates for 2020.

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3. (World Bank, 2020[8]) World Bank Western Balkans Regular Economic Report https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report.
4. (EBRD, 2020[9]) *Transition Report 2020-21*, https://2020.tr-ebrd.com/countries.
5. (IMF, n.d.[10]) IMF Data https://data.imf.org/regular.aspx?key=61545855.

### *Sustainable development*

Over the past decade, Albania has made progress towards reaching the targets of the 2030 Agenda for Sustainable Development, but considerable challenges still remain in meeting most Sustainable Development Goals (SDGs) (Table 20.2). Albania is only on track to achieve or has maintained the achievement of the SDGs in three main areas – quality education (SDG 4), affordable and clean energy (SDG 7), and climate action (SDG 13). Strong performance in the latter two SDGs reflects Albania's heavy reliance on hydropower and limited use of fossil fuels outside of the transport sector. Meanwhile, in the education dimension, the rates of net primary enrolment, lower secondary completion and literacy are above 92% and on track to reach the 100% SDG targets (Sachs et al., 2021[11]).

## Table 20.2. Albania's progress towards achieving the SDGs

| SDG | Current assessment | Trends |
|---|---|---|
| 1 – No poverty | Challenges remain | Moderately improving |
| 2 – Zero hunger | Significant challenges remain | Stagnating |
| 3 – Good health and well-being | Significant challenges remain | Moderately improving |
| 4 – Quality education | SDG achieved | On track or maintaining SDG achievement |
| 5 – Gender equality | Significant challenges remain | Stagnating |
| 6 - Clean water and sanitation | Significant challenges remain | Moderately improving |
| 7 - Affordable and clean energy | Challenges remain | On track or maintaining SDG achievement |
| 8- Decent work and economic growth | Major challenges remain | Moderately improving |
| 9 - Industry, innovation and infrastructure | Significant challenges remain | Moderately improving |
| 10 - Reduced inequalities | Significant challenges remain | Information unavailable |
| 11 - Sustainable cities and communities | Significant challenges remain | Stagnating |
| 12 - Responsible consumption and production | Significant challenges remain | Information unavailable |
| 13 - Climate action | SDG achieved | On track or maintaining SDG achievement |
| 14 - Life below water | Major challenges remain | Stagnating |
| 15 - Life on land | Significant challenges remain | Stagnating |
| 16 - Peace, justice and strong institutions | Significant challenges remain | Stagnating |
| 17 - Partnerships for the goals | Significant challenges remain | Moderately improving |

Note: The order of progress (from greatest to least) is as follows: SDG achieved; challenges remain; significant challenges remain; major challenges remain.
Source: (Sachs et al., 2021[11]), *The Sustainable Development Report 2021: the Decade of Action for Sustainable Development Goals*, https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

Moderate improvement has been noted in many areas, though notable challenges persist. While extreme poverty – defined as people living on less than USD 1.90 per day – has been almost eradicated (0.2%), the share of people living on less than USD 3.20 per day is 8.5%, above the 2030 target of 0% (SDG 1). Health outcomes (SDG 3) have been improving, with mortality rates for mothers and children under 5 declining below the 2030 target levels. However, considerable progress needs to be made in improving universal health coverage. In the area of clean water and sanitation (SDG 6), more progress is needed to expand access to drinking water services (9% of the population still lacks access) and improve wastewater treatment. Significant challenges remain in the SDG related to industry, innovation and infrastructure (SDG 9), which partly reflect low spending on research and development (R&D) and innovation, low-quality higher education, and the weak quality of trade and transport infrastructure as measured by the logistics performance index (LPI) – for more see the Structural economic challenges). More progress is also needed in improving city life (SDG 11) by reducing air pollution and improving access to piped water, transport and other services; and in fostering a circular economy (SDG 12) through the collection and recycling of waste. In the area of peace and institutions (SDG 16), the biggest gaps lie in tackling corruption, improving the protection of property rights and strengthening the criminal justice system (Sachs et al., 2021[11]).

The most significant gaps vis-à-vis the SDG targets are in the areas of decent work and economic growth (SDG 8), and marine life (SDG 14). High unemployment remains an important challenge despite the progress achieved over the past decade. Likewise, stronger economic growth is needed for more and better jobs as well as higher incomes. Growth also needs to be more inclusive. At 41.7, the Gini coefficient measuring income inequality is still well above the target value of 27.5 (SDG 11). Last but not least, significant efforts are needed to reduce marine pollution and improve the sustainability of fishing practices in Albania's coastal regions (Sachs et al., 2021[11]).

### *Structural economic challenges*

Albania faces a number of key structural challenges that undermine its competitiveness, investment environment and integration into global value chains (GVCs):

*Weak knowledge and skills hinder economic diversification and upgrading*

- **Low-quality education** reflects both low spending on education, as well as poorly targeted spending that undermines education outcomes. In 2018, the Albanian Government spent 2.5% of GDP on education (World Bank, 2020[12]), well below the OECD average of 4.5% (OECD, 2019[13]). A significant share of this spending was on teaching staff, and as a result Albania has a high teacher-to-student ratio, especially at the primary school level (18 in Albania, compared to 13 in EU and 15 in the OECD). At the secondary school level, the number of students per teacher is in line with the EU average but below the OECD average (12 in Albania/EU and 14 in the OECD) (World Bank, 2021[2]). Nevertheless, lower teaching quality in Albania is reflected in considerably poorer learning outcomes. For example, in the latest Programme for International Student Assessment (PISA), fewer than 60% of Albanian students achieved the minimum level of proficiency across all testing subjects (reading, mathematics and science) compared to 76% for the OECD average (OECD, 2019[14]). In the case of reading, just 48% of students achieved the minimum proficiency. Although the latest testing results indicate considerable progress since the previous PISA assessment, more progress is needed to improve education quality over the coming years (OECD, 2019[14]).
- **Skills gaps.** Albania's labour market is characterised by predominantly low-skilled and low-waged employment; skills gaps are limiting the scope for economic upgrading and diversification. In the World Bank's employers' Skills Measurement Program (STEP) survey, more than 90% of firms requiring higher-level skills, including cognitive and socio-emotional skills, reported difficulties hiring staff. For most of these firms, the limited number of candidates was reported as the main obstacle, followed by a lack of experience. Over 50% of firms cited the lack of required skills as the main obstacle to filling available vacancies (Honorati, 2018[15]). In the 2019 Balkan Barometer survey, nearly 40% of respondents noted that the skills that they acquired during their education do not meet the needs of their job. The most deficient skills noted in the survey included foreign language skills (42% of respondents); communication skills (24%) and other cognitive skills, including ability to learn on the job (27%); and creativity, innovation and risk-taking (20%) (Regional Cooperation Council, 2019[16]).

*A challenging business climate undermines investment and private sector development*

Over the past decade, Albania has made progress in reducing the regulatory and administrative burden on businesses, especially in the area of judicial reform, trade, resolving insolvency and starting a business. However, Albania is still ranked 82nd out of 191 economies globally on the World Bank's Doing Business (DB) assessment, reflecting considerable outstanding challenges including corruption, weak contract enforcement, lengthy and costly processes for obtaining licences and permits, weak property rights, and high informality (World Bank, 2020[17]):

- **Corruption** remains an important cost of and obstacle to doing business in Albania. In the latest Business Environment and Enterprise Performance (BEEPS) survey, Albanian firms recorded greater depth and prevalence of corruption than firms in peer economies as well as globally. For example, 36.1% of firms experienced at least one bribe payment request, which is considerably higher than the Europe and Central Asia (ECA) average of 8.7% and the global Doing Business (DB) average of 17%. According to the BEEPS, nearly one-third of all public transactions include a request for a gift or informal payment. Furthermore, 34.6% of firms noted that they were expected to provide gifts when meeting with tax officials, compared to the 7.4% and 13.4% ECA and global averages respectively. Over 40% of firms identified corruption as a major constraint for their business (World Bank, 2020[18]). Reforms of recent years that have increased the availability and use of e-services should lead to a reduction in the frequency of meetings with tax officials and reduced incidence of corruption (European Commission, 2020[19])
- **Contract enforcement** is slow, costly and unreliable. Contract enforcement takes on average 525 days, which is somewhat faster than the OECD average (590 days), but considerably longer than the

global leaders on the DB index (120 days). The process is slowed down by the overburdened court system, which has a significant backlog of cases (World Bank, 2019[4]). Contract enforcement is also quite costly: at 42.7% of the claim value, it is well above the OECD average of 21.5%. Finally, and perhaps most importantly, confidence is lacking in the judicial system's fair and impartial decision making. In the latest Regional Cooperation Council barometer survey, 71% of respondents stated that they do not trust the court system, and the same share stated that they do not believe that the judiciary is independent of political influence. Likewise, 76% of respondents do not believe that the law is applied equally to everyone (Regional Cooperation Council, 2019[16]). In the latest BEEPS, 40% of firms identified the courts as a major constraint (World Bank, 2020[18]).

- **Obtaining licences and permits** is a long and costly process in Albania. For example, obtaining a construction permit takes on average 324 days (compared to a 152-day average for the OECD), requires 19 procedures (compared to the OECD average of 13), and costs 6.8% of the warehouse value (compared to 1.5% for the OECD average). A very large part of the costs are two municipal taxes (on infrastructure and an examination fee) (World Bank, 2020[17]).
- **Inadequately defined property rights** are another important deterrent for investment. This is a problem with long historical roots, and has resulted in widespread competing claims over property ownership that are very difficult to resolve. The resulting uncertainty creates an important impediment for investment, particularly FDI.
- **Unfair competition**, particularly from the informal sector, represents an important constraint for businesses in Albania. In the BEEPS survey, 44.7% of firms stated that they compete against informal firms, while 37.2% of firms stated that informal competition is a major obstacle for their business (World Bank, 2020[18]). The share of informal employment is estimated at about 37.8% (WIIW, 2019[5]).

*Infrastructure deficiencies undermine investment, trade and GVC integration*

These deficiencies include the unreliable electricity supply and insufficiently developed transport infrastructure and connectivity:

- **The unreliable electricity supply** is an important obstacle to doing business in Albania. In the latest BEEPS survey, 58.7% of firms stated that they had experienced electrical outages over the past month and 43% of all firms identified electricity as a major obstacle. Nearly 50% of firms own or share a generator (compared to less than 20% for the ECA average), which produces on average about 12% of the total electricity used (World Bank, 2020[18]). Even though considerable progress has been made in recent years to improve the reliability of the electricity supply, more progress is needed on a few fronts. The heavy reliance on hydropower makes the electricity sector highly vulnerable to periods of low rainfall, when the sector has to rely on expensive electricity imports. Distribution losses are also an important challenge. They remain high at 21.5%, with 64% representing technical losses (INSTAT, 2018[20]). Therefore, further diversification of the energy supply, further infrastructure upgrades to reduce distribution losses and strengthening financial buffers against import-induced financial shocks are needed to improve the reliability of the electricity supply.
- **Deficiencies in transport infrastructure connectivity** also reduce the attractiveness of Albania as an investment destination. In terms of network size, Albania lags behind peer economies across all modes of transport. In road transport, the length of motorways is lower than peers of comparable size, as is the length of the overall road network (Eurostat, 2018[21]). In the rail sector, Albania also lags behind peers for freight transported through the network, even compared to economies that are considerably smaller and have a similarly sized manufacturing sector (as a share of GDP), such as Montenegro (Eurostat, 2018[22]). Limitations in transport policy and investment in transport infrastructure development and maintenance mainly account for these gaps – see Transport policy (Dimension 11).

### *Poor access to finance hinders SME investment, innovation and technology adoption*

Even though the banking sector has been stable, liquid and well-capitalised, credit to the private sector – at 34.4% (37% in February 2021) of GDP – is lower than in peers and advanced economies. This is the case despite a significant decline in non-performing loans, lending interest rates, and a strong growth in deposits. In fact, Albania has one of the lowest loan-to-deposit ratios among emerging economies, at 47% (IMF, 2019[23]). Credit is particularly constrained for SMEs, which face steep lending requirements from the banks. These include most notably the high collateral requirements, which exceed 177% of the value of the loan. And since over 90% of loans require collateral, the barrier for SMEs to access finance is high (World Bank, 2020[18]). Meanwhile, alternatives to bank financing are very limited – see Access to finance chapter (Dimension 3).

### *Cross-cutting and sector-specific constraints undermine the growth of key sectors*

Agriculture is mainly characterised by subsistence farming, and compared to peers, holdings are highly fragmented and small scale, the access and take-up of new technologies is low, compliance with standards is limited, and input costs are high (World Bank, 2019[4]). As a result, agricultural productivity is one of the lowest in Europe and agricultural exports are also very low, at just 15% (World Bank, 2021[2]; INSTAT, 2021[1]). Efforts to consolidate land and foster agricultural co-operatives are further hampered by lack of clearly defined property rights – see Agriculture policy (Dimension 14). Limited access to finance also constrains the growth of this sector – see Access to finance (Dimension 3).

- **Manufacturing** sectors and their GVC integration are constrained by gaps in infrastructure, customs and logistics, challenges in the business environment, skills gaps and firms' limited capacities for technology adoption, limitations in access to finance, etc. (OECD, 2019[24]). Upgrading and diversification of the manufacturing sector could play a key role in boosting exports and GVC integration. Analyses of Albania's product space reveal considerable long-term potential for growth in the automotive industry (vehicle and engine parts), machinery and metal processing. Short- to medium-term gains can also be achieved through the expansion of agri-food processing.
- **Tourism** is characterised by high seasonality and concentration in the coastal areas. Moreover, the value added of the sector is still relatively low, because Albania tends to attract mostly regional tourists and diaspora visitors with low spending power. Given the small size of the economy, the development of higher-end tourism would be beneficial. However, further development and upgrading of this sector is constrained by poor infrastructure, lack of quality standards, weak branding and marketing, high informality etc. (World Bank, 2019[4]). See Tourism policy (Dimension 15).
- **The ICT sector** is mainly constrained by infrastructure gaps, the low supply of skilled workers, weak collaboration between the sector and the relevant educational institutions, and lack of access to finance – particularly financing for start-ups and high-risk venture capital, etc. (World Bank, 2019[4]). Although the sector is still relatively small, it is growing very fast (computer programming and related services have been growing at nearly 30% annually over the past five years) with considerable potential to further boost Albania's service exports and GVC integration.

### *Weak management of public finances holds back long-term development*

- Albania faced the COVID-19 pandemic with a relatively limited fiscal space. Increased spending in the aftermath of the global financial crisis, coupled with weaker revenue performance, increased fiscal deficits and elevated public and publicly guaranteed debt from 57.7% in 2010 to 72.4% in 2016. Thanks to subsequent fiscal consolidation, public debt declined to 67.9% in 2019, but this trend was reversed by the pandemic which increased the expenditure needs while reducing revenues. As a result, at the end of 2020, public and publicly guaranteed debt rose to 77.4% of GDP, the second highest in the region (World Bank, 2021[25]). Improved performance in the fiscal sector will require addressing key

underlying structural constraints, including weak revenue performance (27.4% of GDP compared to 44.7% for the EU average) due to a low tax base, high informality, and high tax evasion, as well as inefficient allocation of expenditures (IMF, 2019[26]; OECD, 2021[27]). The latter requires limiting the rise of non-discretionary current expenditures, including high social transfers, thus creating more space for higher and better targeted expenditures on infrastructure, health, education, etc.

*Environmental degradation threatens long-term development and well-being*

- **Air pollution** is an important challenge in cities across Albania. Transport is the main source of pollution due to the growing number of people and vehicles in the major cities. And with nearly 87% of private cars aged 10 years or older, and nearly 20% 20 years or older, the pollution burden is high (INSTAT, 2021[1]). Residential heating is another important source of air pollution, especially in the winter. Since there is no district heating infrastructure in Albania, a large proportion of the population uses old wood-burning stoves and fireplaces for residential heating (UNECE, 2018[28]), leading to high particulate matter (PM) pollution, especially during the winter. Although annual exposure to PM 2.5 is the lowest in the Western Balkan region (18 micrograms per cubic metre, $\mu g/m^3$), it is still considerably higher than the EU and OECD averages of 13.1 $\mu g/m^3$ and 12.5 $\mu g/m^3$ respectively, and nearly double the World Health Organization (WHO) recommended maximum annual exposure level (10 $\mu g/m^3$) (EEA, 2020[29]) (World Bank, 2017[30]).

Albania is highly prone to natural disasters (floods, earthquakes, landslides, etc,) and has suffered significant economic and physical damage as a result of these disasters. It therefore needs to ensure better stewardship of its natural environment, which provides natural buffers against these disasters. This also ensures the preservation of the country's rich biodiversity. Improving water resource management is also important, being essential for the continued reliance on hydropower, as is providing reliable access to high-quality and safe drinking water to all citizens. Preserving natural resources is also critical especially in the context of climate adaptation. Finally, reducing solid waste and fostering a circular economy will contribute to Albania's sustainable development – see Energy policy (Dimension 12).

*Inequality remains an important challenge*

- Even though living standards have improved substantially over the past decade, according to the latest European Income and Living Conditions Survey (EU-SILC), inequality in Albania is above the regional average and 40% of households are severely materially deprived (Eurostat, 2020[31]). There are considerable disparities across ethnic groups, with the Roma and Egyptian minorities lagging considerably behind on most well-being indicators, such as access to education, infrastructure, and public services. Regional disparities are strong as well. GDP per capita in Tirana is more than double that of the poorest province, Kukës. Likewise, health and social security coverage is up to five times as high in Tirana than in other regions (INSTAT, 2021[1]). In light of this, ensuring that the gains from prosperity are shared by all ought to be an important development priority for the Albanian economy. More inclusive growth will improve the incomes and well-being of all citizens.

*COVID-19 has exacerbated structural challenges*

The COVID-19 pandemic has had a significant impact on the Albanian economy over the past year. The brunt of the impact was felt in the second quarter of 2020 when domestic and external demand were hit hard by COVID-related restrictions on movement, disruptions in value chains etc. Exports were hit the hardest, declining by 49.9% year-on-year (y-o-y), while investment fell by 11.1% y-o-y on account of the dual impact of the pandemic as well as the completion of major energy projects that had strongly contributed to investment in recent years. Private consumption also declined by 7.9% y-o-y, as did public consumption (0.6% y-o-y). The GDP decline was moderated by a fall in imports of 36% y-o-y. The output decline lessened in Q3 to -3.5% y-o-y, due to smaller declines in private and public consumption and

exports, a recovery in investment (4.1% y-o-y) and a further decline in imports (-23.9% y-o-y) (European Commission, 2020[3]; European Commission, 2020[32]).

The service and manufacturing sectors were most strongly affected by the crisis. Retail and wholesale trade, transport, and tourism and hospitality services were worst affected, declining by 27% y-o-y in Q2. Industrial output, meanwhile, fell by 13.1%, led by a decline in manufacturing of 19.1% y-o-y. The only sectors that saw an increase in output were agriculture and real estate (European Commission, 2020[3]; European Commission, 2020[32]).

The impact on the labour market was mitigated by government support measures, which included direct and indirect financial support to businesses affected by the pandemic-related closures, including subsidies for employee salaries, guarantees for loans, etc. (OECD, 2021[33]). Unemployment rose mildly in the second quarter, from 12% to 12.5%, but had returned to the pre-crisis level of 12.1% already by Q3 of 2020, while employment continued to decline in Q3 although at a more gradual pace (-1.2% y-o-y down from -3.9% y-o-y in Q2). Labour force participation also recovered to pre-crisis levels in Q3, though the recovery was more pronounced for men than for women (European Commission, 2020[3]; European Commission, 2020[32]).

Government support also helped to mitigate the impact on household incomes and poverty, which were strongly affected by the decline in remittances (-35% y-o-y in Q2 2020). These support measures included a one-off transfer to employees who had lost their jobs due to the pandemic, doubling of unemployment and social assistance payments, and additional support to the most vulnerable households (OECD, 2021[33]).

Many of the structural challenges described above have played a role in either amplifying the impact on the COVID-19 epidemic or limiting the scope of the policy responses to lessen its impact. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** Albania has implemented a number of tax policies as part of its response to the COVID-19 pandemic:
    - Waiving 2020 CIT payments and pre-payments for taxpayers with an annual turnover up to ALL 14 million (EUR 113 000). Postponement of CIT payments and pre-payments concerning the period April-September 2020 to April-September 2021 for companies with an annual turnover above ALL 14 million (except for companies in the banking, telecommunication, pharmaceutical and food trade sectors).
    - Tax filing extension for the submission of the 2019 PIT tax returns, from 30 April 2020 to 31 July 2020. The extension concerns individuals with an annual income above ALL 2 million (EUR 16 200).
    - Deferring rent payments for small businesses, individuals who stopped working during the pandemic and students forced to leave their residence.
    - Wage subsidies paid directly to eligible companies, equivalent to the minimum wage.
    - One-off additional payment for beneficiaries of unemployment benefit or other economic assistance.
    - Series of ALL 40 000 (EUR 320) payments to employees of companies that were forced to close down due to the pandemic.
    - Introducing two sovereign guarantee funds, amounting to ALL 11 billion (EUR 88.5 million) and ALL 15 billion (EUR 120.7 million) each.

  The fiscal response has been critical for avoiding significant economic fallout from COVID-19, especially on labour market outcomes. However, it has resulted in a significant narrowing of the fiscal space. In the context of weaker prospective revenues in the wake of the crisis, particularly if the recovery is slow, improving the efficiency of public spending will be crucial over the coming

months, as will be prioritising expenditures that can support the recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This also includes increasing public investment. The crisis has also highlighted the importance of rebuilding fiscal buffers in the post-crisis period. This goal will require tackling the structural constraints that undermine revenue performance.

- **Innovation and technology adoption:** The COVID-19 crisis has starkly demonstrated the importance of firm adaptability in meeting new challenges and changing circumstances. It has also revealed the advantages that firms which have embraced digitalisation and modern practices have over others. The resilience of the post-COVID recovery will therefore depend on addressing structural issues limiting firm innovation and technology – see Structural economic challenges section – and mainstreaming digitalisation and digital skills.
- **Access to finance:** The crisis highlights the significance of having a well-developed and diversified financial sector that can respond to the financing needs of enterprises, not only in times of crisis but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis came through government support for subsidised lending or lending guarantees. However, the resilience of the Albanian financial sector through the crisis has further reinforced the growing trust in the sector. Going forward, a robust financial sector made up of diversified financial institutions that can provide financing for riskier and innovative ventures, and not just established enterprises, will be very important in the recovery phase and beyond.
- **Informality:** The large size of the informal sector, and the significant share of informal employment even within the formal sector, have limited the scope of the measures to protect the income and employment of people in the worst-affected sectors. Informality is widespread in sectors affected highly by the crisis, including retail trade and tourism, and this segment was not able to benefit from government support measures to the same extent as the formal sector (some support was provided to the informally employed who lost their employment) (ILO, 2019[34]) (European Commission, 2021[35]). Developing a more resilient economy will also depend on enhancing incentives for formalisation and improving the oversight and sanctioning of non-compliance.
- **Health sector:** Spending on health care in Albania, at 5.3% of GDP in 2018, has been below spending in the other WB6 economies with available data, and the EU (9.9%) and OECD (12.5%) averages (World Bank, 2020[12]). This has resulted in relatively high out-of-pocket expenditures (44.6% of current health spending), which negatively impact everyone but particularly the low-income families (World Bank, 2020[12]). The private healthcare system is even more expensive, but as it provides faster and better-quality care, many people choose this option (Health Consumer Powerhouse, 2018[36]).

### *EU accession process*

Albania's path to EU accession began in April 2009 with its application for membership and the subsequent entering into force of the Stabilisation and Association Agreement. In 2010, Albanian citizens were granted visa-free travel to all EU member states that are part of the Schengen area, and in 2014 Albania gained the status of EU candidate country. Following the EU's decision to open accession negotiations in March 2020 and the subsequent presentation of the draft negotiating framework to the Member States in July 2020, Albania is awaiting the start of the negotiations.

Advancing on the socio-economic reform agenda remains a critical priority in Albania's path to EU membership. The findings in this Competitiveness Outlook (CO) 2021 are relevant to a number of critical chapters of the *acquis*, while its recommendations provide the guidance needed to meet the accession requirements. The CO also provides a good basis for assessing the critical challenges that the economy faces as a starting point for developing the Economic Reform Programmes (Box 20.1).

### Box 20.1. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[37]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[38]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

### *EU financial and development support*

The EU is the largest provider of external financial assistance to Albania. Since 2007, the EU has provided EUR 1.25 billion in pre-accession funds aimed at strengthening democracy and the rule of law, reforming the public administration, strengthening competitiveness and improving environmental outcomes and food safety. A further EUR 464 million has been provided through lending from the European Investment Bank (EIB) since 1999. The Western Balkans Investment Framework (WBIF) has provided EUR 143.8 million in grants that have leveraged further investments of an estimated EUR 2.3 billion. Finally, the EU has provided much-needed grant financing of EUR 115 million to support Albania's reconstruction efforts in the aftermath of the 2019 earthquake (European Commission, 2021[39]).

In addition to the grant funding and lending, the EU also provides important support through guarantees for public and private investment to reduce the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade (European Commission, 2020[19]).

The Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the WBIF, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment to support better connectivity in the WB region. It also represents the first step in implanting the flagship projects under the Economic and Investment Plan for the region. Albania is expected to receive up to EUR 193.6 million between 2021 and 2026 under this programme (European Commission, 2021[40]).

The EU has also been instrumental in supporting Albania's response to the COVID pandemic. EUR 50.65 million in bilateral assistance from IPA 2014-2020 was provided to Albania to cover the urgent needs of the health sector and to support economic and social recovery in the crisis aftermath. A further EUR 180 million was approved, and EUR 90 million disbursed, in macro-financial assistance to support the economic recovery. Albania and other WB economies have also been recipients of the EU's regional economic reactivation package of EUR 455 million. In December 2020 the European Commission also adopted a EUR 70 million package to help WB economies gain access to COVID-19 vaccines. Moreover in February 2021, a joint EU/WHO project provided assistance of EUR 7 million to support vaccination readiness and health sector resilience in the region (European Commission, 2021[39]).

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced Albania's Competitiveness Outlook Government[1] and Statistical Office Co-ordinators[2] to the new digitalised assessment frameworks (see the Assessment methodology and process chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, the Ministry of Finance and Economy disseminated the materials among all 16 Policy Dimension Co-ordinators and Statistical Office contact points in Albania. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All 16 Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from the Ministry of Finance and Economy, Policy Dimension Co-ordinators and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders (including chambers of commerce, academia and NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook Government Co-ordinator, Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 29 January 2021. The draft Competitiveness Outlook economy profile of Albania was made available to the Government of Albania for their review and feedback from mid-February to mid-March 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 20.3).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Assessment methodology and process chapter.

**Table 20.3. Competitiveness Outlook scoring system**

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

#### *Exceptions*

Unlike the other 15 policy dimensions, competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time, are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

Albania has slightly improved its performance in the investment policy and promotion dimension. The economy's score has increased from 2.6 in the 2018 Competitiveness Outlook to 3.1 in the 2021 assessment, with notable progress in enhancing its investment promotion and facilitation and implementing green investment strategies. Albania is the third-best performing economy in the Western Balkan region for investment policy and promotion, scoring above the regional average for investment promotion and facilitation and green investment, though trailing behind in its investment policy framework (Table 20.4).

**Table 20.4. Albania's scores for investment policy and promotion**

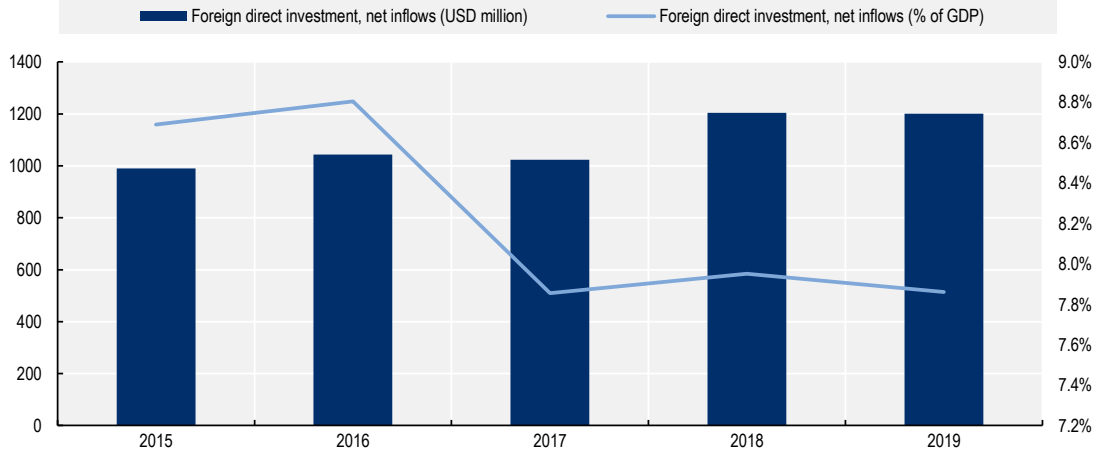
| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1 Investment policy framework | 2.9 | 3.2 |
| | Sub-dimension 1.2 Investment promotion and facilitation | 3.4 | 3.0 |
| | Sub-dimension 1.3 Investment for green growth | 2.8 | 2.0 |
| **Albania's overall score** | | **3.1** | **3.0** |

### *State of play and key developments*

Albania has been increasingly successful in attracting FDI over the last decade, with average net FDI increasing from USD 484 million over 2000-09 to USD 1.2 billion from 2010-19 (

Figure 20.2). Net FDI inflows have represented on average 8.2% of the economy's GDP over the last five years, making Albania one of the best performers of the WB6 economies. This is also a better performance than the average for upper middle-income countries (2.0% of GDP) and OECD economies (2.4% of GDP) over the same period (World Bank, 2020[12]). FDI is concentrated in the energy sector, extractive industries, banking and insurance, telecommunications, and real estate, and comes from diverse sources, notably Austria, Canada, Greece, the Netherlands, Switzerland and Turkey

**Figure 20.2. Net FDI inflows to Albania (2015-19)**




Source: (World Bank, 2020[12]), *World Development Indicators*, https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934255285

### *Sub-dimension 1.1: Investment policy framework*

Overall, Albania's **legal framework for investment** and conduct of business is complex and lacking clarity. The economy does not have a stand-alone investment law; instead it has several laws governing investment activities, including the 1993 Law on Foreign Investment and the 2015 Law on Strategic Investments, as well as a number of sectoral laws and regulations.[3] In 2019, a new investment law that simplifies and unifies the legal framework for investment was drafted and consultations initiated. This new law merges the laws on foreign investment and strategic investment and is currently undergoing final preparations in co-ordination with the state advocacy. It is expected to be adopted within 2021.

Since 2017, the government has started modernising its ageing investment framework, though progress has been slow to materialise. The government has taken steps towards aligning its investment framework with modern international standards and good practice.

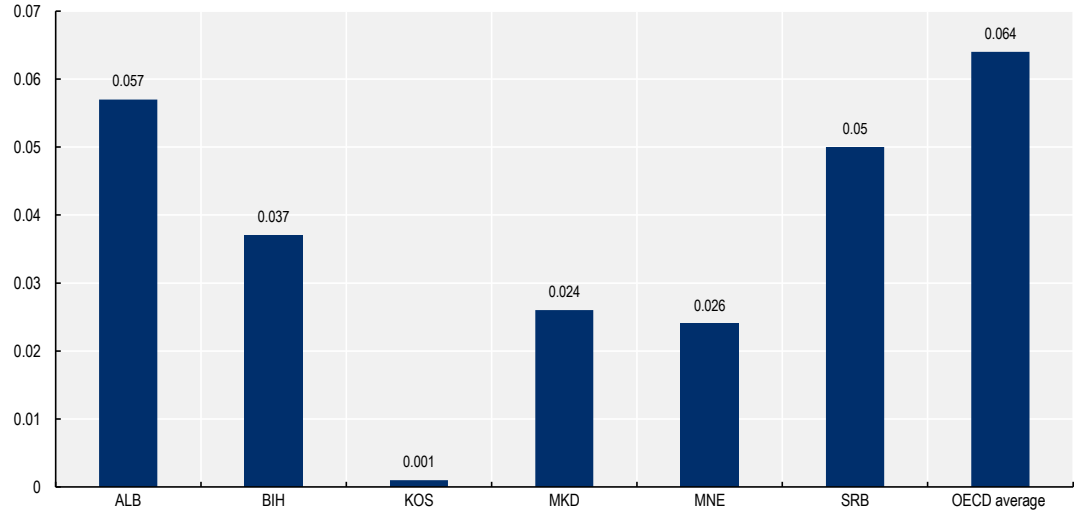
Despite the success of its investment regime in attracting FDI, investors in Albania often complain about the lack of clarity regarding the legal framework, as the government has introduced multiple changes and amendments to the investment framework and sectoral regulations in recent years. They also report a lack of transparency when dealing with the administration, as well as uneven enforcement of the law. These challenges are reflected in the economy's ranking in the 2020 Doing Business Index of 82nd out of 190 economies, scoring particularly poorly on enforcing contracts, at 120th out of 190 economies (World Bank, 2020[41]).

Public involvement in policy making remains limited despite the government's efforts to increase transparency and consultations. All legislation, including those on investment, are published on the website of the National Publication Centre (Ministry of Justice), but are not always systematically available in English. Public consultations with stakeholders on draft laws, national and international strategic draft documents, as well as policies of high public interest are regulated by law and draft legislations are published on a dedicated webpage. The Ministry of Finance organises online meetings with target groups regarding draft legal acts and the Albanian Investment Council provides a discussion forum to gather and discuss opinions. However, the consultation process is efficient as the reliance on online consultations tends to generate limited inputs (European Commission, 2020[19]).

Albania's market is open and **exceptions to national treatment** are limited. The economy's score on the OECD FDI Regulatory Restrictiveness Index, which assesses and benchmarks market access and exceptions to national treatment, was 0.057 in 2019, below the OECD average of 0.064 (a low score indicates a less restrictive regime) (OECD, 2020[42]). The economy maintains some minimal investment restrictions, notably for arms production, inland maritime transport, fishery, notary services and judicial enforcement service, indicating that foreign investment rules do not constitute impediments to FDI. The economy does not currently have a negative list of the sectors where foreign investment is prohibited or conditioned, or which outlines any discriminatory conditions. However, one is currently being prepared with the support of International Finance Corporation (IFC) experts under the Multi-annual Action Plan on Regional Economic Area in the Western Balkans (MAP REA) and is being evaluated internally. Albania places restrictions on ownership of agricultural land, as foreigners are not allowed to acquire agricultural land, forests, meadows or pastures unless they incorporate their businesses locally. Foreigners can, however, rent agricultural land for 99 years. Additionally, ownership of commercial properties is only possible if the proposed investment is worth three times the price of the land.

## Figure 20.3. FDI Regulatory Restrictiveness Index (2019)

Restrictions are evaluated on a scale of 0 (open) to 1 (closed)




Source: (OECD, 2020[43]), FDI Regulatory Restrictiveness Index (database), http://www.oecd.org/investment/fdiindex.htm.

**Investor protection against expropriation** without fair compensation is enshrined in the constitution and the 2012 Law on Expropriation, which explicitly provides for the modalities and procedures of expropriation, and stipulates that expropriation can only occur when it is in the public interest. The law was amended in 2020, resulting in the establishment of the State Expropriation Agency. This new institution plans and handles expropriation claims and calculates the amount of compensation for each property affected. The Law on Foreign Investment provides for additional protection from expropriation for foreign investors.[4] The legal framework does not, however, explicitly recognise[5] the concept of indirect expropriation, which deprives investors of the certainty of compensation if the state interferes indirectly with their operations, impacts their benefits, investments or use (but without taking their property).

Albania has also signed a large network of bilateral investment treaties (BITs),[6] which constitute an additional layer of protection for foreign investors. The Government of Albania is also currently in the process of reforming its existing network of bilateral investment treaties and defining a new BIT model that will balance investor protection provisions and national strategic interests, while complying with EU standards and international good practices.

Administrative-judicial protection is available for parties dissatisfied with expropriation compensation as the Law on Expropriation recognises the right of appeal for the expropriated subject. However, this right is recognised only in relation to the amount of compensation, determined by the State Expropriation Agency, after the evaluation of the technical criteria. The law stipulates that the expropriated party must be notified on the Decision of the Council of Ministers by the State Expropriation Agency, after which the expropriated party only has the right to appeal to the court within 30 days regarding the amount of compensation determined in this decision.

Foreign investors have the same rights and remedies before the national court system as domestic investors when it comes to **dispute settlement**. The justice system is going through a comprehensive and thorough overhaul which, according to the EU, has "continued consistently, resulting in good progress overall" and that "justice reform is expected to contribute to strengthening the business environment and attracting investments" (European Commission, 2020[19]). The reform process is reinforcing the independence of the judiciary and limiting political interference. The justice system's financial resources were increased by 14% in 2018 compared to the previous year. Overall, the court system is improving both in terms of efficiency and effectiveness for commercial procedures. However, due to these judicial reforms and vetting of judges, there have been delays to court proceedings, including the lack of a quorum in some specific courts. The Tirana District Court has a special division that judges commercial matters, known as

the Commercial Section. This section is composed of nine judges specialised in commercial matters. In 2019 the Tirana District Court adjudicated most of the commercial cases within one month from the date of registration: 50.8% of the cases were adjudicated within one month, 36.7% within one to six months, 10.3% within seven to twelve months and only 0.5% took more than two years to adjudicate.

Albanian legislation offers alternative dispute resolution mechanisms. Mediation is regulated by the Law on Mediation in Dispute Resolution[7] and applies to the resolution of all disputes in the field of civil and commercial law. Moreover, Albania has ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). By virtue of their adherence to the New York Convention, foreign arbitral awards are recognised in the economy. However, according to the EU, the impact of alternative dispute resolution continues to be low as "the total number of cases referred to and solved through mediation was 2 077 compared with 1 260 in 2016" (European Commission, 2020[19]). It should be noted that the draft investment law should reinforce the role of international arbitration.

Albania has sound **intellectual property (IP) rights laws** and regulations. The economy is a member of the World Intellectual Property Organization and adheres to the main international treaties and conventions on IP rights, including the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The economy's IP rights are overall aligned with EU legislation, notably in the area of industrial property rights, as well as in improving the functioning of collective management agencies. Key advances include the adoption of secondary legislation on trademarks and the legal protection of designs in May 2018.

The General Directorate of Industrial Property (GDIP), under the supervision of the Ministry of Finance and Economy, is the public authority in charge of registration, protection and enforcement of IP rights. The GDIP operates in compliance with the most important international conventions and agreements on intellectual property ratified by Albania. Since 2018, the GDIP's mandate and resources have been reinforced. It has undergone an institutional reform, and now consists of 39 employees, 15 more than previously. This increase in employees is to meet the objectives set out in the National Strategy on Intellectual Property 2016-2020 and highlights the economy's engagement in reinforcing its IP policy.

The GDIP also co-ordinates with key stakeholders. These include the Copyright Directorate of the Ministry of Culture on respecting and promoting copyright and related rights in Albania, as well as the State Inspectorate for Market Surveillance (SIMS), which is responsible for inspection, control and enforcement of copyright and related rights.

Albania is lagging behind other Western Balkan economies in IP implementation and enforcement**.** However**,** the economy has been making some progress on IP implementation as indicated by the rise in applications for industrial property objects recorded by the GDIP: according to the EU, in 2018, the number of applications to register trademarks rose by 24.4% compared to 2017, and applications for patents and utility models increased by 11.7%. SIMS has improved its performance in all areas in comparison to 2019 (European Commission, 2020[19]). The number of complaints handled by the inspectorate increased by 280%, from 40 in 2019 to 152 in 2020; inspections increased by 26%, from 1 308 in 2019 to 1 649 in 2020; and the amount of administrative measures carried out by SIMS increased by 43.9%, from 221 in 2019 to 318 in 2020 (SIMS, 2020[44]). Mechanisms in place to resolve disputes include the Board of Appeals, Administrative and First Instance Court, Appeal Court, and the Supreme Court.

Additional resources for the GDIP have improved **IP rights awareness raising and access to information** in Albania. The Copyright Directorate offers various amenities and e-services, including an electronic help desk, Patlib (providing local access to patent information and related issues), information kits and other informative brochures, websites, and visual and social media. Since 2018, the GDIP has intensified its IP rights awareness-raising activities in conjunction with businesses, technical and scientific information centres through seminars and lectures in public and private universities as well as for interest groups.

*Sub-dimension 1.2: Investment promotion and facilitation*

Albania has a solid **investment promotion agency structure and strategy**. Although its Business and Investment Targeting Strategy (BITS) 2014-2020 has now ended, the Ministry of Finance and Economy received technical assistance in 2020 to draft the new strategy for investment promotion (BITS 2021-2027), which is now underway. The strategy is expected to include the internationalisation of Albanian investments, outreach campaigns, aftercare programmes, and strategies for attracting FDI and manufacturing products to Albania. The ministry has been working closely with experts since September 2020 to adapt this this strategy to help mitigate the impact of the pandemic.

The Albanian Investment Promotion Agency (AIDA) has a wide mandate that encompasses export promotion and SME development, in addition to investment promotion, facilitation and retention. AIDA co-ordinates and collaborates with several stakeholders at the local and central level to promote and facilitate business processes in order to enhance the development of investment and reinvestment opportunities. The organisation is a government entity under the auspices of the Ministry of Finance and Economy and reports directly to the organisation's board which is chaired by the Prime Minister of Albania.

The agency also hosts the secretariat for the Committee on Strategic Investment, which ensures the implementation of the Law on Strategic Investments. This committee is chaired by the Prime Minister of Albania and includes the Deputy Prime Minister and other line ministries such as the Ministry of Finance and Economy, the Ministry of Tourism and Environment, the Ministry of Agriculture and Rural Development, the Ministry of Infrastructure and Energy and the State Advocate. According to the Law on Strategic Investments, AIDA serves as a one-stop-shop for strategic investments and as an "assisting agent" for investors.

In addition, AIDA co-operates with Albanian embassies and consulates, as well as with the Ministry of Foreign Affairs and Diaspora, bilateral foreign chambers and foreign embassies, in order to attract foreign investment. One of its key objectives is to increase co-ordination within the Albanian network of domestic regional and local investment promotion agencies (IPAs).

AIDA plays an important role in developing linkages between local firms and multinational enterprises (MNEs). This was defined in the Business Investment and Strategy 2014-2020 and is expected to be included in the new strategy. The IPAs provide information and accompanying services both to local firms and international companies through the SME help desk and facilitates contacts by organising training courses, workshops and business-to-business (B2B) meetings. Other measures aimed at creating and deepening linkages include assistance in finding new local suppliers, technology transfer, and information exchange on AIDA's website (B2B online platform), as well as financial support through funds managed by AIDA.

AIDA has substantially increased its staffing, from 28 employees in 2018 to about 38 employees in 2020. In 2019 alone, the agency concluded 20 new employment contracts, confirmed 17 existing contracts and approved 9 departures at staff request or due to disciplinary measures (AIDA, 2019[45]). These changes are a direct result of an expanded mandate and aim to achieve the most effective division of tasks. The agency is organised into five directorates: investment (13 employees), SMEs and projects (8), marketing and research analysis (5), co-ordination (4), and support services (8). In comparison, the Development Agency of Serbia (RAS) has 29 staff members to carry out its more limited mandate, making AIDA the investment promotion agency with the highest level of staffing in the region. AIDA's funding comes from the state budget, via a special sub-programme of the budget of the Ministry of Finance that covers the economy and income generated by its activities and donations. In 2020, AIDA's budget was approximately ALL 64 million (about EUR 520 000).

Albania is also reinforcing its **investment facilitation services and activities**. It has accelerated the digitalisation of its public services and as of January 2020, 73% of all public services were available to citizens and businesses online through the e-Albania Portal. Key developments for investment procedures

include the introduction of e-registration and electronic notification of balance sheets and financial reports. Registration and licensing services are offered through a one-stop-shop model by the National Business Centre, streamlining the certification process by abolishing many licensing requirements and simplifying other licensing procedures. Starting a business has become easier, with forms and procedures published online, and taking 4.5 days on average (World Bank, 2020[41]).[8] Registration costs have been reduced and tax, health insurance and labour registration combined in a single application. AIDA also provides one-stop-shop services for strategic investments.

AIDA is reinforcing its **investor targeting** actions, by adopting a proactive approach involving outreach campaigns for the agriculture sector (2019) and car manufacturing (2020). AIDA evaluates its targeting missions and uses the results for future targeting activity. It keeps an investor tracking database, which is updated regularly. Investor targeting activities are co-ordinated through the use of e-invest software that is managed by the AIDA team. This system connects all government departments and institutions dealing with investments, including embassies, in order to co-ordinate leads and investments. A considerable share of AIDA's promotional budget is devoted to arranging meetings with foreign companies, attending conferences and trade fairs as well as undertaking missions abroad. However, this budget has decreased from EUR 115 000 in 2019 and EUR 72 000 in 2020 and, due to the COVID-19 pandemic, no funds were distributed to SMEs through various grant funding schemes. The support schemes under AIDA have been under revision and budgetary funds were instead used to finance part of the government support measures to mitigate the consequences of COVID-19.

Albania provides a wide range of **investor incentives**, all of which are listed on AIDA's website. Investors can also negotiate other incentives directly with AIDA. Additional incentives and special treatment are also provided for strategic investments, under the Law on Strategic Investments. The law identifies the following sectors as being strategic: 1) energy and mining; 2) transport, electronic communications infrastructure and urban waste; 3) tourism (tourist structures); and 4) agriculture (large agricultural farms) and fisheries. The law also outlines the criteria, rules and procedures that state authorities should use when approving a strategic investment. The government provides fiscal and administrative incentives for companies starting businesses in a Technical and Economic Development Area (TEDA).

Tax incentives for investment remain under the authority of the Ministry of Finance and Economy, which regularly monitors tax expenditures approved by parliament. Tax incentives are analysed and serve as government decisions on future projects. Information on them is publicly accessible through the annual report on tax included in the Budget Law.

**Aftercare services** are included in AIDA's mandate. The agency contacts and surveys foreign investors on a regular basis through a formal co-ordination mechanism and produces annual reports on investor feedback and perceived issues. AIDA also prepares frequent reports to highlight problems faced by investors. These are submitted to the Ministry of Finance and Economy in order to make the necessary policy or regulatory adjustments. Finally, AIDA conducts an annual investor satisfaction survey and organises on-site visits in order to listed to the concerns and needs of each sector.

### *Sub-dimension 1.3: Investment for green growth*

Albania has begun developing a sound **green investment policy and promotion** framework and has developed comprehensive legislation outlining its green growth priorities and objectives. Its General National Spatial Plan (PPKT), Albania 2030, provides a strategic reference framework for the sustainable development of the territory and a reliable and sustainable climate for domestic and foreign investment in long-term infrastructure projects (National Agency for Territorial Planning Albania, 2015[46]). It promotes the balanced economic and social development of the economy, the responsible management of its natural resources, environmental protection, and the rational use of land. The plan was developed using strategic environmental assessment to avoid or minimise any negative impacts. Tirana has aligned its green investment promotion strategies with national policies by incorporating Albania's Green Development

Agenda into its development plans. These include the General Local Plan for Tirana 2030, Tirana Masterplan, Sustainable Development Plan 2018-2022 (Box 20.2), The Green City Action Plan (GCAP) and the Sustainable Urban Mobility Plan, which is being developed.

### Box 20.2. A strategy for green investment in Tirana

Tirana adopted the Development Strategy for Growth 2018-2022 in 2018, which aims to achieve more sustainable economic, social and ecological development by encouraging eco-friendly businesses and farming, as well as by providing the financial means and technological ability for other businesses to be more energy efficient and innovative. The strategy contains four programmes aimed at promoting the green economy:

14. A programme that reinforces rural economic development by supporting eco-friendly business, drafting plans for forestry development and promoting local agricultural and livestock products.
15. A programme to increase infrastructure investments in the irrigation and drainage system, to promote efficient use of public assets and property registration (AMTP), and to strengthen its trade network by creating markets across the municipality's territory.
16. A programme to design two favourable fiscal and tax exemption packages for farmers and businesses to promote and expand their activities, facilitate market access and increase employment and self-employment.
17. A programme to create a Technology and Economic Development Area (TEDA) to promote further investment, job creation and revenue growth; introduce advanced technology; accelerate regional development; and expand national and international market economic ties.

Tirana is also hoping to launch another project in the future that would identify and create genuine industry clusters based on the most successful schemes in the region and Europe.

Source: (General Directorate of Strategic Planning of Tirana, 2018[47]), *Development Strategy of Growth of the Municipality Tirana 2018-2022*, https://tirana.al/uploads/2019/3/20190304142936_szhqbt-2018-2022-30-e-miratuar-per-web-finale.pdf.

Albania continues to respect core investment principles such as investor protection, intellectual property rights protection and non-discrimination in areas inclined to attract green investment. The laws on industrial property and the investment fund provide protection for investors and intellectual property rights, and non-discriminatory procedures in all investment domains. These laws also provide for the establishment of feed-in-premium tariffs through a non-discriminatory tender process for photovoltaic plants larger than 2 megawatts (MW). Albania is continuing to align its national and sub-national plans with international environmental and infrastructure standards by working on implementing the EU's recommendations on transitioning to a greener economy and infrastructure.

Albania has also developed a strong framework for **choosing public and private partnerships (PPPs) for green growth**. According to the laws on public procurement, public auction, and concessions and public-private partnership, the Public Procurement Agency[9] is the institution responsible for all public procurement and PPPs, including those for green projects. On the basis of this legal framework, the Albanian Government is conducting hybrid auctions and auctions for photovoltaic renewable energy. For instance, the 140 MW Karavasta photovoltaic park is being implemented by the bid winner, the French company Voltalia. The winning bid for the 100 MW hospital photovoltaic park will be announced later this year.

### *The way forward for investment policy and promotion*

Though Albania has made substantial progress since the last CO assessment, improving the attractiveness of Albania as an FDI destination requires policy adjustments and reforms in the following areas:

- **Reduce the complexity of the legislative and regulatory framework for investment and increase its transparency**. Accelerating the adoption of the draft investment law would streamline the complex investment regime, improve the investment climate and boost the attractiveness of Albania as an investment destination. This should be complemented by harmonising and stabilising the various sectoral texts and laws governing investment in order to provide investors with a more stable and conducive environment. Finally, reinforcing private sector participation by establishing effective consultation mechanisms with businesses would bolster the transparency and predictability of investment legislation.
- **Reinforce further the independence, resources and capacity of the court system, especially for commercial disputes**. While the reform of the judiciary has progressed well in recent years, investors still complain about enforcing contracts and settling disputes in the economy. In order to improve the attractiveness of the economy, more focus should be placed on improving the efficiency of commercial disputes to reduce the case backlog, as well as building judges' capacity in commercial matters.
- **Increase public awareness and implementation of mediation mechanisms**. While Albania has a mediation law, it is rarely used. Mediation mechanisms are generally favoured by the business community and can help to reduce the backlog of commercial cases by facilitating the resolution of commercial disputes.
- **Align Albanian IP legislation further with international standards and reinforce the co-ordination, resources and capacity of IPR implementation and enforcement bodies**. An effective IPR system is a crucial component of a sound investment climate. While Albania has made important efforts to align its IP legislation with international standards, improve its registration systems as well as raise awareness of IP rights, enforcement remains a challenge. In order to strengthen IP rights, the capacity of the various enforcement agencies needs to be fortified, backed up with sound governance and co-ordination mechanisms.
- **Streamline the multiple investment incentives and reinforce mechanisms for evaluating their cost and benefits, appropriate duration, and transparency**. Simple and unified tax incentive regimes can make it easier for governments to evaluate the cost and benefits of these measures, and improve the allocation of resources and the clarity of the system for investors. In addition, to increase transparency and good governance, tax incentives should be included in the main body of the Tax Law and fall under the authority of the tax administration.
- **Reinforce AIDA's investment facilitation role, notably through better co-ordination with other government bodies and agencies**. IPAs play an important role in the facilitation and retention of investments through their services to accompany the investor through all the steps of a project. In order to fulfil this role effectively – even when the IPA is not the sole interlocutor with the investor – the agency should strengthen its co-operation with other agencies and bodies.

## Trade policy (Dimension 2)

### *Introduction*

Albania's performance on the trade policy dimension has improved since the last assessment. The economy's score has increased from 2.8 in the 2018 Competitiveness Outlook to 3.3 in the 2021 assessment (Figure 20.1 and Box 20.5), with progress made especially on regulatory transparency, improving public consultations in trade policy making and trade policy development and co-ordination. The economy's inter-institutional co-ordination mechanism has been strengthened through the adoption of new rules and procedures for the National Trade Facilitation Committee (NTFC)[10] and the setting up of two working groups focusing on the reduction and elimination of import and export fees and charges. Moreover, a regulatory framework for public-private consultations (PPCs) is in place, which mandates a dialogue with local stakeholders at all stages of trade policy making. All draft laws are published electronically. Channels of communication with the private sector and civil society are established through the NTFC. However, government consultations with local stakeholders are yet to be systematised. A formal process to monitor and evaluate public consultations mechanisms is yet to be fully integrated into the legislative process.

However, limited progress has been made in removing restrictions on an open market for trade in services. Except for the courier services sector, there has been no change or improvement to Albania's trade in services sector since 2014. On the other hand, while the COVID-19 pandemic has undermined the efforts of many states to lower barriers to trade (OECD, 2021[48]), Albania is one of the few economies not to have introduced trade restrictive measures. Albania, like other economies in the region, has become more open to foreign service providers since the previous round of analysis. Future efforts could be oriented towards improving the economy's company regulations and amending costly procedures for registering a company. Finally, the economy still has not reached its full potential in the effective use of e-commerce. Albania has a strong regulatory environment for e-commerce; however, a number of challenges still persist in its implementation. Some strong aspects of the law, such as consumer protection, are not sufficiently monitored and enforced. Similarly, the low use of credit and debit cards and the high use of cash, as well as the low capacity of telecommunication operators and Internet service providers, materially limit the development of e-commerce, even during the COVID-19 pandemic. Albania is fully aware of these difficulties and has recently drawn up an action plan to steer future activities.

### Table 20.5. Albania's scores for trade policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 3.5 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 3.0 | 3.1 |
| **Albania's overall score** | | **3.3** | **3.4** |

### *State of play and key developments*

Albania's exports of goods and services,[11] which had been growing steadily since 2015, stabilised in 2018. Overall trade in 2019 was 79.9% of GDP, roughly the same as in 2018 (in real terms), compared with 75.4% in 2014. Albania's goods exports reached EUR 2.4 billion in 2019, while imports grew more slowly, to reach EUR 5 billion. In 2019, Albania's exports of goods and services reached 31.6% of GDP while its imports were 45.3% (Table 20.1). Overall, the external trade deficit amounted to 13.8% of the economy's GDP in 2019.

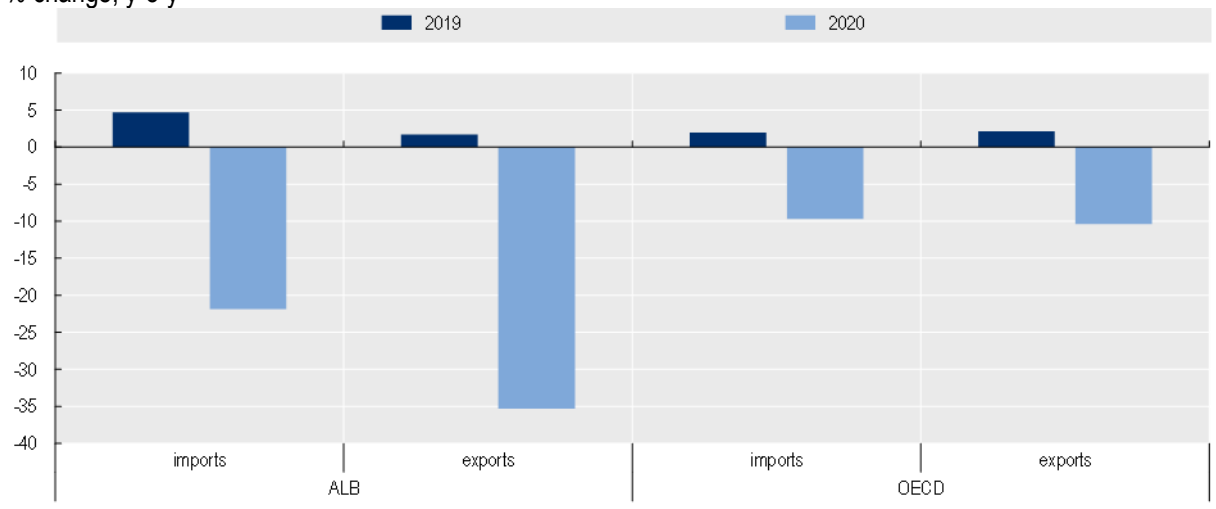
Albania is mostly dependent on trade in services, which makes a larger contribution to the economy than the trade in goods. Albania is a net exporter of commercial services, which amounted to EUR 3.0 billion in 2020, compared to EUR 1.9 billion in imports in 2019. The European Union remains Albania's main trading

partner. In 2020, trade with EU countries represented 61.3 % of total trade. Exports to EU countries accounted for 74.4% of total exports (76.6% in 2019 and 76.3 in 2018) and imports from EU countries made up 58.5 % of total imports ( against 59% in 2019 and 58.4% in 2018). Italy is the largest trade partner for Albania, accounting for 61.9% of total exports (compared to 47.9% in 2019) and 43% of imports (25.3% in 2019).

Like all economies, Albania was heavily affected by the COVID-19 pandemic. Its GDP was already in decline following the 2019 earthquake. The pandemic-related export bans, restrictions on movement of people and closures of shops and services have seen a significant decline in trade, with imports down by 23% and exports by 34% in Q2 and Q3 2020, (INSTAT, 2021[49]) (Figure 20.4). In Q4 of 2020, trade picked up again. On December 2020 the value of exports increased by 5.4% compared with the same period of the previous year and decreased by 15.6% compared with November 2020. The value of imports increased by 10.5 % compared with the same period of the previous year and by 10.1% compared with November 2020 (INSTAT, 2021[49]).

### Figure 20.4. Impact of COVID-19 on trade, Albania versus the OECD (2019-20)

% change, y-o-y




Note: y-o-y=year-on-year.

Source: (IMF, 2020[50]), *World Economic Outlook*, https://www.imf.org/en/Publications/WEO/weo-database/2020/October; (OECD, 2020[51]) OECD Economic Outlook, Volume 2020 Issue 1, https://dx.doi.org/10.1787/0d1d1e2e-en.

StatLink https://doi.org/10.1787/888934255304

The fall in demand from the EU, the destination of almost 75% of Albania's exports, has had the most significant effect on the economy's international trade.[12] The structure of Albania's export basket exposes it to variations in demand. Leather footwear alone accounts for 8% of all Albania's exports. The other sectors concerned are mainly crude oil, which represents 5% of exports, as well as chromium ore, agro-food products (vegetables, perfume plants and processed fish, among others) and metals (crude iron bars and ferro-alloys). The demand shock has had a significantly negative impact on trade in building materials, electrical equipment, plastics and the fashion sector. Decline in trade with Italy has been a large shock, given that Italy alone accounts for nearly 48% of exports and 25% of imports.

Overall, economies with a greater dependence on services trade, such as Albania, have suffered great losses due to the restrictions on movement of people implemented in response to the pandemic. Services such as tourism, education and health contribute a 48.6% share to Albania's GDP. Albania's tourism sector had been growing until 2020, especially in the previous three years, and the revenue from tourism alone exceeds 20% of the economy's GDP. The sector has been greatly affected by the movement and travel restrictions imposed due to the spread of COVID-19. The decrease of tourism has also damaged other

related industries such as food, entertainment and retail, as well as tourism-related investment (World Bank, 2020[52]).

### *Sub-dimension 2.1: Trade policy framework*

Albania has strengthened its trade-related institutional framework since the last assessment cycle. A National Plan for Trade Policy Coordination and Trade Facilitation (2017-2020), was adopted in 2017 – one element of the broader national development and integration strategies.[13] Its main objective is the medium-term integration of Albania into the European Union and is aligned with EU industrial policy and World Trade Organization (WTO) principles.[14] Two ad-hoc working groups have been established to work on the reduction or elimination of fees and charges for imports and exports. Since 2018,[15] the National Trade Facilitation Committee has aimed to enhance inter-ministerial co-ordination and improve the decision-making process on trade issues.

Albania has a solid **inter-institutional co-ordination mechanism** for trade policy formulation. The Ministry of Finance and Economy (MOFE) is responsible for co-ordinating trade policy with the National Trade Facilitation Committee (NTFC), the formal inter-ministerial co-ordination institution, itself composed of state institutions and private sector professionals, and chaired by the minister responsible for trade.[16] The 2018 Order of the Prime Minister "On the establishment of the inter-institutional working group for the trade facilitation and trade policy"[17] extended the scope of the representatives on the committee to include line ministries and the business sector. Moreover, the 2018 Order of the Prime Minister now mandates the NTFC to hold four meetings a year with all stakeholders, including business associations and Chambers of Commerce. In 2019, the NTFC approved the expansion of its scope to include trade in services.

An Inter-Institutional Working Group (IWG) within MOFE co-ordinates and implements public policies in line with the obligations of the EU accession process, including, but not limited to, trade policies. Its duties include ensuring inter-institutional technical co-operation and communication for implementing the commitments under EU integration policy documents.[18] Regular consultations take place through this group with all ministerial institutions working on the implementation of trade policy for Chapter 30 "External Relations" of the *acquis Communautaire*. The IWG consults closely with other working groups responsible for the free movement of goods, intellectual property law, agriculture, etc, as well as other ministries involved in trade through their sectorial policies (transport, health, environment, etc.)

However, evidence shows that these inter-institutional co-ordination mechanisms have yet to reach their full potential and the participation of the private sector needs to be enhanced. The NCFT should meet four times a year, but in the last three years it has met only six times in total, including twice in 2018 and once in December 2019. In 2020 and 2021 the NCFT seems to have increased its activity, in particular through electronic meetings.

A system of mandatory **public-private consultations** is firmly entrenched in the Albanian decision-making and regulatory process from a regulatory point of view. Public consultations are required for policy and legislative development. Inter-ministerial co-ordination and stakeholder consultation processes on trade issues are conducted in a complementary manner during all stages of policy making. The Investment Council was set up in 2015 to intensify the dialogue between the government and the private sector to improve the business climate. The private sector, especially the Chambers of Commerce, but also non-government organisations (NGOs) and academia, are involved in the different stages of trade policy making through NTFC meetings, which are scheduled and made public two weeks in advance. A variety of other stakeholders is also involved through ad-hoc consultation meetings on the measures and policies which were decided upon.

The Law on Public Notifications and Consultations[19] is in line with European standards. It regulates the process of notification and public consultations of draft legislative acts, including national and local strategic policies of high public interest.[20] Within this framework, the NTFC consults with the business community

and other stakeholders, discusses strategic documents and policies, proposes measures to facilitate trade and monitors trade policy by preparing annual reports on the progress of trade policy.

However, there are limitations to the existing framework and its implementation that should be highlighted. The scope of application of the Law on Public Notifications and Consultations does not extend beyond the legislative norms to government decisions. Moreover, even though the law suggests that every law and sub-law on free entrepreneurship, investment, business, production, employment and trade should involve public consultations in an open dialogue between the public and private sector, requests or incentives for consultations and dialogue are limited or lacking (though the government publishes the laws and sub-laws on a dedicated consultation website).[21] Furthermore, although it is compulsory to report on how the contributions by civil society organisations are taken into account, the effectiveness of the feedback mechanisms remains to be proven as there are no concrete data to show that their comments have been used in the decision-making process. Thus, although Albania has established consultation mechanisms, no major progress has been made and a methodology for public consultations has yet to be adopted. Finally, though the electronic web-portal for public consultations[21] is operational, its use by the public has been very limited and it focuses more on process than content (European Commission, 2020[19]). The monitoring process for public consultations is also ad hoc. The Law on Public Notifications and Consultations requires institutions that draft legal acts to publish annual reports on the consultations they have conducted.[22] However, the reports in question are only available for 2020 and not all institutions that conducted public consultations in that year have published their reports. In the area of trade, for example, the report of the Ministry of Finance and Economy is not available. Moreover, the system requires institutions to self-evaluate, which raises the question of harmonisation of approaches.

With regard to evidence-based policy and legislative development, Albania has developed guidelines for regulatory impact assessment (RIA). This has enabled more systematic impact assessments for legislative measures within ministries. Progress has also been made in establishing quality criteria for RIAs and in building capacity in the Prime Minister's Office to guide the process. These regulatory dossiers are made available on the NTFC website after publication or can be acquired on express request by users. This is a positive practice benefiting from a mandatory legal basis.[23]

Albania has extended its network of **bilateral and multilateral free trade agreements** since the last assessment cycle.

Albania joined the WTO in 2000, the first of the Western Balkan economies to do so. It first opened its economy to free trade agreements with the signing of the Stabilization and Association Agreement (SAA) with the European Community, granting preferential customs tariffs for industrial and agricultural products exported from Albania to EU countries.

Shortly after signing the SAA, in 2006 Albania became a founding member of the Central European Free Trade Agreement (CEFTA) with the aim of achieving full tariff liberalisation on trade in manufactured products and agricultural goods, and to establish a negotiating framework for eliminating non-tariff barriers (NTBs).

In terms of trade facilitation policies, Albania established a free trade agreement with European Free Trade Association (EFTA) member states in 2010/11, removing customs duties on industrial products, fish and other sea products as well as tariff concessions for processed agricultural products.

The economy recently reinforced its bilateral trade agreements' network by signing 12 new treaties. It now has 36, of which 13 are with EU Member States, the most recent being the Memorandum of Understanding with Croatia on co-operation in the field of entrepreneurship signed in 2019. Albania also has an extensive network of bilateral investment treaties, 45 in all, with another 7 under negotiation (with Canada, Iceland, Iran, Lebanon, Morocco, Saudi Arabia and the Slovak Republic) (European Commission, 2020[19]).

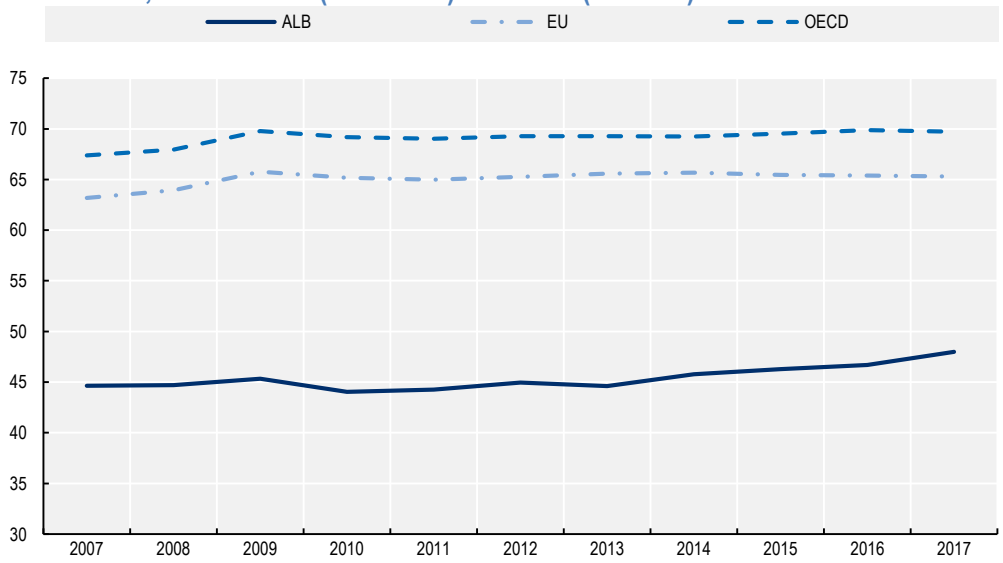
Negotiations are also ongoing with Turkey on the free trade agreement signed in 2008, focusing on trade in services and investment and on the implementation of rules of origin under the Pan-Euro-Med Convention (European Commission, 2020[19]).

### *Sub-dimension 2.2: Services trade restrictiveness*

Services contribute almost two-thirds of GDP in the WB6 economies, which illustrates how strongly economic growth, innovation and labour markets depend on effective policies on services that promote open and competitive service markets. Services contributed to 48.6% of GDP in Albania in 2019, a steady number compared to previous years (Figure 20.5), and account for more than 43% of employment.

Enhancing the openness of trade in services can improve domestic firms' efficiency and productivity, whereas restrictions such as regulatory barriers to trade can be harmful (Box 20.3). Trade in services allows countries to specialise according to their comparative advantages in services and skills. The potential gains from liberalisation in services trade are significant because increased domestic and foreign competition complemented by effective regulation can enhance performance.

**Figure 20.5. Services, value added (% of GDP) - Albania (2007-17)**




Source: (World Bank, 2020[12]), *World Development Indicators* (database), http://data.worldbank.org/datacatalog/world-development-indicators.

StatLink https://doi.org/10.1787/888934255323

### Box 20.3. The costs of regulatory barriers to trade in services

Recent OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[53]). Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rule-making. The costs resulting from barriers to trade in services are much higher than those from trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services. Even exporting to the most liberal countries still requires compliance with regulation at a cost that corresponds to around 30% of the export value in most sectors and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are at around 10% in most sectors and around 32% for financial services.

Source: (Benz and Jaax, 2020[54]), *The Costs of Regulatory Barriers to Trade in Services: New estimates of ad valorem tariff equivalents*, http://dx.doi.org/10.1787/bae97f98-en.

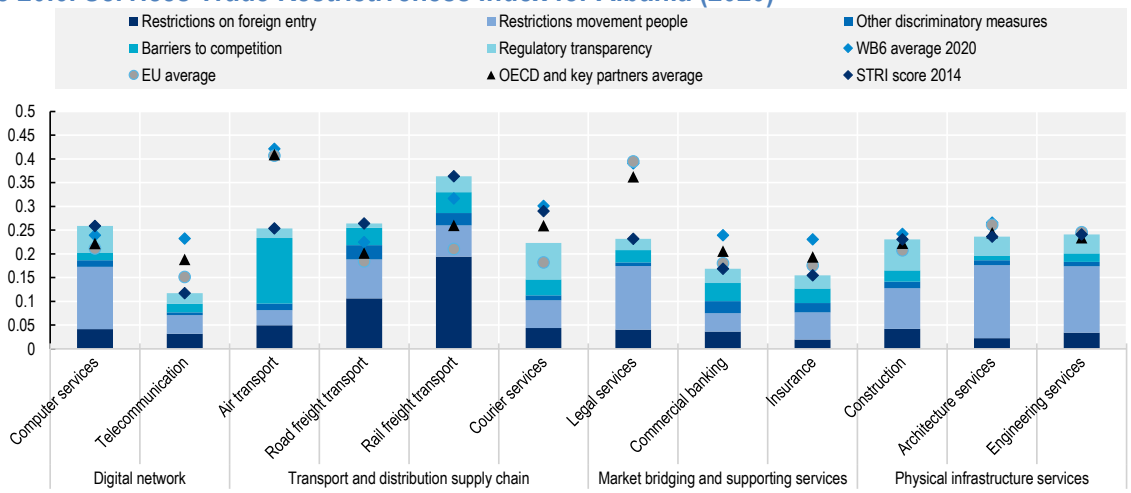
The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse barriers to trade for 12 services sectors** in Albania. The OECD STRI project is a unique, evidence-based diagnostic tool that inventories trade restrictions in 48 economies,[24] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts. For this CO assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices quantify restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[25]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[26] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[55]).

Figure 20.5 shows the STRI indices for each of the sectors as well as the average scores for the WB6, EU and OECD. Like most economies in the WB6 region, Albania's services trade markets are in the more open range compared to the OECD and key partners' average STRI indices (represented by a "+" in Figure 20.6). Its least restrictive sectors (lowest STRI scores) relative to the WB6 average are telecommunication services, air transport and legal services. Those with the highest score relative to the WB6 average are road freight transport, rail freight transport and computer services.

## Figure 20.6. Services Trade Restrictiveness Index for Albania (2020)



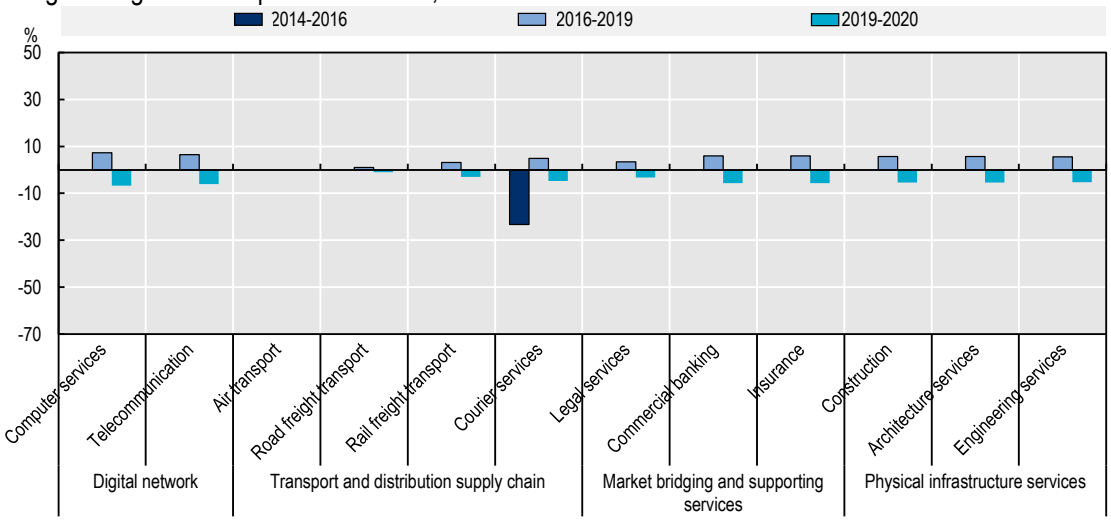

Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand..
Source: (OECD, 2020[56]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255342

Figure 20.7 displays the evolution of Albania's STRI indices by sector and period since 2014 in percentage terms. The economy's trade in services markets was already relatively liberal in the previous assessment cycle, which explains the limited amount of change since. The changes observed mainly reflect evolution in non-regulatory data incorporated in the STRI, such as the World Bank Doing Business indicators. One notable exception is the courier services sector, which benefitted from significant reform via the 2015 Law on Postal Services,[27] which has substantially opened the economy's postal market.

## Figure 20.7. Evolution of STRI scores by sector in Albania (2014-20)

Percentage change over the periods 2014-16, 2016-19 and 2019-20




Note: Values are expressed as percentage change; negative values indicate a reduction in restrictiveness of the economy's trade regulatory environment.
Source: (OECD, 2020[56]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255361

The following analysis starts with the horizontal measures that are included in all sectors and that typically hamper services trade in the economy as a whole – especially in the area of general business regulations,

restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. It then reviews each of the 12 sectors analysed, displaying the STRI scores, explaining what drives the results, and providing a brief description of the most common restrictions and good practices.

**Cumbersome horizontal measures affect firms' ability to operate**

*General business regulations* affect firms' ability to operate in Albania. There are a number of areas in which Albania could improve its company regulations. This is the case for the acquisition or use of land and real estate by foreigners, which is limited by the law.[28] This mainly affects companies' ability to establish offices in the economy and operate a business, especially in the service sectors, which are highly dependent on the mode of supply. Box 20.4 presents the modes of supply of trade in services as defined by the General Agreement on Trade in Services (GATS) and used in the OECD STRI.

### Box 20.4. Examples of the four services supply modes

The definition of trade in services under the General Agreement on Trade in Services (GATS) has four components, depending on the territorial presence of the foreign service provider and the consumer at the time of the transaction. Pursuant to Article I:2, the GATS covers services supplied.

**Mode 1: Cross-border:** Services are provided from the territory of one member into the territory of any other member.

*Example*: A consumer in economy A receives services from abroad through its telecommunications or courier infrastructure. These supplies may include any type of consultancy, legal advice, architectural services, or computer related services.

**Mode 2: Consumption abroad:** Services are provided in the territory of one economy to the service consumer of any other economy.

*Example*: Nationals of economy A have moved abroad as tourists, students, or patients to use respective services.

**Mode 3: Commercial presence:** Services are provided by a supplier of one economy, through commercial presence, in the territory of any other economy.

*Example*: The service is provided within A by a locally-established subsidiary, or representative office of a foreign-owned and controlled company (bank or insurance company, air company, construction firm, etc.).

**Mode 4: Movement of natural persons:** Services are provided by a foreign supplier, through the presence of natural persons of an economy in the territory of any other economy.

*Example*: A foreign national provides a service within A as an independent supplier (e.g., IT consultant) or employee of a service supplier (e.g. IT consultancy firm).

Source: (WTO, GATS, 1995[57]), Article I:2 ; (WTO, n.d.[58]), Trade in services modes of supply, https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm.

The requirement of minimum capital in the form of a deposit that must be placed in a bank or notary's office to register a limited liability company further affects foreign companies.[29] The foreign company must submit the bank document certifying payment of a cash contribution of at least one quarter of the nominal value of its shares, together with the registration application. This restriction only applies for creating joint stock companies with a public or private offer, for which the law expressly provides for basic capital.

Starting a business has become easier (taking 4.5 days on average according to the WB Doing Business indicators (World Bank, 2020[41]). Forms and procedures are published online; registration costs have been reduced; and tax, health insurance and labour registration have been consolidated into a single application. AIDA also provides one-stop-shop services for strategic investments – see Investment policy and promotion (Dimension 1). With regard to the procedures for registering an entity/contractor, the law requires that they be finalised within 24 hours of submission of the completed documentation and accompanied by a payment of ALL 100 (approximately EUR 0.8). However, there is no payment required if the registration is done electronically. Nevertheless, the total cost of completing all the official procedures required to register a company in Albania is still 10.8% of income per capita (World Bank, 2020[41]). Although improved, this is still above the maximum best practice threshold of 2.8% within OECD member states and STRI key partners.

*Restrictions on the movement of people* are also an issue in Albania. Although significant progress has been made in easing the conditions for the movement of people between the CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA Agreement, people from economies outside CEFTA or the EU are subject to more restrictive requirements. Albania applies labour market tests for work permits issued to third-country nationals, although intra-corporate transferees are exempt.[30] This is in line with Directive 2014/66/EU of the European Parliament and of the Council of 15 May 2014, on the conditions of entry and residence of third-country nationals in the framework of an intra-corporate transfer. The length of stay of independent service suppliers (ISS), contractual service suppliers (CSS) and intra-corporate transferees (ICT) is limited to three months.[31] This duration is lower than those observed in the EU Member States participating in the STRI project, and much less than best practice elsewhere, which is more than 36 months (OECD, 2020[56]).

*Standards for the cross-border transfer of personal data* are set by the EU. Transfers to non-European Economic Area (EEA) economies may take place where these ensure an adequate level of data protection or, failing that, where appropriate safeguards (e.g. binding corporate rules or standard data protection clauses) are in place. These conditions are, however, stricter than recommended in the OECD Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data (OECD, 2013[59]).

Unlike some economies in the region, the *legal framework for public procurement* is generally in line with the 2004 EU Directives on public procurement, reflected in Albania's relatively low overall STRI scoring for these measures. The Public Procurement Act[32] does not impose domestic prices preferences or conditions on foreign contractors to source personnel and products locally when selecting tenders and awarding contracts. The procurement process explicitly refers to the principles of transparency, equal treatment and non-discrimination, although there is no explicit mention of non-discrimination towards third-country nationals – an additional protection found in the best public provurement regulatory frameworks and one that ensures legal certainty for foreign suppliers. The procurement process is determined by the estimated value of the procurement and is classified into two different categories in accordance with international good practice. A monetary threshold is used to determine whether the procurement requires an international procurement tender procedure or not. The law provides that procurement procedures with an estimated value above the "high threshold" (re-evaluated by a decision of the Council of Ministers every two years)[33] must be treated as an international tender. It does not exclude foreign economic operators from participating in procedures below this monetary threshold, nor are Albanian economic operators excluded from international procedures. The obligation set by the law for international procedures implies longer deadlines and requires contracting authorities to have all tender documents in English. For procurements below this monetary threshold there and shorter deadlines are no requirement to translate tender documents. However, in all types of procedures, whatever their estimated value, all economic operators (national or international) must submit tenders according to the criteria set.

With regard to *screening foreign investments*, Albania's laws and regulations aim to create a welcoming investment climate. Accordingly, Albania laws do not contain any elements restricting trade in services in

terms of investment screening. Screening of foreign investments refers to cases where laws or regulations enable governments or regulators to alter or prohibit foreign investment projects; the consideration of economic motives or economic interests is explicitly included in the criteria for approval. In Albania, regulations do not mandate that economic interests should be considered in the review of foreign investments. The economy does not set a threshold above which a foreign investment project is subject to screening. [34]

Albania is fully aware of the impact of horizontal measures on its economy and is therefore implementing reforms to remove unnecessary restrictions. Thus, in terms of entry of foreigners, the latest amendments to the law no. 108/2013, "On foreigners", which will enter into force in 2021 (and thus were not taken into consideration for the 2020 STRI scores) plan to ease some existing restrictions. These include 1) visa policy, to create the necessary mechanisms for issuing electronic visas online; 2) residence policy for foreigners in order to shorten the time limits for examining and issuing residence permits; 3) employment policy for foreigners to improve some provisions related to work permits and employment of foreigners by clarifying the time limits and procedures for obtaining a work permit and reducing unnecessary obstacles to the employment of foreign nationals in the territory of the Republic of Albania.

### How restrictive are individual services sectors?[35]

Beyond the regulatory measures that affect Albania's trade in services across the board, there are also a number of sector-specific restrictions in the 12 sectors analysed:

**Air transport services** are defined as passenger and freight air transport, carried domestically or internationally (code 51 under the International Standard Industrial Classification – ISIC – Revision 4). The STRI for this sector covers commercial establishments only. In light of the range of air transport subsectors, the approach in the STRI project is to focus on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant in so far as regulations enacted by relevant authorities affect the ability of foreign carriers to transport passengers and goods between points. The other aviation services are covered more fully in the STRI for logistics services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601 (where 0 signals a completely open sector and 1 indicates a sector closed to foreign service suppliers). Compared to the other WB6 economies, Albania is the least restrictive in the air transport services sector, with a score of 0.253. The economy scores lower than the EU (0.406), OECD (0.409) and WB6 (0.421) averages, reflecting its lack of restrictions in the sector.

Due to the regulatory structure of the sector, which is largely driven by a multilateral approach, there is limited variation across economies in STRI scores. Albania is no exception, although a few specificities should be noted. Freight and passenger transport by air is subject to a 2008 law amended in 2011. A 2019 draft law will bring the sector in line with European Commission regulations on common rules for the operation of air services in the community, but for the time being the law is not fully harmonised with the EU.

As regards *restrictions on foreign entry*, unlike many economies which limit foreign participation in the sector's capital to (at least) less than 50%, Albania does not apply any equity restrictions or specific limitations on the nationality of air carrier board members and managers. The leasing of foreign aircraft with crew (wet lease) is allowed, but subject to prior authorisation. Similarly, the leasing of foreign aircraft without crew (dry lease) is subject to prior authorisation.

*Barriers to competition* figure prominently in the results of Albania's STRI for air services. As with several countries, Albania maintains public ownership in the aviation sector through the national company Air Albania but does not limit foreign ownership in this company. The non-competitive allocation of slots contributes negatively to Albania's score in this sector. Like most economies, Albania allocates slots at airports with high demand on the basis of historical rights, prohibiting the commercial exchange of slots.

However, once historical slots have been allocated, half of the remaining slot pool is allocated to new entrants, which reduces the degree of restrictiveness in the sector.

**Road freight transport** (ISIC Rev 4 code 4293). The STRI for this sector covers commercial establishments only. Cross-border trade is governed by a system of bilateral and plurilateral agreements which provide for permits, quotas and other regulations.

The 2020 scores for all OECD member states and STRI partners in this sector range between a very low 0.124 and a high 0.624. Compared to the other WB6 economies, Albania is the most restrictive economy in the road freight transport sector, with a score of 0.284. The economy performs worse than the OECD (0.201), EU (0.184) and WB6 (0.225) averages. It should be borne in mind, however, that due to the wide dispersion of scores in this sector, Albania is still in the liberal bracket compared to the indices found in OECD member states, particularly among the worst performers.

Due to the specificity of this sector, the score is negatively affected by horizontal measures that affect the whole economy, particularly those related to movement of people and visa requirements, described above.

There are also sector-specific restrictions on the entry of foreigners, which account for about half of the total restrictions. Albania does not apply price regulation for transport services, nor does it have procedures in place to recognise certificates obtained in economies outside the scope of CEFTA and the EU, even though professional qualifications are paramount in this sector, particularly for truck drivers, who must obtain certificates demonstrating their professional competence.

**Rail transport** (ISIC REV 4 code 4912) is provided over a dedicated network where the market structure may take different forms, the two most common ones being: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between the infrastructure management and operations. Regardless of the market structure, there are well-established best practice regulations that also take into account competition from other modes of transport, particularly road transport.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.129 and 1. With a score of 0.363, Albania is the most restrictive economy of the WB6 economies for the rail transport sector. It scores higher than the EU (0.210), OECD (0.260) and WB6 (0.316) averages.

The regulatory environment for foreign investment in rail freight companies is moderately open and non-discriminatory in Albania. As part of the alignment of the rail transport framework in the region with the EU rail transport *acquis*, vertical separation between the infrastructure manager and service providers has been gradually introduced. However, the implementation process is not yet fully complete.

In terms of *restrictions on movement of people*, the sector is negatively affected by the fact that diplomas and qualifications gained abroad are not recognised, apart from the application of preferential rules to EU Member States and CEFTA economies.

*Barriers to competition* are an important contributor to Albania's STRI performance in rail transport services. Competitiveness is reduced by the public ownership of the main rail transport operator. In addition, the government can also overrule decisions by the railway regulatory authority. Transfers and exchanges of infrastructure capacity are generally prohibited. Allowing exchanges of infrastructure capacity could help to reduce congestion on the network.

**The courier services sector** (ISIC Rev 4 code 53) includes postal and courier activities. While courier services have traditionally been important means for communication, the rise of modern information and communication technologies has contributed to the less frequent use of letters for communication between individuals.

The 2020 scores for all OECD member states and STRI partners range between 0.106 and 0.881. With a score of 0.223, Albania is the least restrictive economy for courier services in the WB6 region. The economy scores above the EU (0.181) but below the OECD (0.259) and WB6 (0.301) averages.

Since the previous cycle of analysis, the courier services sector has undergone the greatest transformation of all the sectors in terms of lowering the degree of restrictiveness. The score is, however, still affected by two sector-specific measures: the fact that 1) the universal service provider is the state-owned Albanian Post S.A.; and 2) the designated postal operator obtains preferential tax or subsidy treatment.

Overall, Albania's legislation is fully aligned with the EU postal *acquis* and the postal market has been fully open to competition since 2017. While Albanian Post is the universal service provider, there are a dozen other postal service providers. The Electronic and Postal Communications Authority (AKEP) is the independent national regulator.

While foreign entry restrictions represent the most significant component of performance in about three-fifths of the economies covered, Albania does not totally follow this trend. It does not impose equity restrictions on third-country foreigners, nor does it limit the ability of foreign investors to acquire shares in the incumbent national provider, Albanian Post. Similarly, while the provision of mail services is subject to licensing, as is the case in most STRI economies, licences are issued in a non-discriminatory manner and are not subject to any market test.

In terms of *barriers to competition*, until 2016 Albania had an imposed legal monopoly for a wide range of postal services, including letters and parcels up to 1kg. The designated postal operator (DPO) therefore enjoyed a privileged status which was partially abolished with the 2016 reform. However, residual preferential tax and subsidy treatments remain that favour the DPO. As a consequence, the public company, Albanian Post, retains a leading role in the sector.

*Regulatory transparency* also has a significant impact on the STRI scores for courier services. Although Albania has introduced pre-arrival treatment and a *de minimis* regime, lengthy customs clearance procedures are harming its STRI score. Albania uses transparent criteria for the decision-making process for licensing procedures and has in place an obligation to inform the operator of refusals and an appeal procedure.

**Legal services** (ISIC Rev 4 code 691) cover advisory and representation services in domestic and international law, and where relevant, measures are entered separately for each of them. International law includes advisory services in home country law, third-country law and international law, as well as a right to appear in international commercial arbitration. Domestic law extends to advising and representing clients before a court or judicial body in the law of the host country.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.141 and 1. With a score of 0.232, Albania is the second-least restrictive economy of the WB6 economies for the legal services sector. It scores below the EU (0.394), OECD (0.362) and WB6 (0.391) averages.

Although most economies limit the ownership of law firms to locally qualified lawyers, especially in the field of national law, such restrictions are not in place in Albania, which positively impacts its STRI score in this sector. Similarly, there are no ownership restrictions or requirements for the majority of the board of directors (or partners in the case of partnerships) or the director of law firms to be locally qualified.

However, Albania does apply restrictions on *the movement of people* in that a licensing requirement is necessary to provide legal services in the economy. All foreign lawyers in Albania must be registered in the Register of Foreign Lawyers. In order to obtain a licence to practise, a foreign lawyer must meet certain requirements, including passing the examination of the local bar association. With the new Law on the Bar Association of 2018, EU lawyers who have signed a co-operation contract with a law firm can practise law in Albania without preconditions, and thus enjoy more favourable treatment than their national counterparts from third economies. Nationality, citizenship, and previous or permanent residence are not required to

obtain a licence to practise. However, foreign lawyers do not have the option of obtaining a temporary licence to carry out a specific project or to give advice in certain areas of legal services. This has a negative impact on the STRI score in this sector as temporary licences greatly ease trade in legal services.

In the area of *barriers to competition*, Albania only provides for judicial remedies where business practices restrict competition. In addition, the STRI score is damaged by the imposition of a mandatory minimum capital and minimum and maximum fees for locally licensed lawyers, set annually by the Bar Association.

**Commercial banking** (ISIC divisions 64-66) includes deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of dynamic economies; they provide financing for investment and trade across productive activities and underly all value chains.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.131 and 0.517. With a score of 0.169, Albania is the second-least restrictive economy in this sector of the WB6 economies. It scores below the EU (0.180), OECD (0.205) and WB6 (0.239) averages.

*Restrictions on foreign entry* are often identified as the main contributors to restrictiveness in this sector. On this point Albania remains relatively open. The economy does not limit the share of foreign equity capital in local banks, nor does it restrict the establishment of branches of foreign banks. The licensing of foreign-owned banks is not restricted and is done based on objective and transparent principles applied on the same terms as domestic banks. Albania does not limit cross-border bank mergers and acquisitions. Foreign banks do not have to be established locally in order to provide services to residents. Finally, no restrictions are imposed on the members of the board of directors of a commercial bank.

Although *barriers to competition* generally contribute substantially to the scores for this sector, on this aspect Albania is among the most liberal third of the WB6 economies. Its scores are boosted by its adequate regulation of financial products, and the full operational, managerial and fiscal independence of its supervisory authority from the government. Finally, none of the largest commercial banks are state-owned.

As regards *regulatory transparency* in the licensing process, the authorities are mandated to provide reasons for the rejection of an applicant within a maximum of 15 days, which is in line with OECD good practice. However, the long time and high cost required to resolve a debtor's insolvency contributes negatively to Albania’s scores.

Finally, in the category of *other discriminatory measures,* Albania's adherence to International Reporting Standards (IFRS) has positively contributed to its STRI score. However, Albania applies certain forms of restrictions for foreign banks when raising capital domestically.

**Insurance services** (ISIC REV 4 codes 651 and 652) comprise life insurance, property and casualty insurance, reinsurance, and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.104 and 0.565. With a score of 0.155, Albania is the third-least restrictive of the WB6 economies in the insurance services sector. It scores lower than the EU (0.175), OECD (0.193) and WB6 (0.231) averages.

In terms of *restrictions on the movement of people,* the insurance sector follows the general logic of the financial sectors in Albania in its non-restrictive character. Thus, the main elements that contribute positively to the opening of the banking sector in Albania are to be found in the insurance sector. However, one restrictive element is that a residence is required in order to provide brokerage services.

**Construction services** (ISIC Rev 4 codes 41 and 42) covers the construction of buildings (residential and non-residential) as well as construction work for civil engineering.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464. With a score of 0.230, Albania is the third-most restrictive of the WB6 for the construction services sector. It scores above the EU (0.207) and OECD (0.222) averages, but below the WB6 average (0.242).

Construction services is a labour-intensive sector (skilled and unskilled), which for most economies generally results in a higher share of employment than its contribution to GDP. Given the nature of construction, the potential for mechanisation and automation, and thus capital-intensive production, remains limited. Restrictions on the movement of people applied across all sectors in Albania therefore have a significant impact on the scores for this sector. In addition, it is affected by the measures applied to architecture and engineering services, outlined below.

**Architecture services (**ISIC Rev 4 code 711) cover architectural services and related technical consultancy. These services constitute the backbone of the construction sector, with key roles in building design and urban planning.

For 2020, OECD member states and STRI partners in this sector range from 0.113 to 0.684. With a score of 0.235, Albania is the third-most restrictive of the WB6 economies in the architectural services sector. However, it scores below the EU (0.260), OECD (0.244) and WB6 (0.265) averages.

*Restrictions to movement of people* reflect Albania's lack of progress in recognising higher degrees obtained in third economies, undermining its STRI score. Furthermore, licences or authorisation are required to practise and there is no temporary licensing system in place, meaning that foreign architects do not have the option to be given temporary entry to carry out a specific project or to advise on some areas of architecture services. On the positive side, a local examination is not needed to register on the list of architects and engineers and foreign architecture services suppliers are not required to redo their university degree in full, or to undergo local practice and an exam in order to be licensed.

Albania does not apply equity restrictions on third-country nationals and does not require that equity shares of architectural services firms be held only by licensed individuals or firms in the economy in question. Similarly, Albania does not restrict the form a business can take, and all kinds of businesses are permitted. There is no prohibition on commercial association with other professions. Foreign investors in Albania have the freedom to appoint board members and managers of their choice and there are no requirements in place that either the majority, or at least one, of the board members of an architecture services firm established in Albania be a national, resident or a licensed professional. The same is true for requirements relating to managers. There are no restrictions on the type of shares or bonds held by foreign investors.

*Barriers to competition* are only present to the extent that there is a minimum capital requirement for commercial and public joint-stock companies.

**Engineering services** (ISIC Rev 4 code 711) covers several related activities, such as engineering and integrated engineering services, and engineering related scientific and technical consulting services.

The 2020 scores for all OECD member states and STRI partners range between 0.118 and 0.575. With a score of 0.241, Albania is the second-most restrictive of the WB6 economies in the engineering services sector. It scores below the EU (0.246) and WB6 (0.244) averages, but above the OECD average (0.234).

Engineering services are the backbone of construction and supply. Engineers are involved in the construction of key infrastructure, such as buildings and roads. They also play an important role in the development of production processes and the adoption of new technologies. An important feature is the regulatory complementarity between engineering, architectural and construction services. The Albanian regulatory landscape reflects these similarities, with all three sectors having very similar STRI scores.

In engineering services, the results are mainly due *to restrictions on the movement of people.* This reflects the characteristics of these services, in particular their high intensity of skilled labour. Engineers from third countries are therefore mainly affected by economy-wide restrictions imposed on natural persons seeking to provide services on a temporary basis as intra-corporate transferees, contractual service providers or

independent service providers. In this respect, Albania's score is negatively affected as it applies various economy-wide limitations (as discussed above). The restrictions on the movement of people also take into account the fact that Albania does not have a process for the recognition of higher education qualifications obtained abroad, which plays a negative role in determining the economy's STRI score. In addition, a licence or permit is required to practise and there is no temporary licensing system, which means that foreign engineers cannot be allowed to enter Albania temporarily to carry out a specific project or to provide advice in certain fields. On the positive side, a local examination is not required to register as an engineer in Albania, and foreign engineering service providers are not required to retake their full university degree, local practice or in-country examination in order to obtain a licence.

**Computer services** (ISIC REV 4 codes 62 and 63) cover computer programming, consultancy and related activities and information services.

The 2020 scores for all OECD member states and STRI partners range between 0.123 and 0.448. With a score of 0.258, Albania is the third-most restrictive of the WB6 economies. It scores higher than the EU (0.211), OECD (0.221) and WB6 (0.239) averages.

Albania subjects computer services to general laws that apply to the economy as a whole; this sector is very rarely regulated by sectoral legislation. For this reason, the scoring is heavily affected by cross-sectoral limitations on duration of stay for contractual and independent services suppliers, as well as intra-corporate transferees that enter into the restrictions on the movement of people category. Those restrictions account for more than a half of the total scores in computer services. The skilled labour intensity of the sector together with the complementarity between cross-border trade and movement of natural persons explains why restrictions on movement of people feature prominently in this sector in Albania.

**The telecommunications sector** (ISIC Rev 4 codes 611 and 612) comprises wired and wireless telecommunications activities. These services are at the core of the information society and provide the network over which other services including computer services, audio-visual services, professional services and many more are traded.

The 2020 scores for all OECD member states and STRI partners range between 0.108 and 0.682. With a score of 0.117, Albania is the third-least restrictive of the WB6, scoring below the EU (0.151), the OECD (0.188) and the WB6 (0.231) averages.

In the telecommunications sector, the results depend on two policy areas: *restrictions on the entry of foreigners* and *restrictions on the movement of people*. In all STRI member states, barriers to competition account for 30% of the total STRI scores in the telecommunications sector. This reflects the particular characteristics of the sector, as well as the policy environment in which it operates. It is a capital-intensive network industry and its strategic importance has led many economies to restrict foreign investment and activity in the sector. This is not the case in Albania, where the EU accession process has benefited the sector through a rigorous review of its regulatory regime. The immediate consequence is the alignment of the regulation of the telecom sector with EU regulations and good practice in this field.

In order to ensure fair competition in the telecommunications market, Albania has an independent telecommunications regulator, AKEP, separate from stakeholders and the government. It operates without state intervention and without the presence of a state-owned enterprise (SOE) since the traditional provider has been privatised, in contrast to what is widely observed in this sector in OECD member states and STRI key partners. AKEP has sufficient powers to regulate the sector effectively through ex-ante regulation applied in accordance with EU precepts – but only in the case of the existence of an operator with significant market power (SMP), which is not the case in all telecom markets. *Ex ante* regulations are applied based on regular market analysis and are readily available on the AKEP website. In addition, Albania applies a "use-it-or-lose-it" policy to frequency bands – an important measure that prevents incumbent operators from over-holding valuable frequency licences as well as free tradable spectrum and telecom services.

In absolute terms, the regulatory framework for the telecommunication sector in Albania is competitive and constrained only by measures that apply to the economy as a whole – mainly the movement of people. Even though telecommunications lend themselves easily to cross-border trade from a technical point of view, restrictions on the movement of people account for a modest share of the total STRI score in this sector.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring about significant gains for businesses. It is positively related to firms' process innovation (OECD, 2018[60]). In addition, it enlarges businesses' market scope, reduces operational costs at various stages of business activities and lowers barriers to entry, thus intensifying competition (OECD, 2013[61]). E-commerce also benefits consumers by providing information on goods and services, helping consumers identify sellers and comparing prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[61]).

In the context of the COVID-19 pandemic, e-commerce appears to have been essential for maintaining trade flows despite the restrictions put in place to preserve public health. Indeed, buying online rather than in person reduces the risk of infection and protects jobs. Finally, e-commerce increases the acceptance of prolonged physical distancing among the population while allowing them to maintain a certain level of consumption (World Bank, 2020[62]).

2020 will certainly be a turning point in electronic commerce. This digital transformation underlines the importance of adopting a more holistic approach to policies, as well as more international co-operation (Ferencz, 2019[63]; OECD, n.d.[64]).

Modern e-commerce regulations should focus on a number of key elements, including electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property regulations and intermediary liability. On the other hand, an attractive regulatory environment should refrain from maintaining disproportionately restrictive measures such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows.

This sub-dimension assesses those policies which are implemented in parallel and in addition to those of Digital society (Dimension 10). However, it is mainly focused on the trade in digitally enabled services, given the rapid growth of trade in services in the region.

Albania has a solid and well-designed **e-commerce policy framework,** despite the fact that the actual use of e-commerce is rather limited compared to neighbouring economies. Low use of credit and debit cards and high use of cash, as well as low capacity of telecommunication operators and Internet providers, are among the reasons why e-commerce has not bloomed even during the COVID-19 pandemic.

Regulations related to e-commerce fall under the competence of the Commissioner for the Consumer Protection, under the Ministry of Finance and Economy (MOFE). Albania's institutional framework allows for effective institutional co-ordination of e-commerce across ministries and agencies. The MOFE and the Ministry of Energy and Infrastructure, under the CEFTA Chairmanship in 2019, organised two meetings with businesses operating in this area to identify their needs and potential improvements. Very recently, an action plan for e-commerce has been developed. Prime Minister's Order No. 104 of 10th September 2020 established an inter-ministerial working group on e-commerce, headed by the Deputy Minister of MOFE, to draft this e-commerce action plan, which aims to remove obstacles to the development of e-commerce and identify new challenges in five key pillars: digital business; logistics and customs issues; private sector capacity and capabilities for e-commerce; e-commerce and consumer protection legislation; and electronic payments. Currently, the action plan is being submitted to the line ministries for their opinion and will then be submitted to the Council of Ministers.

Albania has solid legislation that includes the main regulatory pillars of digital trade, while maintaining an open and non-discriminatory regime for foreign digital services. The Law on Electronic Commerce was adopted in May 2009 and amended in 2014 and 2016 and lays down the conditions for providing information services related to electronic activity and information society services, the protection of parties to such transactions, data privacy of consumers and of parties to such transactions, the free movement of information services and the responsibilities of service providers. The law is in line with the European Commission recommendations and with the EC Directives.

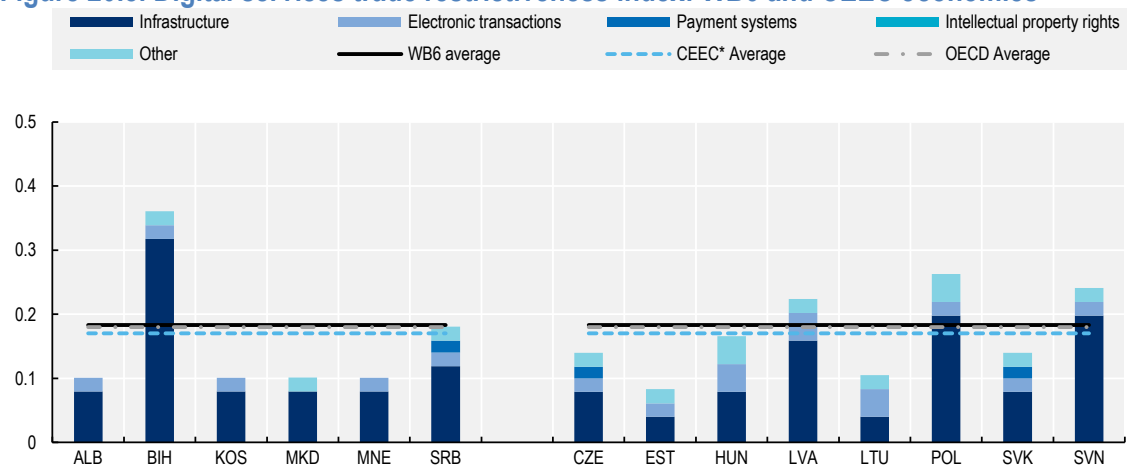
Favoured by Albania's willingness to gradually harmonise its framework with the EU *acquis*, most of the elements of a comprehensive regulatory framework are in place. Regulations on data governance, online consumer protection, electronic signature and intermediary liability are in line with international best practice and harmonised with the EU regulations.[36] The framework balances protecting individuals and consumers with limiting the costs and restrictions faced by digital businesses. As regards cybersecurity, regulation is still evolving, with a general framework complemented by sector-specific regulation – see Digital society (Dimension 10).

With the regulatory framework largely in place, adequate implementation remains a challenge due to Albania's institutional capacity constraints. There are no modern and effective independent regulatory bodies in the area of cyber security. Similarly, the consumer protection regime does not currently have an effective supervisory authority to monitor compliance, raise consumer awareness of their rights or resolve e-commerce disputes. Although progress has been made, areas where competent regulatory bodies are in place, such as electronic signatures and data privacy, could benefit from some improvement in practices and innovations. These issues are intended to be addressed by the new 2020 action plan when it comes into force.

Albania suffers from an underdeveloped e-commerce business community – there are only a very limited number of merchants who offer e-commerce and there is no nationally licensed operator yet to deal with e-commerce. Albania is still a cash-based economy and the use of credit cards, although increasing, is still limited[37] to the largest retailers or hotels. In practice, cross-border Internet shopping is in the early stages, and it's still not common, especially due to the low use of credit cards, low purchasing power and the high cost of shipping. In addition, many online merchants do not ship goods to Albania.

The OECD Digital STRI captures **the restrictiveness of digitally enabled services** by identifying cross-cutting barriers that inhibit or completely prohibit firms' ability to supply services using electronic networks, irrespective of the sector in which they operate. The regulatory data underlying the digital STRI were extracted from the existing OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. The rating takes into account the specific regulatory and market characteristics as well as the links and hierarchies between regulatory measures affecting digitally enabled services (Ferencz, 2019[63]). Figure 20.8 shows Albania's score on the Digital STRI index.

## Figure 20.8. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[56]), Services Trade Restrictiveness Index Regulatory Database, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255380

The 2020 scores in this sector are moderate to high, ranging from 0.043 to 0.488. The WB6 average is 0.183. With a score of 0.101, Albania is in the lower bracket of restrictiveness for its telecoms sector – one of the four-least restrictive WB6 economies.

Although results in most digital STRI economies are generally driven by the lack of effective interconnection regulation, this is not the case in Albania, whose regulation is relatively well-aligned with international good practice. Similarly, although Albania has stricter rules than the OECD guidelines in this area (OECD, 2013[59]), it does not impose excessive conditions on cross-border data flows (beyond those put in place to ensure the protection and security of personal data). However, like the 11 other digital STRI economies, Albania requires that some types of data are stored locally. The transfer of copies abroad is allowed as long as the authorities can have direct access to the data upon request.

Albania does not impose other restrictive regulations typically found in other jurisdictions, such as disproportionate licensing requirements for e-commerce platforms, or limitations on the type of goods or services that can be sold online (other than for generally accepted public policy considerations).

International standards for electronic contracts and key electronic authentication measures such as recognition of electronic signatures are generally in place.

Policy areas relating to intellectual property rights and payment systems account for a smaller share of scores for states participating in the digital STRI. Albania is relatively open in this category from a regulatory point of view, as it follows the principles of European regulations in this field. Thus, intellectual property protection regulations do not provide for less favourable treatment of foreigners and all the necessary regulations related to payment systems are in place, although their use is limited in practice (as mentioned above; and see Box 20.5 for OECD guidelines).

### Box 20.5. OECD policy guidance on mobile and online payments

A key component of a solid e-commerce regulatory policy is the establishment of sound measures for electronic payments and settlements. The main roles of a payment system are to provide a means of transferring value between different parts of the economy and to facilitate transactions at minimum cost. Its design will be optimal if it is organised in such a way as to allow rapid and efficient value transfers, while imposing minimum additional costs and risks. High costs for the payment process can seriously affect economic activity, making transactions too costly. Conversely, the lower costs of efficient payment systems can have a positive effect on economic growth.

Policy makers can help to encourage economic activity by promoting a framework for electronic settlements and payments. The OECD's Consumer Policy Guidance on Mobile and Online Payments (OECD, 2014[65]) provides an informative framework of policy measures to establish a regulatory environment for e-commerce that can be adapted to WB6 economies.

The framework is oriented around a number of pillars:

- Information on conditions and transaction costs. These principles focus on the accessibility and readability of payment information, the complexity of payment conditions, and the clarity and transparency of billing statements.
- The privacy implications of mobile and online payment: the collection and use of payment data.
- Security implications of mobile and online payment transactions: protecting the security of consumer payments.
- Confirmation process: issues that impede e-commerce transactions such as the uncertainty of transactions.
- Children: issues such as the costs incurred by children in accessing goods and services.
- Different levels of protection among providers and payment methods: this includes information on consumer protection and levels of payment protection.
- Fraudulent, misleading, deceptive and other unfair commercial practices: how to regulate inconsistent payment information, renewable contracts, renewable subscriptions and repeat purchases, unexpected charges and consumer confidence.
- Dispute resolution and redress: issues such as the roles and responsibilities of the parties and the cost of redress.

Source: (OECD, 2014[65]), *Consumer Policy Guidance on Mobile and Online Payments*, http://dx.doi.org/10.1787/5jz432cl1ns7-en.

## *The way forward for trade policy*

Albania has as a solid policy framework and inter-ministerial mechanism for trade, and has taken steps to improve these processes further, in particular through the new rules and procedures for the NTFC. Nevertheless, the Government of Albania can improve its competitiveness by paying attention to the following:

- **Monitor and evaluate trade policy-making co-ordination mechanisms** to guide policy makers in improving co-ordination and boosting consultation with an increased number of stakeholders. It should also ensure that the mechanisms can be adjusted based on evaluation results.
- **Establish mechanisms for evaluating and monitoring public-private consultations** to regularly assess their degree of openness and transparency. Ideally, an independent monitoring office with an adequate budget could be set up to allow for systematic evaluations. In addition, training could be provided in the use of various

quantitative and qualitative approaches for measuring compliance with the minimum standards set by regulatory frameworks for public consultations.

- **Implement a policy to increase stakeholder participation:** invite stakeholders who may be reluctant or unaware to become more involved in the legislative and regulatory process for trade, and build their capacity to participate. In doing so, Albania could follow the 2015 EU Better Regulation Guidelines (Box 20.6) to improve stakeholder involvement.
- **Broaden trade in services efforts beyond regional trade agreements**. Significant improvements have been made among the WB6 economies to open services trade through the conclusion of CEFTA Additional Protocol 6 in December 2016. Nonetheless, the STRI analysis in this section has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness.
- **Lift some of the stringent restrictions on services in trade:**
    - **Ease conditions on the temporary movement of natural persons** beyond regional trade agreements. This would further encourage innovation and knowledge transfer, and contribute to economic growth. A starting point could be to remove the remaining labour market tests which apply to third-country services suppliers. This is already addressed in a draft amendment to the Law on Foreigners – entry into force of this legislation will facilitate the provision of services by third country providers. Limitations on duration of stay for contractual and independent services suppliers, as well as intra-corporate transferees, could also be amended in order to make the economy more attractive to foreign services suppliers and investors.
    - **Reduce the remaining barriers to market entry and competition** in the road freight transport, rail freight transport and computer services sectors. Further efforts could be made to increase competitiveness, such as providing redress to firms in the road freight transport sector when business practices restrict competition in a given market. Moreover, the economy could consider providing some form of transit and access rights for international rail transport. Similarly, the licensing and permits which are subject to quotas for domestic traffic in the road freight transport sector could be lifted in order to decrease restrictions in the sector.
- **Finalise the e-commerce action plan**. Doing so will give Albania a much-needed solid e-commerce strategy. The action plan should go through the adoption process and enter into force as soon as possible in order to meet Albania's implementation challenges related to e-commerce, including establishing a consumer protection agency mandated to ensure safety on online transactions and online dispute resolution.

### Box 20.6. Stakeholder engagement throughout the European Commission policy cycle

Following the adoption of the 2015 Better Regulation Guidelines (European Commission, 2015[66]), the European Commission has extended its range of consultation methods to enable stakeholders to express their views over the entire lifecycle of a policy. It uses a range of tools to engage with stakeholders at different points in the policy process. Feedback and consultation input is taken into account by the commission when further developing the legislative proposal or delegated/implementing act, and when evaluating existing regulation.

At the initial stage of policy development, the public can provide feedback on the commission's policy plans through roadmaps and inception impact assessments (IIAs), including data and information they may possess on all aspects of the intended initiative and impact assessment. Feedback is taken into account by the commission services when developing the policy proposal further. The feedback period for roadmaps and IIAs is four weeks.

As a second step, a consultation strategy is prepared setting out consultation objectives, targeted stakeholders and the consultation activities for each initiative. For most major policy initiatives, a 12-week public consultation is conducted through the website “Your voice in Europe” and may be accompanied by other consultation methods. The consultation activities allow stakeholders to express their views on key aspects of the proposal and main elements of the impact assessment being prepared.

Stakeholders can also provide feedback to the commission on its proposals and accompanying final impact assessments once they are adopted by the College. Stakeholder feedback is presented to the European Parliament and Council in order to feed into the legislative process. The consultation period for adopted proposals is 8 weeks. Draft delegated acts and important implementing acts are also published for stakeholder feedback on the European Commission’s website for a period of 4 weeks. At the end of the consultation process, an overall synopsis report should be drawn up presenting the results of the various consultation activities that took place.

Finally, the commission also consults stakeholders as part of the *ex post* evaluation of existing EU regulations. This includes feedback on evaluation roadmaps of existing initiatives, public consultations on evaluations of individual regulations and “fitness checks” (i.e. “comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose”). In addition, stakeholders can provide their views on existing EU regulation at any time on the website “Lighten the load – Have your say”.

Source: (OECD, 2017[67]), *OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy* (draft), www.oecd.org/gov/regulatory-policy/public-consultation-best-practice-principles-on-stakeholder-engagement.htm; (OECD, 2016[68]), *Pilot Database on Stakeholder Engagement Practices in Regulatory Policy. Second set of practice examples*; (European Commission, 2015[66]), *Better Regulation Guidelines*, https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

## Access to finance (Dimension 3)

### *Introduction*

Albania's access to finance score has increased slightly – from 2.4 to 2.5 – since the previous assessment, reflecting some new elements introduced in this cycle. There has been some improvement in access to bank finance, most notably the adoption of the new capital market law which will help to mobilise long-term financing. Moreover, Albania is the second-best performer across the region when it comes to access to bank financing (Table 20.6). However, with a score of 2.3 for the mobilisation of long-term financing, Albania is well below the regional average.

**Table 20.6. Albania's scores for access to finance**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Access to finance dimension** | Sub-dimension 3.1: Access to bank finance | 3.5 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 2.0 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 2.3 | 2.8 |
| **Albania's overall score** | | **2.5** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

The financial sector is bank dominated in Albania; banks account for about 90% of financial sector assets, considerably more than in the euro area (around 45%). There is no limit on the foreign ownership of banks, except for shell banks/companies, bearer shares and nominee shareholders. In 2020, there were four banks with local capital and eight banks with foreign capital operating in Albania. As of December 2020, local banks accounted for 30.6% of the market share in terms of total of assets. Over the decade 2010-20, five banks with foreign capital origin have ceased to operate: two Greek banks were sold to local shareholders due to restrictions of presence imposed by the European Commission; one Italian bank was merged with another Italian one following the merger of both parent banks in Italy; another foreign bank was sold to a local bank following the shareholders' decision; and another foreign bank was self-liquidated on the decision of shareholders.

Albania's regulatory framework for the **banking industry** is moderately well-developed. Basel II core principles are mostly implemented,[38] while Basel III requirements are partially implemented (implementation began in 2019).[39] In 2017, the Bank of Albania adopted the guidelines on the internal capital adequacy assessment process (ICAAP), which has partially aligned its regulations with the requirements of the second pillar of the Basel's Capital Accord. At the time of drafting, the Bank of Albania was drafting a document on the Supervisory Review and Evaluation Process (SREP). Its potential effects will be assessed in the next cycle. In 2019, the Bank of Albania approved the new guidelines on banks' stress tests, as well as the new regulation on the liquidity coverage ratio (LCR). Both entered into force on 1 March 2020, bringing the regulatory framework closer to international standards.

In 2017, a memorandum of co-operation to increase the use of the national currency (ALL) in the Albanian financial system and economy was signed between the Bank of Albania, Ministry of Finance and Economy and the Financial Supervisory Authority. Subsequently, the law on consumer credit and mortgage credit and the regulation on transparency for banking and financial products and services were both amended in 2018. These amendments add extra regulatory requirements for banks and consumers to mitigate exchange rate risks; however, they could make accessing loans more challenging for businesses.

As of December 2020, the banking sector's assets and liabilities in foreign currency accounted for around 50% of total values, while the share of loans in foreign exchange stood at 50% (Bank of Albania, 2020[69]).

Income and expenditure statements indicate that the banking sector has generated a significantly higher profit from foreign currency activity than from domestic currency activity. In 2018, of a profit of ALL 18 billion, around ALL 11 billion was from foreign currency activity. In 2019, foreign currency recorded a profit of around ALL 15 billion (compared to ALL 5 billion for domestic currency). A more detailed analysis of income and expenditure indicates that, despite the fact that domestic currency activity generates around 1.5 to 2 times more income than foreign currency activity, the latter ensures a higher profit for the banking sector due to the significantly lower value of operational and personnel expenditures compared with domestic currency activity (Bank of Albania, 2019[70]).

There is a cadastre in place to **register** all properties. Registration is compulsory and ownership changes are immediately registered. The Registry of Security Charges is the central register and covers the entire territory. Applications for cadastral services can be made online through the e-Albania platform and 100% of the ownership of pledges is documented. However, competing historical claims on properties need to be resolved and clearly defined.

As regards **collateral requirements**, Albania has already established an adequate legal structure for a secured financing system enabling creditors to claim their rights over the movable properties of businesses and individuals. According to the Law on Cadastres, mortgaging requires registration of immovable property, which is used as a security for the obligation. To secure loans, the legal framework identifies a wide range of movable properties (tangible and intangible) such as accounts, instruments, securities, goods, equipment, inventory, vehicle machinery, livestock, intellectual property patents, etc. In practice, it is up to the operators to determine whether or not to accept collateral and/or its minimum value. In addition, the legal framework does not fix a threshold under which collateral is flexible for small businesses, which could potentially make access to traditional lending more challenging for micro and small firms.

No major legal changes have occurred since 2017 to Albania's **credit information services**. The only credit information service is the Credit Register established and managed by the Bank of Albania. The register is available both for financial institutions and the public. All financial institutions providing loan services are required to report, and both positive and negative data are reported. Financial institutions can request online data on existing or potential borrowers providing that a written confirmation from the borrower is issued. Borrowers can require data on their own exposure. However, mandatory reporting is only limited to institutions providing loans, covering slightly more than half of the adult population in 2019 (56%). The Albanian Association of Banks has initiated a project to set up a credit bureau, however the project could not be completed due to legal barriers, notably the article limiting the transfer of information.[40]

Two **credit enhancement and risk mitigation schemes** exist in Albania. The first is the Credit Guarantee Scheme (CSG) for SME loans, for which the main donor is the Italian Agency for Development and Cooperation. The CGS covers up to 60% of loan default, with a maximum of EUR 200 000. The second is Albania Agrobusiness Support Facility[41] (AASF), financed by the European Bank for Reconstruction and Development (EBRD) in co-operation with the Albanian Government. The latter aims to enhance access to finance for Albanian agribusinesses through the commercial banks and non-bank microfinance institutions. It backs 20% of the loans to sub-borrowers disbursed by the financial institutions. Up until the end of 2019, a total of EUR 46.8 million had been granted under AASF, covering more than 6 000 SMEs.

### *Sub-dimension 3.2: Access to alternative financing sources*

Alternative financing sources remain very limited in Albania, creating a major hindrance for business that don't meet the traditional banking criteria. **Factoring and leasing** are available and backed by well-developed legal frameworks, but **crowdfunding, venture capital and business angel networks** are non-existent. However, from 2022, a project to develop crowdfunding platforms, venture capital and business angel networks for entrepreneurs and start-ups that are not eligible for traditional bank lending will be launched by the Albanian Government, in co-operation with German Federal Ministry for Economic Cooperation and Development (GIZ) and the Swedish International Development Cooperation Agency

(Sida) under the EU for innovation programme.[42] The impacts of the project will be assessed in the next CO assessment cycle.

Leasing volumes have been increasing since 2015, from a total value of ALL 5.91 million to ALL 8.85 in 2019 (Bank of Albania, 2020[71]). Factoring and invoice discounting decreased from ALL 0.48 million to ALL 0.27 million over the same period. Of the leasing portfolio, 56% is concentrated on vehicles for personal use and 28% on work vehicles. The remainder (around 16%) is principally for product lines and work equipment.

**Factoring** is regulated by the Law on Granting of Licences to Non-bank Financial Institutions and the regulation on Risk Management in the Activity of Non-bank Financial Institutions. Both regulations were amended in July 2019, adding new requirements for factoring institutions. To prevent money laundering, these requirements cover not only the integrity of shareholders/partners, but also family relations or close personal, working or business relationships with persons with criminal records. In addition, the amendment requires that an internal audit function/unit is established in all institutions subject to the law. The Albanian Government has also put in place several incentives to promote the use of factoring – most notably allowing the interest on factoring to be deducted by up to 20% and exempting factored invoices from stamp taxes.

**Leasing** is mainly regulated by the Law on Financial Leasing; however, both of the laws mentioned above also include requirements for leasing institutions. The financial leasing law clarifies the definitions of lessor and lessee, the main rights and duties of a leasing relationship, how the process can be instigated and all the procedures to follow. The regulatory framework does not impose any limitations on the leasing market development; capital requirements and other criteria for licensing leasing activities are the same as for other non-bank financial institutions. The leasing regulatory framework is regularly revised by the Bank of Albania to comply with the latest market developments. The impact on the market of the regulatory framework is measured, either through off-site analysis or on-site inspections.

On 1 September 2020, the Law on Financial Markets based on Distributed Ledger Technology (DLT) came into force. This regulates the issuance and licensing of entities that are engaged in the distribution, trading and custody of digital tokens and crypto currencies, including **blockchain** as a specific form of this technology. The implementation and monitoring of the law are supervised by both the Albanian Financial Supervisory Authority (AFSA) and the National Agency of Information Society (AKSH). Chapter IV of the law clearly sets out the rules that should apply to security token offerings (STOs) and **initial coin offerings** (ICOs). It requires a white paper[43] to be published in case of ICOs and also defines the responsibilities of the issuer, safeguards for investors and the criteria for advertising STOs and ICOs. The law provides a clear framework for the protection of investors, such as the option of imposing administrative sanctions (Article 98) and in the event of a criminal offence, sending the case for prosecution in accordance with the procedures of the penal code of the Republic of Albania.

### *Sub-dimension 3.3: Mobilisation of long-term financing*

Albania has a well-established legal framework for **public-private partnerships** (PPPs). The law on Concession and Public Private Partnership regulates PPPs in mobilising long-term financing, covering a broad range of sectors. The Concession Treatment Agency (ATRAKO), created in 2007, assists the contracting authorities in preparing and negotiating concessions and PPPs.

In May 2020, Albania adopted a dedicated Law on Capital Markets,[44] drafted in partnership with the World Bank. It promotes the development and integrity of **capital markets**, and regulates **institutional investors.** Both domestic and foreign capital institutional investors are allowed to operate in Albania. Local asset management businesses only started in 2012; as of 2019 only three out of four licensed asset management businesses active in investment funds were operating in the territory. That same year, the total assets under management were ALL 70 billion (around EUR 572 million, or 4.5% of GDP). The regulation on the Operation of Collective Investment Undertakings, Fund Management Companies and

Depositaries, drafted by the Albanian Financial Supervisory Authority, was approved in January 2021. Its impacts will be assessed in the next CO cycle.

Albania has one operational privately owned Securities Exchange (ALSE) under the supervision of the Albanian Financial Supervisory Authority (AFSA). It was created in 2017 and trades government securities. In addition, the new law on Capital Markets allows other corporate securities to be traded. The ALSE had an initial capital of ALL 50 million (around EUR 400 000) and the company has three shareholders: Credins Bank (42.5% of total capital), the American Investment Bank (42.5%) and AK Invest (15%). In September 2019, the AFSA's board approved the increase of ALSE's capital through the issuance of additional shares. The new capital amount is ALL 85 million (around EUR 690 000) and the shareholder structure was changed as follows: Credins Bank 45.59%, American Investment Bank 45.59% and AK Invest 8.82%. The securities exchange started trading securities officially in February 2018 and by October 2019 the turnover on the exchange amounted to ALL 2.8 billion (around EUR 23.2 million).

The Law on Capital Markets increases transparency and investor protection. As result, it has aligned Albania's framework with the EU Markets in Financial Instruments Directive (MiFID) and forms the legal basis to potentially broaden access to the stock market. The **bonds** market issued by joint-stock companies with private placement has been active since 2011. However, there is still no corporate bond market with bonds open to the public. Currently there are six bonds issuers – mainly banks and microcredit institutions – and in 2019 the total outstanding bonds issued with private placement to institutional investors or up to 100 individuals was approximately ALL 7.45 billion (about EUR 61 million).

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finance, policy makers should:

- **Continue efforts to align Albania's banking regulations with international standards**. Monitoring recent regulatory reforms, and bringing the banking regulatory framework further into line with internationally agreed norms, would help build the resilience of the banking sector to withstand potential external shocks, such as the COVID-19 pandemic.
- **Continue efforts to diversify the financial sector**. While the regulatory framework for factoring and leasing is in place with incentives to promote their use, the financial sector remains bank-dominated. Albania needs to continue its efforts to implement the EU for Innovation programme while benefiting from the expertise of GIZ and SIDA to provide funding to firms from outside of the traditional lending schemes and meet their needs at various stages of their growth trajectory and development.
- **Review the blockchain legislative framework regularly** to quickly and efficiently adapt the sector to the needs of domestic firms and international market trends.
- **Facilitate market-based long-term debt financing for businesses**. A solution to increase the liquidity of the bond market and a way round the dependence on bank financing could be to establish a special framework coupled with technology platforms such as crowdfunding for private bond placements by smaller companies. One recent successful example is the Italian mini-bond market framework (Box 20.7).

### Box 20.7. Italy's "mini-bond" market

In 2012 the Italian Government introduced a series of laws[1] to initiate a mini-bond framework for unlisted companies to enable them to issue corporate bonds. The mini-bond framework provides a simplified process whereby unlisted companies with more than 10 employees and an annual turnover and/or assets in excess of EUR 2 million (except micro-enterprises and banks), can issue bonds that are available only to qualified investors. Firms are not required to publish a public prospectus – an admission document is sufficient.

In response to this new regulatory framework, Borsa Italiana introduced the ExtraMOT PRO segment in 2013, dedicated to the listing of bonds whose trading is only permitted to professional investors. Since its introduction, the mini-bond market has seen steady growth, with the number of issuances increasing from 16 in 2013 to 171 in 2018. The cumulated proceeds during this period amounted to EUR 10.6 billion, 25% of which was raised in 2018. Moreover, mini-bonds have also been securitised through special purpose vehicles which have created a diversified pool of mini-bond issuers available for institutional investors.

In 2019 the government introduced mini-bond placements on equity crowdfunding platforms. In October 2019, the operating rules for equity crowdfunding platforms willing to place mini-bonds were published by the competent authority (Consob). These include that the offers must be published on specific sections of the platforms; the issuers are limited to joint stock companies; and eligible investors are required to hold financial assets of at least EUR 250 000, invest at least EUR 100 000 in the mini-bond, or be client of an asset management company. The first offerings were published on crowdfunding platforms in January 2020.

1: Law Decree No.83/2012 and its subsequent amendments (Law Decree No. 179/2012; Law Decree No. 145/2013), Law Decree No: 91/2014; Law Decree No: 157/2019, (Fiscal Decree 2020) and Law Decree No: 160/2019 (Budget Law 2020) which created the possibility for unlisted companies to issue corporate bonds through the so-called mini-bond framework.

Source: (OECD, 2020[72]), *OECD Capital Market Review of Italy: Creating Growth Opportunities for Italian Companies and Savers*, http://www.oecd.org/corporate/OECD-Capital-Market-Review-Italy.htm; (OECD/FAO, 2019[73]), *Osservatorio Minibond : 2020 Italian Minibond Industry Report.*

## Tax policy (Dimension 4)

### *Introduction*

Table 20.7 shows Albania's scores for the two tax policy sub-dimensions, and compares them to the Western Balkan (WB) average. Albania has the highest score (along with North Macedonia) of the WB6 economies for the tax policy framework sub-dimension, driven by its slightly above-average ratings for each indicator. However, it scores below the WB6 average for the tax administration sub-dimension – explained by its low score for the "independence and transparency" indicator (the lowest of the WB economies).

### Table 20.7. Albania's scores for tax policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 3.0 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 2.7 | 3.3 |
| | Sub-dimension 4.3: International tax co-operation | n.a. | n.a. |
| **Albania's overall score** | | **2.8** | **3.0** |

Note: For comparability with the previous assessment, the new sub-dimension (4.3) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

**Tax revenues** as a share of GDP are relatively low in Albania. In 2019, the economy's tax-to-GDP ratio was 25.3% (Table 20.8), having risen from 24.1% in 2015. This ratio is below both the WB6 (30.6%) and OECD (33.8%) 2019 averages. While Albania raises less tax revenue as a percentage of GDP than other WB economies, it has a more balanced tax mix overall. For example, taxes on goods and services and social security contributions (SSCs) combined account for 66.3% of total tax revenues, which is significantly below the 80% WB average for 2019. Albania's lower reliance on these taxes reflects the balance found in OECD countries (58.4% of total tax revenues in 2018). Consequently, other taxes play a greater role in Albania than in other WB economies. While 14.5% of WB economies' total tax revenues originate from personal income tax (PIT) together with corporate income tax (CIT), Albania raises 20.1% of its revenues from these direct taxes. This is below the 33.5% average for OECD countries in 2018. Although Albania's tax structure is more balanced than in other WB economies, increasing its revenues from direct taxes would further diversify the tax mix.

### Table 20.8. Albania's tax revenues as a percentage of GDP

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| Albania | 2.3% | 2.7% | 5.0% | 11.7% | 25.3% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 10.9% | 33.8% |

Note: CIT: corporate income tax; PIT: personal income tax; SSC: social security contributions.
Source: (OECD, 2020[74]) OECD.Stat, https://stats.oecd.org/ 2019 for overall tax/GDP ratio, 2018 for specific tax/GDP ratio); CO 2021 questionnaire for WB6 average and Albania (2019).

Corporate income tax is levied at a rate of 0% or 15% depending on the taxpayer's total annual income. Businesses with a total annual income below ALL 14 million (EUR 113 200) are subject to a 0% rate, while those whose total annual income exceeds this amount are subject to a 15% rate (Table 20.9). In addition, a reduced 5% rate is provided for specific activities. Albania's top CIT rate is the highest of the WB6, alongside Serbia. As a comparison, the average rate in four WB economies with a flat CIT rate was 9.8%

in 2020. CIT revenues account for 2.3% of Albania's GDP (Table 20.8), which sits between the 1.8% WB average (in 2019) and the 3.1% OECD average (in 2018). Dividend income is excluded from the CIT base if distributed by a company subject to CIT. Capital gains, on the other hand, are included in the tax base. When dividends are distributed, companies pay an 8% dividend withholding tax rate. Furthermore, a 15% withholding tax applies to interest payments sourced in Albania. Concerning taxation of international business income, Albania operates a worldwide taxation system whereby resident companies pay taxes on domestic and foreign-sourced income and non-resident companies are liable for taxes on income originating from Albania. A worldwide taxation system is currently adopted in all of the WB economies. However, such systems are increasingly less common in the OECD, particularly in small open economies. Albania may wish to re-evaluate the advantages and disadvantages of worldwide taxation systems.

### Table 20.9. Selected tax rates in Albania

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| Albania | 15.0% | 23.0% | 27.9% | 20.0% |
| WB6 | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT: corporate income tax; PIT: personal income tax; SSC: social security contributions; VAT: value-added tax. CIT and PIT averages for WB and OECD are based on top statutory rates. CIT for Albania is the top statutory rate. PIT in Albania is levied following a progressive rate schedule - the rate displayed in the table is the top rate.
Source: (OECD, 2020[74]) OECD.Stat, https://stats.oecd.org/ (2020 for CIT and VAT, 2019 for PIT and SSCs).

Albania lacked **investment incentives** in its tax system until 2018, when it introduced CIT profit-based incentives. Several profit-based incentives – which generally reduce the effective tax rate – have been implemented. For example, companies operating in the sectors of software production/development, agricultural co-operation, agro-tourism or the automotive industry are eligible for a reduced 5% CIT rate. Furthermore, companies established in so-called areas of technology and economic development are exempt from 50% of their CIT liability for a five-year period. A CIT exemption for 10 years is also granted to hotels certified as "brand name" (four or five star hotels) at the beginning of their economic activity. Cost-based incentives – which lower the cost of investment and increase with the size of the investment – are also available for companies in these technology and economic development areas. For these companies, expenses for scientific research and staff development or training can be deducted from a company's CIT liability at double the value of the investment undertaken (for a 10-year period). These companies can also benefit from cost-based incentives – annual capital expenses may receive a 20% deduction from CIT liability in their first three years of economic activity. However, research has shown that profit-based incentives are more likely to lead to high redundancy of expenditure since the investment may have proceeded anyway (UNCTAD, 2015[75]). Albania may wish to assess empirically whether the current set of profit-based incentives are surplus to requirement and may create unnecessary redundancy.

Following a **PIT reform** in January 2019, personal income in Albania is taxed according to a progressive rate schedule which includes three rates on personal labour income: a 0% rate for taxable income under ALL 30 000 annually (EUR 240), a 13% rate for taxable income up to ALL 150 000 annually (EUR 1 200) and a 23% rate for income over ALL 150 000 (Table 20.9). The 2019 reform increased the threshold from ALL 130 000. PIT revenues in Albania account for 2.7% of GDP, which aligns with the regional average (2.7% in 2019) and the second-highest of the WB economies after Serbia (Table 20.8). However, this level remains significantly below the OECD average (8.1% in 2018). With regards to the taxation of personal capital income, a 15% flat rate applies to income such as interest, royalties, rental income and **capital gains**, including from the sale of immovable property. For **dividend income**, an 8% rate now applies (previously it was 15%). This low taxation of capital income, particularly of dividends, creates an incentive for entrepreneurs to incorporate their businesses and receive income in the form of capital rather than salaries.

Despite yielding the economy's second-highest tax revenues, Albania is less reliant on **social security contributions** than the other WB economies. While revenues from SSCs account for one-fifth of Albania's total tax revenues, they represent only 5.0% of its GDP (Table 20.8). This ratio is the second lowest in the region (after Kosovo) and below the OECD (9.0% in 2018) and WB (9.3% in 2019) averages. The total SSC rate on gross salaries is 27.9%, which sits between the 29.4% WB average (in 2020) and the 26.9% OECD average (in 2019) (Table 20.9). Despite this average rate, Albania's low SSC revenues suggest a narrow SSC base. Ensuring that more workers are active in the formal labour market should be a priority for future tax policies. The total SSC liability split is 16.7% for employers and 11.2% for employees. While OECD countries tend to levy higher employer SSCs than employee SSCs, WB economies on average do the opposite (9.5% for employers and 19.9% for employees in 2020). With regards to the self-employed, the total SCC rate is 26.4%, which is slightly below the WB average (29.7% in 2020). Contrary to other WB economies, which tend to impose high SSC rates on employees, Albania's taxation of labour income is more balanced. High employee SSCs reduce workers' disposable income, undermining their incentives to work in the formal economy, in particular those on low income with low skill levels. The relatively low employee SSC rate, combined with Albania's progressive PIT rate schedule (which shifts the tax burden from low incomes to higher incomes), limits these unwanted spillover effects.

In terms of the **design and functioning of VAT and environmentally related taxes,** Albania relies heavily on revenues from taxes on goods and services, though to a lesser extent than other WB economies. In 2019, revenues from these taxes were 11.7% of GDP (Table 20.8), which makes Albania the least reliant WB6 economy on taxes on goods and services. Though below the WB average (15.9% in 2019), this ratio broadly aligns with the OECD average (10.9% in 2018). Albania levies a standard 20% VAT rate, which is slightly above the averages for the OECD (19.3% in 2020) and WB6 (19.0% in 2020). Since June 2017, the VAT base has been narrowed by the introduction of a reduced 6% rate, which applies to a list of goods and services that includes tourism accommodation services, advertising services in visual media, public transport services and books. However, OECD research has found that reduced rates are not an effective way to help people on low incomes, and can be regressive in some instances (OECD, 2018[76]). The VAT registration threshold was increased in January 2021 to ALL 10 million (EUR 81 000) – a substantial increase from the previous threshold (ALL 2 million or EUR 16 200) and one of the highest of the WB economies. As regards other taxes on goods and services, excise duties are levied on gasoline and diesel, accounting for 2.2% of GDP. Albania has also implemented three other environmentally-related taxes (amounting to 1.1% of GDP): a circulation tax, an annual tax on used vehicles and a tax on plastic material and packaging.

Albania has an aggregated **tax revenue forecasting** model for all major types of taxes. In 2019, several micro-simulation models were implemented in co-operation with the World Bank. They are available for VAT, excise duties, PIT and CIT. Based on tax return data, these models can estimate the effects of alternative tax regimes in terms of revenues, and analyse effects across sectors. Albania is currently working in collaboration with the IMF to develop new models for VAT, PIT and CIT. These models are still being tested.

Albania is the only WB economy that implements a **tax expenditure report**. In 2019, the economy instigated a regular and systematic tax expenditure report for the first time. This report will be published every two years. Previously, a limited set of basic tax expenditure information was published alongside the annual budget. The introduction of a regular tax expenditure report in Albania should help the economy to manage efficiently its new set of investment incentives and other tax expenditures. This reform is welcome, and brings Albania's public finance management system closer to international best practice.

### *Sub-dimension 4.2: Tax administration*

With regards to the **functions and organisation** of the tax administration**,** direct and indirect taxes are collected and administered by the General Tax Directorate (GTD), including VAT for domestic transactions

and social and health security contributions. Customs duties and VAT on imports are collected and administered by the General Directorate of Customs. Both institutions are part of the Central Tax Administration of Albania. The Central Tax Administration mixes a functions and taxpayer approach. The GTD, as well as the regional directorates, are organised on a functional basis. There is also a Large Taxpayer Directorate. Regular training courses are available for employees of the tax administration, notably though the Albanian School of Public Administration.

Concerning **compliance assessment and risk management**, tax audits are carried out by the Regional Directorate of Taxation through their audit division. Taxpayers are selected for audits through a risk-based approach. A monthly audit plan is established, 70% of which is based on recommendations from an IT system of risk modules. The remaining 30% are determined from proposals by the regional directorates. Three types of audits are carried out: 1) comprehensive audits (covering all types of tax and fiscal years since the last audit); 2) fiscal visits (focused on a single type of tax and fiscal year); and 3) field verifications (focused on issues such as registration of taxpayers or use of non-cash register for businesses). Albania has a comprehensive regulatory framework guaranteeing taxpayer rights during tax audits, including the right to appeal, the right to data confidentiality and the right to representation. Within its tax administration, the economy has created a special unit that monitors audit reports vis-à-vis its implementation plan. The Albanian tax administration uses segmentation models by sectors. It is currently designing sectoral plans for the bar/restaurant and construction industries. In January 2021, Albania launched a new fiscalisation process that aims at raising additional revenues and curbing tax fraud without raising any new taxes. By using a mobile application, the new system will enable each citizen to verify immediately if an invoice issued by a business is reported to the tax administration. Once the tax administration receives the information, it can verify the registration of the invoice and take action accordingly.

The **independence and transparency** of Albania's tax administration could be strengthened. While a Law on Tax Procedures defines the functioning and organisation of the tax administration, the administration lacks an independent management board. This might be one area for reform. The GTD's operational budget depends on annual budgeting procedures. A legal framework provides sanctions for misconduct by tax administration employees. The director of the GTD prepares an annual transparency programme.

In Albania, **electronic filing** is available for all taxpayers and is mandatory for all taxes. Tax filling procedures have been simplified and streamlined following a 2016 reform. This reform focused on compliance issues and building a stable declaration system for companies. Among other initiatives, filing guidelines are now attached to tax returns. The software needed for tax compliance is available for free.

Various **taxpayer services** are offered by the GTD and its regional directorates, including online access to information, electronic communications and in-person inquiries. Taxpayer services are accessible to all taxpayers across the economy through the 14 regional directorates, each equipped with a Taxpayers Services Unit. The Taxpayers Services Unit in the GTD monitors the effectiveness of the work carried out by regional directorates. Albania's tax legislation also provides for a Tax Advocate, who protects the rights of taxpayers.

### *Sub-dimension 4.3: International co-operation*

Similar to other WB6 economies, Albania has become increasingly involved in the international tax dialogue and reforms since the last report. It became a member of the Inclusive Framework on BEPS (Base Erosion and Profit Shifting) in August 2019, which led to several initiatives. The Harmful Practices Secretariat is currently reviewing whether Albania's tax system is aligned with the Action 5 minimum standard. With the ratification of the Multilateral Convention (MLI) in September 2020, work on treaty abuse and mutual agreement procedures is scheduled to start shortly. Albania has also signed the Convention on Mutual Administrative Assistance in Tax Matters in 2013. With regards to exchange of information, Albania has been subjected to a peer review for its exchange of information on request (EOIR), carried out by the OECD Global Forum assessment team. Its overall rating is "largely compliant". Albania introduced

a law in February 2020 on the automatic exchange of information (AEOI); the first exchanges should occur in the near future. Finally, Albania has transfer pricing legislation in force and its legislation is in line with the OECD Guidelines on Transfer Pricing.

Albania has carried out some initiatives in the field of **digital taxation,** but would benefit from deeper involvement. With regards to VAT, Albania introduced international VAT/GST guidelines in 2014 (the first to do so of the WB6). Albania levies VAT on cross-border digital services and follows the destination principle. Concerning taxation of income from digital platforms, this income is not currently included in the PIT tax base. However, Albania's tax administration has requested from Airbnb the list of individuals who rent their real estate through their platform. Once this information is obtained, it will be cross-referenced with the individuals' tax returns, which should allow it to be included in the PIT tax base in the future. With regards to the OECD's Tax Challenges Arising from Digitalisation project, Albania might be less affected by Pillar 2 and its global minimum tax than other WB6 economies, as its top CIT rate is the highest in the region (along with Serbia). However, Albania's generous profit-based incentives might bring effective rates on corporate profits below the expected minimum rate. If a consensus is reached on a global minimum tax, Albania could be faced with the choice of either redesigning its set of investment incentives or risk forgoing tax revenues to foreign jurisdictions. Albania is encouraged to carefully assess its position on this issue and draft an action plan if consensus is reached among members of the Inclusive Framework on BEPS.

Regional co-operation is relatively modest in Albania. It has signed a memorandum of understanding on tax matters with Kosovo, focused on training programmes for tax administration employees and co-operation over tax fraud. Overall, Albania has signed 42 conventions for the prevention of double taxation, including with all other WB6 economy.

### *The way forward for tax policy*

To enhance Albania's tax policy framework and achieve their objectives, policy makers may wish to:

- **Continue to support the economy in light of COVID-19**. Albania has implemented a comprehensive set of measures to mitigate the effects of COVID-19. The economy may wish to continue its efforts, while focusing on measures that could spark an economic recovery.
- **Increase tax revenues while maintaining a balanced tax mix.** Albania's 2019 tax-to-GDP ratio remains below regional and international levels. Scope exists to increase tax revenues. This increase should maintain the balance in Albania's tax mix, which resembles the balance found in OECD countries.
- **Continue to strengthen capacities to measure and report tax expenditures.** Albania's new regular tax expenditure report reform is welcomed. It should be maintained and possibly deepened, perhaps by issuing annual reports instead of every two years.
- **Evaluate the scope to broaden the VAT base by reducing the goods and services taxed at the reduced VAT rate.** VAT reduced rates are an ineffective way to support those on low incomes, while those with higher incomes benefit more from the reduced rate. Targeted cash support, reduced employee SSC rates and progressive PIT rates are better tools to support low-income households and make the tax system more progressive.
- **Expand the use of micro-simulation models to forecast tax revenues and to assess the distributive effects of tax reforms**. In 2019, Albania implemented several micro-simulation models and is currently working on new models with the IMF and the World Bank. These initiatives should be strengthened and Albania is encouraged to make wider use of micro-simulation models in the future.
- **Weigh the advantages and disadvantages of the differentiated taxation of capital and labour income**. Taxing capital and labour income differently allows for more targeted tax policies. However, it may create distortive spillover effects and encourage business owners to incorporate and receive

income in the form of capital rather than labour income. Albania may wish to assess its position on this issue.

- **Maintain the balanced taxation of labour income between SSCs and PIT.** Most WB economies levy high SSC and low PIT rates, which negatively impacts labour market outcomes and discourages the registration of informal businesses and workers. Albania's more balanced taxation of labour income provides better incentives for people to enter the formal economy.
- **Prepare an action plan in the case of consensus on Pillar's 2 global minimum tax amongst members of the OECD/G20 Inclusive Framework on BEPS.** The global minimum tax will likely be lower than the current statutory CIT rate in Albania. However, Albania's generous profit-based incentives could lower effective tax rates on corporate income to a level below the expected global minimum rate. Albania may need to choose whether to redesign its investment tax incentives or risk losing tax revenues to foreign jurisdictions. The economy should evaluate its position on this issue and prepare an action plan accordingly.
- **Establish an independent management board for the tax administration**. Independence and transparency are important features of a well-developed tax administration, if the tax system is to be seen as a legitimate public authority with the necessary safeguards in place when collecting money from taxpayers. The policy to establish an independent management board should be supported with strong procedural safeguards to guarantee its independence.
- **Continue to engage with the international tax community and implement international best practice.** Since the last CO report, Albania has strengthened its involvement in international tax matters; this approach is welcome.
- **Carry out a cost-benefit analysis on the merits of a worldwide taxation system for resident corporations**. For small open economies such as Albania, worldwide taxation may entail high administrative costs without raising significant revenues.
- **Foster co-operation and co-ordination on common tax issues within the WB region.** Albania shares common challenges with other WB economies; greater collaboration might be favourable for all economies involved. Areas such as tax compliance, training for tax administration staff and exchange of information would greatly benefit from a co-ordinated regional approach.

## Competition policy (Dimension 5)

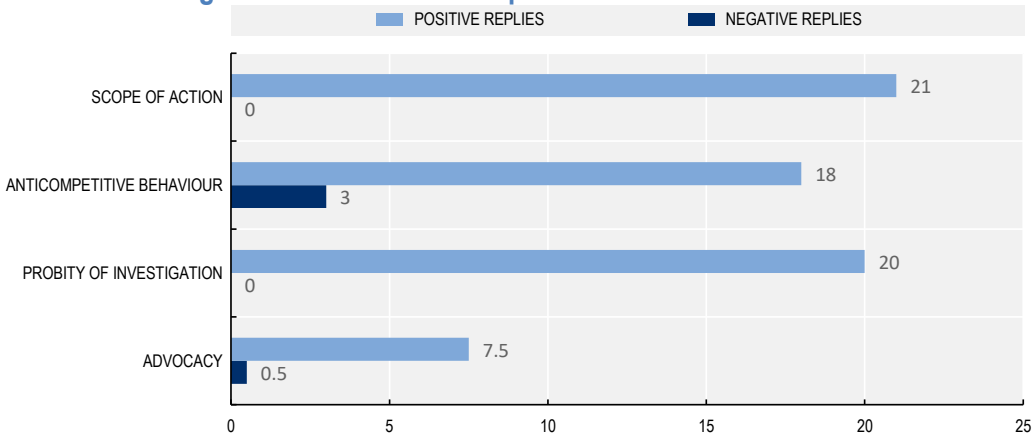
### *Introduction*

Albania's legal and institutional framework for competition shows a remarkable degree of alignment with international good practice.

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas (i.e., scope of action, anti-competitive behaviour, probity of investigation and advocacy, plus a new area: implementation). Scoring is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administered by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy areas has a different number of possible criteria that can be stated as having been adopted. Each policy area is assessed through data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

Figure 20.9 reports the number of positive (alignment with good practices) and negative answers to a questionnaire on alignment administered by the OECD for each of the four policy areas listed.

**Figure 20.9. Albania's legal and institutional competition framework**




Source: Based on the OECD assessment.

### *State of play and key developments*

#### *Sub-dimension 5.1: Scope of action*

Albania's Law no. 9121/2003 on Competition Protection and the implementing secondary legal framework are largely aligned with the relevant provisions of the Treaty on the Functioning of the European Union, namely Article 101 on restrictive agreements and Article 102 on abuses of dominant position, as well as the related EU regulations and European Commission guidelines.

The Law on Competition Protection also provides for prior control of mergers, in line with the EU Merger Regulation. In 2018, the Albanian Competition Authority (ACA) also approved guidelines on restrictions directly related and necessary to concentrations, implementing the related European Commission Notice of 2005.

The ACA is an operationally independent authority, responsible for implementing the Law on Competition Protection. It reports to the Albanian Parliament, which appoints the ACA chair and its four board members.

The administrative capacity of the ACA is above average in the WB region, both in terms of budget and number of staff. Furthermore, the level of staff expertise has been strengthened over the last few years through training courses.

In 2020 the Competition Commission approved the guideline "To empower the competition authority to be a more effective enforcer of the law no. 9121/2003 "On competition protection", as amended "and to ensure the proper functioning of the market". This is approximated with the EU ECN+ Directive (EU) 2019/1 of the European Parliament and of the Council of 11 December 2018, to empower the competition authorities of Member States to be more effective enforcers and to ensure the proper functioning of the internal market.

Chapter VII "Mutual Assistance" and Chapter VIII "Limitation Periods" of the ECN+ Directive, that deal with co-operation with homologue competition authorities of EU Member States, will enter into force and be implemented when Albania joins the EU as a member with full rights.

Albania is closely aligned with international best practice for the scope of action of its competition authorities and their powers to fight anticompetitive behaviour. As shown in Figure 20.9, discrepancies with good practice are almost negligible for this policy area.

The decision-making body of the ACA is the commission, which consists of a chairperson and four members elected by parliament, while the secretariat is the executive body, managed by the Secretary General. Following a structural reorganisation in 2017 approved by the Albanian Parliament, employees are now divided into six directorates: Production Markets Surveillance, Non-Production/Services Markets Surveillance, Market Analysis and Methodologies, Legal and Judicial Affairs, Integration and Communication, and Support Services. The total number of staff has been steadily increasing between 2015 (37 employees) and 2019 (46 employees). This figure compares well with other OECD and non-OECD countries listed in the OECD CompStats database.[45] For example, in 2019 the average total staff of the 15 competition authorities in small economies (with a population lower than 7.5 million) was 114, of whom 43 were working on competition.

Parliament approves the ACA's annual budget, which has grown from approximately EUR 470 000 in 2015 to EUR 645 000 in 2018 and EUR 628 000 in 2019. However, it is very low by international standards. In 2019 the average financial resources of the 15 competition authorities in the small economies listed in the OECD CompStats database were EUR 5.4 million.

The Albanian Law on Competition Protection ensures competitive neutrality. In particular, the **competences** of the ACA encompass any national or foreign undertakings and associations of undertakings that have or may have an influence on the markets in the territory of the Republic of Albania. These include public undertakings and undertakings entrusted with services of general economic interest, as long as their activity is not obstructed.

The ACA has appropriate **powers to investigate** and **powers to sanction** possible anti-trust infringements, e.g. restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms. The authority can impose cease and desist orders and remedies on firms that have committed anti-trust infringements. It can also adopt interim measures if the alleged competition breach poses a risk of irreparable damage on its initiative or following a request by the parties. In addition, it can accept commitments offered by the parties to remove the competition concerns and close the investigation.

The ACA can compel investigated firms and third parties to provide relevant information and can perform unannounced inspections of parties' premises. The assessment of alleged anti-competitive conduct follows a thorough scrutiny of the evidence collected, which typically includes an economic analysis of the competitive effects of vertical agreements or possible exclusionary conducts. The authority has the power to impose fines of up to 10% of the aggregate turnover of the undertaking.

The Law on Competition Protection also allows for a leniency programme, which grants total or partial immunity from sanctions to firms that report to the authority the existence of the agreement and submits

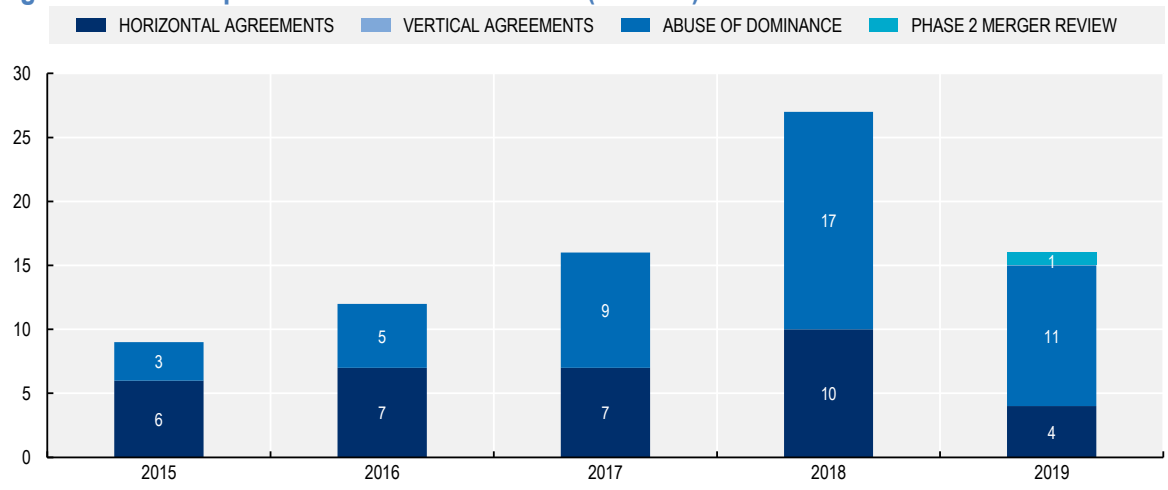
appropriate evidence. The law also provides for *ex ante* control of **mergers**, following the principles of the EU Merger Regulation. The ACA must prohibit concentrations that significantly restrict effective competition, in particular as a result of creating or strengthening a dominant position. It can authorise the transaction subject to structural and/or behavioural remedies – i.e. divestiture of assets and/or obligations to act or refrain from acting in a certain way – suitable for addressing the competition concerns. The assessment of notified mergers must follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration. In the course of the investigation, the ACA can compel merging firms and third parties to provide relevant information and may perform unannounced inspections of parties' premises.

Regarding **private enforcement**, individuals, firms and consumers – either collectively or through consumer associations – can bring a legal action to seek damages from firms that have committed anti-trust infringements.

*Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. Over the last five years the ACA has taken 34 **horizontal agreement** (cartel) decisions and 45 infringement decisions concerning abuse of dominance. It has not conducted any cases on **vertical agreements** (Figure 20.10).

**Figure 20.10. Competition decisions in Albania (2015-19)**




Source: Data provided by the authorities.

The cases conducted by the ACA have mostly related to the agro-food and the energy sectors, insurance, liquid gas, telecommunication and ports, as well as bid rigging in public procurement. Most of them were opened *ex officio* by the authority. No leniency application has been submitted to the authority.

The total amount of fines imposed on participants in anti-competitive agreements over the last five years is EUR 2.2 million. In 2015-17 no fines were imposed on infringers. In 2018 the ACA sanctioned seven undertakings: five undertakings that participated in prohibited agreements and two undertakings for abuse of dominant position (**exclusionary conduct**). In 2020 the Competition Commission took 11 decisions with a total fine amount of EUR 16 256.

Despite the positive increase in sanctions, it should be highlighted that the average annual fines for cartel infringers in 2015-19 for the 15 competition authorities in smaller jurisdictions that participated in CompStats was EUR 2.7 million.

The Albanian Competition Authority performed an appreciable number of unannounced inspections in 2019: 5 cases in 2019, 7 cases in 2018, 5 cases in 2017, 5 cases in 2016 and 6 cases in 2015.

The **merger** notifications received by ACA range from a minimum of 11 in 2015 to a maximum of 30 in 2018. In 2019, the ACA adopted 24 merger decisions. Approximately 40% of the annual merger notifications received by the ACA refer to extra-territorial transactions. The sectors affected by the most relevant transactions were mobile telecom services and banking and insurance.

All mergers were unconditionally cleared in the so-called Phase I (i.e., without the need for an in-depth review in Phase II), except one in the banking sector, which was approved with remedies in 2019 (Figure 20.10). Another transaction was eventually cleared with conditions and obligations in 2020 (Decision of Competition Commission no. 676, dated 07.02.2020 on the authorisation with conditions and obligations, on the acquisition of control of ABCom SHPK from Vodafone Albania SHA).

### *Sub-dimension 5.3: Probity of investigation*

The Albanian Competition Authority is a public, **independent** institution established in 2004, as foreseen by the Law on Competition Protection. It is **accountable** to the Albanian Parliament, to which it regularly submits an annual activity report; in turn, every year parliament issues a resolution on the activity of the competition authority, in which it recommends the main areas of work and sectors of the economy that the ACA should focus on in the following year.

In terms of **procedural fairness**, the ACA must give notice of its decision to open formal proceedings in the Authority Official Bulletin. This notice must state the purpose of the investigation and the parties concerned, while encouraging interested third parties to come forward if they wish to take part in the investigation. All final decisions regarding alleged competition infringements and mergers are published.

Prior to the adoption of a final anti-trust decision, the ACA must inform the party of the relevant facts, evidence and other elements on which the decision is based, and enable the party to submit a defence. The parties have the right to be heard before the commission takes a final decision. At every stage of the proceedings, the parties may consult with the case team.

Likewise, if the ACA intends to prohibit a merger transaction, it must inform the merging parties about the evidence and conclusions on which the decision would be based and enable them to submit their remarks and possible remedies. The parties can participate in the process that leads to the determination of conditions and obligations and can consult with the ACA during the entire procedure.

The authority's decisions can be appealed before the Administrative Court of Tirana within 30 days of the date of notification. The appeal does not have suspensory effect on the decision. The judgements of the Administrative Court of First Instance can be further appealed before the Administrative Court of Appeal.

Every year, the ACA issues its annual report and the annual bulletin of decision, which contains all the decisions taken during the year. Furthermore, the ACA has adopted and published several regulations and guidelines, concerning *inter alia* the investigative procedure, the procedure for concentrations of undertakings, the assessment of dominant position and abuse of dominant position, the assessment of horizontal and vertical agreements and the calculation of fines, which is in full alignment with the EU notice on fines and EU guidelines on fines.

### *Sub-dimension 5.4: Advocacy*

The ACA can formulate opinions on national or local laws or regulations that affect or may affect competition. The competition issues analysed by the authority include restrictions on trading and market access, granting exclusive rights and imposing uniform practices in sales terms and conditions. The authority must assess the degree of restriction or prevention of competition brought by draft normative acts.

The ACA can also assess possible barriers to competition in economic and administrative regulations aimed at pursuing general economic interests. In performing this duty, the authority must co-operate with regulatory institutions and may issue appropriate recommendations.

Pursuant to a specific article of the Albanian Law on Competition Protection, public institutions are obliged to submit their normative acts to the ACA if competition assessment is needed. Since not all public institution were complying with this provision, in 2015 the ACA issued a decision on the obligation to obtain a preliminary assessment by the Competition Authority when granting exclusive or special rights through concessions.

The legal department of the ACA is entrusted with the analysis and assessment of normative acts. In complex cases, a working group is created. The procedure followed by the ACA to carry out its assessment is illustrated in the guidelines Assessment of the Consequences of Legislation on Competition, which also provide a concrete example.

The authority issued 25 formal opinions in 2019 – a substantial increase on 17 in 2018 and even lower figures in previous years. The sectors addressed by recommendations on draft regulations include water, energy, media and telecommunications. Recommendations provided by the ACA were eventually implemented by the Bank of Albania, the Water and the Energy Regulatory Body, the Ministry of Infrastructure and Energy and the Ministry of Health. In 2020, the authority issued 37 formal opinions which included sectors such as energy, water, media and telecommunications, insurance etc.

The ACA co-operates closely with the Public Procurement Agency and exchanges views on investigations into bid rigging. The ACA has also given recommendations to the Public Procurement Agency on the prevention and detection of bid rigging. In 2011, the authority issued a guideline on Fighting Prohibited Agreements in Bids in Public Procurement (based on the OECD guidelines) and a leaflet, Hints of prohibited agreements in bids in public procurement, which are available on its website. In 2019, the ACA signed a memorandum of understanding with the Public Procurement Agency in order to facilitate co-operation between both institutions to protect competition in public procurement through exchange of information, as well as joint meetings and training, etc.

The ACA can conduct a general inquiry in any sector of the economy, on its own initiative or following a request by parliament or other regulators, if price patterns or other circumstances suggest that competition might be restricted or distorted. In the period 2015-19, the ACA concluded an average of four general inquiries a year, addressing key sectors such as higher education, banking, healthcare and liberal professions.

In 2019 and 2020 ACA concluded the following general investigations:

- In the area of liberal professions such as public notaries, attorneys and real estate evaluators in which it made some recommendations to the Ministry of Justice, National Attorney Office and National Public Notary Office related to the profession of attorney and public notary; and to the Ministry of Infrastructure and Energy and to the Real Estate Association, for real estate evaluators. It also made some recommendations to second-level banks on transparent and competitive procedures that should be followed in selecting real estate evaluators.
- In the higher education sector, it made some recommendations to the Ministry of Education, Sport and Youth, National Institute of Statistics, Public and Private Higher Education Institutions, and also gave some conditions and obligations to private higher education institutions.
- In the banking sector, the ACA concluded an investigation, resulting in some recommendations for the second-level banks under investigation.

Furthermore, the ACA organises a number of workshops, training courses, campaigns, and events for consumers, companies and ministries aimed at developing a competition culture. The staff of the ACA have benefited from a series of training courses organised with the European Commission through the EU

Technical Assistance and Information Exchange instrument (TAIEX); IPA Twinning Project (2019-2020) on Further Strengthening the Competition Authority's capacities to protect the free and effective competition in the market, funded by the European Union in co-operation with the Spanish National Commission of Markets and Competition (CNMC); as well as other international projects, including the EBRD Project (2019-2020) on Capacity Building for the Albanian Competition Authority (ACA) - Promoting Advocacy of Competition and Strengthening the Institutional Capacities of the Albanian Competition Authority, in co-operation with the consultancy firm Lear.

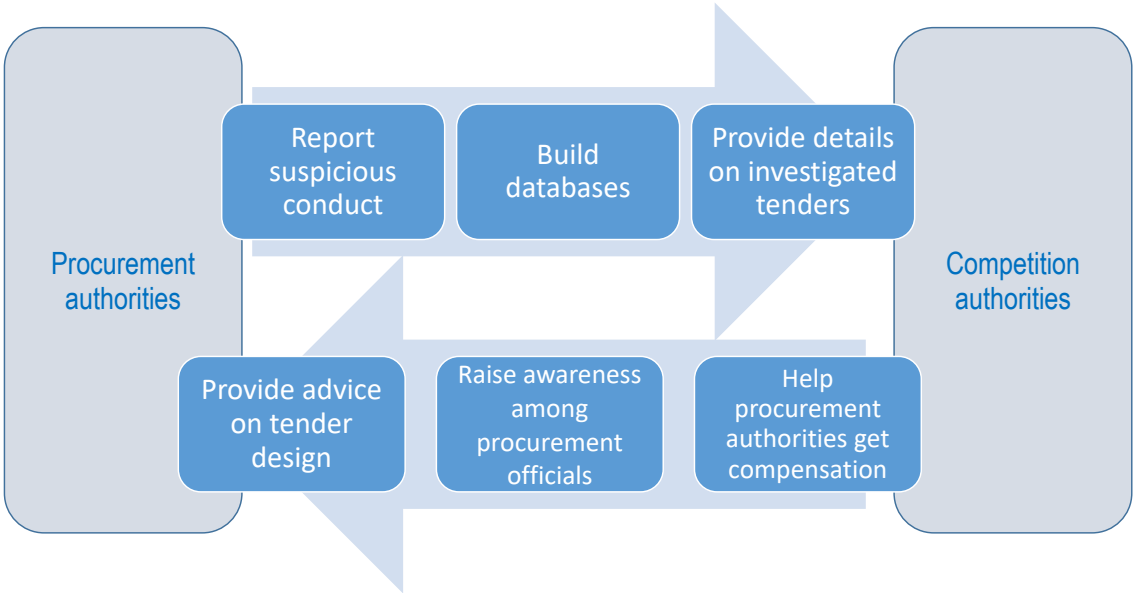
### *The way forward for competition policy*

The ACA demonstrates good enforcement capacity and an appreciable record of formal proceedings tackling prohibited agreements and abuses of dominant position. In addition, the ACA has engaged in a set of advocacy initiatives to promote competition principles and foster competition culture. Nonetheless, there is still scope for improvement, particularly on prioritising competition enforcement and increasing the sanctions for cartels. Furthermore, the challenges brought about by the COVID-19 pandemic suggest the need for some further recommendations aimed at expanding the role that the ACA can play to contribute to a quick economic recovery:

- **Provide the ACA with adequate financial resources, in line with international standards**. Despite an increase over the last few years, a substantial growth in the budget appears necessary to enable the ACA to further develop its potential for competition enforcement and advocacy. In fact, adequate financial resources are crucial not only to recruit but also to retain and motivate officials with high competition skills (see Box 20.8 for an example from Italy).

- **Give priority to boosting cartel enforcement and impose high fines**. Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. The efforts of the ACA should be focused on detecting cartels and imposing heavy fines on infringers, in order to deliver a strong message that firms that engage in collusion risk being severely punished. Fines that exceed the illicit gains can deter offences even when the probability of paying a fine is low. The concern about fines is also a key driver of leniency applications, fostering the effectiveness of the leniency programme and further boosting detection. The ACA might engage in expanding its detection skills, for example by further strengthening the fight against bid rigging (see point below on public procurement).
- **Pay specific attention to public procurement, particularly during the COVID-19 crisis**. Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm for public budget and taxpayers, dampening of innovation and inefficiencies. The ACA has a fruitful co-operation in place with the Public Procurement Agency and the publication in 2011 of guidelines and a leaflet based on the OECD Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[77]), was a valuable initiative to reduce the risks of bid rigging through careful design of the procurement process and to detect bid-rigging conspiracies during the procurement process. Figure 20.11 shows how co-operation between competition and procurement authorities can help detect and avoid bid rigging. Albania's efforts in this domain could be repeated, particularly in times of crisis and emergency procurement. The OECD can also provide assistance through a project aimed at assessing the main rules governing procurement of public works as well as procurement practices of major public buyers. It can provide recommendations for designing competitive procurement and fighting bid rigging in accordance with international good practices. It can also offer training to both competition and public procurement officials based on the Guidelines on Fighting Bid Rigging in Public Procurement.

Figure 20.11. How co-operation between competition and procurement authorities could work




- **Advocate strongly for competitive neutrality, to make sure that all enterprises face the same set of rules, irrespective of their ownership or nationality**. Competitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages. In other words, it is a framework within which all enterprises, irrespective of their ownership (state-owned or privately owned) or nationality (domestic or foreign). In most jurisdictions, the state has a dual role as policy maker/sector regulator and supplier or purchaser of goods and services. Consequently, in markets open to competition the state also acts as a market participant and interacts with private businesses, most often indirectly, through SOEs. Governments may be tempted to grant SOEs certain advantages, e.g. privileged market position, soft loans, outright subsidies, regulatory exemptions or tax benefits. Given the importance of SOEs in Albania and the increased role of the state in the economy that will likely result from the COVID-19 crisis, the ACA can make a decisive contribution to promoting competitive neutrality. The authority might need to discourage the government from granting selective aid to SOEs and resist political pressure to adopt a more lenient approach when investigating SOEs' conduct.
- **Expand international co-operation and training**. In the face of increasingly complex anti-trust issues and the frequent cross-border nature of competition infringements, the management and staff of the ACA should have frequent opportunities to meet and participate in policy discussions. International organisations like the OECD, the International Competition Network (ICN) and United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities to this end. The OECD-GVH Regional Centre for Competition in Budapest also provides an ideal forum for capacity building and sharing of good practices with colleagues from other jurisdictions, focusing on the specific challenges of Eastern European and Central Asian countries. The ACA is already a regular participant in the centre's events and would benefit from actively continuing.

### Box 20.8. Financial independence for the Italian Competition Authority

Until 2012, the financing of the Italian Competition Authority (AGCM) was based on two main sources: annual funding from the state and fees paid by companies subject to merger notification requirements.

Legislative Decree no. 1/2012 modified the AGCM's funding system, which is now based on mandatory contributions imposed on companies incorporated in Italy whose turnover exceeds a threshold of EUR 50 million. The revenues from these contributions replace all previous forms of funding. The level of contribution, originally fixed at 0.06 per thousand, has been gradually lowered by the AGCM to 0.055 per thousand. The authority's financial statements have to be approved by 30 April of the following year, and are subject to auditing by the Court of Auditors.

This funding system can be regarded as an indirect recognition of the positive role played by AGCM in supporting a healthy and level competition field, which justifies the imposition of a small contribution on the largest businesses incorporated in Italy.

Importantly, the previous funding system entailed the risk of possible fluctuations in the amount of the annual budget, due to unpredictability in the number of notified mergers and levels of state funding. The new system shelters the AGCM from that risk, thus allowing for more stable and forward-looking recruitment planning.

Source: (OECD, 2016[78]), Independence of competition authorities: from designs to practices, https://one.oecd.org/document/DAF/COMP/GF(2016)5/en/pdf.

## State-owned enterprises (Dimension 6)

### *Introduction*

State ownership responsibilities for Albania's approximately 78 central SOEs are exercised by the Ministry of Finance and Economy as well as several other line ministries and central government bodies. These dispersed ownership responsibilities are not subject to a common ownership policy. The resulting absence of clear performance expectations from the state contributes to corporate inefficiencies, including many insolvent SOEs, leading to a score on the lower end of the spectrum in the sub-dimension for SOE efficiency and governance (Table 20.10). Albanian SOEs are subject to sound financial disclosure requirements, including a mandate for external audits of their financial statements, resulting in a slightly above-average score for SOE reporting practices. Albania achieves an average score for ensuring a level playing field between state-owned and private companies (sub-dimension 6.3), reflecting the fact that most SOEs are subject to the same laws and regulations as private competitors, but that competitive distortions still exist. These are created, for example, by structural inefficiencies that lead many SOEs to underperform. Albania's performance in the state-owned enterprise dimension has not changed significantly since the last CO 2018 (Figure 20.1). Although the Ministry of Finance and Economy has proposed establishing a central ownership agency, which would have the potential to strengthen SOEs' ownership arrangements, there is currently no consensus within the government on the need for such an entity.

**Table 20.10. Albania's scores for state-owned enterprises**

| Dimension | Sub-dimension | Albania | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 1.6 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 2.8 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 2.8 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising state-owned enterprises | n.a. | n.a. |
| **Albania's overall score** | | **2.3** | **2.6** |

Note: For comparability with the previous assessment, the new sub-dimension (6.4) has not been scored but is discussed in the text below.

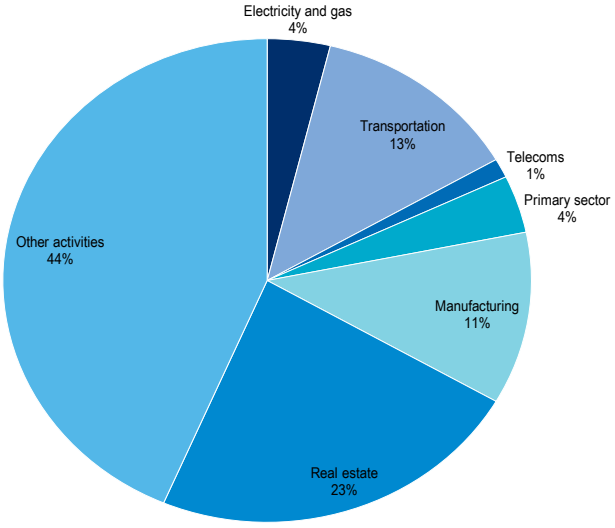
### *State of play and key developments*

#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

Albania's state-owned enterprise portfolio consists of approximately 78 SOEs held by the central level of government, and an additional 73 companies – mainly water supply and sewage companies and local football clubs – owned by municipalities.[46] Of the 78 SOEs held by the central government (the focus of this assessment), 36 are under the sole purview of the Ministry of Finance and Economy. The remaining 42 are overseen by sectoral line ministries, including the Ministry of Energy and Infrastructure which oversees Albania's four economically important state-owned energy companies as well as the state railway company; and the Ministry of Culture, which oversees Alba Films. While the Ministry of Finance and Economy, in undertaking its state budgetary role, is legally responsible for state ownership rights in all SOEs, the administration of 42 SOEs is in practice delegated to line ministries. Some ownership decisions, notably board nominations, in these 42 SOEs are subject to some degree of inter-ministerial co-ordination. By international comparison, the number of SOEs in Albania is overstated, since it includes about 30 entities that are either public agencies, or entities such as universities and hospitals, that in many other countries would not be corporatised and simply operate as entities of the general government. The Albanian state also holds minority shares in 28 companies.

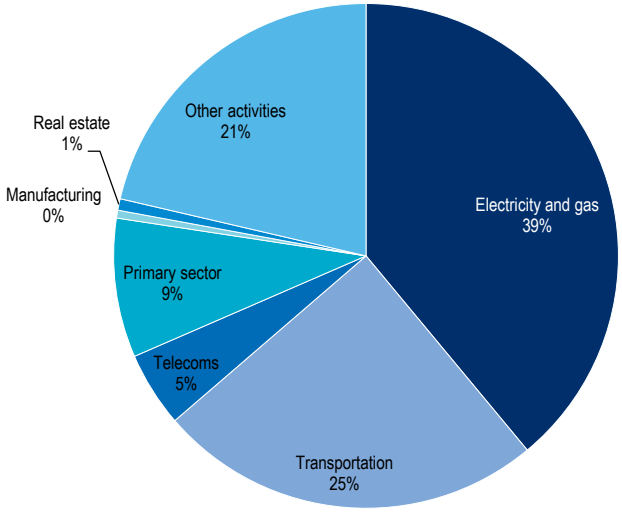
Concerning their sectoral distribution, central government SOEs in Albania are particularly concentrated in transportation (25% of all SOEs by employment and 13% by number of enterprises), electricity and gas (39% by employment and 4% by number of enterprises) and the primary sector (9% by employment and 4% by number of enterprises) (Figure 20.12 and Figure 20.13). The state also owns several real estate and manufacturing companies, accounting, respectively, for 23% and 11% of all SOEs. At the sub-national level of government, 58 of Albania's 73 municipal SOEs are water supply and sewage companies, while the remaining 15 are local football clubs wholly owned by municipal governments. Additionally, municipal governments hold minority shares in 12 football clubs that are majority owned by private investors.

### Figure 20.12. Sectoral distribution of SOEs by number of enterprises




Note: The relatively large proportion of "other activities" SOEs comprises enterprises operating in the following sectors: accommodation and food services; professional, scientific and technical activities; administrative and support services; public administration and defence; education; and arts, entertainment and recreation.
Source: Calculations based on figures provided by the Albanian authorities concerning enterprises majority or fully owned by the central level of government.

### Figure 20.13. Sectoral distribution of SOEs by employment




Source: Calculations based on figures provided by the Albanian authorities concerning enterprises majority or fully owned by the central level of government.

Some illustrative examples of individual SOEs operating in Albania include, in the primary sector: the petroleum production company *Alb Petrol*; in the electricity and gas sector: Electricity Corporation of

Albania (ECA), Electricity Distributor of Albania (EDA), Transmission System Operator (TSO) and the gas transmission company Albgaz; in the transportation sector: Albanian Railways, Albanian Post, Albanian Air and the Airport "Mother Theresa" Tirana, as well as a few port operator companies. Some less commercially important SOEs (some of which are either not operational or are undergoing prolonged liquidation procedures) also include, in the primary sector: the copper ore extraction company *Alb Copper Tiranë* and the chromium ore extraction company *Alb Chrom Tiranë*, and in the manufacturing sector: the wooden furniture manufacturing company Furniture Manufacture Tirana and Tobacco Producer of Albania located in the city of Shkodër.[47] While many of Albania's sectors have been liberalised since the early 1990s, SOEs remain dominant in the energy sector: approximately three-quarters of national electricity consumption is provided by SOEs (European Commission, 2019[79]). Concerning SOEs' general economic importance, central government SOEs account for an estimated 1.6% of total national employment.[48] A 2019 IMF report estimated that SOEs at all levels of government account for between 6 and 7% of total national employment (IMF, 2019[80]).[49]

The Albanian authorities do not gather aggregate financial performance data on SOEs, making it difficult to draw general conclusions about their efficiency. However, a 2019 review of the 36 SOEs under the Ministry of Finance and Economy's purview undertaken by a government working group, found that of the 36 SOEs in the ministry's portfolio, 12 enterprises no longer pursued activities in accordance with their original objectives and 8 were in the process of being liquidated (European Commission, 2019[79]). The Albanian authorities also indicated that several SOEs were "inactive". This points to significant structural issues and inefficiencies in the state's SOE portfolio. As mentioned earlier, the state also holds minority shares in 28 companies, often pointing to failed or stalled privatisations for which the rationale for continued state ownership is not clear. Investments in the state-owned energy sector have historically been insufficient and efforts to liberalise the sector have not been entirely successful (European Commission, 2019[79]).

Concerning the **clarification of ownership policy and rationales**, the Albanian authorities have not developed an overarching state ownership policy defining the objectives of state ownership or describing how ministries should exercise their shareholding function. Line ministries do have policies concerning the functioning of the SOEs under their remit, but these policies do not clearly stipulate the basic rationales for maintaining enterprises in public ownership or what the state expects in terms of the performance of the enterprises in its portfolio. In the absence of clearly expressed reasons and objectives for state ownership, ownership practices inevitably vary across the public administration. Additionally, the authorities report that the objectives of individual SOEs are decided upon by their general managers, subject to approval by responsible line ministries, which, in the absence of overarching guidelines, points to an ad hoc system of objective-setting with an unclear division of responsibilities between the state as owner, SOE boards and management. The Albanian authorities reported, in the context of this assessment, that the rationales for state ownership include: supporting national economic and strategic interests; ensuring continued national ownership of enterprises; supplying specific public goods or services; and supporting social objectives. There is, however, no evidence that these rationales are clearly set out in a policy or legislative document. The possibility that "social objectives" include activities that are not necessarily in the interest of corporate efficiency, or even in the public interest, introduces some risk of SOE under-performance.

In the context of its predominantly decentralised ownership arrangements, Albania has not established a co-ordinating body to **professionalise state ownership** practices and introduce consistency across ownership ministries. In many cases the division of responsibilities for state ownership decisions is not clear in the applicable legislation. Under the Law on the Corporatisation of State Enterprises, the Council of Ministers is accorded certain explicit decision-making responsibilities concerning SOEs, such as defining board remuneration and approving SOEs' articles of association, as well as the possibility to reassign its responsibilities to line ministries. The law further establishes that the Ministry of Finance and Economy is primarily responsible for exercising the state's ownership rights in SOEs and that sectoral line ministries are granted "administrative" roles, but there is no clear overview of how these arrangements should

translate into practice and the Albanian authorities report that the law does not sufficiently define the differences between the two roles (ownership and administrative roles).

There are nonetheless some elements in place to introduce a degree of harmonisation in certain ownership decisions, for example the fact that the Ministry of Finance and Economy nominates one-third of board members of SOEs that are under the administrative purview of other ministries, who nominate the remaining two-thirds. Decisions by the Council of Ministers, for example concerning the composition of SOE boards, also introduce some consistency in ownership decisions. Finally, a concern that is usually associated with decentralised ownership arrangements – namely, an insufficient separation of ownership and regulatory roles – is partly remediated by the fact that ownership ministries have established SOE monitoring units that are separate from their sectoral policy-making units. This helps clarify institutional division of functions.

Albania has taken some basic initial steps to establish a **board nomination framework**, notably through the aforementioned Council of Ministers' decision on the composition and competencies of SOE boards of directors. This policy document establishes that all SOEs must have boards of directors – with six members for strategic SOEs and three members for non-strategic, small and medium-sized SOEs – and accords line ministries and the Ministry of Finance and Economy shared responsibilities for nominating their members. However, there is limited evidence that the process relies on transparent and merit-based appointment criteria, leading to a high risk of political influence in appointing board members.

Albania has not taken any significant measures to **promote independent and professional boards** in SOEs. In general, SOEs are perceived to operate as arms of their ownership ministries, who exercise a strong role in company oversight, despite the fact that the company law accords boards authority over certain corporate decision making. In practice, SOE boards are often staffed by public officials, which include in some cases politically affiliated individuals such as vice-ministers or advisors to ministers, introducing the risk that corporate decision making is influenced by political concerns. Experts interviewed for this assessment indicated that remuneration for SOE board service (which can reach up to four times that of a civil servant salary) can make multiple board positions attractive for civil servants and that, in some cases, public officials serve on many SOE boards. This could make it difficult for these board members to devote sufficient time to their board duties. SOE board and management positions are often perceived to be accorded to individuals based on their personal and/or political affiliations, rather than their professional qualifications.[50] Together, these factors contribute to the perception that SOE boards in Albania do not have sufficient political independence or professional qualifications to adequately fulfill their corporate board duties.

Concerning the legal framework for boards, many supervisory board decisions must subsequently be approved by the General Assembly (i.e. the state shareholder), meaning that boards do not really fulfill the standard role of corporate decision-making entities, at least when compared to stock-exchange listed companies. On the contrary, supervisory boards mainly exist to ensure that decisions of the General Assembly are properly implemented by SOE management. All SOE boards in Albania are two-tier structures: the top-tier supervisory board (comprising only non-executive members) and the lower tier administrative board, which in SOEs is usually composed of a single person "administrator". Concerning board member duties and liabilities, the company law, which is applicable to SOEs by virtue of their status as joint-stock or limited liability companies, does establish that board members must act in good faith in the interest of the enterprise and are liable for any damages to the company resulting from not performing their fiduciary duties. This constitutes sound basic legislation to ensure that board members act in the best interest of the enterprises that they oversee. However, there are no requirements for SOE boards of directors to include independent (outside) or non-executive directors, which introduces the risk that SOE board members may have material interests in the company or related entities that could introduce conflicts of interest and jeopardise their ability to make independent judgements in the interest of the enterprise. The Albanian authorities have not taken steps to encourage gender diversity on SOE boards of directors, reflecting broader limitations in the required professional qualifications of SOE board members.

*Sub-dimension 6.2: Transparency and accountability practices*

Concerning **financial and non-financial reporting**, SOEs are, like all companies, required to submit annual financial statements to the National Registration Centre, which subsequently publishes them. It appears that at least most large SOEs comply with this requirement, but a conclusive assessment would require a more in-depth review. There are no parallel requirements concerning non-financial reporting. As an EU candidate, Albania will be expected to ensure that all large companies, including large SOEs, are required to publish non-financial information on their policies for environmental impact, employee relations, human rights, anti-corruption and bribery and board diversity (under EU Directive 2014/95/EU). Given that several of Albania's large SOEs undertake activities in the public interest, improved disclosure on the nature and funding arrangements of these non-commercial activities is warranted. Currently the state does not produce an annual report on the performance of the SOE sector as a whole or how well SOEs perform the activities that they undertake in the public interest. Just as financial reports are a crucial source of information that shareholders in listed companies need to make ownership decisions, transparency regarding SOEs' public policy activities is important for the public to understand what SOEs are doing in their interest.

Concerning **auditing practices**, all SOEs (i.e. all enterprises in which the state holds at least 51% of shares) are required to have their financial statements audited by an external auditor, in line with good practice. Companies in which the state is a minority shareholder only undergo external audits of financial statements if they exceed a certain size threshold (determined by a mixture of criteria related to their asset valuation, net income and number of employees).[51] Several large SOEs regularly have their financial statements audited by large international audit firms, which suggests a certain quality and credibility of their audit reports.[52] The state as shareholder is responsible for appointing external auditors, in line with standard corporate practices. SOEs are additionally required to establish internal audit committees, but the authorities report that compliance is low. Separately, the Supreme State Audit body also audits some SOEs' financial statements, in particular large SOEs of strategic national importance. The authorities report that the audits undertaken by the Supreme State Audit body focus primarily on ensuring that the activity of each company conforms with relevant legislation, whereas the audits performed by external auditors focus on ensuring that the financial statements have been prepared in accordance with applicable accounting standards. In sum, SOEs are subject to different types of audits at four levels: internal audits by departments within each enterprise (departments which are required for all SOEs, but are reportedly not always established); ministerial audits conducted by the internal audit departments of ownership ministries; audits by the Supreme State Audit body; and external audits of SOEs' financial statements.

Only three of Albania's SOEs have non-state minority shareholders, none of which are listed, since the public stock exchange was shut down in 2014.[53] There are sound basic laws in place to ensure the **protection of minority shareholders** – i.e. basic provisions calling for shareholders' equitable treatment – and no recent publicly reported cases of abuse of minority shareholder rights in favour of the state. Still, it is possible that weaknesses in the judicial system, which are common across the region, could make it more difficult for minority shareholders to obtain redress if their rights have been violated. And good practice calls for the state to take targeted measures, beyond just legal protections, to ensure that minority shareholders are actively involved in corporate decision making so that their interests are consistently taken into account. The SOEs with non-state minority shareholders are as follows: Alb Controll Durrës, which undertakes quality control for import-export goods (97% state-owned), the Share Registration Centre of Albania (SRC) Tiranë, which maintains national shareholder account data (84.94%) and the tobacco and cigarette manufacturing company Tobacco Producer of Albania, Shkodër (89.65%).[54] The Albanian state is itself a minority shareholder in 28 companies, most of which were originally slated for privatisations that have since been delayed (the authorities intend to privatise these companies in the medium term). It is possible that these companies would in fact be considered SOEs, if the state holds the highest concentration of shares and thus exercises control over corporate decision making, but more information on the shareholding structure of these companies would be necessary to draw a conclusion about this.

### *Sub-dimension 6.3: Ensuring a level playing field*

According to data provided by the Albanian authorities, all SOEs are incorporated following the company law (as either joint-stock or limited-liability companies) and face broadly the same **legal and regulatory treatment** as their private competitors. The Albanian company law was adopted in 2008 to align national legislation with the EU *acquis*. The Law on Corporatisation of State Enterprises, adopted in 1995 and subsequently amended, also applies to SOEs but is reportedly subsidiary to the company law. It sets out complementary requirements concerning, for example, the capital of SOEs, their statutes and their boards of directors. The authorities report that SOEs do not benefit from any exemptions from tax, competition, environmental or zoning rules. Nonetheless, a 2019 IMF study found that Albania was one of eight countries that reported granting some legal preferences to SOEs, indicating that SOEs may still benefit from some operational advantages owing to their state ownership (IMF, 2019[80]). As an example of regulatory issues associated with state ownership in certain sectors, the state-owned oil company Alb Petrol has been the subject of some criticism owing to its simultaneous role as a market player and as a regulatory authority with responsibility for granting oil-extraction licenses in some of Albania's oil fields.[55]

Concerning **access to finance**, Albania's large SOEs often obtain debt financing on the commercial marketplace, with a strong possibility of receiving favourable terms owing to their state ownership. In the context of the COVID-19 crisis, an explicit state guarantee was issued to large SOEs to allow them to access bank credit at a fixed rate of 2.85% for the purpose of maintaining employment levels. Beyond the conditions for commercial debt financing, there are some broader issues related to funding support from the state. Firstly, the existence of several insolvent SOEs under the MOFE indicates that many SOEs do not earn economically significant rates of return, which amounts to a cost of equity capital that is not market consistent. The economic downturn associated with the COVID-19 pandemic has exacerbated existing profitability problems for SOEs. The authorities report that the majority of SOEs posted losses in 2020 and will therefore not distribute dividends to the state. Many SOEs also benefit from state subsidies from their responsible line ministries. In the absence of evidence from the authorities that the amount of these state subsidies corresponds to the approximate cost of SOEs' public policy (non-commercial) objectives, it can be concluded that subsidies may constitute a distortion to the level playing field with private competitors, by granting SOEs operational funding advantages. Even if subsidies are merely keeping low-performing SOEs from going insolvent (rather than fuelling market expansion), in this context they would still constitute an inefficient use of economic resources that is not conducive to improving the performance of SOEs. Clarifying the costs of SOEs' non-commercial objectives, and ensuring that state subsidies correspond to these costs, would be important to ensure that SOEs do not hinder the efficient allocation of resources.

### *Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

**Recent SOE reform** initiatives in Albania have mostly consisted of efforts to assess and restructure insolvent SOEs. In 2019, the Ministry of Finance and Economy notably assessed all the SOEs under its remit and made the decision to merge eight insolvent companies with other SOEs. One of the reported rationales for merging these insolvent companies with solvent SOEs was to avoid the costs associated with bankruptcy and liquidation, pointing to broader issues regarding the efficiency of insolvency procedures in Albania. Separately, the Ministry of Finance and Economy formally proposed to the Council of Ministers the establishment of a central Agency for Public Property Administration, but the proposal was ultimately not approved by the government. If such an institution were established and granted ownership rights for Albania's largest SOEs, it could provide a sound institutional foundation for further professionalising state ownership practices and improving the performance of SOEs. At the current juncture, however, there does not appear to be a consensus within the government on the need to establish such an entity.

The legislative framework for **privatisation** in Albania includes two foundational laws: on the privatisation of SOEs operating in strategic sectors and on the privatisation of SOEs operating in non-strategic sectors.

These laws are complemented by several formal published decisions by the Council of Ministers outlining, among others, the institutional responsibilities and procedures for privatisation. Albania has established a special process, involving heightened inter-governmental oversight, for privatisation cases involving SOEs of strategic importance. The process involves the establishment of a Consultation and Transparency Committee, comprising representatives of several departments within the Ministry of Finance and Economy to ensure that the privatisation procedures established by law are respected; make recommendations regarding the legislative, fiscal or economic situation to support the success of planned privatisations; and propose a schedule for privatisations to the Council of Ministers' Committee on Economic Policies.[56] For the privatisation of individual shareholdings in companies, the Ministry of Finance and Economy is primarily responsible for related procedures.

Concerning recent privatisations, in 2016, the previously 100% state-owned insurance company INSIG was fully privatised and the state's remaining 30% shareholding in the construction company *Euroteorema Peqin* was relinquished to private investors. An earlier privatisation of the economy's energy distribution network operator was reversed sometime after 2013. (In 2009 the state sold 76% of its shares in the Electricity Distributor of Albania (EDA) to the Czech majority state-owned company ČEZ, with the aim of boosting needed investments in the electricity distribution system. In 2013, the Albanian state removed ČEZ's license to operate in the economy and ultimately retook ownership of the power distribution company, which is currently under the purview of the Ministry of Infrastructure and Energy.) At the time of writing, the Ministry of Finance and Economy did not have any short-term plans to privatise any of the SOEs or minority shareholdings in its portfolio. However, the authorities did report an expectation that the 28 companies in which the state holds minority shares would eventually be privatised in the medium term. At the time of writing, a proposal by the Ministry of Culture to privatise the state-owned Alba Films was under consideration by the Council of Ministers.

### *The way forward for state-owned enterprises*

As for most economies in the Western Balkans, ensuring that SOEs in Albania operate efficiently, transparently and on a level playing field with private companies will necessitate reforms in multiple policy areas that cannot be done all at once. Choosing the appropriate sequencing of reforms is just as important as their content and depends in large part on the national political climate and current reform priorities.

This being said, the OECD Guidelines on Corporate Governance of State-Owned Enterprises provide a guidepost for reforms that the Albanian authorities can use to inform their policy efforts in this domain (OECD, 2015[81]). Based on the state of play of SOE policy development in Albania, the following priority reform areas – which are in line with the OECD SOE Guidelines – could offer a basis for discussions with the authorities:

- **Strengthen the institutional arrangements for state ownership.** Albania has already taken some steps to separate SOE ownership and regulatory functions, by placing a large number of SOEs under the sole purview of the Ministry of Finance and Economy (which is not a sectoral regulator) and requiring that the SOE board nomination process for other SOEs involves both the MOFE and sectoral line ministries. The authorities should move forward with the initiative to establish a central state ownership agency – or, if this is not possible, a co-ordination entity – to further harmonise state ownership practices and fully separate ownership and regulatory roles. The state ownership or co-ordination entity could be charged with developing an overarching ownership policy, gathering performance and other data on Albanian SOEs and establishing clearly defined performance indicators for SOEs.
- **Increase the independence and operational autonomy of SOE boards of directors.** The presence of politically affiliated individuals on Albanian SOE boards points to a boardroom culture in which decision making is strongly linked to political goals rather than corporate efficiency. The absence of clear performance expectations from the state as an owner exacerbates this potential for politicisation.

As a first step, the authorities should establish SOE board membership criteria that minimise these and other conflicts of interest and ensure that SOE boards are staffed with a sufficient number of qualified professionals. The experience of some OECD countries in establishing inter-ministerial board nomination committees, and involving private recruitment agencies in the process, may be useful for the Albanian authorities.

- **Improve SOEs' efficiency so that they create economic value alongside private companies.** This assessment has highlighted that many SOEs in Albania do not earn economically significant rates of return, meaning that economic resources are not channelled to the economy's most productive actors. When SOEs operate efficiently and on a level playing field with private companies, they create value to the ultimate benefit of the general public, who are the "owners" of SOEs. The Albanian authorities should consider structural reforms within the most economically important SOEs to improve their productivity. Also related to broader market efficiency, the authorities should address any barriers to effective competition in markets where SOEs compete with private companies. Related issues appear to be particularly acute in the electricity sector, where the development of a competitive market is apparently hindered by preferential access contracts granted to state-owned electricity suppliers.[57] The Albanian authorities should move forward with removing barriers to market liberalisation in sectors where the establishment of a competitive market is a stated policy goal, with a view to maximising economic efficiency to the benefit of end consumers.
- **Gather and publish financial performance data on SOEs.** Differing figures regarding the total number of SOEs in Albania, as reported by both the national authorities and by external assessments, point to the need for a clear central overview of how many companies the government owns, including an indication of which companies are "active" and which are insolvent and/or undergoing bankruptcy proceedings. Such a central overview of SOEs could be enriched with employment figures, as well as financial performance data to provide the authorities with a clear understanding of how the SOE portfolio is performing. A mechanism is already in place to ensure the submission of SOEs' financial statements to a central authority (the National Registration Centre), which could provide the data necessary to calculate financial performance figures. Information on SOEs' performance could ultimately provide a point of departure for developing performance indicators (e.g. rate-of-return expectations) that are applicable to individual SOEs and benchmarked against industry standards. Lithuania's state ownership co-ordination body publishes financial performance data on SOEs, and could provide useful inspiration for the Albanian authorities (see Box 20.9). In cases where information for individual SOEs is insufficient, the authorities could develop targeted measures to improve SOEs' compliance with existent reporting requirements.

### Box 20.9. Gathering performance data on state-owned enterprises in Lithuania

Lithuania's Governance Co-ordination Centre (GCC) is a state ownership monitoring and co-ordinating entity which takes the lead in developing annual reports on the performance of the state's SOE portfolio. It also calculates three-year targets for the state's rate-of-return expectations for individual SOEs and comments on SOEs' yearly strategy documents. The annual aggregate report produced by the GCC notably includes the following financial performance data and other quantitative information on SOEs:

- Aggregate financial information on the entire SOE portfolio, including a profit-loss statement and a balance sheet.
- Market value of the state portfolio and explanations of changes compared to previous periods.
- Price-to-earnings ratios for SOEs with shares listed on the stock exchange, with comparisons to foreign industry peers.
- Portfolio returns to the state, including value of dividends, value of taxes and rates of return on both assets and equity.
- Information on SOEs' capital structure: debt-to-equity ratios for the portfolio and for individual SOEs.
- Number of employees overall and per sector, with year-on-year comparisons.
- Detailed related figures on large individual SOEs, together with explanations for significant changes.

Note: This overview is based on the 2017 annual aggregate report. More recent reports are also available, but only in Lithuanian.
Source: (VKC, 2018[82]), *State-Owned Enterprises in Lithuania: Annual Report 2017*, https://governance.lt/wp-content/uploads/2018/09/SOE_Report_2018_EN_WEB.pdf.

## Education policy (Dimension 7)

### *Introduction*

Table 20.11 shows Albania's scores for the four education policy sub-dimensions and the cross-cutting dimension on system governance, and compares them to the Western Balkan six (WB6) average. Albania scores above the WB6 average in all sub-dimensions. Indeed it has the highest score of the WB6 economies for the early childhood and school sub-dimension, driven by its above-average ratings for each of the sub-dimension's three indicators. Likewise it scores joint highest (along with North Macedonia) for the tertiary education sub-dimension.

### Table 20.11. Albania's scores for education policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 3.3 | 3.0 |
| | Sub-dimension 7.2: Teachers | 3.5 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 3.3 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 3.0 | 2.8 |
| | Cross-cutting dimension: System governance | 3.5 | 3.3 |
| **Albania's overall score** | | **3.3** | **3.0** |

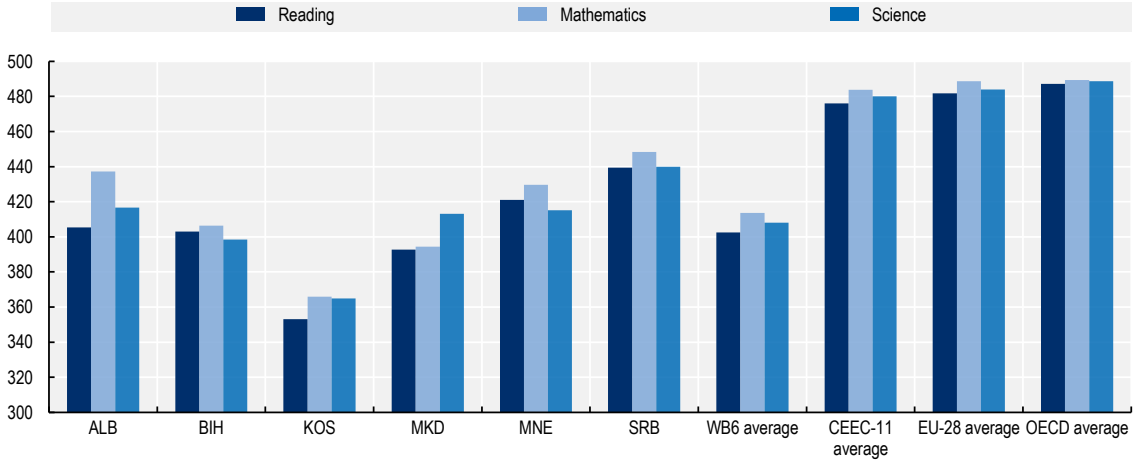
### *State of play and key developments*

Since the last CO assessment, Albania has implemented its competency-based curriculum across all grade levels, developed an assessment framework for pre-school education that aligns with contemporary child development theories and created a manual for monitoring children at risk of school dropout. As of 2019, net enrolment in Albania was nearly universal for primary (98%) and lower secondary (96%) education. However, net enrolment at the upper secondary level was only 82%, lower than the OECD and EU averages (UIS, 2020[83]).

In terms of learning outcomes, Albania's average scores in the Programme for International Student Assessment (PISA) are slightly above the Western Balkan average but much lower than the EU and OECD averages (Figure 20.14). Albania also has a large share of students who have not achieved baseline levels of proficiency in reading (52%) and maths (42%); much higher shares than the OECD average (around 23% and 22% respectively) (OECD, 2020[84]). These findings have implications for Albania's long-term economic development, as students without basic skills are less likely to attain well-paid and rewarding jobs. A positive trend is that improvements in the bottom of Albania's PISA performance distribution are outpacing improvements at the top in every subject, closing the gap between the highest and lowest-achieving students. Nevertheless, there is evidence that children in Albania from socio-economically disadvantaged backgrounds, those living in rural areas and those from Roma and Egyptian Balkan communities continue to face barriers to educational access and are more likely to have lower educational outcomes (Maghnouj et al., 2020[85]).

## Figure 20.14. Performance in reading, mathematics and science in Western Balkan education systems

PISA 2018 mean scores




Note: CEEC - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (OECD, 2020[84]), *PISA 2018 Database*, Tables I.B1.4, I.B1.5 and I.B1.6, www.oecd.org/pisa/data/ PISA database.

StatLink https://doi.org/10.1787/888934255399

Albania has experienced major challenges recently that have had important consequences for the education system, as well as the economy and society at large. First, the November 2019 earthquake that struck the north-western part of the country displaced many students who attended one of the 52 damaged schools and kindergartens. Reassigning these students to other education institutions exacerbated issues of overcrowding in urban schools, some of which were already operating on multiple shifts to accommodate demand. Then, similar to countries around the world, Albania closed schools on 9 March 2020 to help slow the spread of COVID-19.

This crisis has delayed several policy developments in Albania, including the finalisation of the new education strategy. However, at the onset of the pandemic, the Ministry of Education, Sports and Youth, with support from international donors, was proactive in rapidly implementing remote learning across the country by broadcasting television and online lessons and providing teachers and schools with digital tools like Google classroom and Zoom to connect with students. A platform – academia.eu – was also created. While in-person instruction started in September 2020, the effects of the COVID crisis have pushed the ministry to emphasise the importance of digital competencies and it is working to develop online teaching methodologies across all levels of instruction. The creation of three learning scenarios, respectively in-presence learning, mixed online and in-presence learning, and full online learning, allows for the government to maintain flexibility in its response as the health situation evolves. Additionally, separate guidelines were created for organising online learning for students in VET (National Agency for Education, Vocational Education and Traning of Albania, 2020[86]).

There has also been an effort to recruit psycho-social support staff to support student well-being. The government has reported that the number of psycho-social staff has doubled due to the employment of psychologists. To maintain Albania's recent progress in the education sector, enhanced and targeted spending is needed to ensure continuity of learning for all students, especially the most vulnerable (World Bank, 2020[87]).

### *Sub-dimension 7.1: Early childhood and school education*

Albania's performance in the **early childhood education (ECE) indicator** is slightly higher than the regional average (Table 20.11). There is a strong strategic and legal framework for the sector and while gross enrolment in pre-primary education (80.5% in 2018) is lower than the OECD (81%) and EU (98%)

averages, it is significantly higher than other Western Balkan economies, which on average have a gross enrolment ratio of around 53% (UIS, 2020[83]). However, pre-primary education is not compulsory in Albania and the government has not met targets to raise participation to 90% by 2020 (Wort, Pupovci and Ikonomi, 2019[88]). There is also evidence that some children, especially those from ethnic minority groups, continue to face barriers to access (Psacharopoulos, 2017[89]). In terms of ECE quality, in 2018 Albania introduced a series of curriculum programmes for different age groups[58] and an assessment framework to help monitor early child learning and development. There are also educational requirements and standards for pre-school teachers and principals; however, attracting quality teaching staff remains a key challenge in some regions (UNESCO, 2017[90]). While ECE is not exclusively donor-funded in Albania, donor-led initiatives still play an important role in implementing policy and monitoring and evaluating the sector.

The Albanian **instruction system[59]** rates among one of the highest performers in the region for this indicator. The Pre-University Education Strategy 2014-2020 sets out a vision for education and a series of policy priorities.[60] Since 2019, implementation of the competence-based curriculum has been rolled out to all grade levels and learning standards have been established to serve as a baseline for syllabuses, teacher guides, and other materials that support teaching and learning. These materials are being adapted to respond to new blended and digital learning environments as a result of recent challenges, such as the earthquake in late 2019 and the COVID-19 pandemic. Albania has taken steps to align the curriculum with its national examinations, which respectively certify the completion of basic (in Grade 9) and upper secondary education (in Grade 12), although the latter also serves as a university entrance exam. Both examinations are fit for purpose and Albania continuously works to increase their reliability. Another notable feature of Albania's instructional system is the Assessment of Primary Education Pupils' Achievement (VANAF),[61] which marks the only system-wide learning assessment in the Western Balkans. While the VANAF has the potential to help identify and address achievement gaps and support teachers' classroom assessments, the lack of standardised marking procedures do not support system monitoring and comparisons (Maghnouj et al., 2020[85]).

Albania established its school evaluation framework in 2011, setting out school quality standards that cover teaching and learning, in addition to serving as the main reference for external and internal school evaluation. However, the State Inspectorate of Education was dissolved in 2019 and Regional Directorates of Education now have responsibilities for school evaluation. The goal of this reform was to conduct more school evaluations and provide improvement-focused support to schools. As a result, Albania no longer has a single body with a mandate to assure the integrity of external school evaluations – a common feature in many European education systems (Maghnouj et al., 2020[85]). Nevertheless, the school system has seen many positive developments over the last two years. In particular, the ministry's Quality Assurance Agency is now reviewing the School Performance Card (a set of indicators used to rank individual schools) to ensure this data reflects contextual factors and is relevant to instructional quality. Another positive development is the establishment of the Centre for School Leadership[62], which aims to support the preparation and professional development of school leaders. These types of initiatives are likely to further Albania's progress in strengthening its instructional system.

The **early school leaving** rate in Albania has declined over the last decade, but at over 16% in 2019, remains higher than the Western Balkan (8.5%) and EU average (10.2%) (Eurostat, 2019[91]). The Ministry of Education, Sports and Youth has identified several factors that contribute to Albania's high rates of school abandonment, which often start earlier in the education pipeline. Distance between school and home; pressure to contribute to family income; household obligations (e.g. caring for children and elders, etc.); early marriage; and factors such as disability, ethnicity, migration and poverty are all associated with school dropout (MoESY, 2017[92]). While Albania's Pre-University Education Strategy 2014-2020 calls for a specific strategy to deal with dropout and early school leaving, this issue is only covered indirectly through policy documents, such as the National Action Plan for the Integration of Roma and Egyptian Population 2016-2020 and the School as a Community Centre Framework. Without an explicit strategy on early school leaving or dropout and accompanying budget allocations, Albania may struggle to further reduce its share

of early school leavers. Nevertheless, donor agencies have helped develop indicators and collect data to better monitor students at risk of early school leaving and in July 2019, Albania published a manual for monitoring children outside education institutions and at risk of school dropout with support from UNICEF.

### *Sub-dimension 7.2: Teachers*

Albania's score for the sub-dimension on teachers is above the Western Balkan average (Table 20.11), largely because of the economy's high standards for entering the teaching profession and clear regulations on the professional management and development of teachers. All primary and secondary school teachers are required to have a master's degree at International Standard Classification of Education (ISCED) level 7; however, national data suggest that only 79% of teachers had attained this level of education as of 2019. Over the last ten years, teachers in Albania have benefitted from salary increases and average salaries are comparable to other public sector professionals (Council of Ministers, 2017[93]). In 2019, the average annual gross salary of a full-time public school teacher (ISCED 1-3) in Albania was slightly over EUR 6 000. This average is lower than most European countries (European Commission/EACEA/Eurydice, 2019[94]).

While Albania has a general accreditation process for higher education institutions, there are no programme-specific accreditation criteria for **initial teacher education (ITE).** As a result, ITE providers do not have to demonstrate how their programmes help candidates develop the specific competencies needed to teach. However, Albania has taken several steps to ensure the most qualified students enter the teaching profession. For example, ITE candidates must have a minimum grade point average of 7.5, which gradually increased between 2018 and 2020. Candidates must also complete a nine-month teaching internship, pass a state examination and take a separate recruitment test before they can start working in schools. In 2019, Albania also introduced an online portal[63] to manage teacher recruitment nationally. However, there is a general oversupply of teachers, as well as shortages in some specific subjects and regions, especially in rural parts of the country (European Commission, 2018[95]). While Albania has tried to attract teachers to work in rural areas (by offering a transportation bonus), declines in the student population and other demographic changes will likely require a more comprehensive and proactive approach to teacher recruitment policies (Maghnouj et al., 2020[85]).

Albania has a clear regulatory framework for the **professional management and development** of teachers. A specific institution, the Commission for Accreditation of Training Programmes, is responsible for accrediting programmes. And the Agency for the Assurance of Quality in Pre-University Education studies teacher professional development needs using a range of sources, such as teacher self-assessment surveys, appraisals conducted by schools and external experts, results from teacher qualification tests and student results in assessments and exams. Teachers benefit from established professional learning networks and the state budgets pay for professional development activities; however, partnerships with donor agencies supplement delivery. There are three categories of teachers in Albania (qualified, specialist and master), which align with years of work experience and salary increases. Importantly, teachers at different qualification categories are not expected to demonstrate different levels of competency, as teachers' standards are not differentiated by competency level, unlike a growing number of OECD countries.

### *Sub-dimension 7.3: Vocational education and training*

Albania's score in the sub-dimension on vocational education and training (VET) is on par with the Western Balkan average (Table 20.11). Professionally oriented education starts at the upper secondary level, when students are allocated into either general (gymnasium), vocationally oriented programmes. While students in Grade 9 take the National Basic Education Examination to certify their completion of compulsory education, unlike most economies in the region, results from this exam are not typically used to sort students into an upper secondary track because most attend gymnasium[64] (Maghnouj et al., 2020[85]). Moreover, while data from PISA find that vocational students tend to have weaker literacy and numeracy

skills than their peers in general education, Albania has the narrowest learning gap in the region between general and VET education programmes (25 score points) (OECD, 2020[84]).

Responsibility for the **governance of VET** in Albania is centralised in the Ministry of Finance and Economy and, which oversees a state-funded system composed of two types of providers: vocational schools (for young people) and vocational training centres (mainly for adults). The ministry works with several government agencies to manage the VET sector, such as the National Agency for Employment and Skills and the National Agency of Vocational Education Training and Qualifications. Policy coherence at the central level is ensured by the National VET Council and a wide range of stakeholders can engage in the sector's development through regional governing committees and steering committees within VET institutions. Despite efforts to involve social partners, there is evidence that Albania's VET system remains traditionally classroom-based and struggles to respond to local needs, contributing to a mismatch between skills supply and demand (UNDP, 2018[96]). Albania's National Employment and Skills Strategy 2019-22 sets out clear implementation plans, budgets and timelines for offering quality VET to youth and adults. The 2017 Law on VET regulates the sector and aims to modernise qualification standards and framework curricula for VET programmes. However, there is evidence that implementation has been limited since providers often lack appropriate teaching skills and equipment (European Commission, 2020[19]).

Despite the challenges in modernising the overall VET system, Albania has given a new impetus to promoting **work-based learning** (WBL) in recent years, largely driven by a donor-led roadmap for a dual VET scheme (Eurydice, 2021[97]). There are also broad public awareness campaigns, presentations to social partners and dedicated career placement services that help match learners with WBL places. A range of data, such as rates of enrolment and completion of VET programmes and the number of learners who are hired after WBL placements, is collected to further support the sector's development and inform career paths. However, there is no official incentive scheme to encourage employer participation in WBL; nor is there information on the earning outcomes of recent graduates. Moreover, the government reports that engaging businesses to provide internships and WBL places is often a challenge.

### *Sub-dimension 7.4: Tertiary education*

Albania's score in the tertiary education sub-dimension is on par with the Western Balkan average (Table 20.11). School life expectancy (from primary education through tertiary education) has increased in recent decades and was similar to the Western Balkan average (around 14 years) in 2018, but still lower than the average in the EU (16.6 years) and OECD (17 years) (UIS, 2020[83]). While national data show that the share of adults who have attained some form or tertiary education is on the rise, Albania has the lowest rate (24%) of tertiary-educated young adults (30-34 year-olds) in the Western Balkans (European Commission, 2020[19]). Gross enrolments in tertiary education also decreased between 2014 and 2018 (UIS, 2020[83]). These findings can be partly explained by migration outflows driven by the pursuit of education and career opportunities abroad (i.e. brain drain), as well as the closure of private universities[65] which reportedly awarded low-quality degrees (Maghnouj et al., 2020[85]; European Commission, 2020[19]).

There is no overall strategy for tertiary education, although this topic is expected to be included in Albania's future education strategy, which is currently under development. As a result, the sector is regulated by legal frameworks, in particular the 2015 Higher Education Law,[66] and in recent years, the government has been working to develop bylaws. The 2015 law introduced several changes to the higher education system, including greater institutional autonomy for universities, accountability measures and programme diversification to better align with labour market needs (EACEA, 2017[98]). The law also led to an increase in tuition fees that sparked widespread student protests in late 2018 (Erebara, 2018[99]).

Albania has established transparent processes for selection into higher education,[67] and student loans and scholarships are available[68] to support more **equitable access to higher education**. Moreover, a quota system provides a 50% reduction in tuition fees for students facing economic and social difficulties, such as those with disabilities, the blind, Roma and Balkan-Egyptian minorities and orphans. While access to

higher education for these groups is improving, they are still much less likely to participate in higher education; some evidence suggests that the quota system and other equity measures have not been fully implemented (European Commission, 2020[19]).

There have been studies on factors that contribute to higher education participation, and Albania's National Statistics Institute (INSTAT) collects some disaggregated data that can help monitor equity in the tertiary sector.[69] However, the Ministry of Education, Sports and Youth does not analyse this information to identify and address equity issues. Collecting data on the quality and labour market relevance of higher education is the task of individual institutions, which submit annual reports on graduate employment rates to the Ministry of Education, Sports and Youth. However, this information is only based on interviews with a selection of tracked students and there are no centralised definitions. As a result, it impossible for the government or individuals to rigorously monitor and compare tertiary providers and programmes.

Despite somewhat limited information, Albania meets several of the higher level criteria for the indicator on **labour market relevance of higher education.** For example, there are a number of policies and programmes to promote the internationalisation of students and staff, quality assurance bodies align with the standards and guidelines of the European Higher Education Area, and each higher education institution has an academic senate[70] responsible for developing new study programmes and planning academic and scientific research activities. The 2015 Higher Education Law also considers student employability as a parameter for funding and ranking universities (EACEA, 2017[98]). While Albania continues to face high rates of unemployment and large shares of youth who are not in employment, education or training (NEET) compared to EU and OECD averages – see Employment policy (Dimension 8) – these rates have been steadily decreasing in recent years. Public expenditure on tertiary education in Albania as a percentage of GDP (0.68%) was lower than the regional (1.67%), EU (1.12%) and OECD (1.95%) averages in 2017 (UIS, 2020[83]). Further improvements will likely require a combination of greater investment in tertiary education, as well as increases in the demand for skills to use the economy's human capital and discourage emigration (especially by youth), which currently hinders competitiveness.

### *Cross-cutting dimension: System governance*

Albania's score for this cross-cutting dimension is similar to the Western Balkan average (Table 20.11), as some system governance features align with the policies and practices found in European and OECD education systems. For example, there is an established national education strategy and a national assessment system that respectively provide a vision for education and monitor student learning outcomes. Albania also has a national qualifications framework that was introduced in 2010. However, the Albanian qualifications framework does not clearly align with the European Qualifications Framework, making it difficult to recognise Albanian's qualifications internationally. To address this issue, the Albanian Ministry of Education, Sports and Youth and the Ministry of Finance and Economy created a joint task force in 2015 to align the two frameworks with support from the European Training Fund. The task force was expected to complete its mandate by 2022 but disruptions caused by COVID-19 have delayed progress.

The Albanian Pre-University Education Development Strategy 2014-20 sets out policy objectives to improve the governance, inclusion, quality assurance and teacher professional development in the pre-tertiary sector. This strategy does not cover higher education or VET, although the latter is addressed by the National Employment and Skills Strategy 2019-22. Albania developed the pre-university education strategy in consultation with a range of stakeholders and the document includes an implementation plan outlining the main activities, expected outcomes and timelines. However, an external evaluation of the strategy[71] found a 43% gap between the planned education budget in 2019 and what was approved (Wort, Pupovci and Ikonomi, 2019[88]). Considering that government expenditure on education as a share of GDP in Albania (3.6%) is much lower than the OECD (5.2) and EU (4.9%) averages, it is crucial that the country's next education strategy establishes a realistic budget to use available resources most effectively (UIS,

2020[83]). Prioritising investments will be especially important given that the draft education strategy plans to cover the whole education sector, from ECE through to tertiary.

Albania collects information on the education system's inputs, outputs and outcomes. In particular, data on student learning outcomes is collected through regular participation in international assessments and the Assessment of Primary Education Pupils' Achievement (VANAF), which is currently the only fully operational national assessment in the Western Balkans. The majority of EU and OECD countries already administer some sort of national assessment to monitor student learning (OECD, 2013[100]). Albania is also developing a new education management information system (EMIS), which is a positive development for system governance since administrative data and information on student results and the VET sector were all previously stored in separate databases (Maghnouj et al., 2020[85]).

### *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education in Albania can help increase regional competitiveness and create opportunities for more individuals to develop the competencies needed for sustainable development and social cohesion. Albanian officials will need to reflect on the economy's political, social and fiscal environment to determine how best to achieve their education goals. While the 2020 OECD review on evaluation and assessment in Albania's education system (Maghnouj et al., 2020[85]) provides detailed recommendations on how to strengthen the equity and quality of the education sector, the following considerations in particular can provide insights for discussions on the way forward:

- **Develop Albania's new education strategy with a clear set of priorities and a strong monitoring framework.** The development of Albania's next education strategy will cover a critical period for national development and potential accession to the EU, highlighting the importance of directing the education sector towards supporting more students to achieve good and excellent outcomes. It will therefore be important to focus on priorities that are clear and measurable to help mobilise stakeholders across the system. These priorities should be translated into financially viable implementation plans that can be measured through a monitoring framework. For example, Ireland includes specific indicators to measure progress towards national goals for education in its 2018 Action Plan for Education (Department of Education, 2018[101]).
- **Conduct forward planning exercises to identify teacher demand.** Albania has taken several steps to make entry into initial teacher education more competitive and collects a range of data on the skills and preferences of teacher candidates as well as teacher vacancies. However, there is still a general oversupply of teachers and shortages in some specific subjects and regions. The ministry should review and refine its teacher forecasting model and labour market data to inform further adjustments to initial teacher entry requirements and quotas. For example, Scotland (United Kingdom) adjusts admissions quotas to initial teacher education on an annual basis to project teacher supply and demand (Maghnouj et al., 2020[85]).
- **Ensure integrity in external school evaluation.** Since Albania has dissolved its State Inspectorate of Education as part of the education reform, the ministry should take steps to ensure that evaluators have objectivity and distance from responsibility for a school's performance. One way to do this is to supplement regional evaluation teams with contracted evaluators, a common practice found in OECD and European systems (Box 20.10) (Maghnouj et al., 2020[85]).
- **Continue to strengthen the collection and management of data**. Albania has already taken several important steps to modernise the collection and management of education data in recent years and is working to link various databases. These efforts should be continued so the system can more effectively analyse education inputs, processes and outcomes.

### Box 20.10. Contracted school inspectors in Scotland, United Kingdom

In Scotland (United Kingdom), school inspection teams include:

- full-time inspectors employed by Education Scotland, the central inspection body
- contracted associate assessors (i.e. high-performing principals, deputy principals and local education unit staff) who join inspection teams three times a year
- individuals with diverse backgrounds who are selected and trained for their role.

Source: (European Commission/EACEA/Eurydice, 2019[94]), *Assuring Quality in Education: Policies and Approaches to School Evaluation in Europe*, http://doi.org/10.2797/678 (accessed on 18 November 2019).

## Employment policy (Dimension 8)

### *Introduction*

Advances have been made in the regulatory framework of the labour market since the last assessment; however, improvements are more limited when it comes to implementing the regulations. The capacities of relevant institutions (in particular labour inspectorates and social partners), as well as co-operation between agencies, need to be strengthened. Progress has been made to strengthen work-based learning in the education and training system and to detect employers' skills needs, but progress in upskilling low-skilled adults and in encouraging continuous training of adults is limited. Progress has been made to modernise public employment services (PES), as well as in the evidence-based design of active labour market programmes, although financial resources remain too low given the scale of labour market challenges. There have been limited improvements in tackling informal employment and overall average wages remain low.

Table 20.12 shows Albania's scores for the employment policy dimension and each of the four sub-dimensions, comparing them to the WB6 average. Albania scores higher than the WB6 average in all four sub-dimensions, thus achieving an above-average score overall. Albania's score is particularly high in the job quality sub-dimension, making it top in the region for this sub-dimension.

### Table 20.12. Albania's scores for employment policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 2.8 | 2.6 |
| | Sub-dimension 8.2: Skills | 2.8 | 2.2 |
| | Sub-dimension 8.3: Job quality | 2.8 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 3.0 | 2.9 |
| **Albania's overall score** | | **2.8** | **2.6** |

### *State of play and key developments*

The activity rate of the population aged 15-64 in Albania has increased by 5.4 percentage points since 2015, to reach 69.6% in 2019. This rate is higher than the WB6 average, but still below the EU average (Table 20.13).[72] Real GDP and employment have grown over the assessment period. The employment rate of the 15-64 age group increased by 8.3 percentage points since 2015 reaching 61.2% in 2019 (INSTAT, 2020[102]). Jobs have mostly been created in the service sector and in industry. The activity and employment rates have also increased among those aged 65 and above[73] (INSTAT, 2020[102]) (WIIW and World Bank, 2020[103]). The employment rate increased from 55.5% in 2015 to 68.3% in 2019 among young adults aged 25-29 (INSTAT, 2020[102]) (WIIW and World Bank, 2020[103]). The unemployment rate (15-64) has decreased continuously from 2015 to 2019, falling to 12%. This is one of the lowest rates in the region, though still markedly above the EU unemployment rate and the 4.1% average for Bulgaria, Romania, Hungary, Slovenia and Croatia (WIIW and World Bank, 2020[103]; INSTAT, 2020[102]; Eurostat, n.d.[104]).

### Table 20.13. Key labour market indicators for Albania (2015 and 2019)

| | Albania | | WB6 average | EU average |
|---|---|---|---|---|
| | **2015** | **2019** | **2019** | **2019** |
| **Activity rate (15-64)** | 64.2% | 69.6% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 52.9% | 61.2% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 17.5% | 12.0% | 16.3% | 6.4% |

Note: WB6 average rates are based on author's own calculations using simple averages.
Source: (INSTAT, n.d.[105]), *Statistical Database*, http://databaza.instat.gov.al/pxweb/en/DST/?rxid=caba46dc-9b6f-4a2a-bf84-02693c7b3076; (Eurostat, n.d.[104]), *Labour Force Survey Database*, https://ec.europa.eu/eurostat/web/main/data/database.

As a result of the COVID-19 pandemic, registered unemployment rose by 30% between March and September 2020, with both men and women equally hit. About 32% of registered jobseekers applied for unemployment benefit (formal employment) over this time period. The average monthly number of unemployment benefit recipients during the first nine months of 2020 was 50% higher than in 2019 and the number of unemployed jobseekers that were employed during the period January-October 2020 declined by 22% compared to the same period in 2019. The unemployment risk was significantly higher for the low-skilled; those performing trade, services and elementary occupations; as well as the informally employed. This led to a 19% increase in the number of financial aid recipients between March and September 2020. Linked to their low skills level and presence in the informal economy, the Roma were the most hit by unemployment (+34%), according to administrative data.

During the pandemic the Agency of Employment and Skills handled the registration of new jobseekers as usual and PES offices remained open. However, the agency does not have the capacity to rapidly implement the newly introduced employment incentive measures targeted at dismissed workers and informal workers who lost their jobs due to the pandemic (in this case the formalisation of employment relationship is supported). This points to the urgent need to increase the capacity of the Agency for Employment and Skills. Measures targeted at specific vulnerable groups include transportation subsidies, financial support to single parents for childcare, a 12-month subsidy for employing people with disabilities as well as subsidies for workplace adaptation.

### *Sub-dimension 8.1: Labour market governance*

In 2017, the Albanian Government took the drastic decision to reduce the number of ministries in the cabinet. After 25 years of existence, the government shut down the Ministry of Labour and Social Welfare without prior consultation with social partners and distributed its work on labour and professional education to the Ministry of Finance and Economy and the social welfare component to the Ministry of Health. This reflects a reduced political commitment to employment and social issues. Capacities for employment policies have been reduced and the need for co-ordination between the two different line ministries lengthens decision-making processes.[74] The National Employment Service was renamed the National Agency for Employment and Skills in 2019 (Council of Ministers, 2019[106]). It offers opportunities and aims to fulfill the rights of citizens to gain profitable employment, receive professional counselling and qualifications for any such employment and also receive financial income support through its network of employment offices around the country.

As regards the **regulatory framework**, the Employment and Skills Strategy 2019-2022 is the key policy document for labour market governance. It intends to align the relevant Albanian legislation with the relevant EU Directives. An assessment of legal and institutional gaps is still underway. Most progress so far has been made in aligning occupational health and safety (OHS) regulations.

Improving working conditions is a key challenge. A working conditions survey by Eurofound conducted in 2015 showed that 44% of Albanians were not very or not at all satisfied with their working conditions, while this was the case for only 12% of respondents in the EU (Eurofound, n.d.[107]). The results of the working conditions survey conducted in 2020 will shed light on progress on working conditions. Working time is one important element of working conditions. In 2019, half (56.6%) of those employed worked between 40 and 48 hours a week, while 20.4% worked for more than 49 hours a week (INSTAT, 2020[102]).[75] In 2018, most occupational accidents occurred in the mining (23%), manufacturing (23%) and construction (15%) sectors. While self-reporting of companies on accidents at work has improved recently – an online reporting and a system of e-inspections was introduced – data are still too poor to get an overview of improvements in working conditions. For example, the reduction of fatal accidents at work could be recorded. Linked to the reduced economic activity in the context of the COVID-19 pandemic, the number of fatal accidents fell by 26% between January and August 2020 compared to the previous year. It remained rather constant between 2016 and 2019.

Self-employment is one of the causes of in-work poverty (Jorgoni, 2019[108]). The share of self-employed among the employed increased substantially between 2015 and 2016, but decreased slightly thereafter. In 2018, 34% of all employed were self-employed (32.3% in 2019) – substantially above the WB6 average (23.1% in 2019).[76] Many self-employed people work in the agricultural sector, often in a context of subsistence.[77] There is no evidence of clear regulation of labour rights or social protection of gig workers.

The Employment Promotion Law of 1995 introduced quotas and levies for public and private employers of people with disabilities, while the new Employment Promotion Law adopted in December 2018 regulates the setting-up of an employment fund for the employment and skills development of people with disabilities. However, the levies have never been enforced, and the envisaged national employment fund has not been established. The law should be implemented effectively to use the fund for vocational rehabilitation. Some progress has been achieved by using the management information system for disabled beneficiaries, which is still in the pilot phase (European Commission, 2019[79]).

Child labour remains a concern. It is assessed that in 2018, 4.6% of children aged 5-14 were working (mainly in agriculture, as well as "street children", especially those from Roma communities). Previous data based on a 2010 survey conducted by the International Labour Organization (ILO) and CRCA (Child Rights Centre Albania) show that 7% of children up to 14 years of age were working (ILO and INSTAT, 2012[109]). As the two sources are not comparable, it is not possible to state that child labour has been reduced. A legislative framework[78] sets 16 as the minimum working age, and changes were introduced in 2017.[79] In 2020, a new practical guide was issued to help labour inspectors identify and control forms of child labour and respond appropriately. The guide was drafted by the Organisation for Security and Co-operation in Europe Presence in Albania, in close co-operation with the State Inspectorate of Labour and Social Services, the State Agency for the Rights and Protection of the Child and the Office of the National Anti-Trafficking Co-ordinator at the Ministry of Interior.[80] The pandemic situation in Albania has affected orientations and planning, but nevertheless training of labour inspectors to use this guide has been a priority. Although the number of Child Protection Units increased recently, co-operation with the State Labour Inspectorate and Social Services could be improved (US Department of Labor, 2018[110]). There is also a need to strengthen the system for monitoring child labour (European Commission, 2019[79]).

Only small improvements have been made in recent years to increase the institutional capacity of **labour inspectorates** to make sure OHS regulations are implemented, informal employment reduced and child labour detected. Only 7% of companies are inspected annually and labour inspectors have difficulty accessing all sites where there are potentially poor working conditions (e.g. mining). Labour inspectorates lack the financial resources to travel to all inspection locations, and equipment is out of date.[81] The number of labour inspectors has remained nearly constant since 2014 (the number of staff was 154 in 2019, 98 of whom worked as inspectors). The average caseload for each inspector is around 12 600. By way of comparison, in Germany inspectors concerned only with the detection of informal and illegal employment have an average caseload of around 6 000, and in addition there are dedicated inspectorates dealing with OHS issues (ZOLL, 2020[111]). Deficiencies in implementing the regulations are also linked to the lack of clear rules and guidelines. There is no curriculum or specific training for acquiring the skills needed to be a labour inspector and there is also no legally defined certification procedure. However, ILO is providing regular training.[82]

There are plans to improve and refine the risk assessment for planning the activities of the inspectorates based on improved data on the sector and previous non-compliance by companies During the summer months inspections are also done in co-operation with tax authorities to detect informal employment in the trade and service industries. More efforts are needed to intensify this co-operation between entities throughout the year. The share of fined companies and workers is low given the number of inspections, pointing to the low capacity of labour inspectorates and potentially highlighting corruption.[83] A new procedure has been introduced recently to contain corruption. It introduces the principle of imposing the same fines for the same type of companies.[84] These rules are necessary as the law does not specify any rates for fines.

Transparency has been improved through more detailed reporting. The platform MATRICA has been launched on the State Labour Inspectorate website which aims to ensure the transparency of labour inspectors' decision making and allows companies to self-correct by issuing warnings. This service is designed for setting standards in business relations. By the end of November 2019, the platform contained 26 000 registered inspections including all the details of the visit, findings, evidence and decisions for every case. Of this number, 6 000 were re-inspections. The site revealed that about 3 000 legal provisions had never been implemented by the inspectors (Seferaj, 2019[112]). This platform should be assessed regularly for the quality of monitoring activities of State Labour Inspectorates, progress should be monitored regularly and policy conclusions drawn.

The implementation of OHS regulations in companies also appears to be weak. The Labour Code was adopted in July 2015 and has since been amended. Experts note that it is not fully implemented, with implications for the labour market and the enforcement of the OHS directives and capabilities (according to stakeholder statements collected by the independent expert). Only roughly one-fifth of companies have OHS councils in place. In some cases, though they exist formally they are not active and do not meet three times a year as foreseen by law, especially in SMEs. In particular, the setting up and effective operation of OHS in SMEs is problematic. There are deficiencies in the implementation of inter-subject (or cross-sectoral) advice on safety and health at work for small enterprises.[85] While the State Labour Inspectorate participates in OHS meetings to provide information, it has not been contacted if health and safety issues arise. The Employment and Skills Strategy 2019-2022 sets out ambitious plans to strengthen the capacities of all key actors in labour market governance, including inspectorates, line ministries and regional actors. The effective implementation of these plans remains to be seen. The ILO will support the government by tackling these implementation issues when drafting the new OHS strategy in 2021.[86]

A **social dialogue** framework exists; however, social partners in particular trade unions have rather weak capacities, despite capacity-building efforts by international donors (Dragoshi and Pappa, 2015[113]). In 2019, the Confederation of Trade Unions (KSSH) reported having 110 000 members and the Union of the Independent Trade Unions of Albania (BSPSH) counts 84 000 members. Together this corresponds to a trade union density of roughly 20%,[87] which is low compared to Austria (28%), but similar to or even higher than some other transition economies (e.g. Lithuania, Hungary) (OECD, 2019[114]). Currently, there is an initiative to draft a law on the trade unions in Albania, but preparations are still in the preliminary stages. There are only two paragraphs in the current Labour Code on how trade unions should function, but not much on their duties, responsibilities or representation in decision-making process.[88]

Collective bargaining at sector level is almost non-existent. Collective agreements are mainly concluded at company level, as with some private sector companies, e.g. in the construction and energy sectors (Dragoshi and Pappa, 2015[113]). In 2017, the overall coverage of collective bargaining in Albania was 25.1%, significantly lower than in Austria (Eurofound, 2019[115]). Although newer monitoring data are not available, there are no signs that the situation has improved. Most collective bargaining agreements are concluded in the public sector, often without fixing higher labour standards than those fixed by law.[89] Workplace representatives are limited to health and safety councils and these are often not active (see above). Dispute conflict regulation and the implementation of mediation offices needs to be improved.

The National Labour Council is an institution for **tripartite** dialogue, and there are other tripartite institutions. Significant efforts are still needed, however, to transform the National Labour Council into an effective social dialogue forum at both national and regional levels and to implement the tripartite action plan (European Commission, 2019[79]; ABC News Albania, 2020[116]). Some decisions are still taken without prior consultation of all National Labour Council members (e.g. for the latest increase of minimum wage in 2020).

*Sub-dimension 8.2: Skills*

Albania still employs the highest share of low-educated people in the Western Balkans (56.9% in 2018) (WIIW and World Bank, 2020[103]); this low level of skills is associated with poor employment conditions and in-work poverty (Jorgoni, 2019[108]). Another key challenge is the persistently high share of young people aged 15-24 who are not employed or in education or training (NEET) (25.5% in 2018 and 26.5% in 2019, compared with the EU NEET rate of 10.1% in 2019) (INSTAT, n.d.[117]) (Eurostat, n.d.[104]).

Results from a STEP employer survey conducted in 2017 indicate that more than half of companies faced difficulties recruiting both routine and non-routine workers, pointing to skills shortages, although companies in other economies in the region encountered even larger recruitment difficulties. In particular, innovative firms, larger firms (100+ employees) and foreign-owned companies faced problems in finding non-routine workers in Albania (WIIW and World Bank, 2020[103]). This points to the need to modernise curricula, as well as to equip adult workers with the skills needed in the labour market in order to reduce the **skills mismatch**.

In recent years employment growth has been highest among the highly skilled (World Bank and WIIW, 2020). Employment has also grown amongst the low-skilled, although at a slower pace. The slight decrease of employment of medium-skilled workers may be partly linked to raising enrolment rates of young people in tertiary education over the past decade. In the school year 2019/20, 18 200 students were enrolled in VET (out of a population of 197 333 in the 15-19 age group), while 130 300 were enrolled in tertiary education (out of 226 400 people in the 20-24 age group) (INSTAT, 2020[118]). The ratio of VET to tertiary students slightly deteriorated between 2015 and 2019. Albania marked considerable progress between 2010 and 2015, with 22% of adults aged 30-34 having completed tertiary education (university level), a growth of 10 percentage points. In 2018, 34.7% of women had completed higher education compared to 23.3% of men (INSTAT, 2020[102]).

The number of VET students is lower than other WB6 economies. VET is the least attractive option at upper secondary education level (Government of Albania, 2019[119]). The National Employment and Skills Strategy aims to modernise VET and to promote work-based learning, laws have been adapted accordingly and there is an action plan and a budget attached to promote work-based learning, which is welcome. However, other challenges and weaknesses of the VET system need to be addressed as well, such as skills mismatches, poor-quality or irrelevant training, unequal access, and weak linkages to the private sector (Jorgoni, 2019[108]); see also Sub-dimension 7.3: Vocational education and training. Workplace-based professional practice modules recently introduced in curricula in VET and tertiary education cannot always be completed, as it is not possible to find enough companies willing to offer work-based training opportunities.

Since 2017, the employability of all VET graduates (both secondary education VET students and trainees) has been traced through an annual tracer study conducted by the National Agency for Employment and Skills (NAES). The results indicate that in 2019, 52% of 2018 graduates were employed and 12% were concurrently working and studying, giving a total employment rate of 64% (Jorgoni, 2019[108]). The NAES is responsible for the administration of VET providers. Tripartite bodies co-ordinate stakeholders, such as the National VET Council and Steering Committee of NAES. Although the NAES periodically conducts a skills needs analysis to steer training offers, skills mismatches persist, and more efforts could be made to use skills needs assessments to improve the quality of training offers.

There is a system in place for validating and certifying **adult learning**. As experience from other countries shows (e.g. Portugal), linking upskilling measures to validation and recognition of prior learning increases its effectiveness (Düll et al., 2018[120]). Improvements have been made to address skills mismatches at the local level. Since August 2019, the Skills for Work project has started supporting key providers of education and training (vocational and university, public and non-public) to set up a structured dialogue platform for collaborative skills development with companies and employers in the WB6 region.

One of the findings of the skills needs survey of 2017 was the lack of digital skills and soft skills (Rama and Cabiri, 2018[121]). Therefore the Start Smart package was launched in 2018 by the PES to develop basic job search skills and social skills of long-term unemployed jobseekers and provide training exercises. Exercises are of a practical nature and involve trainees in the training process. At the end of the two-week training, work-related social skills are assessed and communicated to the PES. The scheme has been piloted in five districts, and was planned to be extended across Albania in 2019 to provide training to over 20 000 unemployed jobseekers (which would represent 12% of the unemployed and 28% of registered unemployed according to Labour Force Survey data) (Prime Minister's Office, 2019[122]). Facilities and IT equipment have been provided and staff trained. In 2019, NAES started to implement the Start Smart package in all Vocational Training Centres with GIZ support. In 2019, 12 327 unemployed jobseekers, mainly young people, participated in Start Smart courses, a strong increase from 2018 but below the announced objective.[90]

Participation in continuous training for work-related or non-work related issues stood at 10% in 2016, well below the EU average of 30% (Eurofound, 2019[123]).[91] While 32% of highly-skilled people participated in such training, only 2% of the low-skilled did (INSTAT, n.d.[124]). Participation rates in formal and non-formal training are highest among the 25-34 age group. More efforts could be made to upskill the low-skilled and to increase continuous training among prime age and older workers.

### *Sub-dimension 8.3: Job quality*

In terms of **quality earnings**, the Ministry of Finance and Economy is responsible for setting the minimum wage nationwide for full-time workers; social partners are only consulted, whereas in EU countries, social partners are generally equal partners (Country Economy, 2021[125]). The minimum wage was ALL 26 000 per month or EUR 213 in 2019, which was 50% of the average wage, up from 46% in 2015 (INSTAT, n.d.[126]). The minimum wage is increased only sporadically, but increases are significant each time. In 2019, the real minimum wage was increased by 8.3% (WIIW, World Bank, 2020[127]). In 2019, Albania and Serbia had the highest ratio of minimum wage to average wage in the region.[92] It would be advisable to carry out a study of the potential impact of the minimum wage on informality, and on its potential to prevent poverty in low wage sectors – such as manufacturing, construction, trade and agriculture (where the minimum wage represents between 58% to 70% of the sector's average wage) – and occupations, such as plant and machine operators, crafts workers, elementary occupations, service and sales workers, and skilled agricultural workers (the minimum wage represents between 79% and 87% of wages earned in these occupations).[93] The percentage of workers earning a gross monthly wage 60% below the average gross income in Albania was 44.7% in 2017 (Jorgoni, 2019[108]). Labour inspections carried out in 2018 indicate that 26% of employees are declared as being paid the minimum wage, which is a relatively high level. Albania relies on administrative tax data on wages. Although the Labour Force Survey (LFS) does contain questions on wages, INSTAT does not publish any wage data based on the LFS or make them widely available except for empirical research. INSTAT does not show rural and urban disparities either (Jorgoni, 2019[108]; European Commission, 2019[79]).

Despite the high minimum-to-average wage ratio, wages can be considered to be low and Albania risks getting trapped in a low wage-low productivity cycle (EBRD, 2020[128]). A key challenge is to increase productivity further. Low wages are also a factor contributing to in-work poverty. While in-work poverty declined between 2012 and 2018, it is still high at 38.7% in 2018 (Jorgoni, 2019[108]). Data indicate that individuals with low educational attainment, those in informal or part-time employment, those residing in large households with young children, and those in low-wage jobs face a significantly higher risk of in-work poverty (Borgen Project, 2020[129]; Macrotrends, 2021[130]).

In terms of **policies to promote female employment**, Albania has made substantial progress in increasing women's activity and employment rates over the past decade. The employment rate of women aged 15-64 years increased from 45.5% in 2015 to 54.4% in 2019 (INSTAT, 2020[102]), which is 11.9

percentage points above the WB6 average, though still 8.9 percentage points below the EU average. While in 2019 women's activity rate was the highest in the region (10 percentage points above the WB6 average), it was still 7 percentage points below the EU average and 3.7 percentage points below the average of the five south-eastern EU countries which may serve as a reference for Albania (Bulgaria, Croatia, Hungary, Romania and Slovenia).

In 2019, the employment rates were highest for highly skilled (69.0%) and low-skilled women (52.9%), pointing to labour market segmentation for female employment as well (WIIW and World Bank, 2020[103]; INSTAT, 2020[102]). Despite the high unemployment rate of highly educated women (13.6% in 2019), their employment prospects are better than for medium educated women (15.5%) (INSTAT, n.d.[131]). Nevertheless, the unemployment risk for female graduates from tertiary education is a major concern, in particular in the light of reported skills shortages.

The employment gap, measured as the difference between the male and female employment rate, decreased between 2015 and 2019 from 15 to 13.8 percentage points. The Ministry of Health and Social Protection and Institute of Statistics of the Republic of Albania have prepared a gender equality index, a measure for monitoring progress in gender equality, following the European Institute for Gender Equality (EIGE) methodology (EIGE, 2017[132]). **Albania scored 60.4 points in the gender equality index, which is below the score for** North Macedonia (62), but above the scores for Montenegro (55) and Serbia (55.8). The 2019 EU average is 67.4 (MoHSP, 2020[133]).

In 2019, Albania's gender wage gap was 10.1%, and thus below the EU average (14.1% in 2018).[94] A study of women's position in the construction industry, a largely male-dominated industry, shows that women typically work either in elementary occupations or as professionals, while men typically work as skilled crafts workers.[95] The share of women with tertiary education in the industry was much higher than for men. Despite the higher educational level of women within the construction sector, in 2018 the gender pay gap was 10.6% (INSTAT, 2020[134]). One possible explanation for this above average wage gap is the fact that a high share of men are self-employed, while women tend to be employees. Another explanation is that women tend to be overqualified in elementary occupations. A higher share of women than men are employed in the agricultural sector, many of whom work as unpaid family members. Poor working conditions for women in the textile and footwear industries, where they lack proper labour protection and social protection, is an issue (90% of those employed in this industry are women) (European Commission, 2018[135]).

In order to guarantee the implementation of labour legislation with a special focus on women, the State Inspectorate of Labour and Social Services signed a memorandum of co-operation with the Public Procurement Agency on 14 June 2019. It aimed to guarantee the implementation of the Labour Code, respect for gender equality in employment, women's rights in labour relations and awareness by economic operators who submit bids in the public procurement process.

The main policy area to promote women's employment is the active labour market policy implemented by the PES. Progress has been made to train staff of labour offices in gender equality issues.[96] Half of the registered unemployed are women, as well as 62% of participants in active labour market programmes. The National Agency for Employment and Skills also implements one targeted programme, the employment promotion programme for single mothers with dependent children and child-mothers (MoHSP, n.d.[136]). Civil society organisations specialised in providing services to specific groups of women play an important role in improving women's role in employment and paid work.[97] For example, they facilitate information provision, and provide vocational training courses in the workplace as well as employment mediation.[98] Here, co-ordination with government institutions has improved. A key remaining challenge is the lack of childcare facilities. Recent changes to the Labour Code aim to support work-life balance for working parents but there is no monitoring of the implementation of these changes (European Commission, 2019[79]).

Legislative amendments have been adopted to improve the employment and workplace environment for women, defining and reversing the burden of proof in cases of sexual harassment (European Commission, 2019[79]). However, implementation of the law remains questionable. Few cases of sexual harassment are reported and there is a lack of knowledge and awareness about harassment, a lack of trust in institutions, and a lack of training for employers and managers of institutions (People's Advocate, 2017[137]).

An advisory group for co-ordinating and monitoring the implementation of the Action Plan for Women Entrepreneurs (2014-2020) was mandated to bring together and co-ordinate women's entrepreneurship actions among public, private and non-government institutions. In practice, however, the advisory group – which consists of seven ministries, the Institute of Statistics and the Bank of Albania – has convened only four times and has not met since the lead ministry, the Ministry of Economic Development, Tourism, Trade and Entrepreneurship was dissolved in September 2017. Only small-scale programmes have been implemented in recent years to promote women's entrepreneurship (OECD, n.d.[64]).

### *Sub-dimension 8.4: Activation policies*

The modernisation of the **public employment services (PES)** and a reorganisation of services provided at local and regional level is underway, as set out in the Employment and Skills Strategy 2019-2022. According to the strategy, the new system of employment services will begin operating in the course of 2021. The objectives of the strategic document are in line with international good practice, although important details need to be defined, such as key performance indicators, the concrete design of the performance management and human resources development plans, and concrete plans for the provision of services through various channels. A new information system for job matching is under construction based on skills related to the profession (European Skills/Competences, qualifications and Occupations ESCO), and a manual for jobseekers and employers on how to use related tools is being drafted. Work has started to design and implement a statistical profiling tool of the unemployed (taking into account factors such as age, gender, educational level, job qualification, literacy skills, etc.). The intensity of counselling will be based on segmenting the unemployed by their difficulty of being placed (with interviews varying between 25 and 60 minutes) and potentially lead to drawing up individual action plans. These are important steps in moving towards a more advanced **active labour market programme (ALMP)**. The number of registered job vacancies increased between 2017 and 2018 but declined between 2018 and 2019 (according to registered data provided by the PES).

While efficiency gains can be expected through a new IT system, individualised counselling and follow-up of the unemployed – who often face severe and multiple employment barriers – requires sufficient staff capacities, as do services provided to employers. As the number of registered unemployed has fallen significantly, caseloads for employment counsellors have improved since 2013. However, the caseload of nearly 300 registered unemployed people per counsellor is still high, given that roughly two-thirds of the unemployed are long-term unemployed (64.3% in 2019 according to LFS data – although only 48% of registered unemployed were long-term unemployed in August 2019).[99] Recent improvements have been made, more than doubling the number of staff at the central level in 2020. Staff capacities need to be increased at local level as well, and staff trained in the skills needed for comprehensive guidance and follow-up for jobseekers with employment barriers, for conducting skills assessment (which is for now largely based on occupational categories) and for providing employer related services.

The strategy envisages dedicated employer services being set up. It would be important for these employer services to be proactive and offer not only placement services but also a range of counselling services to employers, e.g. to reduce their staff fluctuation, identify skills needs and support SMEs that lack human resource management skills. The reforms should be implemented rapidly and progress assessed regularly in order to improve service delivery.

Target groups for active labour market programmes are in principle well defined. There is a strong focus on youth, vulnerable groups and groups on the margin of the labour market (including Roma and Egyptian

communities), which is relevant given the high level of poverty and exclusion of vulnerable groups in Albania. It seems that progress in the implementation of vocational rehabilitation is being made with a more comprehensive approach, although the number of participants is low. ALMPs have been continuously introduced, but only a limited percentage of the unemployed participate in these schemes (5.5% in 2017) and funding has remained low and has not increased since 2015 (ILO, n.d.[138]). Objectives of training programmes include developing the basic skills (reading and writing) of unemployed jobseekers with low qualifications. Progress in implementing training for low-skilled adults should be regularly monitored and the scale and scope of the programmes assessed.

A number of ALMPs are targeted at young people, including employment incentives such as 12-month social security exemption for converting an informal employment relationship into a formal employment contract, and 6-month wage subsidies for helping young graduates to enter the labour market; a new public works programme ("community employment", paying half the minimum wage); on-the-job training programmes and apprenticeships; and a new training programme for self-employment. The outcomes of these new programmes should be thoroughly monitored.

An unemployment benefit scheme is in place, but only 1.6% of the unemployed receive benefits (WIIW and World Bank, 2020[103]). The duration of unemployment benefit depends on previous contribution history, with a maximum of 12 months for those having contributed for 10 years or more and for the older unemployed. The unemployment benefit level is however not linked to previous earnings – instead a lump sum is set at 50% of the minimum wage and supplements are paid for families with children. The unemployment benefit level is low compared to the OECD average of 66% of previous in-work income (OECD, 2020[139]). This limits the effectiveness of unemployment benefits in rendering formal employment attractive, and could in principle make "envelope wages"[100] appear attractive. Most registered unemployed receive income support, including coverage by health insurance, which is another incentive to register with the PES.

The number of jobseekers registered at the PES receiving either unemployment benefit (around 10%) or social assistance (economic aid, 90%) more than halved between 2015 and August 2019 (from 65 456 to 24 401), according to administrative data provided by the government. Yet the number of unemployed decreased only by 25% over the same period (from 224 000 in 2015 to 165 000 in 2019 according to Labour Force Survey data). The reasons for the stronger fall in the number of registered unemployed should be analysed, and could be linked to improved placement, increased sanctioning, or increased underemployment. In 2019, 64.3% of the unemployed were long-term unemployed and this situation had not changed much since 2017; in previous years decreases in the numbers of long-term unemployed were more significant (WIIW and World Bank, 2020[103]) and (INSTAT, n.d.[140]).

Among the registered jobseekers who were placed into employment in 2018, only roughly 10% were, or had been, beneficiaries of the economic aid schemes. Some progress has been made in placing jobseekers from the Roma and Egyptian communities into ALMPs and into jobs, but more progress is needed overall. Although placing vulnerable groups is not an easy task, this outcome indicates that activation efforts for economic aid beneficiaries need to be improved. Integrating vulnerable groups into the labour market requires a comprehensive approach and close co-operation between employment and social services, as good practice from EU countries shows (Konle-Seidl, 2020[141]; Duell et al., 2018[142]). The co-ordination between social welfare agencies and local PES is poorly developed and would need to be improved. Most importantly, social care services remain insufficient and underdeveloped.

Supported by the World Bank, a reform of social assistance (economic aid) was rolled out economy-wide at the beginning of 2018, introducing in-work benefits by extending social assistance eligibility to people in low-paid employment, those receiving a modest income from household agricultural activity in rural areas, or those receiving other forms of social protection benefits (such as pensions or disability benefits) (Jorgoni, 2019[108]). While the introduction of in-work benefits reflects international good practice (Immervoll and Scarpetta, 2012[143]; Jimeno et al., 2012[144]), the level of social assistance, currently at less than one-third

of the minimum wage, remains low. It is recommended to evaluate the impact of this reform. A recent act foresees welfare benefits for the self-employed who lost their jobs due to the COVID-19 pandemic, in line with praxis of some EU Member States (Duell, 2020[145]).

The employment promotion programmes (EPPs) implemented in 2015-16 were evaluated in 2018, highlighting the need to revise EPPs and change how they are implemented. A working group has been set up to improve ALMP design. Future evaluations should also pay attention to the quality of employment in order to design strategies for sustainable labour market integration. For instance, linking the level of wage subsidies to the minimum wage may see jobseekers placed mainly in low-wage jobs (Jorgoni, 2019[108]).

### *Cross-cutting sub-dimension: Informality*

The share of informal employment among the 15-64 age group was 37.5% in 2019 (including specific forms of solo self-employment or self-employment in micro-enterprises) (INSTAT, 2020[134]).[101] While informal employment had decreased between 2015 and 2018, the incidence of informal employment increased by 1.5 percentage points between the second quarters of 2018 and 2019 (WIIW and World Bank, 2020[103]). Albania is the only economy in the WB6 region to have seen such an increase in informal employment during this period. Labour inspectorates only identified about 3 000 cases of informal employment. There has been no proper campaign since 2017 to fight informality. The whistle-blower directive for informality in the private sector that was announced by the government in 2017 was heavily criticised by all stakeholders, and was also raised as an issue by employers in the National Labour Council as it creates a conflictual situation between employers and employees.[102]

In 2014, the pension system was reformed to strengthen the contribution-based pension element. This should increase the incentives to be formally employed. A new active labour market programme has been introduced recently to set incentives to convert informal employment contracts into formal ones (providing exemption from social security contributions for 12 months – see above). However, it is too early to assess the impact of this measure. Salaries below ALL 30 000 are exempt from income tax.[103] This should in principle lower the incentive for workers to take up informal employment, yet informal employment is still widespread.

### *Cross-cutting sub-dimension: Brain drain*

Within the WB6 region, the outflow of populations is highest in Albania, with 2.2% (62,000 people) of the economy's overall population migrating mainly to the EU, mostly to Italy and Greece (WIIW and World Bank, 2020[103]). Between 2015 and 2019, the number of emigrants increased by 6%.[104] In 2018, 38 703 people emigrated (INSTAT, 2021[1]). Emigration rates for both high-skilled and low-skilled people are high, and above the average for the region (Herbert, Capuano and Marfouk, 2013[146]). A survey of the emigration potential of young people indicates that Albania has the highest rate of the WB6: 43% of young people responded that they would like to move to another country within the next six months (Lavric, 2021[147]). Employment opportunities and higher earnings are by far the main reasons for young people to emigrate.

The World Bank LinkedIn Digital Data for Development show that Albania has mainly lost technical skills through migration in the area of computer networking, web development, data storage technologies and telecommunications, affecting not only the ICT sector but also banking, higher education and international affairs. Within the region, Albania is the economy that has experienced the largest losses of business management, people management and problem-solving skills (WIIW and World Bank, 2020[103]). These skill sets are vital for running modern businesses. Brain drain is currently reported to be an issue also for the healthcare occupations (doctors, nurses, physiotherapists).[105]

Albania implemented the Brain Gain Programme from 2006-2011, which aimed to integrate the highly skilled and scientific diaspora into Albania's socio-economic development through their involvement in the

transformation of public administration, higher education, science, and the business sector, as well as to instigate the return of diaspora professionals (Predojević-Despić, 2021[148]). However, the impact of that programme was limited (Gëdeshi and King, 2018[149]; UNDP Albania, n.d.[150]). Experience from India shows that it may take quite some time for the links to the diaspora to result in brain circulation and brain gain (ILO, 2019[151]). Currently, the only policy in place is to include return migrants as a target group for ALMPs, but this mainly relates to the low-skilled.

In 2018, remittances contributed to nearly 10% of GDP. As a consequence of the COVID-19 pandemic, remittances are likely to diminish due to travel restrictions preventing the return of migrants (World Bank, 2020[152]; OECD, 2020[153]; World Bank, 2019[154]).

### *The way forward for employment policy*

Key efforts needed to advance in the employment dimension relate mainly to strengthening the institutional capacities of a variety of government and other actors at both the national and local level to implement regulations effectively, to increase transparency in monitoring of working conditions and wages and to deepen labour market analysis. In particular:

- **Do more to strengthen social partners' role in tripartite social dialogue, including on setting the minimum wage**. This would also include making a regular assessment of labour inspectorates' capacity to detect remuneration below the minimum wage and informal employment. An assessment of the impact of the minimum wage on informal employment and on poverty reduction should be conducted.
- **Increase the capacity of labour inspectorates to detect informal employment and child labour and tackle poor working conditions**. This includes training labour inspectorate staff, issuing clear guidelines, increasing the number of labour inspectors, increasing resources for making on-site visits across the territory, modernising equipment, making use of monitoring results to steer activities and improving methods of risk assessment. Labour inspectorates should also expand their implementation of preventive measures. The activities foreseen in the employment and skills strategy related to labour inspectorates should be implemented. A comprehensive and publicly available monitoring system is needed of working conditions, including child labour, the results of which can feed into policy. Improved co-operation between relevant stakeholders is also key for detecting poor working conditions (Box 20.11).

- **Evaluate the implementation of the cross-sectoral Strategic Document for Occupational Safety and Health 2016-2020 and its action plan, which aim to strengthen institutional capacities.** Draw conclusions on measures that were effective and those which were not, as well as on challenges and gaps remaining.
- **Launch awareness-raising activities targeted at employees and employers to pursue continuing training and to set adequate financial incentives for continuing education and upskilling of the medium and lower skilled.** This would involve offering adequate financial incentives and targeting low-skilled, prime age and older workers as well as SMEs for participation in adult learning. Other OECD countries have introduced individual learning accounts (OECD, 2019[155]), have set in place an infrastructure for guiding adults in their upskilling pathway (see e.g. Qualifica centres in Portugal), and implemented programmes to upskill low-skilled adults and supported companies to do so (OECD, 2019[156]). In order to increase the employment of women, more efforts are needed to implement flexible working time schemes to reconcile work with family lives and to expand quality child care facilities. Efforts to co-ordinate activities with civil society organisations should be continued.
- **Continue efforts to improve local social services for vulnerable groups and to develop close co-operation between social and employment services.**

- **Do more to understand the drivers of informality among workers (differentiated by men and women) and employers in order to design adequate policy responses.**
- **Co-ordinate policies to encourage the return of medium and high-skilled people to Albania**, to promote start-ups and open up business branches, and to encourage ties with the highly skilled abroad, e.g. through co-operation in research. At the same time, it is necessary to offer employment opportunities, in particular to higher educated young people and to improve the quality of jobs. Encourage investments into the economy using remittances. Help skilled workers who have gained experience abroad to find good living and working conditions when coming back.

### Box 20.11. Strategies for combating undeclared work

In Norway, co-operation among relevant agencies has been formalised to detect and combat undeclared work. An internal database to facilitate information exchange between joint offices was created in December 2016. In addition, a National Interagency Centre for Analysis and Intelligence was set up to undertake national threat assessments for joint strategic measures against economic crime, for example by delivering intelligence reports, which should help decision makers to analyse cross-national trends.

In the Netherlands, the "chain approach" tackles labour exploitation in the cleaning sector. It involves a two-fold strategy, including raising awareness among businesses who hire cleaning companies, and a prevention strategy focused on changing attitudes to undeclared work in the sector. It has resulted in a decline of cleaning companies working undeclared in the Netherlands.

Note: Economic crime, also known as financial crime, refers to illegal acts committed by an individual or a group of individuals to obtain a financial or professional advantage. The principal motive in such crimes is economic gain **Invalid source specified.**.
Source: (European Commission, 2020[157]), *What Works when Tackling Undeclared Work? Realities in Member States*, https://ec.europa.eu/social/main.jsp?langId=en&catId=1298&furtherNews=yes&newsId=9740.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Albania has made substantial progress in this dimension since the previous assessment (Figure 20.1). With an average score of 1.8 (Table 20.14), it performs somewhat better than some regional peers, such as Bosnia and Herzegovina and Kosovo, but scores below the Western Balkan six average, falling significantly behind the regional innovation leaders. Improvements have been made in particular with regards to the overall STI system, but further efforts are needed to consolidate recent policy changes and generate real long-term impact.

**Table 20.14. Albania's scores for science, technology and innovation**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Science, technology and innovation dimension** | Sub-dimension 9.1: STI system | 2.2 | 2.4 |
| | Sub-dimension 9.2: Public research system | 1.9 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 1.1 | 1.6 |
| **Albania's overall score** | | **1.8** | **2.1** |

### *State of play and key developments*

Overall, science, technology and innovation in Albania could benefit from significant improvements. The Government of Albania has taken several steps to improve the overall performance of the sector in recent years. However, despite some increases, the overall investment in research and development (R&D) remains systemically low, at 0.06% of GDP. Lack of reliable and systematically collected statistics on STI outputs makes it challenging to assess the progress and impact of policy measures.

#### *Sub-dimension 9.1: STI system*

Albania has a well-developed **STI strategy.** The National Strategy for Scientific Research, Technology and Innovation (2017-2022) is well designed and meets international best practice, setting policy objectives for improving the regulatory and institutional framework for STI, supporting business-academia collaboration and enhancing international co-operation. A Smart Specialisation Strategy (S3) is in the process of being defined. The roadmap for the S3 process was drafted and the mapping phase is ongoing with EU support, with the quantitative phase almost completed and the qualitative one to be launched soon. However, there is little evidence that much progress has been made in achieving the objectives of the national STI strategy as a number of structural, financial and staffing issues identified during the previous assessment cycle remain unaddressed.

The **institutional framework** to oversee and implement STI policy remains a key obstacle to effective policy implementation. Following major restructuring in 2017, the National Agency for Scientific Research and Innovation (NASRI) was established, which is mainly responsible for implementing STI policies jointly with the Albanian Investment Development Agency (AIDA), Albanian SME Agency, and Innovation Fund. Focus and collaboration between the two implementation agencies, NASRI and AIDA, remain somewhat uncoordinated. In addition, three ministries are responsible for overseeing various aspects of the STI framework, but without a formal co-ordinating mechanism in place. This has resulted in overlapping responsibilities, inefficient budgeting and a lack of clear ownership of the implementation of STI policies and goals.

STI policy is embedded in a comprehensive **regulatory framework.** Legislation to regulate intellectual property (IP) was developed with EU assistance, and additional reforms to strengthen IP legislation are expected to enter into force at the end of 2020. While there is evidence that the regulatory framework is being implemented, a number of key commitments have not been met. For example, although the

intellectual property strategy includes commitments to establish technology transfer centres and a legal framework governing business-academia collaboration, neither have been achieved. Similarly, administrative activities and programmes still lack adequate funding to achieve their objectives within the policy framework, limiting the capacity of government officials to fulfil their duties in an effective and co-ordinated way. Therefore, enforcement of STI legislation, and IP in particular, remains questionable.

Promoting **international collaboration** is a key aspect addressed in the STI framework, which actively encourages participation in international research facilities and other initiatives. However, there is little evidence of concrete actions supporting these objectives or of significant progress in this policy area since the previous assessment cycle. While Albania has participated in the Horizon 2020[106] framework since its founding, very few Albanian firms (including just one SME) have participated in the programme successfully. Indeed, applicants from Albania have the lowest success rate (8.72%) of any economy participating in Horizon 2020, though there has been a more positive trend in recent years (European Commission, 2020[158]). Although Albania is not a full member of Eureka,[107] it participates in the network through a national information point (NIP) and appears to be making progress in formalising its membership in the programme. Finally, Albania's continued participation in the Western Balkans Enterprise Development and Innovation Facility (WBEDIF) has helped to further efforts to support international technology acquisition among Albanian firms. However, further efforts are needed to strengthen the knowledge economy to support uptake of more sophisticated international innovation financing products.

Albania has identified **alignment with EU STI policy** and the EU *acquis communautaire* as strategic priorities and incorporated them into its relevant STI strategies. The economy has formally adopted the European Research Area[108] (ERA) roadmap and is making efforts to achieve ERA priorities, such as gender equality in scientific research and innovation, among others. Although Albania participates in EURAXESS[109] and has an operational country page, national job listings are not currently published on the platform and only one higher education institution (University of Vlore) has adopted the EURAXESS charter and code. Albania is already actively engaged in European Cooperation in Science and Technology (COST),[110] however, further efforts could be made to improve networking with European partners to facilitate international collaboration. Albania does not participate in the European Innovation Scoreboard due to the limited availability of STI-related statistics, and initiatives to actively promote open science are limited.

### *Sub-dimension 9.2: Public research system*

The public research system in Albania has seen moderate gains since the previous assessment, and the STI policy framework explicitly promotes scientific excellence. Specifically, the **institutional structure of the public research system** has benefitted from stronger institutional co-ordination and oversight. A new Law on the Academy of Sciences was adopted in September 2019, aiming to increase the integrity of the scientific research system. However, it has not yet been decreed by the President of Albania. Similarly, a new Law on Scientific Research and Innovation has been finalised but is still pending adoption. The establishment of a new Quality Assurance Agency for Higher Education (ASCAL) in 2017 has strengthened quality assurance at higher education institutes (HEIs) and research and development institutes (RDIs), which undergo regular self-assessment based on a harmonised methodology and a new Quality Code. There is solid institutional co-ordination between ASCAL and sub-national government bodies to ensure the consistent application of public research regulations and initiatives. However, the economy reports that ASCAL and other relevant government agencies lack sufficient funding and resources to achieve their objectives and execute their responsibilities. Likewise, despite an initiative to conduct an initial mapping of Albania's research infrastructure in 2018, the economy has not yet developed a roadmap to develop a research infrastructure.

The STI framework includes the explicit goal to increase investments in scientific research and development to 1% of GDP by 2022, compared to just 0.06% of GDP in 2018. Despite a significant three-

fold increase in **public research funding** between 2018 and 2020 (to reach approximately EUR 1.8 million), the public research system remains systemically underfunded and Albania still lacks a clear methodology for funding for research, development and innovation. Albania does not currently collect data on gross domestic expenditure on research and development (GERD), although the system is funded from a combination of institutional and performance-based sources. A new Financing Model of Public Institutions of Higher Education and Scientific Research, approved in 2018, introduced an updated but incomplete funding system for HEIs and RDIs. According to the system, institutional funding is allocated based on an institution's national ranking and through competitive grants, with the latter being distributed through NASRI in line with international best practice. However, insufficient evidence was provided to demonstrate that they are fully operational (this would require estimates of the number of competitive grants, the percentage of successful applications for competitive grants and other key indicators).

Albania is increasingly affected by brain drain. Since the previous assessment cycle, the government has implemented measures to foster **human resources for research and innovation**. Nevertheless, the actions taken remain scattered and insufficient to overcome major shortcomings in the development of human resource capacity in research and innovation. A range of programmes has been established since the previous assessment cycle to develop researchers' skills, including on proposal writing, applying for research programmes, and project management, which is an important step in recognising and addressing shortcomings in this policy area. Notably, efforts to leverage the Albanian research diaspora are increasing and initial work is underway to create a platform for brain circulation. In addition, in 2020, the decision was made to re-accredit doctoral programmes, which had previously been suspended for five years due to their poor academic quality and widespread plagiarism. There is currently no initiative in place to make research careers more attractive, yet programmes supporting young researchers that facilitate participation in international research are seeing growing uptake, leading NASRI to develop increasingly ambitious targets for the desired number of researchers and institutions benefitting from such programmes. In contrast, there is little support for domestic researcher mobility, either within academia or between research institutions and the business sector, and Albania's participation in the Marie Skłodowska-Curie Actions (MSCA)[111] continues to be limited, with only three Albanian research organisations having benefitted to date.

### *Sub-dimension 9.3: Business-academia collaboration*

The promotion of business-academia collaboration is incorporated in Albania's National Strategy for Scientific Research, Technology and Innovation (2017-2022), yet little progress has been made to date to implement this. Financial incentives remain limited, with no innovation vouchers or competitive grants available to spur business-academia collaboration. Likewise, human resource policies in HEIs provide no incentives for researchers to participate in collaborative initiatives with the business sector. There is little evidence that the economy has acted to change the incentive structure to encourage business-academia collaboration since the previous assessment cycle.

The overall **collaboration promotion framework** is weak, most notably due to the absence of clear or measurable objectives for co-operation between the business community and academia, as well as substantial budgetary limitations. However, a collaboration-promotion framework is currently being developed, with policy makers consulting stakeholders and conducting a pilot programme. This is expected to be complemented by a Law for Scientific Research and Innovation, scheduled to come into effect in 2021. In addition, there have been some efforts to improve communication and raise awareness of available tools and opportunities among relevant stakeholders in business and academia, particularly with regards to opportunities under Horizon 2020 and on intellectual property. However, the impact of these measures is yet to be shown. Albania has also participated in regional networking events to establish a technology transfer office.

Overall, incentives for business-academia collaboration remain underdeveloped and ineffective due to inadequate funding and demand from relevant stakeholders. Although national STI strategies, particularly

the OECD-led Triple Helix Action Plan, contain well-designed provisions to strengthen **financial incentives for collaboration**, the vast majority of these provisions have not been implemented since the previous assessment cycle. The voucher scheme was suspended in 2016 due to a lack of funding. Furthermore, while the introduction of innovation vouchers was envisaged under the Triple Helix plan, the initiative was again abandoned amid lack of buy-in from local stakeholders. AIDA, which hosts Albania's Innovation Fund, has operated a voucher scheme assisting SMEs to innovate since 2018. However, the scheme does not explicitly focus on business-academia collaboration. Likewise, there are no competitive co-operative grants available, and a focus on research is not prioritised within Albania's public procurement process. Some HEIs recognised as innovation support organisations have benefited from donor funding for innovative or collaborative projects, such as business incubators, although such financial incentives remain limited.

Similarly, **non-financial incentives for collaboration** remain largely nascent, and there is no clear governance framework in place to develop any policies or measures. Despite mobility schemes being included in the 2017-2021 Action plan to support the development of innovative policies based on the Triple Helix approach, efforts to develop targeted mobility schemes to increase exchanges between academia and businesses are still needed. Likewise, there are no incentives for researchers to collaborate with businesses during research activities, as performance is purely based on conventional assessment criteria such as the number of publications and citations. While the General Directorate of Industrial Property (GDIP) provides services that support patent counselling and commercialisation of intellectual property, and discussions with the European Patent Office to facilitate patent applications by Albanian SMEs are ongoing, there is no support available for patenting or commercialisation through research-industry co-operation. Commitments to draft a legal framework specifying the rights and obligations of actors participating in business-academia collaboration have previously been made. However, no evidence of such a framework was provided by the economy. Despite these shortcomings, Albania has increased efforts since the previous assessment cycle to support communication and awareness raising of business-academia collaboration. Educational and networking events are reportedly organised regularly for a broad range of stakeholders from across society.

There have been no major changes to **institutional support for business-academia collaboration** since the previous cycle, when Albania reported having no key action plans or policy frameworks in place. There is little evidence that the economy has taken concrete action to develop such a policy framework. Since the previous assessment cycle there have also been no activities to monitor or expand the physical or institutional infrastructure to support business-academia collaboration, though Albania is in the initial stages of developing a first Technology Transfer Office with EU support. Currently, there are no other facilities in place to bring about greater business-academia collaboration. Previous research suggests that there are currently five technology transfer services operating in the agricultural sector, and one technology institution operating in Tirana.

### *The way forward for science, technology and innovation*

Albania is striving to improve its national STI system and has taken important steps forward. However, ambitious plans must be informed by reliable data and supported by cohesive cross-government co-ordination and funding. Measures to further enhance STI policy implementation may include the following:

- **Prioritise implementation of the existing STI policy framework.** Albania has a well-designed STI strategy and action plan informed by international best practice that target important policy objectives. However, little progress has been made to implement these ambitious goals. Streamlining the governance of the STI framework and defining roles and responsibilities of implementation bodies could help achieve meaningful progress towards meeting its STI policy objectives.

- **Finalise the development of the Smart Specialisation Strategy.** If designed well and linked to a targeted action plan and funding, the S3 strategy would be an important tool to complement and accelerate implementation of the existing STI framework.
- **Increase investment in public sector research.** In line with its own goal to increase investments in research to 1% of GDP, Albania should consider expanding the range of financial incentives for business-academia collaboration. Investments in the scientific research system would make the profession more attractive, leading to higher quality of research outputs in the medium to long term.
- **Expand data collection to support evidence-based STI policies.** Current statistical collection practices leave key gaps in STI-related data that limit the extent to which policy implementation can be monitored effectively. This prevents Albania from participating in key international initiatives such as the European Innovation Scoreboard. Participation in the OECD's STIP Compass database would be an important opportunity to develop statistical data collection through expert guidance to meet international best practice.
- **Improve the incentive structure to encourage academia and businesses to seek co-operation with each other.** Organising more events to bring the various communities together and raise awareness is an important step. Likewise, the economy could re-introduce innovation vouchers to create financial incentives for innovation.

## Digital society (Dimension 10)

### *Introduction*

As shown in Table 20.15, Albania scores slightly above the Western Balkan average for digital society indicators. With increased efforts to develop broadband infrastructure and a solid regulatory framework, the economy has achieved an above-average score for the access sub-dimension. It also ranks third among the WB economies for use, and second for the society sub-dimension. However, Albania has an average score for the trust sub-dimension, and scores below average for jobs.

**Table 20.15. Albania's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 3.2 | 2.9 |
| | Sub-dimension 10.2: Use | 2.5 | 2.4 |
| | Sub-dimension 10.3: Jobs | 2.0 | 2.3 |
| | Sub-dimension 10.4: Society | 2.5 | 2.1 |
| | Sub-dimension 10.5: Trust | 2.2 | 2.2 |
| **Albania's overall score** | | **2.5** | **2.4** |

### *State of play and key developments*

In 2018 the ICT industry's contribution to GDP was 2.9%, which increased further during 2019.[112] However, the industry faces a deficit of highly skilled ICT professionals, which is linked to the gap between the skills developed by the education system in Albania and those needed by the labour market. In 2017, the Ministry of Innovation and Public Administration, which had covered the entire spectrum of IT development and information society services in Albania, ceased to exist and its responsibilities were transferred to the National Agency for the Information Society (NAIS) for digitalising the public administration, and to the Ministry of Infrastructure and Energy for broadband development. Since then, the NAIS has been transformed into the focal point for e-government development in Albania, directly managing and supporting all IT staff across the public sector. The implementation of the Digital Agenda 2015-2020 has demonstrated positive results, particularly in terms of public administration digitalisation and proliferation of e-services on the e-Albania portal. A revised Digital Agenda action plan for the next period was approved by the Council of Ministers in December 2020. The government's interoperability platform supports 53 public institutions to deliver e-services and exchange data. In 2019, the platform registered a 35% activity increase, a trend that was boosted by the COVID-19 pandemic, resulting in a 100% increase in 2020. While current use rates of e-Albania services are increasing, low computer literacy amongst the over 60s and the fact that 40% of the population resides in rural areas where Internet penetration is still very low, create a digital divide that needs to be urgently addressed.

#### *Sub-dimension 10.1: Access*

**Broadband infrastructure** has been significantly improved through the implementation of the National Broadband Plan (NBP) for 2013-2020, although the fixed broadband penetration rate in 2019 was still low at 15.6% of the population and 58% of households, as compared to more than 35% of population in the EU (ITU, 2019[159]). While the number of fixed broadband subscribers increased by 20% from 2018 to 2019, a significant urban-rural divide exists (penetration is 36% in Tirana but only 7% in rural Shkodra) (AKEP, 2019[160]). Broadband speeds can now reach 1 Gigabit per second (Gbps), but the majority of subscribers (55%) have speeds of 4-10 Megabits per second (Mbps). On the other hand, the NBP 2013-2020 promoted 4G investment in mobile network infrastructure, leading to a 56% increase in investment to reach the record figure of about ALL 6.35 billion (approx. EUR 51 million) in 2019. This demonstrates that policy implementation over the last few years has improved the relevant legal and regulatory framework, creating

an enabling environment for private sector investments. The new NBP for 2020-2025 was approved in June 2020 to continue the economy's work towards its ambitious broadband connectivity targets. The NBP 2025 foresees strengthening the capacities of the institutions responsible for developing broadband at the central and local (municipality) level. It aims to close the digital divide in Albania, not only through broadband infrastructure development, but also through ensured affordability and proliferation of e-services. It also promotes the establishment and operation of a Broadband Competence Office (BCO), taking into consideration that a Thematic Group on Telecommunications and Broadband was created in February 2019 to provide horizontal co-ordination among public bodies and relevant external stakeholders.

The NBP 2025 was based on a feasibility study and cost-benefit analysis (CBA) performed by the Ministry of Infrastructure and Energy, with the support of an EU and Western Balkans Investment Framework (WBIF) technical assistance programme, the Regional Broadband Infrastructure Development project,[113] which was completed in July 2020.[114] The study illustrates the needs, options, and financing structure for rural network development in Albania. Based on the feasibility study, the government will secure a EUR 24 million loan from the European Investment Bank (EIB) for implementing the NBP, which includes further regulatory and organisational reforms to improve the existing framework for broadband infrastructure development. The Ministry of Finance and Economy has already adopted the guidance for state aid for broadband infrastructure development, in accordance with the EU framework, during Q4 of 2019. The broadband ATLAS was created by the national regulator, the Electronic and Postal Communications Authority (AKEP), and is continuously updated to ensure an extensive and realistic visual mapping of the existing backbone infrastructure and backhaul, including existing ducts and other passive elements. The ATLAS supports the implementation of the right of way in electronic communications, facilitating broadband infrastructure investments, promoting the co-ordination of civil works and sharing existing infrastructure of (other) utilities to reduce the cost of broadband deployment. The Ministry of Infrastructure and Energy is also implementing a second project, the Digital Balkan Highway, which is supported by the World Bank and aims to investigate whether it is possible to improve regional interconnectivity in the Western Balkans through infrastructure sharing of the optical fibre ground-wire installed over the years by local energy utilities (World Bank, 2017[161]). The ministry has also developed a draft 5G Roadmap and Strategy for Albania (the Expert Report: 5G Strategy for Albania).

Albania has fully aligned its **ICT regulatory policy framework** with the EU 2009 regulatory framework. The regulator AKEP is fully staffed and has the resources to perform its responsibilities, which is reflected in the active improvement of the regulatory framework through adjustments that support private sector investments in communications infrastructure development. For example, the Law on the Development of High-Speed Electronic Communication Network of 2016 promotes shared use of existing physical infrastructure and a more efficient development of new physical infrastructure (other utility networks included). The Regulation on the Implementation of the General Authorization Regime of 2017 promotes competition, encourages investment in networks and services for electronic communications, and enables the protection of subscribers' and users' rights. Albania also signed the Regional Roaming Agreement in April 2019, progressively reducing roaming charges among WB economies by July 2019 and eventually leading to the elimination of roaming charges by July 2021 (European Commission, 2020[162]). AKEP regularly monitors the market, publishes reports with data and relevant indicators, and implements regulatory impact assessments of each proposed regulation.

Albania developed a policy framework for **data accessibility** in 2015, but since then implementation has proceeded at a relatively slow pace. The Policy Document for the Implementation of Public Open Data and the Creation of the Open Data Portal, adopted in 2015, promotes data openness and re-use of public sector data, as well as basic legislation on creating open data portals. However, the Law on Open Data and the Re-use of Public Sector Information, which transposes Directive (EU) 2019/1024, is still pending adoption.[115] The National Agency for Information Society (NAIS) has created the government open access portal - the Open Government Data Portal of Albania[116], where data sets are being published by public institutions, as well as the Partnership for Open Government Initiative (PQH/OGP) portal.[117] On a positive

note, the number of datasets available in the former have increased from 17 in 2018 to 101 in 2020. The NAIS provides co-ordination and technical for support interoperability, which is delivered via the so-called Government Gateway that enables data exchange among all public institutions. Albania has been actively implementing the Open Government Partnership[118] (OGP) action plans, but the dissolution of the Ministry of State for Innovation and Public Administration in September 2017 greatly affected continuity of implementation of the 2016-2018 action plan (Vurmo, 2019[163]). (Vurmo, 2019[163]) also observed that public participation in the implementation of the OGP action plans was weak or even completely absent, while the multi-stakeholder forum, OpenAlb, that facilitated civil society participation in the 2016-2018 OGP action plan, has been inactive since December 2016. However, a new OGP Action Plan 2020-2022 has been developed through a consultative process co-ordinated by the Deputy Prime Minister and the Development and Good Governance Unit within the Office of the Prime Minister. A regulatory impact assessment (RIA) "light system" was adopted in 2018 with a formal requirement for implementation for every legislative proposal, but its implementation has been progressing slowly (European Commission, 2019[79]). Some practical implementations are now appearing, such as the RIA prepared for the new law on open data, which was reviewed by independent experts. However, there was no realistic participation by citizens and businesses in the process.

### *Sub-dimension 10.2: Use*

Albania embarked on **digital government** development in 2013 and has demonstrated strong commitment to transforming public administration through digitalisation and other significant reforms. Aiming to reduce the enormous bureaucracy of the state, the government pledged not only to digitalise its services, but also to reduce the number of associated documents required to complete any citizen's application by re-engineering government processes. It now ranks 59th out of 193 countries monitored by the UN in the e-Government Survey 2020 (United Nations, 2020[164]). To underpin this transformation, the government re-organised the National Agency for Information Society (NAIS) in 2017 (Box 20.12). With NAIS spearheading its digital government transformation, the e-Albania portal was created and connected to the Government Interoperability Platform which allows interaction between 53 public institutions' electronic systems. An action plan for 2020 was agreed with these institutions, aiming to eliminate over-the-counter public services, replacing them with complete online-only public services with a single application point on e-Albania.

The e-Signed Documents Circulation System was also set up for document exchange between public institutions (more than 139 institutions were interconnected in 2020). As of December 2020, 1 021 online public service applications were working (out of around 1 400 services in total). All documents required to complete these services, except personal declarations and private sector documents, are gathered in e-sealed format by the institutions themselves. Although the government planned to provide more than 90% of all public services online on the e-Albania portal by the end of 2020, achieving this promise will require further work during 2021 (United Nations, 2020[164]). While 373 e-services currently enable the entire administrative procedure to be completed online, 648 only enable application submission, while the actual document or licence needs to be picked up by the citizen or business over the counter. As of December 2020, the e-Albania platform counted more than 1.7 million registered users, of which almost 760 000 were new users added during the COVID-19 pandemic.

### Box 20.12. Co-ordinating a whole-of-government digital transformation

The National Agency for Information Society (NAIS) is the core institution in Albania for the digitalising the government and its services to citizens, businesses and public sector employees. It is responsible for co-ordinating government work in the information and communication technology (ICT) area and the e-services government portal (e-Albania.al). NAIS promotes new technologies, connecting systems to the Governmental Interoperability Platform, and drafts strategies and policy implementation plans for e-Government and the information society. It is the co-ordinating regulatory authority responsible for the state databases and electronic signature services in Albania.

Since 2017, based on the Decision on the Reorganization of the National Agency for Information Society (NAIS), the information technology (IT) staff of line ministries and institutions are under the organisational chart of NAIS, although they are physically employed in the premises of those institutions. Their role is to support the employees of the respective institutions in their daily IT activities, namely in using the IT systems and tools for public administration and managing the e-services provided by their institution. This close co-ordination mechanism that directly connects centralised NAIS staff to all decentralised IT staff across the economy, has enabled service standardisation and boosted e-service quality.

NAIS is primarily state funded and employs more than 330 people, more than 90% of whom are highly skilled technical staff. The main challenge that they face is modernising the legal and regulatory framework and changing public officials' mindsets while they attempt to redesign and reform public administration processes through ICTs. The top-level government and high-ranking public officials have been strong supporters of online services and digitalisation. In 2018, NAIS prioritised the list of ICT projects needed to improve the e-government infrastructure in Albania and during 2019, approximately 30 systems were either created or upgraded in collaboration with the respective institutions.

Source: National Agency for Information Society (NAIS).

NAIS has performed extensive capacity building for public sector officials, primarily to change mindsets towards the new digital government system. It has trained 2 000 civil servants working over the counter on how to use the new systems and how to assist citizens on the e-Albania portal. NAIS maintains all information systems and digital government portals, and evaluates and acts on anonymised surveys conducted by external stakeholders on the quality of services on the e-Albania portal. It has also implemented the Public Consultations Portal,[119] where all draft legal acts are published for open consultations; and the co-governance platform Albania We Want,[120] which assists and supports citizens stuck in the bureaucratic labyrinth. This has proved to be an effective tool for combating the lack of transparency and accountability in public administration. Reports are published on individual institutions' websites, and NAIS provides centralised reports on the progress of digital government development.

Programmes to support **private sector ICT adoption** have not been prioritised, although policy documents like the Digital Agenda and the National Strategy for Development in principle promote SMEs' adoption of ICTs. Some indirect support for buying ICT equipment has been provided through the Innovation Fund. Under the scope of the fund's main objective to foster innovation and support innovative start-ups, it co-finances technology audits, purchase of software and hardware, and capacity building in ICT. However, the impact of this type of support, and other innovation funding programmes, is limited by the small number of beneficiary companies (e.g. only 62 companies are Innovation Fund beneficiaries). There are no programmes promoting e-commerce or e-business in Albania to boost ICT adoption by companies. According to a 2020 survey by the Albanian Institute of Statistics, although 28% of enterprises employ an ICT specialist, which is higher than the EU average (19% in 2019), only 45% of enterprises had a website (the EU average was 77% in 2019) and the majority (89%) used it mainly to publish product catalogues or price lists (INSTAT, 2021[165]). Also, 12.8% of enterprises were involved in e-commerce activities in 2020.

As the EU average in 2018 was 20%, this indicates that the e-commerce environment is still underdeveloped (INSTAT, 2021[165]).

*Sub-dimension 10.3: Jobs*

Basic **digital skills for students** are developed in the primary and secondary education system, in line with relevant objectives in the Digital Agenda 2015-2020 policy framework. The National Pre-University Curriculum Framework, developed by the Institute of Educational Development, identifies digital competence as one of seven key competencies to be developed in general education and vocational programmes. The Institute for the Development of Education is the main government body for developing ICT curricula for schools, as well as teacher training and qualification testing on ICT curricula and competencies. Indicators of digital skills for students are not systematically monitored or reported. Although a minimum level of digital skills is required to pass to the next level in secondary education, the main hindering factor is the low level of broadband Internet connections in schools and the lack of computers for students. According to Regional Cooperation Council (RCC) data, availability of Internet connections in schools was as low as 4.8% of schools in 2017 in Albania, although recent efforts have improved the situation (RCC, 2020[166]). In 2020, 1 255 schools (approximately 25%) have Internet connections at speeds slightly above 10Mps.

The lack of digital skills in the economy negatively affects both the demand and supply of digital products. It also undermines the potential of digitalisation to create employment and generate positive spillovers to other sectors of the economy, in particular services such as tourism. The development of **digital skills for adults** is not yet fully integrated into VET systems or lifelong learning programmes. Although the Digital Agenda makes specific reference to digital skills, and the National Employment and Skills Strategy 2019-2022 emphasises the development of skills that match labour market needs in its specific objectives, there is still a wide gap between youth skills and market needs. The National Agency for Education, Vocational Training and Qualifications (NAVETQ) is responsible for promoting the Electronic Platform for Adult Learning in Europe (EPALE) as well as matters related to the National Qualifications Framework and VET information management system. The donor-funded Skills Development for Employment (SD4E) Programme (UNDP, 2020[167]) has implemented a complete skills' needs analysis (including 2 560 enterprises covering all sectors of the economy) and supported the Ministry of Finance and Economy on the new VET Law and related regulatory framework in an effort to improve the overall quality of VET services and the development of skills for employment. A decision on the criteria and procedures for inclusion of lifelong learning qualifications in the levels of the Albanian Qualifications Framework was adopted in 2019. During the COVID-19 pandemic, VET schools were instructed to conduct online distance learning through various commercial or free platforms and guidelines were developed to support administrative issues for the online teaching process and tips on distance learning and student assessment.

Albania has not allocated sufficient resources to **ICT sector promotion**, particularly for the IT sub-sector, despite its recognised growth potential. Although policy documents like the Digital Agenda 2015-2020 and the National Strategy for Development and Integration 2014-2020 focus on re-using open public data, developing electronic services and digitalising public administration, no specific focus is placed on strengthening the domestic IT industry, even though it could support the effective implementation of these strategies. On the other hand, the growth of the communications sub-sector is realistically supported through the National Broadband Plan and the improved legal and regulatory framework that facilitates private sector investments in network infrastructure development. The ICT industry can benefit from government-funded programmes common to all sectors of the industry, like the Competitiveness Fund, the Innovation Fund, other programmes for innovation start-ups (e.g. TechSpace[121]) and R&D grants provided by the National Agency for Scientific Research and Innovation. However, aside from financial support programmes, ICT industry stakeholders report that finding or training highly skilled ICT professionals is difficult and retaining them is even harder, since brain drain heavily impacts this industry. On the upside,

ICT sector companies benefit from a reduced profit tax rate (5% instead of a 20% nominal tax for all other sectors). The ICT industry suggests that tax incentives and social security reliefs would also be beneficial for retaining talent.

### *Sub-dimension 10.4: Society*

Although there is no specific policy document that provides a **digital inclusion framework**, some aspects are addressed by the Digital Agenda 2020 and the new National Broadband Plan for 2020-2025, which includes a strategic objective to reduce the digital divide though rural broadband infrastructure projects. On top of increasing broadband penetration, the digital transformation of the public administration and e-government services development also provide a realistic opportunity for increasing digital inclusion. Provisions have been made for citizens who are unable to apply online for e-services to get support from trained employees at local post offices or ADISA[122] counters. Moreover, the Strategy for Social Protection 2015-2020 included a target for developing an integrated information system for financial aid and social services for people with disabilities.

Obligations for web presentation of public sector bodies based on e-accessibility standards were enacted in 2019 and evidence suggests that progress has been made with its practical implementation (e.g. functionalities based on World Wide Web Consortium standards for e-accessibility are now embedded in ministries' websites). However, the framework doesn't adequately promote certification schemes based on accessibility requirements and standards for ICT product and services. On the positive side, several multi-user information systems (MISs) have been created for social services during the last few years, such as the MIS for Economic Aid (application and eligibility process for the economic aid and disability payment), the National Register for Persons with Disabilities, the Integrated MIS for Social Services (application and eligibility process for social service payment), the Rome Alb (the database system which includes inter-sectorial data for the Roma people) and the Revalb (electronic system operated at the local level which records domestic violence). The implementation of most of these MISs was supported by donors. A database for digital inclusion indicators has not been created, but some data on Internet use by age, gender and location are monitored by the Institute of Statistics, while broadband penetration indicators are monitored by the Electronic and Postal Communications Authority (AKEP).

### *Sub-dimension 10.5: Trust*

The framework for digital **privacy protections** is not completely aligned with the current EU framework. The existing Law on Personal Data Protection (PDP) was originally adopted in 2008, and the preparation of a new law that transposes the EU General Data Protection Regulation (EU 2016/679) started in October 2020 through an IPA-funded project.[123] The new law, which will also transpose the Police Directive (EU 2016/680), will be ready for adoption in the last quarter of 2021. The Law on Electronic Communications also includes a chapter on e-privacy based on the Privacy and Electronic Communications Directive (2002/58/EC). The existing framework includes several by-laws and regulations for online privacy protections, including the most recent Instruction on certification of information security management systems, personal data and their protection, which was adopted in 2018. The Information and Data Protection Commissioner (IDP Commissioner) has prepared a draft law on ratifying the 2018 Protocol amending the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, which is not yet adopted. Moreover, the draft act on amendments to the Law on the Right to Information, including the European Commission's recommendations to transform the Commissioner's decision to an executive title, obliging its execution by all public administration officials, has been prepared but is still to be submitted to parliament. While the IDP Commissioner's office publishes annual reports on data protection activities on their website (including data on PDP, complaints, inspections and objections), they have insufficient resources for public awareness raising and professional training and depend on donor support for such activities. On a positive note, in November 2020, the Commissioner's Office was approved to employ 7 new staff members, raising the total number to 44.[124] In its annual report for 2019,

the Commissioner confirms that public authorities are becoming more transparent (voluntary data disclosure), even though more work is required in terms of information content and quality.

The Commissioner's office has organised the Privacy App competition to design a smart phone application that enables individuals to file a complaint from their smart phones in case of any violation or misuse of personal data. The IDP Application (for Android OS) is already available. The Commissioner's Office also continued implementing various awareness-raising activities on the right to information and data protection in 2020. In the context of measures to address the COVID-19 pandemic, the IDP Commissioner has strengthened the personal data protection framework by adopting three guidelines in 2020:

1. Guidelines on the protection of personal data in the context of measures taken against COVID-19 (20.03.2020).
2. Guidelines on the processing of personal data in specific sectors within the measures against COVID-19 (06.04.2020).
3. Guidelines on the processing of personal data in accordance with the COVID-19 Hygiene and Sanitary Protocols (04.05.2020).

These contain important guidance for employers on complying with the principles and legal criteria for processing personal data in the context of emergency measures taken against the spread of the coronavirus that require continuous monitoring of employees' health conditions. These instructions aimed to regulate employees' personal health data processing in quantity and qualities that – reasonably – exceed the usual processing of data during normal working conditions. Processing includes not only collecting and storing processed health data, but also transmitting it to law enforcement bodies tasked with combatting the pandemic, including bodies authorised by law to conduct epidemiological surveillance. The IDP Commissioner stipulated that the processing of personal data of the respective data subjects may last only as long as the purpose of the processing exists. Consequently, with the disappearance of the coronavirus pandemic, any controller (including employers and law enforcement bodies) is obliged to delete or destroy the personal data processed in this framework. Personal data controllers must remain aware of the importance of respecting the principles of proportionality and data minimisation when processing personal data. In the case at hand, this means that information processed should be adequate, relevant and limited to what is necessary to achieve the specific purpose of preventing or mitigating the spread of the virus.

Despite the guidelines and efforts of the IDP Commissioner, there have been complaints that the media has repeatedly breached privacy rules on citizens' personal health data during this period, including releasing names of deceased persons and pictures from the morgue of Tirana during late 2020. Such actions have often been the subject of debate and discussion on social media platforms. The Office of the IDP Commissioner has examined 315 complaints since the pandemic began, namely between March 2020 and February 2021.

Insufficient legislation on **consumer protection in e-commerce** and its lack of promotion by the government hinder the development of e-commerce in Albania. Internet purchases are not popular among the population, either due to the low use of credit cards, low purchasing power or the high cost of shipping. Additionally, many online merchants do not ship to Albania. The ICT survey by the Institute of Statistics indicated that only 10.1% of individuals ordered or bought products and services online during 2019, compared to an EU average of 60% (INSTAT, 2019[168]). In 2016, the government lowered the duty-free amount from EUR 150 to 22, which significantly reduced cross-border online shopping. Recently, efforts have been made to prepare the transposition of the EU regulation on cross-border parcel delivery services (2018/644/EU), which is expected around June 2021. The basic framework for consumer protection in e-commerce consists of a number of laws and regulations that require improvement, including the law on e-commerce and the law on consumer protection, which is aligned to the EU Directive on consumer rights (2011/83/EU). The inter-sectoral Strategy on Consumer Protection and Market Surveillance 2020 contains some elements regarding e-commerce. The Consumer Protection Commission (CPC) is the competent

authority for law enforcement in e-commerce, but according to their reports, very few complaints about e-commerce have been filed. There are no indicators on consumer protection in e-commerce that are regularly monitored by a state body. Some e-commerce indicators are collected within ICT use surveys by the Institute of Statistics, but they do not address consumer protection. The implementation of the framework is weak in offering opportunities to consumers to access consumer education information and advice, as well as how to file complaints related to e-commerce. The draft Action Plan for Development of Electronic Commerce 2021-2024, still to be adopted by the Council of Ministers, is expected to address some of the current issues in the field of e-commerce, including consumer protection.

The **digital security risk management** framework is based on the Digital Agenda and the National Strategy for Cybersecurity 2020-2025, adopted in December 2020; as well as the Law on Electronic Signatures (2008); the Law for Electronic Identification and Trusted Services (2015), which partly transposes the eIDAS Regulation (EU 910/2014);[125] and the law on Cybersecurity (2017), which partly transposes the NIS Directive (EU 2016/1148). The Authority for Electronic Certification and Cybersecurity (AKCESK) supervises the implementation of the legal framework. The AKCESK has been the national computer emergency response team (CERT) since 2017, and maintains the central registry of cybersecurity incidents and the list of Critical Information Infrastructure (CII). It also incorporates the former National Authority for Electronic Certificates, performing supervision and control of the provision of e-signatures services, meaning that it registers, accredits and supervises the Certificate Service Providers. It is currently in the process of becoming a Full Member of the global Forum of Incident Response and Security Teams (FIRST) and has acquired accredited member status in Trusted Introducer. It has already signed MoUs for co-operation with other CERTs in the Western Balkans. AKCESK is also responsible for monitoring and collecting data on cybersecurity. However, AKCESK is challenged by a lack of human, technical and financial resources, which has kept the national CERT, AL-CSIRT, from becoming fully operational and has only marginally allowed for capacity building and cybersecurity exercises to be conducted. On a positive note, the new structural organisation of AKCESK was approved in January 2020, which formally established the Al-CSIRT and opened the way for hiring seven new staff members, two of whom were hired by the end of 2020. Another welcome development was a wide Internet safety awareness campaign[126] during 2018 and 2019 in 15 schools in 7 regions, in which 312 children were trained as peer educators and an additional 15 000 children took part. This activity falls under the adopted National Action Plan of Child Online Safety 2017-2020.

### *The way forward for digital society*

Despite some important steps to improve the digital society policy framework, the government of Albania should pay more attention to the following aspects:

- **Accelerate the adoption of open data and data re-use legislation and strengthen the demand for open data innovation through inclusive co-creation processes**. Although the policy framework and open data platforms are in place, proliferation of published datasets is slow, the general public has not been widely engaged and the level of informed public debate on data-driven issues remains low. The government would need to raise public awareness, build capacities of public officials and develop public-private partnerships on open data innovation for the creation of e-services and applications for citizens and businesses.
- **Improve the legal framework on e-commerce and e-business and promote private sector ICT adoption through financial support programmes**. Design targeted programmes for SMEs to enable digitalisation of a large number of companies from all industry sectors. Chambers of Commerce could help assess the type of support needed and select appropriate financial schemes (such as subsidies or tax relief) for purchasing software/hardware and staff IT training, while promoting business process transformation through e-commerce and e-business development.

- **Provide adequate public investment for developing the digital skills of students and adults, in parallel to increasing Internet connectivity and ICTs for schools**. Access to broadband communication services, functioning computers and digital education aids need to be ensured for every school and every student in the economy. IT curricula, progressing from basic to advanced digital skills, need to be designed with support from the ICT industry. VET education and IT curricula also need to be updated to improve quality and improve students' digital skills for employment. Employment services could work with the ICT industry to design training programmes that address the needs of the labour market. Public capacity-building programmes at municipality level should also be implemented to empower citizens, so that they can fully enjoy the benefits of digitalisation in public administration.
- **Adopt accessibility requirements in public procurement of ICT products and services and create corresponding certification schemes**. Digital inclusion policies need to ensure that an ICT product or service is considered accessible when it can be used by all its intended users, given that a person's ability to use technology may be impaired by various physical, sensory, emotional or cognitive disabilities. Related policies need to ensure accessible ICTs as a powerful enabler of people's ability to participate in every aspect of modern life.
- **Design a programme for consumer protection in e-commerce that realistically promotes consumers' education or guidance and builds trust in e-commerce**. Consider conducting widespread awareness campaigns that educate the public on their rights and how to exercise them in e-commerce transactions. Provide online guides for consumers and e-traders and build consumer trust in e-commerce. The programme would also need to address legal and regulatory shortcomings (e.g. regarding e-payments, taxation and banking sector practices), improve protection against fraudulent or misleading practices and privacy abuse issues, and introduce dispute resolution and redress mechanisms in e-commerce. The programme would also need to prescribe regular monitoring of e-commerce and consumer protection indicators.

## Transport policy (Dimension 11)

### *Introduction*

Since the last Competitiveness Outlook (CO) assessment (2018), the main transport policy improvements made by Albania concern transport vision and transport project selection. Only moderate efforts have been observed in road safety, even though Albania declared 2020 as the Year of Road Safety. Policy progress in the railway sector has stagnated. Albania's performance in the transport dimension is the second best in the region and above the Western Balkan six (WB6) regional average (Table 20.16), but further efforts are still needed to achieve the EU average. Sub-dimension 11.1 on planning scores above the WB6 average, and Albania has the most developed transport project selection system of all economies in the WB region. Sub-dimension 11.2 on governance and regulation is in line with the WB6 average, while sub-dimension 11.3 on sustainability has a low score both for Albania and the other WB6 economies, which is explained by the low scoring for the road safety strategy, environmental sustainability and combined transport strategy indicators.

**Table 20.16. Albania's scores for transport policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 3.3 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 2.5 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 1.5 | 1.3 |
| **Albania's overall score** | | **2.5** | **2.0** |

### *State of play and key developments*

#### *Sub-dimension 11.1: Planning*

Since the last CO assessment, Albania has continued to follow its **transport vision** in the Sectorial Strategy for Transport (SST) and its action plan for 2016-2020. It takes a holistic policy-making approach that considers the transport model, multimodality and tourism policy. Various consultations with public institutions, implementation agencies and NGOs were held during the strategy development process. Roles and responsibilities are clearly allocated amongst institutions. The SST is aligned with the National Development and Integration Strategy 2015-2020, which has also identified priority transport projects. In total 43 priority actions were identified in the SST across all transport modes for the five-year period, including 144 tasks, with implementation plans and allocated budgets, covering a balance between soft measures and investments, and meeting the criteria of relevance, effectiveness, efficiency, consistence, coherence, utility, sustainability, and monitoring defined within the SST. Implementation is proceeding well. According to the SST's latest monitoring report (MIE, 2019[169]) and additional data provided by the government, over 80.5% of the tasks have been completed, 10.7% have not been completed and the remaining 8.8% have not started yet.

In February 2019 the Technical Secretariat and Thematic Groups on transport, energy, telecommunication and broadband were established; their human and financial capacities are sufficient to execute their tasks to identify, select and prioritise projects for the development of the transport strategy. This accomplishes one of the very important tasks defined within the SST action plan. They are responsible for implementing the SST and its action plan, as well as renewing the Single Project Pipeline (SPP).[127] The Technical Secretariat is made up exclusively of Ministry of Infrastructure and Energy (MIE) representatives, which is not an ideal setup when the SST covers so many different fields (environmental, social, tourism, budgeting, etc.). It is recommended that representatives from the other relevant ministries be involved in this secretariat too. Meanwhile, some other high-level decision groups (Integrated Policy Management Group, formed in 2015, and the inter-institutional working group for monitoring the implementation of the SST) do

include representatives from different ministries (Ministry of Finance and Economy, and other implementation agencies depending on the agenda). Until 2019, transport-related strategic documents were always aligned with the European Commission Staff Working Document (CSWD) on EU Enlargement Policy. With a new CSWD issued in October 2020 (European Commission, 2020[19]), it is expected that the new SST (as the existing strategy expired in 2020) will have to also be fully aligned with the latest CSWD. The MIE has secured the necessary financial support from the EU Delegation in Tirana to develop the SST and its action plan for the period 2021-26, which is expected to be finalised by mid-2021.

The Albanian National Transport Plan (ANTP) serves as a transport master plan, and was adopted by the government in 2017 (MIE, 2017[170]). It is updated every four years. The second revision of the ANTP, i.e. the 3rd ANTP covering the period 2019-2023 (MIE, 2020[171]), was approved in 2020, prioritising the projects from the SST (i.e. SPP) using the transport model. The new SST for the period 2021-2026 should be aligned with all the latest strategies and plans (e.g. ANTP3, and the Strategy for Application of Intelligent Systems in the Road Transport adopted in June 2020 – a new multimodal strategy that is expected to be finalised in 2021, etc.). The new national transport strategy should incorporate lessons learned from the monitoring of the previous SST implementation and ensure all activities are implemented. However, it remains to be seen to what extent such lessons will be used to inform future strategy updates.

A new governance tool developed in 2020 to support integrated policy, strategy implementation and monitoring,[128] should be implemented in each spending department of the institutions funded by the state budget, such as financing and economy, procurement, information technology (IT), etc. Its current implementation level is not entirely known, however. Some legislation has been adopted as a result of the strategy (as presented for each of the transport modes below), but it is not clear to what degree it is harmonised with the EU's Transport Community Treaty (TCT) (EUR-Lex, 2017[172]) since the data are not available for all required fields. The exception is the trans-European Transport Network (TEN-T) development (50% transposed and implemented, and 50% partially transposed and implemented).[129]

There has been co-operation with other WB economies (Greece, Kosovo, Montenegro and North Macedonia) to exchange experiences on transport planning, as per the previous CO's recommendations, especially through cross-border co-operation programmes for transport facilitation, tourism promotion in border areas, employment, etc. Co-operation also occurred during the development and review of the ANTP (with Croatia, Greece, Italy and Slovenia). The exchange of good practice included joint planning through the Transport Community Permanent Secretariat's (TCPS's) Technical Committees. All these activities need to be expanded to other WB economies on a regular bilateral basis and intensified, as the proper development of transport vision and planning leading to a single and competitive regional transport market can only be ensured through regular regional discussion involving the implementation agencies.

Since the last CO assessment, Albania has significantly progressed in developing the legislation needed to improve **transport project selection** and project implementation, supported by the financial management information system. New guidelines for procedures, preparation, presentation and reporting of annual financial content in general government units have been adopted. In addition, a Decision for procedures for public investment management has been adopted; the methodology sets out comprehensive, weighted criteria for project selection. The brand-new horizontal governance tool, described above, is expected to improve institutional co-ordination across ministries and implementing agencies, with the main purpose of following up implementation of the SST, and monitoring expenditure. Within the project selection process, each project in the SPP process has to be developed based on the EU Guide to Cost-Benefit Analysis of Infrastructure Projects (European Commission, 2013[173]), including assessing the environmental and social impacts and safety. A prioritisation process is applied to all projects in the SPP process. The government claims that affordability is taken into account within the prioritisation framework, but clear explanations with good practice examples of transportation affordability were not available. A straightforward methodology is needed for assessing whether projects are affordable to the wider population and to Albania's economy.

*Ex post* monitoring is conducted annually by the technical assistance services contracted by the Delegation of the European Union in Albania within the last five years, and the prioritisation framework is updated based on this monitoring. According to the government, *ex post* monitoring by local institutions is also planned, but there were no reports available at the time of writing. Results of monitoring and evaluation analysis inform policy framework design and implementation updates as per OECD good practice, and the methodology based on the OECD Development Assistance Committee (DAC) Rio Markers for Climate Handbook[130] has been applied.

Since the last CO assessment, the Law on Public Procurement (2018) has been upgraded, with some amendments to tackle corruption,[131] and is partially aligned with the EU Directive for improving the effectiveness of review procedures concerning the award of public contracts (Directive 2007/66/EC). The amendments to the Law on Concessions (2019) prescribe the unification of award procedures for road concessions/PPPs with all other concession/PPP procedures. The procurement process is applied to all transport projects funded through the state budget. Both **implementation and procurement** processes are followed through the financial management information system. *Ex post* evaluation of the implementation and procurement processes is done for projects funded from both national and international funds, and the lessons learnt have been incorporated into amended legislation mentioned above. The amendments cover flexibility, self-initiated tariff raising by the concessionaire for container terminals, and withdrawal of the procurement procedure due to unfair and discriminatory processes for road construction and airport concession processes. These help to create a favourable legal framework to attract foreign investors.

The roles and responsibilities of the government bodies involved in procurement and implementation procedures are well-defined, and human and financial capacities are adequate for the tasks assigned to the institutions and implementing agencies carrying out the activities. National bodies (e.g. national audit offices) oversee the procurement and monitoring of PPPs. The MoF and the ATRAKO are responsible for concession/PPP projects. Co-operation with other WB economies is established in project implementation and procurement, and good practices are being shared and applied where possible (e.g. the development of one-stop shops[132] at the railway border crossing point with Montenegro, and at the road border crossing points with Montenegro and Kosovo). Implementation strategies for all transport modes exist and are followed according to the mid-term budget programme. If the project is funded through international financial institution (IFI) funds, IFI procurement procedures are applied. The procurement procedures are consistently monitored.

Albania still has much to achieve in developing an **asset management system** (OECD, 2001[174]),[133] though very good progress has been noted in the road sector since the last CO assessment (see below). An asset management system does not exist for every transport mode. Some efforts have been made to establish an asset management system as described in the Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6 (CONNECTA, 2018[175]), which represents the strategic framework for roads and railways. However, the asset management system has not been successful (e.g. the GIS and database were not being updated regularly). This Maintenance Plan has been adopted in 2020 and represents the strategic framework for roads and railways.

A successful action for the asset management system was to develop the road database (RDB) in 2000-02, which was populated with inventory data collected through visual surveys and GPS co-ordinates (for the roads' axes).[134] However, this was only updated until 2009 and again in 2016, so it cannot be used as the main reference to assess the areas where the return on investment will be the greatest. The World Bank Project Results-based Road Maintenance and Safety Project (World Bank, 2017[176]) has entered into its third year of implementation. The project covers routine and periodic maintenance of about 1 333 kms of Albania's main roads through Output and Performance-based Maintenance and Rehabilitation (OPRCs). Once the assignment is complete Albania will have established a road asset management system (RAMS_ portal), road database, reference system, pavement management system (PMS), bridge management system (BMS), and road maintenance management system (RMMS). It will also have

prepared an annual network roughness and surface distress data collection plan, determined average vehicle fleet characteristics, and evaluated current features of the road database related to the management and evaluation of recurrent maintenance activities and proposed improvements. When complete, it will equip Albania with all the necessary tools to plan road asset management comprehensively. Once the system is developed, national financial sources for the sustainability of the system should be secured.

Railway infrastructure asset (RIA) inventory data should be collected by the Infrastructure Manager, but they are either non-existent, not stored in a digital format or often outdated. The RIA inventory should include periodic monitoring of the conditions of infrastructure assets. An ongoing project funded by the EBRD to develop the railway asset management system was launched in February 2020.

The asset values have been incorporated into the new Albanian Financial Management Information System (AFMIS), which is quite innovative as it is the only single information system in the region that will contain all asset values.

Traffic flow data are not regularly monitored. An IFI-funded survey in 2006-10 used 1 000 traffic counters. These data are related only to the primary road network.

### *Sub-dimension 11.2: Governance and regulation*

Since the last CO assessment, regulatory reforms have continued at a steady pace in the field of **aviation regulation**. The Single European Sky (SES) I package has been fully transposed and implemented, though SES II regulations have not been fully transposed yet. Albania is an associated member of the BLUEMED Functional Airspace Block (FAB), which aims to avoid national fragmentation as it affects safety, limits capacity, and above all, adds to cost. The Airport Charges Directive is an important piece of EU legislation guiding the way charges should be set and monitored. They should be based on non-discrimination and transparency principles set by the EU, and quality standards related to the service-level agreements for services provided at the airport. The Airport Charges Directive has been transposed and implemented in Albania.[135] The market is monitored regularly by the Albanian Civil Aviation Authority (ACAA), but information on the monitoring scope, depth and frequency is not available. An air traffic management plan has been developed and monitored regularly through the Local Single Sky Implementation Monitoring (LSSIP) (EUROCONTROL, 2019[177]).[136] Safety culture,[137] covering safety risk assessment and safety assurance, has been adopted.

Air traffic is growing in Albania. The total number of passengers transported from all airports increased in the period 2017-19 by approximately 27%, amounting to 3.34 million passengers. This is a very good achievement in comparison with the global and EU averages, which increased respectively by 11.7% (IATA, 2020[178]) and 4% (EUR-Lex, 2014[179]) over the same period. Given the significant growth of this transport mode and its projected importance for the economy, it is important that Albania continues regulatory reforms and brings the governance of the aviation sector closer to European standards and international best practices. The Albanian Government is ready to promote higher tourism growth, and its impact will be assessed in the new national transport strategy for the period 2021-2026. The Sustainable Tourism Strategy (2019), promoting stronger economic growth and easier access to accommodation infrastructure, was recently adopted. Therefore, a positive trend in air passenger transport is expected due to potential tourism growth.

Some positive alignment efforts have been noticed in the **railway regulation** sector in Albania since the last CO assessment, but significantly more efforts are needed to align legislation with the TCT. The Law on the Railway Code has initiated rail reforms in accordance with the TCT. Structural reforms have been adopted, as well as proposals to establish national bodies, such as the Railway Regulatory Agency, National Safety Agency (NSA), National Accident and Incident Investigation Authority (NAIIA), Railway Licencing Agency (RLA), and an independent Infrastructure Manager (IM) from Railway Undertakings (RU), the entity in charge of maintaining rail vehicles. The RLA has been in existence since 2018, but its

funds are limited. The proposed NSA will take over the operations of the Railway Inspection Directorate. The budget for this transformation already exists. Rail reforms are monitored on a quarterly basis and monitoring reports are published annually. The latest available is for 2019, and covers network inspection, legal framework, controls for the infrastructure manager and railway undertakings, inspector monitoring, rail safety, as well as administrative and financial fields. The new NAIIA is proposed to jointly cover the rail and sea sectors. It was proposed in 2019 to unbundle operations from the IM but is yet to happen. Draft legislation for the access reforms was prepared but not yet adopted by the government due to institutional and financial issues (budgets for the new institutions are not approved through the medium-term budget plan).

The SST defines the framework for rail freight corridors but Regulation (EU) 913/2010 on Rail Freight Corridors has not yet been transposed. Regulation (EU) 1371/2007 on Rail Passenger's Rights and Obligations has been partially transposed through the new Railway Code. There is a new regional Rail Action Plan (TCPS, 2020[180]), endorsed by the Ministerial Council of the TCPS in October 2020, covering the period 2020-23. However, the actions related to rail market opening, passenger rights, border/common crossing operations, interoperability, governance and modernisation are not yet available. An overview of the results achieved on alignment is expected soon. A Network Statement (NS) was issued for 2019, but only for infrastructure – not for service facilities. Directive (EU) 2012/34 on establishing a single European railway area states that operators of service facilities that are not controlled by the infrastructure manager must supply information on charges for gaining access to the facility and for providing services. Interoperability Directive EU 2016/797 (EUR-Lex, 2016[181]) is partially transposed into the Law on Railway Code. Albania has already advanced bilateral co-operation in the railway sector by signing a border crossing agreement with Montenegro for an OSS at the Tuzi border crossing point (BCP); this is working well. This is the only railway BCP so there are no similar activities with other WB economies.

The National Register of Railway Vehicles was established in 2020, which is very positive. It will consist of a single database of all used vehicles, owners, entities in charge of vehicle maintenance and vehicle technical information, as well as limitations on vehicle use. However, by 2024 this new national vehicle register will be transformed into a centralised registry for European Vehicle Register (EVR) vehicles in line with Commission Implementing Decision 2018/1614. The Railway Inspection Directorate regularly inspects the rail network and legal framework, and publishes annual reports which set out maintenance planning.

A significant downward trend has been noticed in passenger railway transport, and fleet utilisation is low compared to the EU average (Table 20.17). There are many steps to be taken to revive railway passenger transport. On the other hand, the high modal share of railway fleet utilisation shows that the market is progressing in the right direction. The only railway connection from Albania to Europe is through Montenegro and Serbia via railway Route 2 and Route 4 (European Commission, 2015[182]). Given the current rehabilitation and modernisation of railway Route 4 between Bar (Montenegro) and Belgrade (Serbia), the railway share is likely to increase in the coming years, and especially in the coming decade when the rehabilitation of 210 kms of railway is completed between the Montenegro/Serbia border and Belgrade. At the same time, construction and reconstruction works need to be continued in Albania as planned in the national transport strategy and the action plan. In addition to this, positive movements have been noticed in the funds allocated for railway infrastructure since the last CO assessment, with investment increasing approximately five-fold, amounting to EUR 0.55 million in 2019. However, this is still below the average for the last decade and several times lower than the EU average.

## Table 20.17. Trends in rail transport in Albania (2017-19)

| Rail network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU-28 average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of track) | +71.8 | 0.008 | 2.8 |
| Freight (tonnes*km/km of track) | +14.3 | 0.055 | 6.6 |
| **Rail fleet utilisation** | **Change over 2017-19 (%)** | **2019** | **Share of the EU-28 average (2017) (%)** |
| Passengers (passengers*km/train*km) | -58.1 | 9.6 | 7.1% |
| Freight (tonnes*km/train*km) | +151 | 696 | 124% |
| **Mode share** | **Change over 2017-19 (%)** | **Share of total transport (%)** | **Share of the EU-28 average (2017) (%)** |
| Passenger transport (passengers*km) | -16 | 2.06 | 6.8% |
| Freight transport (tonnes*km) | +70 | 42.94 | 18.3% |

Source: Inputs provided by the government as part of the quantitative questionnaire (CO2021); (Eurostat, 2021[183]), Victims in road accidents by NUTS 2 regions, https://ec.europa.eu/eurostat/databrowser/view/tran_r_acci/default/table?lang=en; (INSTAT, n.d.[184]), Albanian Institute for Statistics, http://www.instat.gov.al/.

Some progress has been made in **road market regulation**, with significant efforts undertaken since the last CO assessment to harmonise legislation with the TCT. Specifically, legislation has been further aligned with Regulations 1071/2009/EC on preparing policy for an integrated intermodal transport system, harmonising passenger and freight transport legislation and strengthening regional co-operation by integrating the national core network into the TEN-T. Albania continues to participate in the European Conference of Ministers of Transport (ECMT) multilateral quota system (ITF/IRU, 2014[185]), which enables hauliers to undertake an unlimited number of multilateral freight operations in the 43 European member countries participating in the system. However, road network performance is only assessed occasionally and only for some indicators.[138] There is still scope to significantly improve measurement of other indicators[139] to monitor the road market sector.

The COVID-19 outbreak is affecting the entire transport and mobility market across the world, and the WB economies are no exception. In the second quarter of 2020 Albania introduced measures at border and customs control to enable the provision of essential goods and medical equipment. These consist of "green lane" measures on its major corridors for transporting emergency goods. Passing through these green lane border crossings should not exceed 15 minutes (including any checks and screenings), and so procedures should be minimised and streamlined, etc. The implementation of these measures could have a direct impact on how the border crossing is treated in the future. These include installing measures which minimise crossing times, such as the OSS at the Preševo/Tabanovce road BCP between Serbia and North Macedonia (which is similar but more advanced than the one at the Sukobin/Muriqan road BCP between Albania and Montenegro); automating customs procedures; and traffic management measures which convert physical queues into virtual queues, such as through the electronic queuing management system (e-QMS) installed in Baltic countries. These are currently being developed by the CONNCETA team along the Corridor X through Hungary, Croatia, Serbia, North Macedonia, and Greece, etc.).[140]

The existing legislation for **inland waterways (IWW) and maritime market regulation** is either fully transposed (e.g. flag state, port state control, international safety management code, ship-generated waste, minimum safety and health requirements on boat fishing vessels, enhancing ship and port facility security, and enhancing maritime port security) or needs to be amended or replaced to be aligned with international conventions and agreements and with the EU *acquis* and TCT (e.g. access to the market, international relations, international agreements, vessel traffic monitoring and information systems, etc.). The IWW sector is limited to two lakes (Skadar Lake shared with Montenegro and Ohrid Lake shared with North Macedonia), both regulated by bilateral agreements. According to the Maritime Code of the Republic of Albania, transport related tariffs are defined by the Ministry of Infrastructure and Energy and the Ministry of Finance. The project Enhancing the Development of Albanian Maritime Sector through Technical

Assistance and Increased Partnership (UNDP Albania, 2018[186]) is funded by the IFIs and started in 2018. It aims to provide a baseline assessment of the institutional and financial setup in the maritime transport sector, as well as to develop the institutional and legal framework to support maritime sector development, all based on the Norwegian experience (one of the leading maritime countries worldwide). It is expected to be finalised at the end of 2021. There are no specific incentives prescribed for shifting to the use of maritime transport. Indicators to measure performance of maritime transport have not been established yet. Statistical data are collected periodically and published every year in the Statistics Bulletin of the Statistic Institute of Albania. The total tonnes transported using maritime transport in Albania increased by 10.7% in the period 2017-19 and amounted to 4.5 million tonnes in 2019. The total number of passengers transported increased by 4.4% in the same period, amounting to 1.57 million passengers in 2019.

Indicators to assess the performance of all transport modes are either non-existent or not properly established (missing indicators include average user costs, travel time satisfaction level-reliability, value of assets, market research and customer feedback, quality of user information, audit programmes, etc.). Data surveys are not conducted regularly or planned soundly (planning should include a clear purpose, the level of data needed, and budgets need to be allocated); they tend only to be conducted for the purposes of the specific projects. Therefore, there is no basis for a quality assessment of transport network performance.

### *Sub-dimension 11.3: Sustainability*

Further efforts are required to improve **road safety** in Albania (Table 20.18). The National Road Safety Strategy[141] (NRSS) 2011-2020 has ended and was not in line with the relevant EU legislation (European Commission, 2019[187]; EUR-Lex, n.d.[188]; EUR-Lex, 2018[189]; Road Safety Sweden, 2020[190]; United Nations, 2020[191]). Areas not aligned include road infrastructure safety management, the safe system approach, and "forgiving" roads, etc.). Alignment is expected only after 2021 as the new strategy needs to be adopted but the government is still trying to find sources to finance it. The main law resulting from the NRSS is the amended Road Code of the Republic of Albania (2015), covering many new regulations.[142] The speed management plan, establishing a traffic management centre, and public awareness campaigns have not been implemented yet due to insufficient human and financial capacity within the ministry and respective implementing agencies. An important area not well developed so far in the road safety sector is an update of the strategy and legislation based on the monitoring report. The monitoring report for 2016 is more detailed than the one from 2019 due to a lack of human resources. An impact assessment of the NRSS has not been conducted.

Based on the Road Code and its sub laws, the Road Crash Database is administered by the Traffic Police in co-operation with other institutions.[143] The actual road accident data system is updated every month and the data are available from the traffic police. The database seems very limited in its expansion capacity.[144] The current technical assistance project for maintenance and road safety is expected to recommend a new road accident information system.[145] The Draft Road Safety Regional Action Plan, developed by the TCPS in 2019, was approved in April 2020, and the regional Road Safety Action Plan (TCPS, 2020[192]) was endorsed by the TCPS Council of Ministers in October 2020. Albania needs to align the national plans to achieve the goals set within this plan.

### Table 20.18. Road safety trends in Albania (2010-20)

| | 2010-20 (%) | 2017-20 (%) | 2020 |
|---|---|---|---|
| Change in the number of fatalities (Albania) | -48.6 | -18.5 | 181 |
| Change in the number of fatalities (EU-27) | -23* | -2.5* | - |
| Number of fatalities per million inhabitants (Albania) | - | - | 63.3 |
| Number of fatalities per million inhabitants (EU-27) | - | - | 51** |

* Covering the period 2010-2019.
** 2019.
Source: (European Commission, 2020[193]), *2019 Road Safety Statistics: What is behind the figures?,* https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004; (INSTAT, n.d.[184]), Albanian Institute for Statistics, http://www.instat.gov.al/.

The goal of the EU Policy Orientation on Road Safety 2011-2020 (European Commission, 2010[194]) is to reduce road fatalities by 50% between 2010 and 2020 as part of the Decade of Action for Road Safety 2011–2020 officially proclaimed by the UN General Assembly in March 2010. Albania's NRSS is aligned with the EU document and this goal has been almost achieved as Albania decreased the number of fatalities in the period 2010-2020 by 48.6% (Table 20.18). However, it will need to make additional efforts to reach the new goal in the European "Vision Zero" Strategy for 2050 of a 50% further decrease in road fatalities in the decade 2021-2030. As there is no strategy yet developed for the new decade, then expectations should not be high. Since the last CO assessment, stagnation has been noticed in the road safety strategy indicator in comparison with the previous part of the decade. The reasons for this are unknown. The indicators presented above show some positive signs, and Albania has declared 2020 as a Road Safety Year, but much more effort is needed not only to harmonise the legislation with the TCT, but also in the areas of education, awareness campaigns, enforcement, etc.

Albania does not have an environmental sustainability strategy for the transport sector. **Environmental sustainability** is partially covered in the SST and its Action Plan for the period 2016-2020, which is linked to the Sustainable Transport Plan (STP) prepared in 2015 with the assistance of the EBRD and accepted by the Albanian Ministry of Transport and Infrastructure. The STP is a key document to meet the energy savings targets for the transport sector through 1) the quantitative assessment of past, existing and projected levels of energy use and greenhouse gas (GHG) emissions by transport mode; 2) increased use of more sustainable materials to reduce GHG emissions; 3) climate change adaptation; 4) reduction of other harmful emissions; and 5) improvements in transport's impact on biodiversity, the local environment, etc. In addition to this, the SST sets objectives for environmental protection. A shift from road to other transport modes, as well as incentives for e-mobility, are considered through the ANTP3.

The legal and regulatory framework to support **combined transport**[146] is not yet defined even though the national transport strategy set some priority actions. Co-modality is proposed though the ANTP3, approved in 2020, and the Intermodal Transport Strategy was finalised in January 2021, setting out strategic actions[147] for the development of intermodal transport in Albania.

The World Bank's Logistics Performance Index (LPI) (Düll et al., 2018[120]) is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation. In the latest ranking (2018), Albania is 88th of 160 ranked countries, with an LPI score of 2.66. This is slightly below the world average (2.85) and far below the EU average (3.52). Albania's best score is for the timeliness indicator[148] (ranked 73) while the worst score is for infrastructure[149] (ranked 110).

Data collection is key for assessing the performance of all sustainability areas. A strategy for data collection needs to be established as a basis for the assessment of the transport sector, as it will directly influence the prioritisation processes within the transport policy in general.

### *The way forward for transport policy*

Albania has taken some important steps forward to develop a competitive transport sector, as presented above, but special attention should be paid to the following challenges:

- **Enhance implementation, monitoring and readjustment of the approved policy framework.** The transport policy framework is only periodically revised based on monitoring reports. Adapting the policy framework based on regular monitoring is key to keeping it up to date, relevant and effective. Monitoring reports need to be developed for each strategy and other strategic documents, and should also be publicly available.
- **Develop national cost-benefit analysis (CBA) guidelines and tailor them specifically to Albania, ensuring they cover all transport modes.** It is very important for each economy to develop its own CBA guidelines with accompanying national technical instructions. The guidance needs to be updated often, at least every two years**.** A good example is the United Kingdom's Transport Analysis Guidance (UK Government, 2019[195]), which provides information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure consistency amongst the discount rates used for similar projects in the same economy, it is necessary to develop an economy-specific benchmark for all technical and economic parameters, including the financial and economic discount rate in the national guidance documents, and then to apply it consistently in project appraisal at the national level. Empirical research needs to be conducted at the national level to generate input data for calculating externalities.
- **Continue rail reforms**. The basic reforms have started (e.g. structural reforms have already been adopted by the central government and commenced, access reforms are drafted but not yet approved, and the SST has set one of the priority actions for freight corridor reforms). These reforms should be continued, especially those to promote competition, and access reforms which will allow for an efficient system with better performance. Freight corridor management reforms are needed as a prerequisite for the next steps related to high-quality capacity and a competitive modal shift to rail. Passengers' rights and obligation reforms should be directed to meeting passenger expectations so as to promote rail travel. Interoperability reforms should be done gradually as they take time and funds, but they are very important for developing international railway transport.
- **Prioritise road safety.** The monitoring results of the existing road safety strategy, including lessons learnt, should be used to develop the new strategy. Further efforts are required to align national legislation with the TCT and EU *acquis*. All actions proposed in the new strategy need to include the implementing agency responsible, the timeline for implementation, the budget, and monitoring indicators. An impact assessment of the new strategy also has to be carried out. A road safety agency needs to be established with the appropriate staffing and funding resources, to undertake activities (e.g. education, awareness campaigns, development of road safety coordination bodies in local communities) to follow-up the implementation of the strategy and increase safety on Albanian roads. Box 20.13 contains an idea from Montenegro that could act as inspiration.
- **Maintain transport facilitation as a key priority.** More OSSs are needed, and other measures in the newly endorsed regional Action Plan for Transport Facilitation (Transport Community, 2020[196]). Measures include improving and upgrading existing information and communication technology infrastructure, constructing or modernising infrastructure to remove physical and technical barriers and increasing existing capacities, capacity building to improve performance efficiency, etc. Implementing these measures will be a key trigger for increasing the competitiveness and connectivity of the WB region, and driving its deeper integration in the European market. Very good examples could be emulated from the region – North Macedonia and Serbia have recently introduced a well-developed OSS system and are currently in the initial stages of implementing a pilot project for an electronic queuing management system.

- **Develop an Integrated Environmental and Transport Action plan.** This plan needs to integrate the existing indicators and to include any missing ones in a framework for environmental sustainability in the transport sector. A good example was developed by the European Environmental Agency in the form of the Transport and Environment Reporting Mechanism (European Environment Agency, 2020[197]), which prescribes indicators for tracking transport and environmental performance in the EU.[150]

### Box 20.13. Innovative ideas in road safety: Road safety social impact bonds in Montenegro

In 2018, the UNDP in Montenegro, in co-operation with the key national players in road safety, developed a new idea related to road safety social impact bonds. These are an innovative alternative performance-based public financial instrument, which shifts the policy framework from inputs and outputs to outcomes and value for money. The idea is to involve the private sector in investing in road safety improvements with the main aim of strengthening sustainability jointly with the public sector. The public partner commits to paying outcome payments to the investor if and only if the predefined and measurable social goals are met. This idea has great potential for other economies in the region (and beyond) to replicate and scale up the model.

Source: (UNDP Montenegro, 2014[198]), *Rethinking road safety in Montenegro*, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

## Energy policy (Dimension 12)

### *Introduction*

Albania has made significant progress since the last Competitiveness Outlook. Together with North Macedonia, Albania is a regional leader in all most all sub-dimensions and indicators for the energy dimension. Its score has risen from 2.0 to 3.2 (Table 20.19). While it has made significant progress in all sub-dimensions, its most important advances are in regard to the regulator, deployment of a power exchange, working towards establishing a natural gas market, and unbundling.

**Table 20.19. Albania's scores for energy policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Energy policy dimension** | Sub-dimension 12.1: Governance and regulation | 3.5 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 2.9 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 3.3 | 3.0 |
| **Albania's overall score** | | **3.2** | **3.0** |

### *State of play and key developments*

#### *Sub-dimension 12.1: Governance and regulation*

The energy sector is guided by a comprehensive **energy policy, legal and institutional framework**. This framework is closely aligned to the EU Third Energy Package, which can be seen as a benchmark for good practice to be applied in the Western Balkans (Box 20.14). However, there is a divergence in opinion over the extent to which the Albanian framework reflects the Third Energy Package. The government states that transposition and implementation ranges from 58% to 85% across the various sub-sectors. Meanwhile, the Energy Community rates transposition to be at 47%, with an additional 44% needing improvement and 8% being completely untransposed, while implementation ranges between 28% and 77% across the various sub-sectors (Energy Community Secretariat, 2020[199]). Despite the differences in the range, it should be stressed that Albania has made strides since the last assessment (Energy Community Secretariat, 2019[200]). Moreover, Albania is amongst a select few WB6 economies to have transposed some, and possibly all, of the network codes—including all codes on network connections. Moreover, the government has stated that Albania is also working to transpose the first elements of the EU's Clean Energy Package (Box 20.14).[151] Meanwhile, the sector is guided by an extensive set of policies, with up to 50% of the policies having been implemented so far. The sector has state entities with specific and clearly defined roles. Finally, a variety of indicators and data are collected and published at regular intervals, supporting a comprehensive approach to monitoring and to policy design for the sector.

Furthermore, Albania has extensive legislation that assures comprehensive consideration of externalities such as greenhouse gases and air quality within the energy sector. For example, the sector is guided and governed by UN targets known as the National Determined Contributions (formalised in the Decision of the Council of Ministers No. 762 from 16.9.2015), which provide the energy sector with a carbon dioxide emissions reduction target of 11.5% between 2016 and 2030. This is equivalent to reducing annual carbon dioxide emissions by 708 000 tonnes by 2030, or a reduction of 2 tonnes of annual emissions per capita by 2030. Furthermore, the new drafts of the Law on Climate Change contain articles that should allow a European Union-style emission trading scheme to be implemented in Albania in the future.[152]

### Box 20.14. The EU's Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability.

Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Co-operation of Energy Regulators – ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package, which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all of WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies, as members of the Energy Community, whose *acquis* reflects most of the Third Energy Package. Moreover, with many WB economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are part of the accession requirements.

To conclude, the Third Energy Package provides for the implementation of good international best practice for competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

However, there are some shortcomings that need to be overcome in order to truly state that the energy market is compliant with international good practices. For example, while the establishment of the power exchange is a positive development, it is not expected to start operation until sometime in 2021. Moreover, while market liberalisation has moved forward for customers on the 35 kV (and up) lines, customers in the retail market are still tied to the universal suppliers with regulated prices. This is supplemented by a policy through which supply side liquidity from the wholesale market is diverted through an agreement between Korporata Elektroenergjitike Shqiptare (the largest generator in Albania) and the universal supplier and distribution system operator to provide them with priority supply. Similarly, there has been progress in unbundling Operatori i Shpërndarjes së Energjisë Elektrike SH.A (the former distribution system operator);

however, the operational unbundling is still outstanding—for more details please see Sub-dimension 12.3: Energy markets.

Meanwhile, **the energy regulator**, the Energy Regulatory Entity (ERE), is established as an independent regulator in line with international good practice. This independence is reflected in its autonomous decision making on its work activity, human resources management – including salaries – and financial activity. Moreover, ERE follows international good practice for monitoring and the accountability of its work package. Nonetheless, there are some minor shortcomings. First and foremost, the legislation governing ERE lacks some requirements, including a rotation scheme for board members, a requirement for reporting on compliance of supply prices with public service obligation limits, a requirement for ERE to design and implement steps to promote competition and liquidity, as well as a requirement for ERE to request transmission and distribution system operators to change their terms and conditions.[153]

Finally, the Energy Community Secretariat has raised some concerns regarding the fines that ERE can impose (Energy Community Secretariat, 2020[201]; Energy Community Secretariat, 2019[200]). More precisely, Article 107 of the Albanian Energy Law limits fines to between 0.1% and 3% of annual revenue. Meanwhile, Article 37 of EU Directive 2007/72/EC and Article 41 of EU Directive 2009/73/EC stipulate that regulators should be able to "impose effective, proportionate and dissuasive penalties on electricity undertakings not complying with their obligations under this Directive or any relevant legally binding decisions of the regulatory authority" and limits this to 10%. In other words, while Albania's provision is compliant with EU directives, the Energy Community Secretariat is concerned that the Albanian upper limit of 3% is well below the 10% set out in the EU directives. Nonetheless, the Energy Community Secretariat ranks ERE to be amongst the top three regulators in the Western Balkans (Energy Community Secretariat, 2020[199]).

Regarding the **management of energy infrastructure**, Albania has an advanced and comprehensive infrastructure management policy in place, of which at least 75% has been implemented. However, Albania's performance is being held back by having only partially transposed the EU Regulation 347/2013 on guidelines for trans-European energy infrastructure. The Energy Community Secretariat notes that the following key aspects of the European Union Regulation have not been transposed (Energy Community Secretariat, 2019[200]; Energy Community Secretariat, 2020[201]):

1. A methodology and criteria used to evaluate investments in infrastructure projects, particularly for high-risk infrastructure.
2. Publication of a procedures manual for granting permits to projects of Energy Community interest.

Moreover, while roles and responsibilities are clear, the overshadowing aspect of unbundling muddies the waters a little. Nonetheless, the system entails a clear strategy and guidance for enhancing Albania's infrastructure and regional integration. This is further backed by a comprehensive system for collecting indicators and monitoring, as well as an asset registry and management system.

### *Sub-dimension 12.2: Security of energy supply*

While Albania does not have a natural gas market at the moment, it is seeking to establish a **natural gas supply framework**. Since the end of 2020, Albania is connected to and receiving natural gas extracted from Azerbaijan via the Trans Adriatic Pipeline.

As it stands today, the Albanian natural gas sector is governed by an extensive legislative and policy framework, including emergency plans. Nonetheless, while the transposition of the Energy Community *acquis* with regard to natural gas is complete,[154] implementation is rated at 42%. This low score reflects two aspects. The first is that the natural gas market in Albania is very nascent and currently lacks a wholesale market. The second is that there are serious issues with unbundling and a lack of natural gas

market rules (see unbundling section in Sub-dimension 12.3: Energy markets). On a positive note, the gas network codes, supply rules and customer protection laws have been adopted.

Meanwhile, the policy framework provides for comprehensive guidance to the sector, including on a supply framework and increasing the penetration of natural gas in the Albanian energy mix. To this end, the National Sectorial Plan for the Albanian Gas Sector (commonly referred to as the Albanian Gas Master Plan) identifies key infrastructure investment projects to be implemented over the short, medium and long term (Table 20.20).

### Table 20.20. Key infrastructure investment projects

| | |
|---|---|
| **Short term** | |
| Development of the TAP pipeline, Vlora TPP development of the gas distribution system in the city of Vlora | Development of transmission system to supply customers in Fier and Ballsh and the development of local gas distribution systems in the areas of Fier and Ballsh |
| **Medium term** | |
| Development of transmission system to supply industrial areas in Elbasan, and the development of gas storage areas in Dumre | Development of transmission system for the supply of industrial and commercial customers in the area of Durrës and Tirana |
| **Long term** | |
| Development of gas transmission system near Korça, to supply the planned Korça TPP, and further in Pogradec<br>Development of Alkogap project<br>Development of the transmission system in Shkodra | Development of the transmission system from Ballshi to Tepelena and Gjirokastra<br>Development of the transmission system from Pogradec to Prrenjas and further to North Macedonia<br>Development of transmission system for TPP planned in Kuçova |

Albania is actively participating in expanding the regional natural gas pipeline network, such as the Trans-Adriatic natural gas Pipeline (TAP) project,[155] Ionian Adriatic natural gas Pipeline (IAP) project,[156] and the Albania-Kosovo natural gas interconnection. However, there is no comprehensive monitoring system as the absence of a natural gas market means there are limited opportunities to measure, collect, and analyse indicators and information.

The **electricity supply framework** is governed by a comprehensive legislative and policy framework including possible supply distribution, which is governed by Article 90 of the Law on the Power Sector. The electricity supply framework is guided by state entities with clearly defined roles and is monitored based on extensive data and indicators that are collected and published at varying frequencies.

**Renewable energy** accounts for a significant share of Albania's energy mix—approximately 35% of its domestic energy supply (Eurostat, 2020[202]; Eurostat, 2020[203]). However, it should be noted that most, but not all, of renewable energy in Albania is derived from hydro generation and subject to significant annual fluctuations due to hydrological changes. That is, of the 2 162 megawatts (MW) of total renewable installed capacity in 2019, 14 MW was from non-hydro sources—up from 1 MW in 2018 and 2017 (Eurostat, 2020[204]). Therefore, an urgent task facing Albania both from an optimisation and risk minimisation perspective is to increase and diversify the renewable energy mix. While Albania is well advanced and well placed for non-hydro renewable energy growth, implementation is not finalised and is patchy in some areas. Albania's annual renewable generation potential is 10 733 gigawatt hours (GWh) (by 2030), and it generated around 8 000 GWh of renewable energy in 2018—or around 80% (Eurostat, 2020[203]). By virtue of having extensively developed its hydro power generation, Albania still holds significant potential for wind and solar generation. (IRENA, 2019[205]) estimates Albania's technical total potential at 3.7 terawatt hours (TWh) for solar and 13.7 TWh for wind.

Overall, the renewable energy sector is guided by extensive policy, contained in the updated National Renewable Energy Action Plan, although this guidance extends only till the end of 2020; as well as the National Consolidated Renewable Energy Action Plan (NCREAP 2019-2020), and the Law on the Promotion of the Use of Energy from Renewable Sources. According to information provided by the government, around 50% of the Law on Renewable Energy and more than 75% of the NCREAP have been implemented. The main outstanding tasks to implement the law fully are the adoption of secondary

acts in order to enable a conducive investment framework for investors in renewable energy. In particular, the stability and predictability of the renewable energy framework, as well as its transparency and non-discrimination for investors, still need to be enhanced.

Project allocation is assigned in theory via competitive auctions with the use of feed-in premiums or contract-for-difference (instead of feed-in tariffs). However, despite this theoretically positive position, Albania has postponed the auction and use of feed-in premiums/contract-for-difference until 2021. The delay in the switch to feed-in premiums is also reflected in the execution of a recent solar project which will partially employ feed-in tariff support—although the contract has not been finalised. Continuing this theme of partial implementation, while the law recognises the principles and concepts of guaranteed integration/connection to the grid and priority dispatching of renewable energy, when it comes to implementation the associated secondary legislation and the rules setting the cost of connection are absent. Moreover, the balancing responsibility of renewable energy generators is enshrined in the law, but this has been suspended until 2022—although transitory non-discriminatory balancing rules are being introduced. Another positive step to note is that the law recognises the role of distributed small-scale self-consumption producers (prosumers) in combination with net metering—although some taxation questions are still to be resolved.

As already mentioned, one current issue at hand is the continued dominance of feed-in tariffs, a subsidisation approach no longer favoured in most of Europe due to the disconnect it creates between incentive-driven renewable energy generation behaviour and market realities (Box 20.15). However, for now it appears as if feed-in tariffs will remain the dominant subsidisation approach in Albania.[157]

Another negative aspect to be noted is that the cost associated with renewable support subsidies is being levied only on consumers connected to the distribution grid and not on consumers directly connected to the transmission grid, such as large industrial consumers.

**Energy efficiency** in Albania is still in its early stages. Although it has an extensive primary legislative framework for energy efficiency,[158] the transposition of the EU Third Energy Package is not complete, including the adoption of bylaws and secondary acts (Energy Community Secretariat, 2020[201]). As a result, the Energy Community Secretariat rates Albania's implementation at 56%[159] (Energy Community Secretariat, 2019[200]) which also agrees with the government's perception of implementation of 58%. However, it should be noted that Albania is actively working on increasing the transposition. A new version of the Energy Efficiency Law has been finalised and awaits adoption. Moreover, the legislation for energy certification of building systems is being drafted and at the time of writing was expected to be adopted and deployed sometime towards the end of 2020.

In addition to the legislative framework, the sector is guided by an energy efficiency policy in the form of the Third National Energy Efficiency Action Plan (DCM No. 709 dated 01.12.2017), of which around 50% has been implemented. While the plan provides targets to 2020, it does not contain targets beyond 2020 apart from expected developments. It is therefore important that new policy guidance with a vision beyond 2020 is released soon. To this end, Albania is drafting the National Energy and Climate Plan which will contain new targets to 2030 (Energy Community Secretariat, 2021[206]; Energy Community Secretariat, 2021[207]). There is no dedicated energy efficiency strategy for industry, although the first considerations have been made.

The sector is guided by two state entities: the Ministry of Infrastructure and Energy and the Energy Efficiency Agency. The latter was established in 2018 and is in the process of being fully staffed. In other words, there is currently a shortage of human resources in public entities. There is no dedicated government-funded energy efficiency fund—although energy efficiency investment opportunities are realised as part of a project funded by the international financial institutions or commercial banks. Additionally, the government has initiated various projects to refurbish government buildings (and dormitories).

Albania does have a system in place for data collection and monitoring of energy efficiency. It collects information in the context of its responsibility as an Energy Community member and has published four progress reports between 2018 and 2020.[160] One indicator collected is the energy intensity of the economy. This was 0.22 thousand tonnes oil equivalent per million Euros in 2014 and is expected to drop to 0.21 in 2020 (a 0.7% decline per annum) and to 0.18 in 2030 (a 1.4% decline per annum). However, there are some issues with regard to data collection. The data are based on top-down estimates and are supposed to be collected by the Energy Efficiency Agency. However, the following four issues prevent the Energy Efficiency Agency from collecting accurate/actual data:

1. the absence of energy auditors to provide data
2. shortcomings in the Law on Energy Efficiency (absence of an identification mechanism for large energy consumers)
3. delayed secondary legislation (governing areas such as minimum energy performance requirements, national calculation methodology, and energy performance certification)
4. the absence of a bottom-up methodology for data collection (currently being development with IFI assistance).[161]

### *Sub-dimension 12.3: Energy markets*

Albania has also made significant progress in introducing competitive **market operations**. However, as Albania does not have a natural gas market, this section will almost exclusively focus on the power sector.

Albania's energy market is guided by an extensive set of legislation and policy. One positive aspect is that Albania has finalised the shareholder structure of the new power exchange together with Kosovo, and has formally formed the power exchange, ALPEX. It is expected that the power exchange will be operational sometime in 2021. Furthermore, a dry run for the balancing market has begun, with the balancing market expected to start operating sometime in 2021. This is a significant step towards a competitiveness-driven balancing market in which imbalances are paid for and compensation paid to balancing service providers.

However, some key issues remain, especially until the power exchange becomes active. First and foremost, the universal supplier of electricity, FSHU, and the distribution system operator for electricity, OSSH, continue to receive electricity for the supply of customers under universal supply and distribution losses on a preferential regulated price basis from the largest generator, Korporata Elektroenergjitike Shqiptare. Korporata Elektroenergjitike Shqiptare also has to compensate FSHU and OSSH for any electricity that had to be the purchased at unregulated prices from the wholesale market (bilateral market)—or at least the difference between the contract/regulated and unregulated price. Connected to this issue is that all consumers in the retail market and wholesale consumers connected to lines below 35 kV are still tied to the universal suppliers and are thus paying regulated prices. Moreover, European Union Regulation No 1227/2011 on the wholesale energy market integrity and transparency is currently not transposed or adopted. This does not mean that market manipulation is rampant, but suggests that Albanian regulation does not reflect good practice and the price outcome of the future power exchange platform could misrepresent the economic situation.

The state of **unbundling** in Albania, much like market operation, is on the right track to align with best practices, but it is not quite there yet. Starting with natural gas, the two transmission system operators have been unbundled and certified. Nonetheless, their certification was conditional on the Trans Adriatic Pipeline and Albgaz (which is also the distribution system operator) implementing certain steps. However, in both cases, not all conditions have been met so far. In the case of Albgaz, the outstanding issue relates to Albgaz not being in a position to make its own investment decisions. This power currently still rests with the Ministry of Infrastructure and Energy. Nonetheless, both companies have adopted their network codes which grant third party access, in line with the primary legislative environment for third parties and following

the practices set out the EU's Third Energy Package. Moreover, the codes set out the standard entry-exit tariff approach in line with the Third Energy Package.

In the case of electricity, the transmission system operator, Operatori i Sistemit të Transmetimit, has been unbundled and certified as such. The unbundling of the distribution system operator is in progress. More precisely, Operatori i Shpërndarjes së Energjisë Elektrike SH.A has been restructured into a holding company with three subsidiaries: the distribution system operator OSSH, the universal service supplier FSHU and the electricity market supplier/trader FTL. However, the functional unbundling, or in other words the operational independence of the OSSH, is still in progress. The functional unbundling encompasses various areas: the unbundling of accounts; the separation of assets; the separation of management; finalising relevant service-level-agreements between the Operatori i Shpërndarjes së Energjisë Elektrike SH.A companies; independent communication and branding of the restructured companies to avoid any potential confusion; adoption of a compliance programme; and giving independent and effective decision-making rights to OSSH. While some of these have been completed, the majority have not. Therefore, the Energy Community Secretariat has not yet issued a positive opinion on the state of unbundling of OSSH (Energy Community Secretariat, 2019[200]; Energy Community Secretariat, 2020[201]).

**Third-party access** is enshrined in the legislation. Nonetheless, the Energy Community Secretariat notes that third-party access to the new electricity interconnector between Albania and Kosovo is still not ensured (Energy Community Secretariat, 2020[201]).

The power sector's **regional integration** is guided by extensive policy and legislation that aim to establish a competitive power market and expand the interconnections with neighbours. The government notes that more than 50% of the policy for regional integration has been implemented.[162] A positive development is that the capacity for Albania's interconnectors is assigned using joint auctions via the Coordinated Auction Office in South East Europe. The exception to this approach is the use of split auctions with Serbia's JSC Elektromreža Srbije. Albania has adopted all three network connection network codes, as well as the capacity allocation and congestion management and the rule for the nominated electricity market operator.

Finally, although today Albania has no market coupling, one of its key hurdles, the lack of a power exchange, has been overcome. While the exchange is not yet in operation, the expectation is that it will be soon. Significant progress is expected as a result. Moreover, with KOSTT SH.A. and Operatori i Sistemit të Transmetimit (OST) joining forces to establish the power exchange, they have signed an agreement to establish a new load frequency control (LFC) block, Albania-Kosovo (AK).[163] Implementation will commence once the KOSTT system is established as a separate control area. This is expected to be the first step towards Albania's broader integration with organised regional electricity markets (Energy Community Secretariat, 2020[201]). However, market integration could be improved, especially with regard to natural gas, and to a lesser extent electricity.

### *Cross-cutting dimension: Energy incentives – direct and indirect subsidies in the energy sector*

The issue of subsidisation is, as in other Western Balkans economies, a key topic and is present in Albania in various forms.

First and foremost, as detailed in the energy market section above, the continued use of Korporata Elektroenergjitike Shqiptare as a source of electricity (or payment) for various activities – including universal supply – is not only a form of subsidisation but also undermines competitive price formation as it withholds some of the lowest marginal cost energy generation from the market.[164] This also holds true for the issue raised above regarding consumers being bound to regulated prices and one supplier. Unlike with Korporata Elektroenergjitike Shqiptare, which is about supply side liquidity, the lack of retail liberalisation and price deregulation means that significant demand side liquidity is withheld from the market.[165]

Another form of subsidisation in Albania's energy market is the existence of outstanding payments among energy stakeholders and between energy stakeholders and the government. Firstly, there is a significant volume of arrears owing between key entities which remain unsettled as some entities refuse to accept the retroactive imbalance cost associated with their activities. All in all, the arrears between Operatori i Shpërndarjes së Energjisë Elektrike SH.A (former distribution system operator), Operatori i Sistemit të Transmetimit, and Korporata Elektroenergjitike Shqiptare (transmission system operators) amount to around ALL 18 billion. Meanwhile, Korporata Elektroenergjitike Shqiptare (the state and largest generator) and Operatori i Shpërndarjes së Energjisë Elektrike SH.A (former distribution system operator) owe ALL 5.47 billion in taxes to the government—down from ALL 8.36 billion in 2018. These outstanding payments are a form of subsidisation as the result is that these entities had lower operational costs than other non-state entities.

Finally, a similar form of subsidisation is the existence of a different payment ethic on the part of public entities, including water supply companies, towards Operatori i Shpërndarjes së Energjisë Elektrike SH.A (former distribution system operator). In 2020, the total debts of all state-owned entities – including water supply companies, all the other state-owned companies, the budgetary and non-budgetary entities – amounted to ALL 27.3 billion, of which ALL 16.2 billion was racked up by water supply companies.

While Albania is working on tackling these issues, including paying arrears, these subsidisations need to cease and be settled as they push the market away from competitiveness-driven equilibrium and the associated optimised distribution of scarce resources to the highest value-added consumers.

### *The way forward for energy policy*

Overall, it can be concluded that Albania has made strides in deploying a competitive energy market based on international good practice and that a strong foundation is in place. Nonetheless, there are some outstanding steps to be taken before Albania is truly there:

- **Complete the transposition and implementation of the EU Third Energy Package**. Its full transposition and implementation would help Albania lay the foundations of an energy market based on international good practice (Box 20.15). Moreover, Albania should now consider transposing and implementing the EU's Clean Energy Package, which reflects the latest lessons learned by the European Union with regard to legislation and policy for a sustainable and low-carbon energy sector (see Box 20.14).
- **Finalise the power exchange and unbundling of the distribution system operator**. Both factors will contribute to the transparent and non-discriminatory operation of the market, which should attract participants and lead to a competitive market in which prices are optimised and economic rent distributed efficiently. In other words, resources would be more efficiently allocated using economic forces and in line with international good practice. Moreover, these steps should be coupled with the **liberalisation and regulation of the retail market** to further enhance the competitive market forces.
- **Finalise and implement the non-hydro renewable energy support scheme**. Renewable energy projects should be allocated via competitive auctions and the support scheme should be switched to feed-in premiums to promote renewable energy generation. By attracting investors, these measures should support a liquid market with generation at a lower marginal variable cost in the long run. For good practice on support schemes see Box 20.15.
- **Terminate the preferential contract between Korporata Elektroenergjitike Shqiptare and other public service/universal suppliers**. The current approach is withdrawing important liquidity from the market that would otherwise have led to stronger price pressure and thus to a more competitive energy market and overall economy.
- **Support the development of energy efficiency** to harness its competitive benefit for Albania's economy. Together with the expansion of renewable energy, energy efficiency minimises the cost of

energy to the economy while creating a sustainable and climate-resilient energy market in which energy demand is more muted both with respect to future growth and variability over time.

- **Aggressively pursue regional integration and market coupling**. International trade is a great source of market pressure that will support a fair, transparent, and non-discriminatory market and thus lead to economic gains for both the energy market and wider economy.
- **Design and implement a greenhouse gas pricing mechanism that eventually transforms into a greenhouse gas certificate market/trading scheme** in line with international good practice and as stipulated in the new draft of the Law on Climate Change. This step should support efforts to achieve a sustainable and climate-resilient energy market that is efficiently decarbonised in a competitive and efficient manner using economic market forces.

### Box 20.15. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated independent of the electricity market price (Banja et al., 2017, p. 15[208]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (CEER, 2018, p. 12[209]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (European Commission, 2013, pp. 12-13[173]). The latter has been a problem especially as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (European Commission, 2013[173]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (European Commission, 2013, p. 8[173]).

The European Commission suggests using a feed-in premium scheme in combination with the following good practice recommendations (European Commission, 2013[173]):

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable project and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

However, the Council of European Energy Regulators reports that in 2016/17, 17 of the 27 European Union member countries still used some form of feed-in tariff, although mainly for small projects, while around 16 used feed-in premiums, including to complement feed-in tariffs (European Commission, 2014[210]).

For further and more detailed exploration of renewable energy subsidies and best practice please see the sources below. Meanwhile, for more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.

Source: (Banja et al., 2017[208]), "Renewables in the EU", https://e3p.jrc.ec.europa.eu/sites/default/files/documents/publications/kjna29100enn.pdf; (CEER, 2018[209]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (European Commission, 2013[173]), European Commission guidance for the design of renewable support schemes, https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (EUR-Lex, 2014[179]), *Guidelines on State Aid for Environmental Protection and Energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Environment policy (Dimension 13)

### *Introduction*

Albania has only slightly improved its performance in the environmental policy dimension (Figure 20.1). Its overall score has improved from 1.8 in the 2018 Competitiveness Outlook to 1.9 in the 2021 assessment, with some progress noted in the natural asset base sub-dimension. Albania's scores in the resource productivity and environmental quality of life sub-dimensions, as well as its average score, are lower than the regional averages (Table 20.21). Albania ranks fifth of the six Western Balkan (WB6) economies for environmental policy.

**Table 20.21. Albania's scores for environment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 13.1: Resource productivity | 1.8 | 2.0 |
| | Sub-dimension 13.2: Natural asset base | 2.2 | 2.1 |
| | Sub-dimension 13.3: Environmental quality of life | 1.8 | 2.3 |
| **Albania's overall score** | | **1.9** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 13.1: Resource productivity*

As a Non-Annex-I signatory to the United Nations Framework Convention on Climate Change (UNFCCC) and its Paris Agreement, and as a party to the Kyoto Protocol, Albania has committed to an 11.5% reduction of carbon dioxide ($CO_2$) emissions compared to the baseline for the period 2016 to 2030, and to limit global warming. A GHG emissions inventory exists online and emission reduction targets have been set, but the target of a 38% share of renewable energy sources in gross final energy consumption by 2020 has not been attained.

**Climate change mitigation and adaptation policies** have nevertheless advanced in Albania since the last assessment. Most notably, the Law on Climate Change was adopted in January 2021 and establishes the institutional framework and rules for monitoring, reporting and verifying greenhouse gas emissions, in line with EU regulations and *acquis*. It provides, among others, a legal basis for adopting a National Energy and Climate Plan (NECP) for 2021-2030. Moreover, a Strategy on Climate Change, and related Action Plans on Mitigation and Adaptation (2019-2030), were adopted in 2019, and represent a general cross-cutting strategy with policy objectives and concrete actions to: 1) reduce GHG emissions; and 2) make Albania resilient to climate change. The strategy focuses on energy, transport, agriculture, land use and forestry, with a revised 32% renewable energy target by 2030 (European Commission, 2020[19]). As nearly two-thirds of Albania's total $CO_2$ emissions come from transport (60% in 2014), with road transport by far the main contributor, Albania has made efforts to decrease the sector's environmental footprint through the Sustainable Transport Plan (2016-2020),[166] adopted to help meet the targets of reducing energy consumption and improving overall sustainability. Other sectoral strategies aimed at mitigating climate change include the Inter-sectoral Strategy for Agriculture and Rural Development (2014-2020), which is expected to help tackle climate change by promoting resource efficiency through investments in energy-saving physical assets in agriculture. In addition to climate change mitigation measures, this strategy aims to reinforce adaptation to climate change (e.g. through measures on landscape restoration and reforestation).

Albania has started updating its Nationally Determined Contributions (NDCs) for the period after 2020, for which it received technical expertise and capacity building from the NDC Partnership and its Climate Action Enhancement Package, which Albania joined in 2019. In parallel to this, the economy has started

developing its National Energy and Climate Change Plan (to be finalised in the first trimester of 2021), which will be aligned with the updated NDCs, the Strategy for Climate Change Mitigation and Adaptation and the new law on Climate Change. Measures to align the legislative framework with the EU *acquis* on establishing monitoring and reporting mechanisms for GHG emissions have been undertaken (mostly through the new Law on Climate Change). Harmonisation measures covering GHG emission reductions, especially the EU Emissions Trading System (ETS), are planned under the new law but have not yet been undertaken. As an UNFCCC signatory, Albania has submitted three National Communications (in 2002, 2009 and 2016) and was preparing the Fourth National Communication and the First Biennial Update Report at the time of drafting; these are the only monitoring mechanisms existing in this field.

As far as climate change adaptation is concerned, some improvements have been noted since 2017. Although major climate change-related risks have not been identified further since the Third National Communication, a Disaster Risk Reduction strategy was being prepared in 2021. Albania has put efforts into raising awareness and increasing capacity at central and local levels to adapt to climate change. Several projects are currently being implemented, such as a school programme that teaches environmental issues, recycling, climate change, renewable energy and similar; and a reforestation project (Clean and Green), which aims at planting 20.2 million seedlings by the end of 2020. Actions have also been taken to establish early warning systems for water-related disasters.[167] However, other natural hazards, such as earthquakes,[168] have not yet been taken into consideration.

**Circular economy** legislative and policy frameworks are still non-existent in Albania, although some positive developments on recycling have been recorded over the last couple of years. The recycling rate for municipal waste has grown slightly, from 17.2% in 2016 to 18.5% in 2018 (INSTAT, 2020[211]), which is the highest in the Western Balkans region. However, 76.4% of waste is landfilled. The new National Waste Management Strategy and its Action Plan (2020-2035) envisage a gradual transition from a linear to a circular economy by encouraging waste diversion through waste reuse and recycling. The government also plans to revise the legislative framework in this area, such as through the new Law on Extended Producer Responsibility, which is planned to be adopted during 2021 and which will promote a circular economy, in particular through establishing markets for secondary materials. In addition, Albania was planning to ban the production, import and use of plastic bags by the end of 2020. COVID-19 has delayed this but it is expected to be finalised in 2021.

**Municipal waste management** is generally underdeveloped in Albania. Municipal waste generation per capita (462 kg) is still lower than in the EU (492 kg per capita in 2018). It is collected in most cities and towns, but rarely in rural areas (Eurostat, 2020[212]; EEA, 2018[213]). In addition, waste is primarily deposited at disposal sites that do not comply with any sanitary standards, and are sometimes alongside rivers (UNECE, 2018[214]). Even when the waste is disposed of at one of the three existing sanitary landfills, it is rarely treated first.

Albania's legislative framework covers all types of waste, whereas the Decisions of Council of Ministers (DCMs) cover specific waste streams. No major changes have been recorded to the legislative framework since 2017. Two main strategy documents have been adopted since the last assessment, in 2019 and 2020 respectively: the aforementioned Waste Management Strategy (WMS) with related Waste Management Plan (WMP) (2020-2035) and the National Sectorial Plan for Solid Waste Management (NSPSWM) (2019-2035). The WMS is a result of the revised National Waste Management Strategy and National Waste Management Plan (2010-2025), whose main measures and targets have largely not been implemented or achieved. The reason lies in its ambitious goals (e.g. increase the amount of waste collected by local authorities that is recycled or mixed to 55% by 2020, starting from a very low base and with underdeveloped separation-at-source infrastructure) and the overall lack of staff and financial sources to ensure fuller enforcement. The main objectives of the WMS are to bring the legal framework into line with EU directives, increase government capacities at national and local level and mobilise finance to achieve the targets – mainly through public-private partnerships (PPP). Its action plan specifies measures, timelines and budget, and monitoring and evaluation are set to be conducted annually. The NSPSWM is

a detailed investment plan for local and regional solid waste management infrastructure (waste collection and transport, reduction and recycling of waste, treatment and disposal facilities) for the period 2019-2032.

The government estimates that about 200 large uncontrolled dumpsites and various small sites were in operation in 2020 in Albania. The WMP plans to replace these with 10 regional controlled landfill sites by 2028.[169] According to the NSPSWM, Albania was constructing the landfill of Maliq/Korca at the time of drafting. Like the other WB economies, investment in waste collection and treatment infrastructure has largely been donor-supported. One incinerator plant with energy recovery has been built in Elbasan since the last assessment, and two incinerators with energy recovery were being built in Fier and Tirana (to be finalised by mid-2021), financed through public-private partnerships. However, the construction of new incinerators poses concerns in terms of compliance with the EU waste *acquis,* including the waste hierarchy principle and the recycling targets[170] (European Commission, 2020[19]). The government's shift in prioritisation towards a waste incineration strategy has weakened the recycling industry (only one of the five recently established recycling plants is currently operational) and is seen by local stakeholders as a way to develop a more lucrative waste management industry.[171] Measures are taken to combat unregulated burning and illegal dumping of waste and inspections are normally carried out following a plan approved at the beginning of the year. However, the inspectorate is being reorganised and this mechanism no longer seems to work.

Waste collection and treatment services are funded from waste collection fees, but their amount remains low and insufficient for this purpose. A DCM on the methodology to calculate waste management costs from 2018 specified that each municipality can calculate and change the tariffs and costs. As a result, waste tariffs have increased in certain municipalities, leading to an improved waste service. However, the most vulnerable social groups have not received any kind of special treatment in terms of fees. Waste separation at source is almost non-existent in Albania,[172] despite a legal obligation to do it. The 2014 DCM on the separate collection of waste at source states that local authorities must organise this using a three-bin system (UNECE, 2018[214]). The new WMS (2020-2035) envisages its systematic introduction in the medium to long term.

### *Sub-dimension 13.2: Natural asset base*

Albania is a relatively water-rich country, harbouring far larger per-capita quantities of renewable internal freshwater resources than its WB peers (9 362 $m^3$ of water annually) (World Bank, 2017[215]). Major water demand comes from agriculture – mainly for irrigation (64% in 2017), followed by households (20%) and industry (16%) (Düll et al., 2018[120]). Almost all of Albania's nationally produced electricity comes from hydropower. In addition to the big hydropower plants (HPPs) situated within the Drin, Mati and Vjosa river basins, there are around 70 small HPPs, 38 of which have been operational since 2018 (UNECE, 2018[214]). It is important to highlight that water is not consumed in the process of hydropower generation (i.e. water is extracted but it returns to its source) and the overall water balance remains unchanged.

The legislative framework for **freshwater management** was amended in 2018. Amendments to the basic legal act in this field – the Law on Water Resources Integrated Management – delegated new responsibilities to the Water Resource Management Agency (established under the Prime Minister's Office), which previously served as the technical secretariat of the National Water Council. The provisions of this law apply to all surface and groundwater, prevention of pollution at source, emissions control and water quality standards, as well as the prevention of and protection against flood risks. However, mapping of hazards and flood risks is still at an early stage. Moreover, the recently approved DCM in December 2020 on the Content, Development and Implementation of the National Strategy of Water Resources Management, Water Basin Management Plans and Flood Risk Management Plans improved the transposition of EU directives on water policy, chemical analysis and monitoring of water status, the protection of groundwater and management of flood risks.[173] Obtaining licences for constructing hydropower plants is regulated by the law as well, which requires detailed environmental impact

assessments and strategic impact assessments to be conducted. However, it seems that this procedure has been largely circumvented: no cumulative impact assessment of HPPs in protected areas has been made and there are also cases in which licences for HPPs were given before an EIA report was issued, or of the EIA report not being taken into account when issuing a licence (UNECE, 2018[214]).

As for the policy framework, Albania adopted the new National Strategy for Integrated Water Resources Management (NSIWRM) (2018–2027) in 2018, which serves as the overarching framework document for water management. NSIWRM covers five pillars: 1) improving water quality; 2) enhancing water quantity; 3) managing water risks; 4) building an information system on water; and 5) efficient and effective water management. The strategy is however not aligned with the sectoral strategies, such as agriculture or irrigation. Activities to raise awareness of water-related risks are also envisaged in the NSIWRM. Implementation began in 2019 through a three-year action plan. However, many of the activities foreseen in the plan lack financial support and their timelines are unrealistic. A number of bodies[174] are responsible for water management in Albania and vertical and horizontal co-ordination works well. Nevertheless, they all lack the financial and human resources to conduct their roles, and capacity-building is not organised regularly.

Some progress has been made on river basin management plans. A river basin management system is in development and there is co-operation with neighbouring economies, although this co-operation should be renewed. The Special Commission on Transboundary Water Management, chaired by the Deputy Minister of the Ministry of Foreign Affairs was established in December 2019. In February 2020, the National Water Council endorsed the Drini-Buna and Seman river basin management plans and started the procedure for their adoption by the Council of Ministers.

Even though some data and projections are collected on water demand from agriculture, industry (including energy) and households, there are still no modelling tools for the realistic projection of water demand, especially in climate change scenarios. Therefore, these are not guiding decisions on handling competing uses now and in the future. Water information systems and databases have been created but are not regularly updated. Data on water risk management seem not to be collected, even though there is an obligation to publish them in the Water Cadastre – however, technical issues impede its appropriate functioning.

Albania's **biodiversity and forest management framework** has been slightly modified since the last assessment, with the adoption of the Forest Policy Document (2019-2030) being a major change (discussed below). The Law on Protected Areas was amended in 2018 to put greater emphasis on the planning and development of these areas, and the Law on Biodiversity was amended in 2020 to increase alignment with the EU Regulation on compliance with the Nagoya Protocol.[175] The Biodiversity Strategy is valid until 2020 and a new one, covering the period 2021-2030, was being developed at the time of drafting. There is no implementation report as such, but Albania's Sixth National Report to the Convention on Biological Diversity (CBD) assesses the implementation of the biodiversity strategy up until mid-2019, including progress towards the Aichi targets (Box 20.16). Programme outputs are monitored at the end of each year, in line with the medium-term budget process co-ordinated by the Ministry of Finance and Economy. Moreover, a DCM created a special fund for protected areas in January 2021.

The biodiversity strategy is evaluated annually in the framework of the implementation of the National Sustainable Development Goals. Systematic monitoring of biodiversity takes place, led by the National Environment Agency (as defined by the 2009 DCM on environmental monitoring). Since the last assessment, the government has developed a national platform for biodiversity (BioNNA), which is currently the largest aggregator of primary biodiversity data in Albania and is planned to grow further by aggregating new datasets. A national database on wild fauna species data (WIMS) has also been created in 2018.

### Box 20.16. The status of the Aichi 2020 biodiversity targets in Albania

The CBD's Strategic Plan for Biodiversity 2011-2020, including the Aichi Biodiversity Targets, provided an overarching framework on biodiversity – not only for the biodiversity-related conventions, but for the entire United Nations system and all other partners engaged in biodiversity management and policy development. Parties agreed to translate this overarching international framework into revised and updated national biodiversity strategies and action plans within two years, which are intended to define the current status of biodiversity, the threats leading to its degradation and the strategies and priority actions to ensure its conservation and sustainable use within the framework of the socio-economic development of the country. There are 20 Aichi biodiversity targets grouped around 5 strategic goals: A: Address the underlying causes of biodiversity loss by mainstreaming biodiversity across government and society; B: Reduce the direct pressures on biodiversity and promote sustainable use; C: Improve the status of biodiversity by safeguarding ecosystems, species and genetic diversity; D: Enhance the benefits to all from biodiversity and ecosystem services; and E: Enhance implementation through participatory planning, knowledge management and capacity building.

Albania's Sixth National Report to the CBD notes several areas of progress in implementing the Biodiversity Strategy. Most notably, the status of Aichi 2020 biodiversity targets in Albania, in line with the national targets, is as follows:

- Protected area coverage: Albania has already exceeded the Aichi target of 17% of its terrestrial area being protected, as the coverage has reached 18.5%. More limited progress has been made on marine and coastal protected areas (3%), with the target being 6% by 2020.
- A national legal framework for the Nagoya Protocol on access and benefit sharing of genetic resources has been approved.
- Management plans for protected areas have been approved and implemented.
- An endangered species action plan has been adopted.

Source: (CBD, 2020[216]), *Aichi Biodiversity Targets*, https://www.cbd.int/sp/targets; (Ministry of Tourism and Environment of Albania, 2019[217]), *Sixth National Report to the Convention on Biological Diversity of the Republic of Albania*, https://www.cbd.int/doc/nr/nr-06/al-nr-06-en.pdf.

Although forests make up a smaller share of the total land area of Albania (28%) than its regional peers (42%), the Ministry of Tourism and Environment estimated that almost one-third of forests (8.2%) were of high nature value[176] in 2018 (Düll et al., 2018[120]). The new Law on Forests was adopted in 2020 and established the organisation and functioning of the National Forest Agency. Moreover, the new Forest Policy Document (2019-2030) aims to make forest management more effective, mainly through improving the institutional framework. This is particularly important as municipalities have been responsible for sustainable management of forests since 2016, but they receive little assistance from the government, which impedes their effectiveness. Monitoring of the forest document's results is set to be conducted annually and conclusions should be shared with the relevant stakeholders – however, no reports had been produced at the time of drafting.

The national forest inventory system was finalised in 2021 and a national forest programme was being established at the time of drafting. There is no system in place for systematic monitoring of the condition of forests – this is conduced only indirectly through the climate change adaptation and mitigation actions. The National Real Estate Register has been established through the Immovable Property Registration Offices. This means it is now possible to register forests on the unified data system (forests in the southern part of Albania are currently being registered). The Law on Forests regulates and oversees forest fire prevention measures and sets clear penalties for illegal logging.

**Land-use legal and policy frameworks** remain underdeveloped in Albania and have not advanced since 2017. The main strategic document is still the National Strategy for Land Consolidation (2016), but no comprehensive land-use planning policy has been developed to date.

Various national and local bodies are responsible for land-use management, but they all lack qualified staff and financial resources. So far, horizontal and vertical institutional co-operation seem to be functioning well, although there are no permanent co-ordination bodies for spatial planning. No capacity building or training have been conducted for the responsible bodies.

Some of the major land-use issues in Albania relate to outdated building codes and illegal construction. This is a problem across the entire territory, but particularly the coastal areas. Tackling these challenges is especially important in light of the economy's proneness to geophysical hazards, such as earthquakes. In addition, the legislation on strategic investment raises concerns for the protection of biodiversity, as it may allow large tourism and industrial investments in protected areas, e.g. the proposed airport in the Vjosa-Narta area[177] (European Commission, 2020[19]). On a positive note, the Agency for Territorial Planning and Development developed local plans in 2018 together with local municipalities. These aim for the sustainable development of the territory and the rational use of land. Priority was given to the preservation of the agricultural land fund and only a small area of agricultural land was planned for the construction of agricultural facilities.

Key indicators related to land-use management are not frequently collected nor are they available online. In addition, they are not georeferenced or harmonised across government bodies like property tax and forest management.

### *Sub-dimension 13.3: Environmental quality of life*

**Air quality** in Albania has improved over the last decade and is the best in the WB6. Albania's mean annual exposure to $PM_{2.5}$ of 18.2 µg/m$^3$ is the lowest in the WB region,[178] which averaged 25.77 µg/m$^3$ in 2016. However, it is still higher than the EU and OECD averages (13.1 µg/m$^3$ and 12.5 µg/m$^3$ respectively in 2017) (EEA, 2020[29]) (World Bank, 2017[30]). Air pollution is still a concern, especially the high concentrations of PM and carbon monoxide (CO) in winter months, largely stemming from the predominant type of residential heating (i.e. wood and coal). Moreover, levels of nitrogen oxides (NOx) exceed recommended limits as a result of vehicle emissions, especially in the capital city and other urban areas. Local experts report that emissions from incomplete combustion by vehicles is an important concern, exacerbated by the large share of old or malfunctioning engines and missing catalytic systems, mostly caused by illegitimate vehicle check-up procedures.

Some changes have been made to the legislative and policy framework in Albania since the last assessment. The main Law on Protection of Ambient Air Quality entered into force in July 2018, harmonising further the national legislation with the EU *acquis*. A new DCM on emissions from mobile sources has also been adopted, aiming to strengthen air pollution measures and reduce emissions from motor vehicles. In 2019, the government approved the National Plan on Air Quality Management (NPAQM) (2019-2026), which along with the National Strategy on Ambient Air Quality (NSAAQ) (2014-2024), represent major strategic documents in this area.

The NPAQM aims to restore air quality in areas which exceed limit values of air pollutants or where there is a high risk of exceeding them. It focuses mainly on measures to contain and reduce emissions from traffic and industry. It does so by dividing the territory into three air quality zones and outlining specific measures for each of them:

- Zone A (focusing on traffic pollution): the agglomerations of Tirana and Elbasan, where air quality is endangered, and it is necessary to ensure compliance with the daily and annual limit values for particulate matter ($PM_{10}$ and $PM_{2.5}$) and nitrogen dioxide ($NO_2$).[179]

- Zone B (focusing on industrial pollution): the municipal units of Fieri, Durrësi, Vlora, Shkodra, Korça, Patosi and Ballshi, where air quality standards for at least one pollutant are already exceeded, or there is a high risk of exceeding them due to industrial pollution and traffic.
- Zone C: the rest of the country, where air quality standards are unlikely to be exceeded (91.8% of the Albanian territory and 65% of the total population).

However, the NPAQM mostly focuses on transport measures. It does not provide for improving the monitoring system or making it fully and continuously functional (European Commission, 2020[19]). Both the NPAQM and NSAAQ envisage preparing local air quality plans and short-term action plans, but not until 2021. When it comes to monitoring implementation, this is not conducted regularly and it is not clear how frequently it will be done.

There are several institutions[180] dealing with air quality, but they all suffer from limited administrative and technical capacity and financial resources, primarily for monitoring and inspections. There is also a lack of relevant legal acts regulating co-ordination, implementation and immediate action if air pollution safe thresholds are exceeded. Thus immediate action is not ensured. Urban air quality is monitored by the National Environment Agency (NEA), mostly through a network of six fixed automatic stations, in addition to one mobile station in Tirana. However, lack of funding means that air monitoring equipment is not being maintained or calibrated, and all stations have been turned off (European Commission, 2020[19]). Furthermore, the monitoring process does not cover air quality assessment in rural or rural background locations. Current ambient air quality monitoring practices, including data collection and reporting, are not fully in line with the EU requirements. A national air emission inventory is prepared each year and the data compiled into annual reports as part of the State of the Environment Report, published on the NEA's official website.

Management of the **water supply and sanitation system** remains undeveloped in Albania. Although some improvement has been made in the water supply coverage of population in urban and rural areas since the last assessment, the situation is still far from satisfactory. The overall sewerage coverage remained about 51% in 2018, with a significant discrepancy between urban (79.8%) and rural areas (only 15%) (UNECE, 2018[214]). Wastewater treatment plants cater for only about 15% of the population, and face key concerns such as lack of licensing and tariffing for wastewater treatment, insufficient operation and maintenance and negative environment impact due to underdeveloped networks and connections (European Commission, 2020[19]). Despite the construction of new urban wastewater treatment plants (eight were built in 2016 and three were being built at the time of drafting), lack of funding and limited technical capacities mean three are idle, and their long-term operational arrangements are unclear. Changing investment priorities as a result of the COVID-19 pandemic might reduce funding further, especially as the main sources of funds for infrastructure are the state budget (which is largely insufficient as underlined by the government) and donor support, though to a much lesser extent. The current water service fees are inadequate to cover or complement infrastructure investments as well as water supply and services, although these are partly being funded by transfers from the municipalities and taxes.

The legislative and policy framework was being developed at the time of drafting: a Law on Water Supply and Sewerage Sector and the new Sectoral Strategy for Water Supply and Sewerage Services (SSWSSS) (2020-2030). The latter aims to improve the quality of water supply and sewerage data; improve access to water supply and sewerage (WSS) services for the population; strengthen the financial sustainability and affordability of WSS services; build WSS workforce capacities; and improve the governance and regulatory framework of the sector. Although the legislative and policy framework are not fully aligned with the EU *acquis* in the area of wastewater management, monitoring mechanisms are envisaged by the MIE and the Monitoring and Benchmarking unit and concrete objectives, budget, measures and timelines have been set.

No major changes to the **industrial waste management** legislative framework have been made since the last assessment. However, the newly adopted Waste Management Strategy (2020-2035) tackles industrial

waste management as well (see Sub-dimension 13.1: Resource productivity). Alignment with the EU legislation on industrial pollution and risk management is still at an early stage (European Commission, 2020[19]).

By law, any chemicals produced in or imported to Albania need to be registered on an electronic chemical register. However, the national chemicals register has not been established yet as the responsible institution – the Chemicals Office – only became operational in July 2020 and the secondary legislation defining the procedures for establishing and maintaining the register is not yet in place. A Pollutant Release and Transfer Register (PRTR) system has been functioning since 2015 and is maintained by the NEA. As regards managing and controlling industrial risks and accidents, the Seveso-III Directive (Directive 2012/18/EU) has not been fully transposed yet.

There is no policy or legislative basis for soil protection, or the identification and management of contaminated sites in Albania and very little has been done to identify and clean up contaminated sites since the last assessment. There are plans for cleaning up the old PVC plant in Vlora and improving the capacities for storage and treatment of the Centre of Dangerous Chemicals Collection and Treatment in Elbasan, but their realisation might be impeded by budgetary constraints.

### *The way forward for environment policy*

Definite progress has been made in Albania since the last assessment, especially in the legal and policy framework for climate change, biodiversity and air pollution. However, performance on a number of dimensions needs to be improved further and planned activities need to be fully implemented. Some of the priorities are as follows:

- **Direct more investment into improving wastewater systems and treating more wastewater.** Although Albania has taken some action to renovate and update its water supply and sanitation system, the activities are limited in scope and decisions on where to invest have not always been supported with concrete data. It is therefore important to conduct a clear mapping of the situation and identify key investment priorities. The government should try to finance these projects as much as possible from the domestic budget and higher water tariffs (at rates that take into account the needs of poor and vulnerable groups in the population). Where donor support is provided, the government should make sure these finances flow regularly to ensure the sustainable maintenance of the water supply and sanitation system.

- **Develop adequate capacities to forecast, monitor, warn and inform the population of the risks from multiple hazards and ensure suitable and timely responses to hazardous events**. Albania is one of the most at-risk economies in Europe from multiple hazards. The 2019 earthquake revealed the weaknesses of its systems, hence its resilience to hydro-meteorological and geophysical hazards urgently needs to be improved (Reliefweb, 2017[218]). Albania should invest in modern equipment, focus on guidance and clear procedures as well as on building skilled human resources to efficiently and effectively respond to hazards. Box 20.17 gives examples from Turkey and Australia.

- **Develop a comprehensive land-use policy framework to ensure effective land-use planning, preserve land and foster resilience to natural hazards, such as earthquakes**. The government of Albania lacks an all-inclusive land-use policy framework to provide a clear direction in this area. It should focus on modernising the building codes, updating seismic hazard maps and combatting unregulated and illegal building activities. As for the latter, measures such as creating a register of buildings without permits and conducting legalisation procedures (where possible) might be taken into consideration.

### Box 20.17. Managing natural disasters: Case studies from Turkey and Australia

The Marmara Earthquake in 1999 shed light on **Turkey's** challenges in dealing with natural disasters. With the establishment of the Disaster and Emergency Management Authority (AFAD) in 2009, Turkey has shifted its disaster management approach from crisis management to risk management. AFAD is in charge of preventing disasters and reducing disaster-related damage in Turkey. It plans and co-ordinates post-disaster response and promotes co-operation among various government agencies. It operates through a central agency and its 81 provincial branches, which manage local emergency action. AFAD also has 11 regional special search and rescue brigades and 23 regional logistics warehouses. AFAD's budget comes from the central government and special international emergency and humanitarian funds. AFAD's Strategic Plan acknowledges the growing risks posed by climate change. Disaster risk management and climate change adaptation complement one another. Therefore, they have been integrated into different levels of governance and across sectors. As part of building capacity for managing climate-related natural hazards, AFAD is identifying best practices around the world and also working to learn lessons learned from recent floods in Turkey.

With the goal of building local capacity and capability, the state of **South Australia** has formed 11 metropolitan and regional Zone Emergency Management Committees responsible for strategic emergency management planning within their zone. Each of these committees is chaired by local government and includes additional local government representation as well as representatives from the South Australian Police, State Emergency Service and a dedicated Zone Recovery Planner.

A key activity undertaken in each of the zones is to develop all-hazard risk studies (one per zone) with a comprehensive assessment of risks. These follow a standardised zone emergency management planning framework, based on the International Standard for Risk Management and National Emergency Risk Assessment Guidelines. As part of these all-hazards risk studies, a number of risk assessment workshops were conducted involving stakeholders such as state government agencies, key experts and civil society organisations from the respective zones) This ensures that accurate and relevant information is collected and partnerships among local stakeholders are created, further reinforcing community resilience.

The zone emergency management planning framework and its assessment tools are linked with the state emergency risk assessment processes and registers, as well as those of local government. This consistent measurement of risks helps in information and data sharing, contributing to better informed communities.

Source: (OECD, 2019[219]), *Environment Performance Review; Turkey*, https://www.oecd-ilibrary.org/environment/oecd-environmental-performance-reviews-turkey-2019/climate-change_9789264309753-11-en; (Parliament of Australia, 2020[220]), *National Emergency And Disaster Response Arrangements in Australia: A quick guide*, https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1920/Quick_Guides/NationalEmergencyDisasterManagement.

## Agriculture policy (Dimension 14)

### *Introduction*

Albania has slightly improved its performance in the agriculture dimension. The economy's score has increased to 2.8 in the 2021 assessment (Figure 20.1), with the most progress made in agro-food system capacity (Table 20.22). However, Albania still scores lower than the other Western Balkan economies averages in Sub-dimension 14.4: Agricultural innovation system.

**Table 20.22. Albania's scores for agriculture policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 3.2 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 3.0 | 2.9 |
| | Sub-dimension 14.3: Agriculture support system | 2.8 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 2.0 | 2.6 |
| **Albania's overall score** | | **2.8** | **2.7** |

### *State of play and key developments*

Agriculture in Albania is an important economic industry, accounting for 20.3% of total GDP (Figure 20.15) and almost 41% of employment (INSTAT, 2020[134]). The sector remains the largest provider of employment for women, with 51.3% of employed women working in agriculture compared to 35.2% of men. The production of fruit and vegetables represents 20% of agriculture production value; however, it represents 36%[181] of total agricultural exports and has been consistently increasing over the past decade (INSTAT, 2020[221]).

Favourable climatic conditions and continuous improvement to regulatory standardisation means that Albania's agricultural products are becoming more competitive in regional markets. Fresh vegetable production in 2019 was 832 732 tonnes, up by 7.9% from 2018. Vegetable production in greenhouses represented 21.3% of total vegetable production in 2019, up 5.5% from 2018.

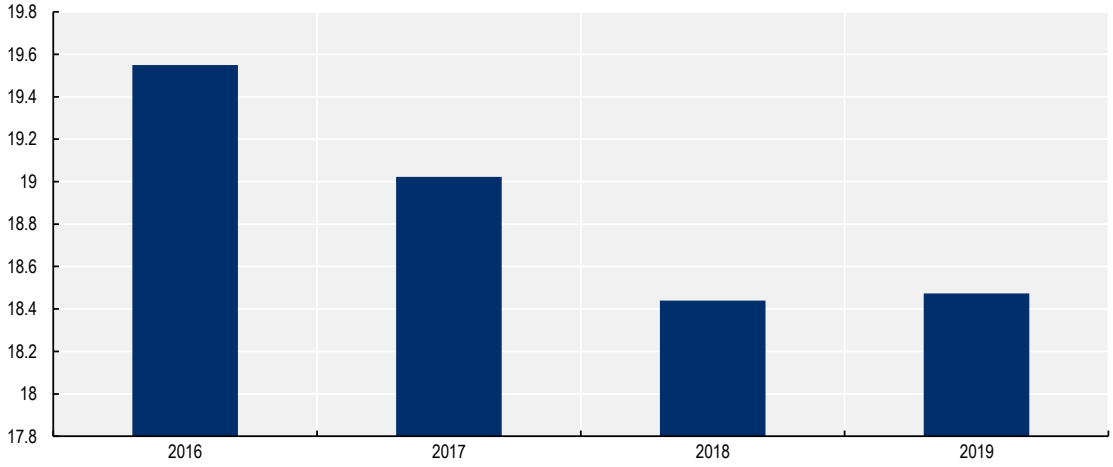
Olive production was heavily subsidised by the state in the period 2009-15, and consists of around nine million trees. This made Albania the leading olive oil producer in the Western Balkans, though its current production still represents only 0.6% of EU production levels.

Small ruminants are another important sub-sector in Albania. The annual milk production from sheep and goats amounts to about 87 000 tonnes for each category, although with some differences in productivity per head. Most meat and milk are destined for the local and national market. The main products, other than processed milk, are cheese, cottage curd and butter.[182]

Fishery and aquaculture production has increased in the period 2014-19, with the total quantity of fish increasing from 11 022 tonnes to 15 011 tonnes. Sea fishing production has remained stable, but aquaculture production increased from 1 500 tonnes to 5 229 tonnes.

## Figure 20.15. Agriculture's contribution to GDP in Albania (2016-19)

(in %)




Source: (INSTAT, 2020[221]), *Agriculture Statistics 2019*, http://www.instat.gov.al/media/7202/press-release-agriculture-statistics-2019.pdf.

StatLink https://doi.org/10.1787/888934255418

### *Sub-dimension 14.1: Agro-food system capacity*

Albania's **rural infrastructure policy framework** involves several comprehensive programmes. Its National Regional Development and Cohesion Programme was harmonised with EU standards in 2019 and continues to address the needs of the sector and its producers. Its approach includes policies and strategies at the national level, planning at the regional level, and implementation of a seven-year programme. The current Rural Development Programme 2014-2020 was updated in 2019 to harmonise with EU standards.

The Albanian Development Fund (ADF) continues to implement large-scale rural infrastructure programmes The Local and Regional Infrastructure Programme (2019-2021) aims to promote socio-economic development through regional infrastructure projects focusing on improving tourism, accessibility between communities, access to basic services, and encouraging co-operation among local government units. Meanwhile, the Local Roads Connectivity Project (2018-2022) is improving access to select agricultural and tourism centres and strengthening municipalities' capacity to manage their road assets, in turn allowing farmers better access to markets and agriculture processing centres. The funding of regional projects managed by ADF, apart from the national budget, is heavily supported by a number of financial institutions through loans and donations, namely the World Bank, Instrument for Pre-Accession Assistance, Central European Bank, International Bank for Reconstruction and Development, and the European Investment Bank.

The ADF has developed a strong administrative capacity for planning, implementation and monitoring of programmes and provides regular and timely annual reports on programme monitoring which are submitted to all national institutions. However, access to information for farmers, such as market developments, technical options and weather remains limited. Thus information sharing capacity needs improvement.

Irrigation infrastructure in Albania is disorganised and inefficient due to a decentralised system with an unclear division of responsibilities. By the end of 2019, irrigation capacity had only reached 245 000 hectares (ha) of a target 360 000 ha by 2029. This represents an improvement of around 20 000 ha since the end of 2017 when irrigation capacity was at 225 000 ha.

However, modernising irrigation infrastructure has been recognised as one of the top priorities of the Government of Albania. In 2018, the Strategy for Irrigation and Drainage in Albania (2019-2031) was prepared by the Ministry of Agriculture and Rural Development (MARD) in consultation with stakeholders

and with technical assistance from the Water Resources and Irrigation Project (WRIP) financed by the World Bank. The strategy identifies the main strengths, weaknesses, opportunities and threats to irrigation, drainage, dams and reservoirs, and flood protection. It includes an action plan that lists the activities, implementation responsibilities, implementation timeframe, expected results, and performance against strategic objectives and costs.

In terms of **the irrigation policy framework**, the management of irrigation and drainage systems, including building capacity, was transferred from national to municipal control in 2016. The Water Users Organisations (WUOs) that were responsible before 2016 for the operation and management of secondary and tertiary canals under the national administration are now inactive as they were unable to manage the water systems effectively due to a lack of knowledge, technical skills and financing. The Law on Administration of Irrigation and Drainage has therefore only deemed WUOs as optional structures for delivering irrigation services if the municipalities decide their involvement is necessary. If WUOs demonstrate that they can function satisfactorily, both by technical and financial standards, then municipalities can transfer management responsibilities to them. For the period 2016-20, municipalities were supported with around EUR 42 million, 84% of which was allocated for rehabilitating irrigation infrastructure. The other 16% provided each of the 61 municipalities with an excavator to help them maintain irrigation and drainage channels.

Irrigation infrastructure is monitored quarterly by the MARD and the results have a large impact on policy making and its improvement. For example, the decision to transfer part of the irrigation and drainage responsibilities to municipalities was made based on these assessments.

The current **agricultural education system** in Albania remains underfinanced and the number of agriculture students continues to decrease due to a lack of reach and quality of vocational training programmes. The education policy framework is based on the National Strategy for Employment and Skills 2014-2020. The strategy describes the current challenges, strategic areas and proposed measures for creating a skilled workforce that can respond to market demand (including in agriculture). While the strategy foresees a number of measures to address agricultural development bottlenecks, no specific measures have been dedicated to improving agriculture education and training.

Currently, there are very few agricultural vocational schools and the number of agricultural vocational high school graduates is decreasing (Table 20.23). The Agricultural University of Tirana and the Faculty of Agriculture at the University of Korça are the only higher education agricultural institutions in Albania. While the majority of university graduates still work in agricultural and related sectors, the number of students continues to decrease. In 2019, the number of students enrolled in the first year of agriculture studies was 30% less than in 2017 (Figure 20.16).

### Table 20.23. Agricultural vocational training institutions in Albania

| Vocational training focus | Number of schools |
|---|---|
| Crop production | 8 |
| Agri-business | 5 |
| Veterinary science | 3 |
| Agricultural machinery | 2 |
| Animal production | 1 |
| Silviculture, forestry and furniture production | 1 |

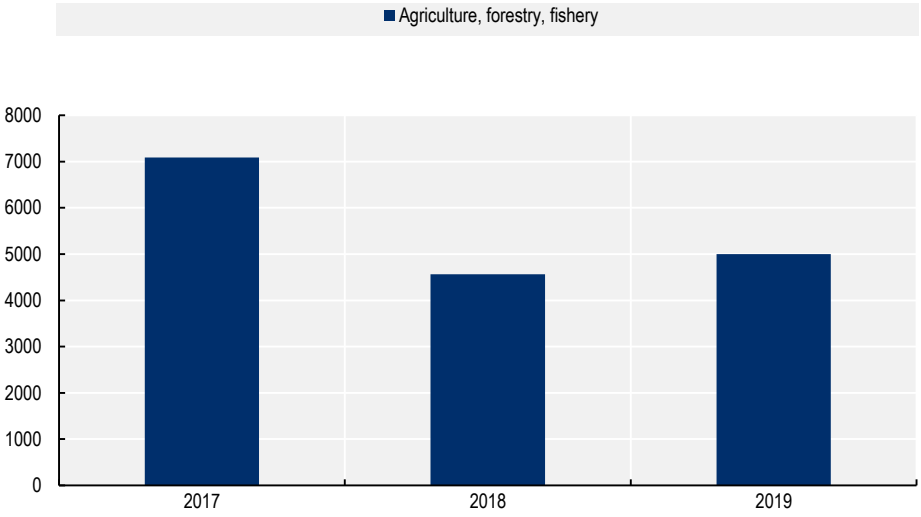
Source: (INSTAT, 2020[221]), *Agriculture Statistics 2019*, http://www.instat.gov.al/media/7202/press-release-agriculture-statistics-2019.pdf.

The integration between vocational education and training systems is still weak and the curricula offer little scope for practising the skills learned, a crucial component of agricultural work. The education and training system remains underfinanced, offering limited incentives for businesses in offering training places. Although the agriculture sector largely employs the working poor and low-skilled workers, the vocational

education and training services do not reach rural areas, where education levels are generally lower than urban areas and where most of the Albanian population currently resides.

### Figure 20.16. Enrolments in the first year of agriculture degrees (2017-19)

Number of students




Source: (INSTAT, 2020[221]), *Agriculture Statistics 2019*, http://www.instat.gov.al/media/7202/press-release-agriculture-statistics-2019.pdf.

StatLink https://doi.org/10.1787/888934255437

*Sub-dimension 14.2: Agro-food system regulation*

While human and financial resources for **regulating natural resources** are adequate, monitoring of policy objectives and public investment has not reached its full potential. National water sector reforms in Albania are still being implemented. There are several regulations and strategies for natural resources, governing access to and use of water and the environmental impact of agro-food activities. The National Strategy for Integrated Water Resources Management 2018-2027 (NSIWRM) sets the framework for the development of policies in spatial planning, environmental protection, biological and landscape diversity, agriculture, forestry, fishing, transport and tourism (for details see Sub-dimension 13.2: Natural asset base).

The governance of water resources in Albania is highly centralised. The main decision-making authority is the National Water Council (NWC), composed of several ministers and chaired by the Prime Minister. However, in 2018 the Technical Secretariat of the NWC was transformed into the Agency of Water Resource Management,[183] which is now under the direct responsibility of the Prime Minister rather than the Ministry of Agriculture and Rural Development. It is responsible for the administration and management of water resources, including water management in inter-regional and national plans and projects in agriculture, urban planning and industrial and territorial development.

The national water cadastre has increased information sharing and integration with the various institutions concerned with water management and use in Albania.[174] Since 2016, river basin management plans are being prepared for all rivers that are important for agricultural productivity, covering water quantity for irrigation, structural works for irrigation and drainage, wastewater purification, environmental protection, water quality etc.

The **regulations on seeds and propagation** material in Albania are strongly harmonised with EU directives and protocols, including consistent monitoring and evaluation on a quarterly basis following EU guidelines. The regulations on seeds and propagation material cover agricultural production, environmental protection and consumer health. There is institutional co-ordination among government agencies with clear divisions of responsibilities and mandates.

The legislation on registration of plant varieties in the National Catalogue and their maintenance is aligned with EU protocols. The new Law on Fertiliser Products was approved in 2020 and harmonises the rules for production, registration, trade, import, export, use, quality control, traceability, information, advertising and inspection of activities related to fertiliser products, as well as the organisation and operation of relevant structures.

### *Sub-dimension 14.3: Agricultural support system*

Albania's **agricultural policy framework** is harmonised with EU policies and implementation is monitored regularly by the Ministry of Agriculture and Rural Development. Agriculture policy is covered by the Law on Agriculture and Rural Development and complemented by the Inter-Sectoral Strategy on the Development of Agriculture and Rural Development 2014-2020 (ISARD).[184]

The ISARD outlines the strategic interventions needed for Albanian agriculture and rural areas to meet the challenges of the EU single market and to adapt Albanian agricultural and rural development policies to the Common Agricultural Policy (CAP). The ISARD is harmonised with the main principles of the EU policies, the CAP and the Instrument for Pre-accession Assistance for Rural Development policies (IPARD), and focuses on addressing the specific problems in Albanian agriculture and rural areas. While institutional responsibilities for agricultural support policies and IPARD implementation are clearly and effectively divided among national and regional government agencies,[185] the national programme has only used 25% of the IPARD budget, hindering further development.

Ambitious indicators were set in the 2014-2020 ISARD to measure policy implementation. These indicators include real economic growth of the agriculture sector, an increase in labour productivity in agriculture and processing, full compliance by formal agriculture holdings with EU standards, an increase in the average farm size, an increase in the export-to-import ratio, and creation of new jobs, new micro-enterprises, and new producer groups. However, the targets set within these indicators for the period 2014-20 are rather high, so will most likely not be met. For example, real economic growth of the agriculture sector was targeted at 5% per year until 2020, whereas the real average by the end of 2019 was 2.4%, (Albanian Institute of Statistics, 2020[222]). Additionally, the export-to-import ratio was set at 1:3 for 2020, while the actual ratio is far from this objective (around 1:2), proving that planning needs to be more realistic and annual reviews of the indicators are necessary.

MARD publishes an annual report that provides information on its monitoring activities at two levels for producer support spending, as well as challenges and recommendations for future implementation. Financial monitoring includes evaluating the procedures in place, whether the procedures were followed and criteria respected, the number of beneficiaries, the annual budget and annual spending. The physical monitoring system conducts random checks with producers on how support from the ministry was implemented.

**Domestic support instruments** in Albania are in line with IPARD support and financing measures and have made substantial progress on introducing preventative measures for natural disaster mitigation. The instruments for agriculture producers include investments for modernising and standardising agricultural production. In 2020, the measures included support for breeding animals, bee-keeping, replacing plastic sheeting in greenhouses, organic production, implementation of standards and certification (Global GAP) and support for establishing or reconstructing rural tourism capacities.

The current support measures are divided into National Support Schemes and IPARD II Programme (2014-2020) support. The national support schemes for 2019 were granted to 4 009 beneficiaries for a total amount of EUR 6.5 million. While the budget of the IPARD programme for the period 2014-20 is EUR 71 million, by the end of 2019 only EUR 16 million had been used due to the IPARD agency's limited capacities for full implementation of the measures, as well as overly demanding criteria for applicants. Domestic support instruments complement the IPARD programme and there is no overlap of support measures or

financing. While there are no agri-environmental measures similar to those under CAP agri-environmental scheme in place yet, these measures are being formulated.

The Law on Civil Protection was updated in 2019 and introduced new national and local strategies, harmonised urban planning at local and national level, and regional strategies for risk assessment. According to the new law, the state is responsible for the damage caused by natural disasters. As each ministry is responsible for allocating a portion of its annual budget to reducing the risk of disasters and civil protection, the MARD allocates around 2% to 4% of its total annual budget to natural disaster mitigation.

Albania has a liberal **trade regime** and has followed guidelines set by the EU and the World Trade Organization (WTO) since 2000. Customs procedures reflect the Customs Tariff Nomenclature that is based on the Harmonized Commodity Description and Coding System (HS). Legislation for agricultural trade relies on the Customs Code of the Republic of Albania, the Nomenclature of Goods and Free Trade Agreements.

Albania implements preferential tariffs on agriculture products originating from member countries of the EU, CEFTA, EFTA and Turkey. There are import tariffs and tariff-rate quotas for agricultural commodities (crops and livestock) and inputs (fertiliser and pesticides). The base tariff rates are defined in the Combined Nomenclature of Goods 2020. Preferential tariff rates and tariff-rate quotas for agricultural commodities are also based on free trade agreements. Albania does not apply export credit support, export duties and/or export prohibitions for agricultural commodities (crops and livestock). As the United Kingdom has left the EU, Albania and the United Kingdom have negotiated a Trade Partnership Agreement which foresees tariff-rate quotas and preferential tariff rates, but this agreement has not yet been signed.

The **taxation system** for the agriculture sector remains unified and imposes few taxes on farmers. Tax on agricultural land is paid by hectare, with the exclusion of farms planted with orchards and vineyards, for the first three years from the moment of planting. The taxes are paid to the municipal budget according to the location of the land. A profit tax is obligatory for all legal entities that conduct economic activities according to law. In agriculture its rate is 5%. For entities that carry out certified agro-tourism activities, according to the legislation in force in the field of tourism, the profit tax rate is 5%. This rate applies for a period of 10 years for legal entities that benefit from certified agro-tourism status obtained before December 31, 2021.

VAT exemptions in agriculture include the supply of agricultural inputs, such as chemical fertilisers, pesticides, seeds and seedlings, except for hormones; as well as supply of veterinary services, with the exception of veterinary services for pets. A compensation scheme applies to agricultural producers at a rate of 6%: agricultural producers benefit from the right to compensation if their annual turnover does not exceed the minimum registration limit for VAT, or if the producer supplies goods or services originating from their work in one of the activities defined.

Albania's **sanitary and phytosanitary (SPS) framework** is partially compliant with international standards and EU requirements, but both the food safety and veterinary services fields continue to face capacity limitations in terms of technical support, training and policy. While Albania is a member of the FAO-WHO Food Code, WTO SPS Agreement, World Organization for Animal Health (OIE), International Plant Protection Convention (IPPC), and European and Mediterranean Plant Protection (EPPO) and has established functional national contact points for each organisation, little progress has been made in bringing the national SPS framework in line with international guidelines.

A reference laboratory for food safety, phytosanitary and veterinary network exists but as the law does not oblige accreditation of tests, only a limited number of specific tests on food safety are recognised by international certificates, preventing the recognition of the procedures abroad. In the phytosanitary field, tests are partly recognised and there is an ongoing process for their recognition amongst CEFTA members. The preparation of secondary legislation for food safety rules has continued, with the exemption of small food operators from applying HACCP procedures;[186] however, the area continues to face capacity

limitations such as lack of technical support and expertise, scarce resources and specific training, as well as a lack of written procedures on quality assessment, limiting compliance with international standards.

While the National Food Authority carries out regular controls under a risk-based plan approved at the beginning of the year, the standard operating procedures to ensure compliance with the legislation have yet to be approved and there is little effort to bring the practices in line with international guidelines. Duplicate inspections continue at the farm level by inspectors of the Regional Veterinary Service and Plant Protection Agencies and the National Food Authority due to unclear divisions of responsibilities and mandates. While inspections and their financing are based on a risk approach, there is no clear legislative plan for risk approach procedures.

As regards veterinary policy, the Regional Veterinary Service and Plant Protection Agencies (RVSPP) were established in 2018/19. A reform of the veterinary service was started in 2018 but has not yet been completed and the sector faces problems with staffing, animal waste management and farm biosecurity and fishery products (European Commission, 2019[79]).

### *Sub-dimension 14.4: Agricultural innovation system*

The **research and development framework** is based on the National Strategy for Scientific Research, Technology and Innovation for 2017-2022, along with the Action Plan for the Support of Development of Innovative Policies. The action plan aims to improve links between academic, industry and government institutions. Although the research strategy aims to increase investments for scientific research, technology and innovation to up to 1% of GDP by 2022, the share of public spending on scientific research in 2018 only reached 0.06% of GDP. The research strategy aims to increase practical projects involving research institutes and farmers, improving production technology and the competitiveness of Albanian producers. While under review as of 2020, the strategy also aims to continue working with the EU Horizon 2020 programmes that support Albania's research institutes in developing new methodologies and techniques in agricultural research.

There are numerous institutions involved in Albania's agriculture research and development sector**,** [187] but it remains underfunded and poorly organised in its division of responsibilities and administrative capacities. Albania has become increasingly aware of gaps in agricultural research and has begun prioritising and targeting the exact areas where more research and innovation support is needed for further harmonisation with EU processes. The National Inter-Sectoral Strategy for Agriculture and Rural Development (NISARD) 2014-2020 action plan aims to further develop the agricultural innovation system. But progress has been slow and there is little co-ordination or information sharing among the academic institutions and regional agencies responsible for agriculture research and development.

Albania's **agriculture extension services** have made progress on intra-institutional co-operation but lack administrative and human capital capacities. There are five regional Agricultural Technology Transfer Centres (ATTC) in Albania, with the role of enabling the smooth transfer of agricultural technology according to the needs and regional priorities within the ATTC's jurisdiction. The ATTC has 153 employees offering training and educational material to farmers and agribusinesses. These National Extension Agency Services are partly or fully free of charge for all farmers, and each regional office adapts to the needs of farmers in the most prominent agricultural sectors in the area. The ATTCs are widely used by farmers and producers. However, their programme frameworks could improve by including services that farmers request and adapting to emerging market needs and requirements.

Access to information for farmers, such as market developments, technical options and weather, remains limited, and is only provided through a personal phone call with the representative of the extension service office. Moreover, the administrative and human capital capacities of Albania's extension services do not meet the needs of agricultural producers. The level of information sharing primarily depends on how active the advisors are within the regional extension service offices, which differs from region to region.

### *The way forward for agriculture policy*

The following suggestions for future efforts and priorities of the Albanian Government could help improve agriculture policy:

- **Enhance rural infrastructure policy capacity by replicating Albanian Development Fund (ADF) good practices in planning and management of large-scale projects**. The experiences of ADF should be transformed into operational mechanisms and practices that can be used in implementing the next Agriculture and Rural Development Programme (2021-2027). From 2019, the needs of the sector have been addressed in the framework of the regional development and cohesion programme in harmonisation with the EU approach, which is why replication of good practices and further building of the administrative capacity is necessary.
- **Complete the monitoring and evaluation system for irrigation water management**. This will allow the MARD to follow up on the progress of developing and managing irrigation systems across the territory. The M&E system will be an important tool for municipalities to undertake self-assessments of their annual progress on irrigation and drainage activities.
- **Increase the capacity of the IPARD agency**. Efforts are necessary to ensure the agency's administrative capacity is adequate to fully implement available IPARD II funding. Staff need to be further trained and prepared for allocating the remaining measures under the IPARD II programme as well as forthcoming ones.
- **Improve the performance of the agricultural education system**. Institutions and businesses should increase networking, as well as the practice and training hours for students. Financial remuneration or other rewards should be used to motivate businesses to offer students practice hours.
- **Upgrade the SPS system and fully harmonise it with EU requirements**. Restructuring the veterinary sector and building the necessary technical and administrative capacity in the field of food safety and phytosanitary services is necessary. The food safety standardisation and accreditation of laboratories should be considered a priority.
- **Increase the funding and enforce the implementation of the National Strategy for Scientific Research**. There is a need to increase investment in research, in line with market demand, stimulate the links between producers and researchers and support innovation projects in targeted agriculture sub-sectors. Extension services need to be further supported by increasing the expertise of advisors through continuous training.

## Tourism policy (Dimension 15)

### *Introduction*

Table 20.24 shows Albania's scores for the five tourism sub-dimensions and compares them to the WB6 average. Albania has the third highest score in the tourism dimension (after Montenegro and Serbia). Albania scores above the WB6 average in four sub-dimensions, scoring highest in the tourism branding and marketing sub-dimension. Albania scores below the WB6 average in sustainable and competitive tourism, which is mainly due to its low score in promoting sustainable development and operations within the tourism sector. Since 2018, Albania has mainly progressed in improving partnerships with stakeholders (part of Sub-dimension 15.1), accessibility and accommodation capacity (Sub-dimension 15.2), quality assurance and VET frameworks (Sub-dimension 15.3), and tourism branding and marketing (Sub-dimension 15.5).

**Table 20.24. Albania's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Governance and co-operation | 2.4 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 2.5 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 1.8 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 1.3 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 2.8 | 1.6 |
| **Albania's overall score** | | **2.1** | **2.0** |

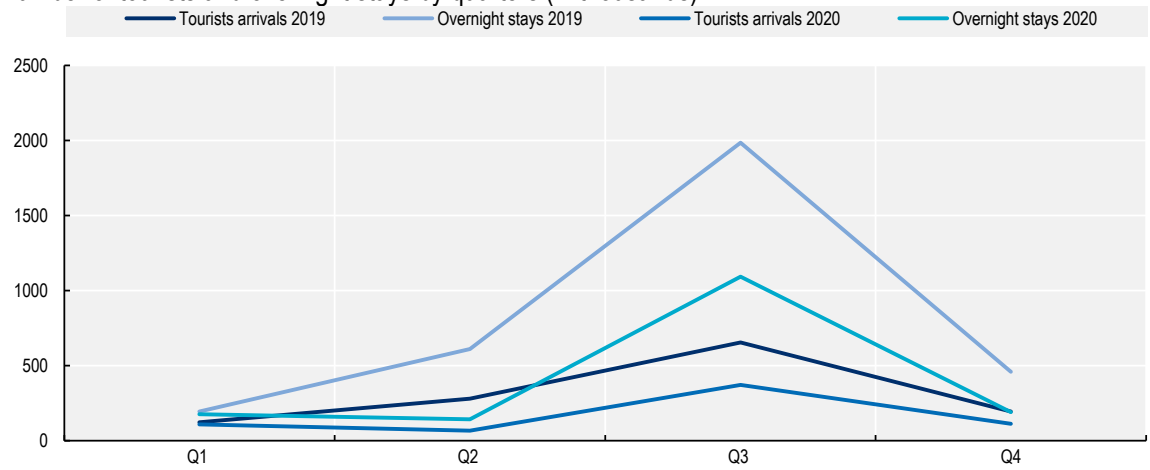
### *State of play and key developments*

Tourism has become one of Albania's most important economic sectors. In 2019, international tourist arrivals reached 6.4 million, which is higher than the WB6 average (INSTAT, 2020[223]). Average annual tourist arrivals in the last 10 years have increased by 13%, which is the second highest growth in the region, just behind Kosovo (14%). This fast increase in international tourist arrivals has contributed to tourism's growing share in GDP and employment. In 2019, the total (direct and indirect) contribution of tourism to GDP was 21.2% (USD 3.26 million and an 8.3% increase on 2017) (WB6-CIF, 2020[224]), while the direct contribution of tourism to GDP was 8.8%. Its total contribution to employment was 22.2% or 254 300 jobs, while its direct contribution was 8% or 91 500 jobs (WEF, 2019[225]). Moreover, tourism in Albania contributes 38% of total exports, which is again the second highest share among the Western Balkan economies. The growth of tourism is partly driven by the overall growth in investments, as well as the improvement in promotion and marketing on international markets. This significant improvement is reflected in Albania's improved ranking in the World Economic Forum's Competitiveness Index. It has risen by 24 places (ranking 48$^{th}$) in the effectiveness of marketing and branding to attract tourists indicator, and by 71 places (ranking 35$^{th}$) in the country brand strategy indicator. Although Albania has improved its overall position by 12 places, its ranking at 86$^{th}$ place indicates that further efforts should be made to improve its competitiveness (WEF, 2019[225]).

Despite these remarkable improvements, some challenges still hamper Albania's tourism sector. The key challenges are strong seasonality (with the peak season in July and August) (Figure 20.17), the concentration of tourism in the coastal areas, the large informal economy and the low average receipts per arrival (only USD 390, the lowest in the WB region). These challenges are enhanced by the lack of high-quality tourist products and services, limited human resource capacity and the lack of effectiveness and efficiency of governance at national and local levels.

## Figure 20.17. Seasonality of Albanian tourism (2019-20)

Number of tourists and overnight stays by quarters (in thousands)




Source: (INSTAT, 2020[223]), *Movement of People*, http://www.instat.gov.al/en/themes/industry-trade-and-services/tourism/; (INSTAT, 2021[226]), *Movement of People*, http://www.instat.gov.al/en/themes/industry-trade-and-services/tourism/.

StatLink https://doi.org/10.1787/888934255456

In order to address these challenges, Albania has set out strategic goals and policy measures in its new National Strategy for Sustainable Tourism Development (2019-2023).[188] The strategy aims to diversify the tourism offer (coastal, natural and thematic tourist products); increase the added value of tourism for the economic and social development of the economy; develop new, high-quality tourist products and services; and improve the economy's image through local products. However, some key challenges are not sufficiently considered in the new strategy. These include poor governance at national and local levels and the lack of sustainable tourism promotion.

The biggest current challenge is the COVID-19 pandemic, which put the development of the tourism industry on hold in 2020. Tourism was one of the sectors most affected by the pandemic. In order to mitigate the impact of the virus, Albania closed its borders in March 2020 (with a few exceptions, mainly transport of goods and diplomatic corps). Tirana International Airport closed to air traffic except for state, military, medical and emergency flights. As a result, in the third quarter of the year 2020, the number of tourists arrivals decreased by 43.3% compared to the same period in 2019 (INSTAT, 2020[223]), and by 47% on annual level compared to 2019. In terms of accommodation occupancy, the number of nights spent in the third quarter of 2020 decreased by 45% in comparison to the third quarter of 2019 and by 50,7% on annual level compared to 2019 (INSTAT, 2021[226]) (Figure 20.17).

The Albanian Government has established the national tourism recovery programme, which includes incentives to local businesses, establishing partnerships with airlines, promoting blue tourism, online promotion of Albania as a safe tourist destination, organising events and reorienting public investments.

A Decision of the Council of Ministers (in April 2020) introduced a financial assistance package corresponding to ALL 7.04 billion for the period April-June 2020 to employees of entities (physical/juridical persons) in the accommodation sector. In addition, 176 000 workers, 10 0000 of whom were employees in the tourism sector benefited from a monthly USD 400 payment in April 2020 (WB6-CIF, 2020[224]).

Constant dialogue has been established between the Ministry of Tourism and Environment (MTE) and the stakeholders of the tourism industry in order to assess the situation and the ongoing challenges. This co-operation has helped to develop recommendations to address the current crisis in the best and most efficient way in order to minimise the impact of COVID-19 on Albanian tourism, protect travellers and restore trust. The MTE, in collaboration with the Sustainable Rural Development (SRD) programme,[189] has developed a questionnaire to identify the issues currently faced by accommodation structures in order to target support. In collaboration with the Ministry of Health and Social Protection the MTE has drafted a

protocol for anti-COVID-19 measures for the 2020 tourism season. This document aims to guide and regulate the necessary preconditions for tourism enterprises to guarantee the successful continuation of their activity while avoiding spreading the virus inside and outside accommodation structures. This draft proposal will be implemented once the government relaxes some measures (WB6-CIF, 2020[224]).

### *Sub-dimension 15.1: Governance and co-operation*

Albania's tourism **governance and institutional set up** is defined by the Law on Tourism, adopted in 2015. The Law on Tourism (2015) establishes the responsibilities of central and local governments and outlines the institutions involved in the tourism sector both at national and local levels. Tourism development is overseen by the Ministry of Tourism and Environment, which is responsible for the development, management, co-ordination and implementation of the tourism strategy. The National Tourist Agency of Albania is the central organisation responsible for tourism branding and marketing. The new Strategy for the Sustainable Development of Tourism (2019-2023) clearly defines the strategic objectives, policy measures and actions to be implemented by different ministries, the budget allocation and the implementation timeframe. Due to the crosscutting nature of the tourism sector, it is included in other national strategies (Table 20.25). In December 2019, the Thematic Group on Tourism and Culture Development and the Prefectures of the Regions was established, headed by the Deputy Minister of the Ministry of Tourism and Environment, in order to ensure joint policy, cross-sectoral co-operation and decision making at the highest level.[190] The thematic group consists of representatives from the MTE, the Ministry of Culture and subordinate institutions, according to the area of responsibility. The work of the Thematic Group is included in the annual progress reports on Competitiveness and Investments. However, there is still no formal government body which also includes other ministries and public institutions to co-ordination of tourism development at the government level.

**Table 20.25. Albania's cross-cutting tourism strategies**

| Title | Key focus area |
|---|---|
| The General National Territorial Plan 2015-2030 | Sustainable tourism based on natural resources |
| Integrated Cross-Sectoral Plan for the Coast 2015-2030 | Coastal as well as urban tourism |
| Sectorial Strategy of Transport and Action Plan 2016-2020 | Focus on connectivity and accessibility |
| Cross-Cutting Strategy Digital Agenda of Albania 2015-2020 | Development of connected tourism/ e-tourism |
| Cross-Sectoral Strategy for Rural and Agricultural Development 2014-2020 | Development of rural tourism as well as tourism related to culture, nature, mountains, etc |

A 2019 progress report on the implementation of the tourism strategy has been published and the 2020 report is being drafted, which are positive steps. Since implementation of the six previous tourism strategies[191] was weakened by inefficient governance and patchy implementation due to government changes (Ciro A., 2019[227]), special attention is needed to strengthen implementation. This is even more important in a context of weak inter-ministerial co-operation, which is evident in the conflicting sectoral development priorities (such as promoting the construction of small hydropower plants in natural protected areas rather than sustainable tourism and development of nature/adventure tourism). Additionally, the government reports that lack of knowledge and capacities of public officials are key challenges for effective and efficient governance of the tourism development in the economy.

**Partnerships with stakeholders** are established through the Private Sector Advisory Committee of Tourism (KKSPT). This advisory body is chaired by the Minister of Tourism and includes representatives of national enterprise associations, higher education institutions, chambers of commerce, associations and NGOs operating in the field of tourism, as well as representatives of international institutions/donors. The main tasks of KKSPT are to advise the Minister of Tourism by designing tourism development strategies, legislation and regulations to report on the progress of the private sector and propose policy measures for issues related to tourism. However, the efficiency of this body is rather weak, and private tourism stakeholders report that their recommendations are often not taken into account. The Investment Council

platform was set up in 2015 by the Albanian authorities with support from the EBRD to intensify the dialogue between the government and the private sector, improve the business climate and promote good governance. The Investment Council is composed of high-level government officials, representatives from business associations and multilateral agencies. The government regularly takes into account the council's recommendations, particularly since the November 2019 earthquake and the COVID-19 pandemic.[192]

Regional Committees for Tourism Development are established in each prefecture to co-ordinate the work of central institutions and local government units (**vertical co-operation**). These committees include representatives of local government units, district representatives, representatives of local associations in the field of tourism, educational and training institutions for tourism, and representatives of the MTE. Territorial tourism branches have been established as administrative structures of the MTE to co-ordinate the implementation of tourism product development policies and tourist destination management. At the local level they are responsible – among other things – for inventorying the main tourism resources and businesses, supporting the infrastructure and activities in the tourism sector, and ensuring compliance by local businesses with the Law on Tourism and relevant policies. However, the efficacy of local level governance remains a key challenge. Most municipalities are not able to fulfil all the responsibilities defined in the Law on Tourism (for example, the certification of accommodation facilities), due to the shortage of competent public officials (in many cases tourism is only an additional task for local officials), and the lack of financial resources for tourism development. Besides, there is not yet any regular monitoring or evaluation of policy measures implemented at the local level.

Albania's **tourism data collection and sharing system** is still at an early stage of development. Only limited progress has been achieved since 2017, including new tourism data and surveys published since 2018. A tourism data collection and sharing framework is formally in place and the Law on Official Statistics was adopted in 2018. The National Statistics Institute (INSTAT) is the leading institution for data collection and sharing. Moreover, a tourism statistical working group brings together all the main institutions that can provide reliable tourism data (i.e. INSTAT, Central Bank, Customs Office, and General Directory of State Police). Some improvements should be seen with the implementation of the newly adopted mandatory categorisation of accommodation facilities. However, the reliability of statistical data is very low due to the large informal economy in tourism (Ciro A., 2019[227]). Overall, Albania lacks a comprehensive data collection framework that would provide a clear methodology for data collection and analysis.

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

As mentioned in the previous assessment, Albania's Sector Strategy for Transport and action plan 2016-2020 take tourism and **connectivity** into consideration by including measures to improve connectivity, safety and security at border crossing points. Since 2017, Albania has improved its destination accessibility for tourists by reducing visa requirements. In addition, electronic visas are now available for entering Albania and an e-Visa Internet portal was launched in November 2020.[193] The development of bilateral agreements with all WB economies, allowing travellers to cross borders with only an identity card or passport and with only one customs point (entrance), has also facilitated border crossing.

An **accommodation capacity and quality assurance framework,** which increases the availability and quality of accommodation, is in place and several policy measures have been implemented. However, most of the policy measures, such as a reduction of VAT and income tax for accommodation facilities, were already adopted before 2017. The promotion of private and public investment in tourism remains a priority policy goal in the new National Strategy for Sustainable Tourism Development 2019-2023. It includes measures for promoting private strategic investment and attracting well-known international brands in the hotel industry, defining priority areas for tourism development, and orienting private and public investments to improve basic public infrastructure first. This is a positive approach to ensure the efficient use of limited financial resources. However, for this approach to be fruitful, Albania needs to focus on putting in place high-level inter-ministerial co-operation and adopting a public infrastructure investment

programme or action plan to ensure compliance with overall public infrastructure development goals (see also Sub-dimension 15.4: Sustainable and competitive tourism). Moreover, the lack of clearly defined property rights along with other cross-cutting challenges in the business environment further hamper investment in tourism. Although policy measures have been implemented, no information on their effectiveness in terms of impact on accommodation facilities is available.

In 2016, Albania started to set up more comprehensive quality assurance by adopting a consistent accommodation quality standard framework. In 2019, the MTE started the process of categorising accommodation structures[194] and established a register of accommodation facilities. All types of accommodation must be registered, apart for private apartments and rooms. The legal basis for including these two accommodation types in the mandatory categorisation is currently going through the approval process[195]. The main remaining challenge is to empower the Tourism Inspectorate to undertake regular inspections.

**The tourist information system** provides information on tourist destinations, accommodation, attractiveness and tourist services. Information is provided via websites, road signs and at tourist information centres. It is available in multiple foreign languages and is regularly updated by the National Tourist Agency. However, a tourist information system framework that connects the current tourist information system to a comprehensive national information database is still lacking, thus impeding further improvement in this field.

### *Sub-dimension 15.3: Availability of a qualified workforce*

A qualified workforce is an important element in developing tourism in Albania further. In 2019, Albania made progress in its **skills supply framework,** improving its position on the WEF Competitiveness Index human resources and labour market indicator by 8 places (ranking 31st). It improved even more in the ease of finding skilled employees indicator, moving up 17 places. However, its 78th place overall in the ranking in this indicator shows that further actions are still required (WEF, 2019[225]). The National Tourism Development Strategy envisages establishing a Regulatory and Institutional Framework for the development of vocational education and qualifications in tourism, as well as training of human resources engaged in the sector. Assessing skills gaps and training needs is also planned.

Albania's overall **VET framework** is well advanced, with good co-operation with private stakeholders and the National Agency for Vocational Education, Training and Qualification being established, well equipped and with a sufficient budget and staff for implementing its activities. A monitoring system has been set up under the National Employment and Skills Strategy 2019-2022 (NESS) and the budget for VET programmes has been rising continuously over the last four years. In 2019 it was four times higher than in 2015. It seems that this progress is the result of donor projects in the economy and across the region. However, Albania still needs a sector-specific human resources strategy, including clear measures to fill the gap between supply and demand by adapting the curricula to the needs of the market.

Although there is no **higher education framework**, Albania has developed the so-called dual programme for catering/tourism management, which is a three-year educational programme prepared and implemented in close co-operation between universities and private sector stakeholders. Established in 2006, 50% of the programme consists of practical training in companies.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

A **comprehensive natural and cultural heritage enhancement framework** is being developed, though progress has been limited in this field since 2017. Natural and cultural heritage is included in the National Strategy for Sustainable Tourism Development 2019-2023 and is characterised as a resource for the development of nature-related and thematic cultural tourism products. In 2019, the National Strategy for Culture 2019-2025 was adopted by the government and includes the main policies and specific objectives

for cultural heritage. However, modest progress has been made in managing natural heritage. Despite being included in the Policy Document on Biodiversity and Law on Protected Areas,[196] a more comprehensive framework is needed for drawing on natural heritage for tourism. Although co-operation among the responsible ministries has been established to co-ordinate policy measures and activities in the field of natural and cultural heritage, the policy measures are defined in several policy documents, and are not brought together in a separate tourism policy that would allow for regular monitoring and evaluation.

The principles of **sustainable tourism development** are defined in the National Tourism Development Strategy and in the Law on Tourism. However, specific measures for the actual promotion of sustainable tourism development are not defined. A policy framework is needed to promote sustainable tourism and operations within the tourism sector that includes clear measures to help tourism stakeholders develop sustainably. In 2019, the European Union and the European Bank for Regional Development launched a EUR 40 million Programme for Sustainable Tourism in Albania to improve the contribution of quality sustainable tourism to economic growth and the competitiveness of Albanian regions. This is an opportunity for Albania to make progress in sustainable tourism development.

Albania has made some progress in establishing a comprehensive **tourism investment policy framework,** though a **tourism innovation policy framework** is not yet in place. Policy measures for promoting investment in the tourism sector are included in the action plan of the National Strategy on Sustainable Tourism Development 2019-2023. The strategy supports the implementation of three specific objectives: 1) promoting private strategic investments to attract well-known international brands in the hotel industry; 2) defining priority areas for tourism development and orienting private investment towards them; and 3) orienting public investment towards improving basic infrastructure. The promotion of investment in tourism infrastructure is also included in the Strategic Investment Manual, issued by the Albanian Investment Development Agency and dealing with facilitating and supporting direct investments in Albania. In addition, several measures in the form of fiscal incentives (see Box 20.18) and tourism investment incentives are available.

Despite these clear indications that the promotion of investment in tourism is a priority for Albania, the effectiveness of these policy measures could not be assessed as there is no monitoring or evaluation conducted. While the first monitoring was planned to be implemented in 2020, no evaluation framework is planned to be developed.

### Box 20.18. Fiscal incentives to boost the tourism industry in Albania

In order to boost the tourism industry, Albania has created several fiscal incentives:

- 6% VAT for accommodation structures (bed + breakfast)
- 6% VAT on any supply within “hotel/resort 5*, special status” structures (brand name)
- exemption from building tax and impact tax on infrastructure
- hotel/resort 5*, special status (brand name), support by administrative procedures
- exemption from profit tax for 10 years for “hotel/resort 4 * and 5*, special status” eligible for special status until December 2024
- 6% VAT for certified entities in agro-tourism (sleeping + restaurant but not drinking)
- infrastructure impact tax exemption for agro-tour operators who invest in this area
- income tax decreased from 15% to 5% for certified entities in agro-tourism from January 1, 2018.

Source: (Invest in Albania, n.d.[228]), *Invest in Albania*, https://invest-in-albania.org.

*Sub-dimension 15.5: Tourism branding and marketing*

According to the Travel & Tourism Competitiveness Index 2019, Albania has improved its ranking in the effectiveness of marketing and branding to attract tourists indicator, moving from 72nd to 48th place (WEF, 2019[225]). The National Tourist Agency of Albania is the central national organisation responsible for **tourism branding and marketing.** Since 2015, the National Tourism Agency has managed the promotion brand of Albanian tourism "Albania go your own way". In 2019, the development of a new marketing brand was begun, but the process has been slowed down by the COVID-19 crisis. There is no monitoring or evaluation of the brand image and no marketing strategy. Key public and private stakeholders are involved in implementing the marketing plan, although a formal marketing co-ordination body is not established yet. The budget allocated for tourism promotion and marketing for 2019 is rather low (EUR 700 000), and is nearly 43% lower than in 2015, which could have a negative impact on future tourism development.

A **digital tourism marketing framework** is not yet formally established. However, some digital marketing activities are included in the overall tourism marketing strategy and were implemented in 2019. Moreover, a few digital marketing activities – such as the Marketing of Albanian Tourism campaign through sponsored advertisements on Google Ads and social networks – have been implemented. This approach includes regular monitoring of the progress of digital marketing campaigns, which is a positive development for an efficient digital marketing framework. Currently, the main weakness in this area is the lack of policy measures for building the capacity of tourism stakeholders, including providing incentives for them to implement digital marketing strategies and tools.

## *The way forward for tourism policy*

To ensure further successful development of tourism, policy makers should:

- **Strengthen the governance structure at the central level by establishing efficient inter-ministerial co-operation**. This is essential to harmonise tourism policy priorities with other national sectoral policies priorities.
- **Involve private sector stakeholders more actively** in decision making to better address their needs and support them in implementing their development projects.
- **Introduce regular monitoring and independent evaluation** of implemented policy measures.
- **Move away from developing more mass tourism in coastal areas**, and start developing new, high-quality and personalised tourist experiences based around natural and cultural sites. Bookings should be available on short notice. Albania should also prepare a new marketing strategy and related action plan, with an objective to attract more domestic tourists in the context of COVID-19 – an area which has been relatively neglected so far but could help to disperse tourist arrivals over the year.
- **Develop a comprehensive training programme for public officials at national, regional and local levels** to impart the relevant skills and competencies to manage tourism development effectively.
- **Enable municipalities to implement their legally assigned tasks for tourism development**. Prepare an in-depth analysis of the main constraints and bottlenecks to implementing their assigned responsibilities. Define a special programme of policy measures and other actions to improve their ability to cope with tourism development efficiently.
- **Develop a comprehensive framework for promoting sustainable development within the tourism sector.** It should include the mandatory consideration of sustainability criteria in all investments in tourism infrastructure. It should also be supported by public incentives, awareness raising and training for tourism stakeholders and use best practice from other countries.[197]

- **Do more to improve tourism data collection and sharing** by introducing digital collection of data (see Box 20.19), and by developing Tourism Satellite Accounts to empower policy makers with reliable information when designing policy measures.
- **Conduct a comprehensive analysis of the informal economy in tourism and prepare a programme** with clearly defined measures for its systematic reduction.

### Box 20.19. Croatia's eVisitor initiative

The Croatian National Tourist Board, together with local tourist boards and other stakeholders, have developed the eVisitor check-in and check-out initiative as a unique information system connecting all tourism offices in the country. The system also includes about 60 000 accommodation providers.

As of 2016, all domestic tourism boards have access to all the data on accommodation providers and their facilities, as well as the tourist arrivals and departures in their area. This system simplifies the process of checking in and out, helps to control tourist tax payments, and provides a unified national platform for the collection and processing of data on accommodation providers and their facilities. It also enables all accommodation providers (natural and legal persons) to independently and at any time check their guests in and out and calculate their current tourist tax obligations. Importantly, the collected data allow tourist movements to be analysed and categorised according to multiple criteria, such as length of visit, location, gender, age, country or place of residence. This is expected to significantly improve data collection and facilitate tourism marketing and promotion activities.

The system also fosters co-operation with other public authorities, such as the customs administration, the Ministry of the Interior and the State Attorney's Office, to access and use the collected data via remote access to the database.

Source: (eVisitor, 2020[229]), *eVisitor Croatia*, https://www.evisitor.hr/Info/hr-HR/.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 20.26 shows Albania's scores for the Anti-corruption policy dimension and compares them to the Western Balkan (WB) average. Albania has the highest score (along with Montenegro) of the WB6 economies for the anti-corruption public awareness and education indicator. The other indicators are below the WB6 average, although there is a potential of swift progress regarding anti-corruption law enforcement bodies considering the implementation of institutional reforms at the time of this assessment. Albania has an elaborate legal framework in several areas of prevention of corruption. Compared to the previous Competitiveness Outlook, Albania has intensified its anti-corruption awareness-raising activities. A track record for the investigation, prosecution and adjudication of high-level corruption cases has been established, but the effectiveness of specialised anti-corruption bodies still needs to be fully developed.

**Table 20.26. Albania's scores for anti-corruption policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 1.0 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 4.0 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 2.5 | 2.8 |
| **Albania's overall score** | | **2.1** | **2.5** |

Note: For comparability with the previous assessment, the two new sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 16.1: Anti-corruption policy framework*

The Inter-Sectoral Anti-Corruption Strategy (ISACS) 2015-2020 (extended until 2023) provides the anti-corruption policy framework and its **policy documents, co-ordination and implementation** includes the classic components of anti-corruption policies: prevention, repression and awareness raising. The Inter-Sectoral Reform Strategy in Public Administration 2015-2020 and the Mid-Term Strategy 2018-2020 of the Public Prosecutor's Office also envisaged anti-corruption activities.

Anti-corruption policy planning includes funding needs. The latest action plan (2020-2023) defines funding amounts for most activities. In terms of monitoring, responsible institutions have been asked to report the amounts of financial disbursements for the activities performed. According to the government, in 2017-19, the annual financial disbursement for these activities fluctuated around ALL 200-350 million. The share of international donor funding in this amount varied from approximately one-third in 2017/18 to around one-fifth in 2019. International support remains significant in 2020 and is expected to continue.

The Minister of Justice fulfils the role of the National Co-ordinator Against Corruption (NCAC). Albania has developed an advanced system of performance monitoring. The ISACS itself includes general and specific performance indicators, and the action plan contains so-called passports of indicators. The monitoring is organised into two stages, whereby each implementing institution reports the level of implementation of its activities, the budget allocated, problems encountered, etc. while the NCAC reports on overall progress. In quantitative terms, by the end of 2019, 11 objectives had been achieved, with implementation of 6 objectives in progress. Only one objective had not been realised (improving the legal framework for the prosecution of economic and financial crimes and, in particular, the establishment of the asset recovery office) (NCAC, 2020[230]). In terms of monitoring by civil society, the Institute for Democracy and Mediation

conducts an annual survey. This continually reveals sceptical public opinion; for example, in the 2019 survey, 71% of respondents indicated having no confidence in the prosecution of grand corruption cases, with no substantial change on previous years (Vrugtman and Bino, 2020[231]).

In view of the decision to draft a new action plan for 2020-2023, the Ministry of Justice requested the Organisation for Security and Co-operation in Europe (OSCE) Presence in Albania to conduct an external mid-term review of the ISACS for the period 2015-2018. The review report does not seem to be published online, but according to the government, one of the general conclusions of the review was that sanctions for corruption were not yet delivering results.

The NCAC engages in regular consultations with civil society. It submits draft monitoring reports of the ISACS for public review and solicits comments through online calls for consultation. According to the government, relevant comments and suggestions are reflected in the drafts before approval. Repeated online consultations and in-person discussions took place regarding drafts of the 2020-2023 action plan. While drafts and adopted planning documents, as well as monitoring reports, are regularly published on the Ministry of Justice website,[198] in the past the NCAC did not publish overviews of any received, accepted, or rejected proposals. While such feedback may have been provided in a less formal manner, it was reportedly not provided systematically (European Commission, 2020[19]). However, recently Albania has started the practice of publishing reports of consultations on the ISACS monitoring reports.

There is no obligation for public agencies to carry out **corruption risk assessments** and no systematic engagement in this activity yet. However, the Action Plan 2020-2023 for the ISACS envisages the development of integrity plans (including risk assessment) by all ministries and subordinate institutions. Several public entities have already identified and assessed risks and drafted consolidated risk registers. In 2020, the Ministry of Justice published the Integrity Risk Assessment Methodology for Institutions of Central Government (Sulstarova, Met'hasani Cani and Bezhani, 2020[232]), carried out a risk assessment and published the integrity plan for the ministry. Eight subordinate institutions of the Ministry of Justice have started risk-assessment processes. Several municipalities have also approved integrity plans.

Laws do not envisage **corruption proofing of legislation**. According to the government, a document on corruption proofing has been drafted but it is not yet publicly available. In the past, Albania has engaged the Institute for Development Research and Alternatives (IDRA) think tank to establish a system of corruption proofing but there is no evidence that this co-operation has continued.

### *Sub-dimension 16.2: Prevention of corruption*

Albania's institutional structure contains several **corruption prevention bodies** and arrangements.

The Directorate of Programs and Projects in the Anti-Corruption Field in the Ministry of Justice and the Network of Anti-Corruption Co-ordinators play the key role in policy planning, co-ordination and monitoring. Established in 2019, the directorate co-ordinates activities with the implementing institutions, drafts policy documents and monitoring reports, proposes activities, etc. The network comprises 17 co-ordinators across the public sector and serves to collect, analyse and co-ordinate information on corruption incidents and anti-corruption activities.

Two institutions play a central role in inspections and administrative investigations. Established in 2018 and headed by the NCAC, the Inter-Institutional Anti-Corruption Task Force is responsible for inter-institutional inspections and, as of early 2020, had recommended 118 dismissals and produced 38 criminal referrals (European Commission, 2020[233]). The Special Anti-Corruption and Anti-Evasion Unit (SACAEU), established by the Council of Ministers in February 2020 under the Prime Minister, is responsible for supervising inspection activity; co-ordinating the initiation of administrative investigations and audits; carrying out verifications, controls, and inspections in ministries, central institutions, prefect administrations, and companies with state capital; and following up and implementing tasks set by the National Committee against Corruption and Evasion headed by the Prime Minister, etc. At of the time of

preparing this Competitiveness Outlook assessment, no data were available on the performance of the SACAEU.

These bodies are placed under direct or indirect control of the political leadership and have no special safeguards for their independence. The Minister of Justice, in his/her role as the NCAC, directly heads the Network of Anti-Corruption Co-ordinators and the Inter-Institutional Anti-Corruption Task Force. The Directorate of the Ministry of Justice is headed by a director – a civil servant selected and appointed under the general civil service rules. The Prime Minister appoints the Director General of the SACAEU, who has no fixed term in office. In terms of staff, these anti-corruption bodies are small institutions. As of June 2020, the directorate had six staff members and five vacancies (three vacancies on 3 March 2021). The SACAEU had 7 employees, as well as 12 full-time and 5 part-time employees attached to other institutions.

The High Inspectorate for the Declaration and Audit of Assets and Conflicts of Interest (HIDAACI) is a legally independent institution, established in 2003 and headed by the Inspector General. Parliament appoints the Inspector General and oversees the body. To safeguard the independence of the HIDAACI, support from three-fifths of all Members of Parliament is required to appoint the Inspector General. However, only a simple majority is necessary if the first vote fails (SELDI, 2019[234]). The HIDAACI is a growing institution. From 2003-19, its employees increased from 35 to 70 (including inspectors, whose number increased from 12 to 28).

The HIDAACI is the central authority responsible for implementing and enforcing the Law on Prevention of **Conflict of Interest** in the Exercise of Public Functions (adopted in 2005). The law defines actual, potential and apparent conflicts of interest as well as different kinds of pecuniary and non-pecuniary private interests. The rules apply in a comprehensive manner to officials and employees of central and local state institutions, including enterprises and organisations controlled by the state. The key obligation in the system for managing conflicts of interest is a case-by-case self-declaration where a public official him/herself assesses whether his/her private interests may lead to a conflict of interest. The superior official or superior institution may also request such a declaration. The law prescribes in detail the measures that officials and their superiors may take to prevent and resolve conflicts of interest.

As the central institution for managing conflicts of interest, the HIDAACI advises officials and their superiors on specific cases of suspected conflicts of interests and questions of ethics. It also carries out verifications of and administrative investigations into conflicts of interest and checks compliance with prohibitions and restrictions of private interests (such as restrictions on entering contracts with public institutions). It applies administrative sanctions, initiates legal actions with the competent public institutions to declare invalidity and regulates the consequences of acts and contracts issued under conflict of interest circumstances. Units responsible for implementing the law on prevention of conflict of interest in public institutions are required to report annually to the HIDAACI on activities carried out, including cases of conflict of interests, actions taken to prevent or process them, and outcomes. Based on the reports, the Inspector General prepares evaluations and recommendations. The HIDAACI has published several guides on preventing conflicts of interest.[199] According to the government, the HIDAACI is engaged in developing further legal changes in the area of conflict of interest.

Official statistics on administrative fines applied by the HIDAACI merge several types of violation into a single category (non-declaration of private interests, conflict of interest, and violations of the law on whistleblowing). There has been a decrease in the number of fines issued – from 436 in 2017 to 54 in 2019. The information provided does not reveal the causes of this declining trend. The HIDAACI does not make public its reasoned decisions in these cases.

Albania has a track record of effectively enforcing **asset and interest disclosure** based on declarations submitted upon taking office, on annual basis thereafter, and after leaving the office. The Law on the Declaration and Audit of Assets, Financial Obligations of the Elected Persons and Certain Public Officials (adopted in 2003) applies to a generally comprehensive circle of high/mid-level officials. A few categories are missing which could be considered for inclusion in the future, such as members of regional councils

(currently only heads of councils are covered by the declaration) and executives of all state-owned enterprises (currently only administrators of joint-stock companies with over 50% participation of state capital and more than 50 workers are covered). In terms of data relevant for monitoring the economic situation and interests of officials, the contents of the declarations do not cover unpaid outside activities (however, officials must disclose them within the institutions where they are employed); beneficial ownership unless visible through declared profit; trusts (only the trustee should be declared as a related person); or virtual assets such as cryptocurrencies. Data on spouses, cohabitants and adult children must also be declared but not for other individuals residing in the same household as the official. The Inspector General may also request declarations from other people considered to be related to a declarant.

The HIDAACI administers the declaration system and carries out auditing. A complete audit of the declared data must be carried out every two, three, four or five years for specified categories of officials, in cases when data from legitimate sources lead to questioning the authenticity and accuracy of the declared information, and in cases when arithmetic and logical checks reveal discrepancies. According to government data, the number of cases referred to law enforcement based on the verification of the declarations has been increasing (32 in 2017, 53 in 2018, 115 in 2019). There is a sustained track record of referring cases of high-level public officials for prosecution (27 cases in 2018, 7 cases in 2019) (European Commission, 2020[233]). The cases referred for prosecution in 2018 resulted in six convictions and seven dismissals; among those referred in 2019, one resulted in a conviction and a dismissal (European Commission, 2020[19]). However, there is evidence that a significant share of the cases forwarded by HIDAACI are not followed up adequately (GRECO, 2020[235]).

The HIDAACI is working towards launching an electronic system for declarations in 2021. Public access to the declarations has been based on requests for information. The electronic system is expected to ensure publication by default. Currently, the website Open Spending Albania provides access to searchable data on the declarations.[200]

The Law on Whistle-blowing and Whistle-blower Protection (adopted in 2016), and several auxiliary documents, provide **whistle-blower protection**. The law protects whistle-blowers in both the public and private sectors with the presumption of good faith in the whistle-blower unless the contrary is proven. The whistle-blower is entitled to confidentiality (including about his/her information sources) and protection from any retaliation measures, including but not limited to those listed in the law. The law invalidates any rules or private agreements which exclude or limit the rights of a whistle-blower.

The law deviates in several ways from EU Directive 2019/1937 on the protection of persons who report breaches of European Union law. Only corruption can be the subject of whistleblowing under the Albanian law. Whistleblowing can be internal and external (to the HIDAACI), but external whistleblowing is subject to conditions such as well-grounded reasons to be sceptical about the integrity and impartiality of the responsible unit within the organisation, etc. These conditions for external whistleblowing may act as a deterrent and are more restrictive than those envisaged in the EU Directive. The law is restrictive regarding public whistleblowing and strips the whistle-blower of the right to protection once he/she announces publicly the alleged act or practice of corruption. This is an important deviation from the directive, which envisages protection for a person who makes a public disclosure if certain conditions are fulfilled. According to the Albanian law, a whistle-blower may choose to remain anonymous, but he/she must justify reasons for the anonymity.

There are several means of protecting whistle-blowers, such as the invalidity of retaliatory measures and the possibility to seek compensation for harm. However, the law envisages no protection for people connected to the whistle-blower and no right to protection due to the mistaken identity of a whistle-blower. There are also no specific provisions for free legal aid for whistle-blowers. The whistle-blower alleging that he/she is the subject of an act of retaliation submits a request for protection to the responsible unit within the organisation. If the responsible unit exceeds the deadline for taking measures, the request is submitted to the HIDAACI, which must investigate the allegations. There is no explicit mention of the possibility of

applying for protection immediately to the HIDAACI or of provisional protection before the administrative investigation is completed. No evidence is available on how effective the protection measures are in practice.

As the central authority for whistle-blower protection, the HIDAACI has ensured the establishment of responsible units within public authorities with more than 80 employees (168 responsible units in total) and within private sector entities with more than 100 employees (444 responsible units in total). Nevertheless, whistle-blowing activity has been relatively low. According to the government, the HIDAACI received 8 whistle-blowing reports in 2017, 16 reports in 2018, 14 reports in 2019 and 9 reports in 2020. Over 2017-20, the HIDAACI received 5 requests for protection. In all these instances, no direct or indirect acts of retaliation were found. The number of internal whistle- blowing reports was 7 in 2017, 3 in 2018, and 3 in 2019. No evidence is available on the number of criminal cases started as result of whistle-blower reports.

Despite awareness-raising activities, monitoring by the Albanian Helsinki Committee found that lack of information about the law and reporting mechanisms among potential whistle-blowers and responsible units is one of the main causes of the small number of whistleblowing reports in Albanian ministries. Other reasons are lack of confidence that the reports will be received and treated with professionalism, impartiality and independence; in some cases, fear of revenge; preference for other reporting channels; and negative experiences of reporting in the past (Komiteti Shqiptar i Helsinkit, 2019[236]).

Albania highly prioritises public **awareness raising and education** on corruption-related matters. The ISACS envisages a range of awareness-raising campaigns and trainings. Moreover, the Ministry of Justice has its own communication plans for anti-corruption-related activities.

Public outreach activities organised by the authorities include “runs against corruption” around the lake of Tirana in 2018 and 2020, anti-corruption film festivals, and the Integrity Weeks in February and December 2020. These and other activities have involved international and domestic partners such as the Delegation of the EU to Albania, embassies of partner countries, the International Chamber of Commerce in Albania, etc. In 2018-19, five consultative forums took place on topics such as the implementation of whistle-blower protection, internal audit, freedom of information, and conflicts of interest among high-ranking officials. In February 2020, the NCAC launched the forum of civil society organisations on anti-corruption, which formally strengthens partnerships with civil society. It is envisaged that every government anticorruption initiative should be discussed in this forum.

Extensive and varied training activities have taken place, including training of the trainers of the School of Public Administration. In 2018, the HIDAACI held several training sessions for responsible authorities on prevention of conflict of interest (about 350 participants). In 2019, 14 training sessions were provided for the responsible units of the public sector on their duties and responsibilities under the Law on Whistle-blowing and Whistle-blower Protection (217 participants). Other institutions (the Ministry of Justice, the School of Public Administration) have also provided training on anti-corruption topics. Moreover, a variety of guidance materials have been prepared. The national budget has been the source of funding for multiple activities.

### *Sub-dimension 16.3: Independence of the judiciary*

The High Judicial Council (HJC) appoints judges for life. The Constitution and the Law on the Status of Judges and Prosecutors in the Republic of Albania determine criteria for admission to the initial training of candidates, the procedure for application and preliminary assessment, asset and background checks, ranking of graduating candidates, appointment of candidates, and assignment of the appointed magistrates to positions. Judges are selected and promoted through competitive procedures. The HJC and the School of Magistrates ensure transparency by announcing vacancies for judges on their websites.[201] According to the government, the School of Magistrates publishes the dates of all stages of competitions for the

recruitment of magistrates, candidates who will participate in the competitions, and the winners of each stage.

The HJC appoints court chairpersons following the promotion process. The mandate of court presidents lasts three years with the right to one re-appointment. When a chairperson resigns or an application for re-appointment is rejected, the HJC publishes a vacancy announcement. The procedure is described in detail, including the ranking of candidates, and the HJC publishes information on the appointment process online.

The HJC has been operational since December 2018 and comprises 11 members. The general assembly of judges elects 6 members, and parliament elects 5 members who are representatives of civil society, academia and the bar association. The HJC appoints, evaluates, promotes and transfers judges of all levels; decides on disciplinary measures for judges of all levels; proposes to the President of Republic candidates to the High Court; approves the rules of judicial ethics and monitors their observation, etc. CSOs have been monitoring the performance of the HJC. The Institute for Political Studies found that the HJC displayed many more elements of transparency than the previous High Council of Justice (ISP, 2020), though an earlier report by the Albanian Helsinki Committee found less consistent practice in terms of transparency (Komiteti Shqiptar i Helsinkit, 2019[236]).

The Law on the Status of Judges and Prosecutors in the Republic of Albania determines the disciplinary liability of judges. The recently created office of High Justice Inspector is responsible for initiating disciplinary proceedings. Guarantees of due process include the rights of the magistrate subject to the proceedings to submit a written defence, attend any hearing, call witnesses, present documents, take other measures for providing evidence, be represented under the provisions of the Code of Administrative Procedures, and recover his/her legal costs where no disciplinary measure is imposed. The magistrate has the right to appeal a decision imposing a disciplinary measure.

Albania has been undergoing a fundamental justice reform since 2016. A vetting process started in 2016 for all judges and prosecutors as a single extraordinary measure overseen by the International Monitoring Operation. The vetting process is stipulated in the Constitution of Albania as amended in 2016 and detailed in the Law on the Transitional Re-evaluation of Judges and Prosecutors in the Republic of Albania. More than 286 dossiers were processed, resulting in 62% being dismissed (mostly due to matters concerning unjustified assets) or resigning (European Commission, 2020[19]). As a result of the judicial reforms, judges' salaries have been increased significantly. However, the vetting process has also placed a strain on the judiciary from an increase in vacancies. For a certain period, the High Court and the Constitutional Court became practically dysfunctional (Venice Commission, 2020[237]).

According to the government, the allocation of court cases is done by lot electronically, and the High Inspector of Justice must regularly inspect the division of cases. Once anonymised, judicial decisions delivered in open proceedings are reportedly available on the court websites.

### *Sub-dimension 16.4: Business integrity and corporate liability*

The non-binding Corporate Governance Code defines the responsibility of company boards for risk oversight and the creation of a sound system of internal control to safeguard the company's interests and shareholders' investments (Principle 6). Little evidence is available on the implementation of the code, other concrete **business integrity** practices, or incentives for companies to improve the integrity of their operations. Albania participates in the Extractive Industries Transparency Initiative (EITI), which represents a global standard of transparency and accountability in the management of natural resources, and the economy is considered to have achieved meaningful progress towards meeting the EITI Standard.[202]

In July 2020, Albania adopted the Law on the Register of Beneficial Owners. The register should be established in 2021. The law implements the 5th Anti-Money Laundering Directive (2018/843), requiring that access be provided to any member of the general public to data on beneficial owners. The definition of a beneficial owner in the law reflects the definition in the anti-money laundering directives. According to

the Law on Prevention of Money Laundering and Financing of Terrorism, those subject to the law, including designated non-financial businesses and professions, must identify beneficiary owners and take measures to verify their identities before and during the establishment of business relationships.

According to information provided by the Minister of State for Protection of Entrepreneurship (MSPE), in a dialogue between the private entrepreneurship and the governmental institutions, the MSPE addresses complaints from an administrative perspective, including those on corruption. The MSPE handles individual complaints and deals with them either through meetings with the relevant parties or through written communication with the respective institutions.

Albania has established the **liability of legal persons** for all criminal offences. According to the Penal Code and the Law on Penal Liability of Legal Persons (adopted in 2007), a legal person will be held accountable for criminal offences that have been committed in its name or for its benefit, by its bodies and representatives, by a person who is under the authority of the person representing, directing and administering the legal person, or due to the lack of control or supervision by the person who directs, represents and administers the legal person. The law does not explicitly state that the corporate liability is autonomous, i.e. can be applied independently of the liability of the perpetrator – physical person.

The law envisages the main penalties to be fines and the termination of the legal entity. The upper limit of fines for offences, which carry the maximum prison sentence of seven years (as for all active corruption offences), is approximately EUR 45 000, which is extremely low given the possible scale of large corruption transactions. Together with the main sentence, one or more additional penalties can be handed down, including closing one or more of the legal entity's activities or structures; placing the legal entity in controlled administration; a ban on participating in procurement funded by public funds; revoking the right to obtain or use licences, authorisations, concessions or subsidies; a ban on publicly seeking funds and financial resources; removing the right to exercise one or more activities or operations; and an obligation to publish the court decision. The law recognises compliance as a mitigating circumstance, i.e. the elimination of the organisational shortcomings which resulted in the criminal offence by applying organisational models suitable for preventing the criminal offence.

There have been few convictions of legal persons for corruption offences. According to the government, one sanction was applied in 2016, two in 2017, and two in 2018. The implementation of the legal framework for corporate liability would benefit from guidance on anti-corruption compliance (prevention measures) that legal entities should ensure in order not to be accused of failure to exercise due control or supervision.

### *Sub-dimension 16.5: Investigation and prosecution*

The level of **investigation activity regarding high-level corruption** has by far exceeded the levels of indictment and conviction. While 102 cases against high-level officials were sent for prosecution in 2018, and 90 cases in 2019, the numbers of indicted persons were respectively 7 and 5 (European Commission, 2019[79]; European Commission, 2020[233]). The statistics provided by the government indicate five convictions for high-level corruption in 2017 and three convictions in 2018. According to information provided by the government, as of October 2020, prominent cases handled by the institutional anti-corruption structure (abbreviated as SPAK; see below) included an investigation launched into the former Prosecutor General, as well as proceedings against 10 former judges in the High Court and the Constitutional Court.

Courts have reached convictions in a few prominent cases, such as the conviction for passive bribery of a judge of the Appeals Court by the Serious Crime Court of first instance in 2018 (confirmed by the instance of appeal in 2019). He was sentenced to imprisonment of 2.5 years, and the prosecution has requested confiscation of his assets EUR 144 810, USD 1 000, and ALL 9.3 million (Exit News, 2020[238]). Other high-profile convictions in 2019 concerned a former Minister of Interior, three judges of the Durres Appeals Court, and a judge of the High Court (European Commission, 2019[79]; European Commission, 2020[233]).

In terms of **specialised anti-corruption investigative and prosecutorial bodies**, the Constitution and the Law on Organisation and Functioning of Institutions to Fight Corruption and Organised Crime (adopted in 2016) have created the Special Anti-Corruption Structure (in Albanian: Struktura e Posaçme Anti-Korrupsion, SPAK). The SPAK consists of the Special Prosecutor's Office (SPO), which is independent from the Prosecutor General, and the National Bureau of Investigation (NBI), subordinate to the SPO.

The SPO was established in 2019, and it presents indictments in the anti-corruption and organised crime courts of first instance and appeal as well as in the High Court. In the period 9 March 2020-30 April 2020, 42 criminal proceedings were registered and 37 completed by the SPO.[203] The NBI is to become fully operational in 2021.

The legal framework contains safeguards for the independence of the SPO and the NBI. Based on competitive procedures, the High Prosecutorial Council (HPC) elects the Chief Special Prosecutor for a three-year term without the right to reappointment, and the Director of the NBI for a five-year term with the right to reappointment once. The Chief Special Prosecutor of the SPO should be elected from the ranks of the prosecutors of the SPO. Based on pre-defined rules of ranking, the HPC should appoint the best-ranked candidate. After an open and transparent recruitment process, a committee consisting of the Chief Special Prosecutor and the two special prosecutors with the most years of service should recommend a candidate for the position of the Director of the NBI to be appointed by the HPC. The HPC may dismiss the Chief Special Prosecutor and the Director of the NBI in cases established by law. The SPO carries out its functions independently, and the higher prosecutor may not instruct a special prosecutor on the merits of an investigation or case. Special prosecutors supervise the NBI and give directions to its investigators.

The SPAK has an independent budget as a separate item in the state budget. The Head of the SPO prepares the draft budget. When the Council of Ministers proposes a different budget proposal, the Head of the SPO has the right to participate in parliamentary proceedings to defend his/her own proposal.

In terms of staffing, as of July 2020, the SPO had 13 prosecutors (the minimum number according to the Constitution is 10 prosecutors). According to the law, the SPO is supported by several administrative units such as the Expertise Sector, the Financial Investigation Sector, and the Sector for International Co-operation and Liaison for Joint Investigations. However, according to information provided by the authorities in consultations in October 2020, the administrative staff of the SPO had not been fully recruited yet. In July 2020, the HPC appointed the Director of the NBI. Investigators of the NBI were selected based on competition, and the staffing was reportedly close to completion as of January 2021. According to law, the NBI will receive support from a commission of criminal justice experts appointed by the missions of the European Union and the US Government.

The Constitution envisages specialised courts with the competence to adjudicate corruption and organised crime as well as criminal offences committed by current and former high-level officials as defined by the Constitution and law. These specialised courts have been in operation since the end of 2019.

### *The way forward for anti-corruption policy*

To strengthen the anti-corruption policy framework and its implementation, policy makers should:

- **Establish legal obligations to carry out corruption risk assessments, develop integrity plans and implement corruption proofing of legislation**. The practice of risk assessment should be monitored and analysed to ensure that public institutions carry it out with sufficient thoroughness. Corruption risk assessment allows vulnerabilities to corruption to be detected even before corrupt acts happen. If carried out with commitment, due resources and skill, risk assessment is one of the most potent prevention tools. In Albania several public institutions have carried out risk assessments and used them to develop risk registers. Albania should make efforts to ensure that this practice becomes universal in the entire public sector. Including the relevant obligation in the law, providing necessary methodological support, and ensuring centralised monitoring of the quality of the assessments would

ensure an effective approach. Establishing the legal basis for systematic corruption proofing of legislation would be a key step to limit corruption risks arising from deficiencies in the legal framework.

- **Ensure effective operation of the new electronic system for declarations of public officials** to allow for automatic analysis, exchange of data and public disclosure. The Western Balkan Recommendation on Disclosure of Finances and Interests by Public Officials recognises monitoring by the general public as one of the most effective tools, and recommends making income and asset declarations available online. According to the recommendation, a useful public database of declarations requires electronic and free access, and data in searchable, machine-readable format (EIN, 2014[239]).
- **Further develop legislation to protect whistle-blowers,** including by providing protection for public disclosure and for persons connected with the whistle-blower, removing conditions for external reporting to the HIDAACI, and establishing the right to protection due to the mistaken identity of a whistle-blower. According to the relevant EU directive, a person who makes a public disclosure qualifies for protection if, inter alia, the person has reasonable grounds to believe that the breach may constitute an imminent or manifest danger to the public interest or, in the case of external reporting, there is a risk of retaliation or there is a low prospect of the breach being effectively addressed. The directive also envisages mandatory and optional measures of support for whistle-blowers, such as comprehensive and independent information and advice, which is easily accessible to the public and free of charge, on procedures and remedies available, on protection against retaliation, and on the rights of the person concerned; effective assistance from competent authorities before any relevant authority involved in their protection against retaliation; legal aid, counselling or other legal assistance; financial assistance and support measures, including psychological support, for reporting persons in the framework of legal proceedings.
- **Strengthen corporate liability for corruption offences** by significantly increasing the maximum applicable fines. International standards do not define what sufficient sanctions look like, but the OECD Working Group on Bribery in International Business Transactions recommends that monetary sanctions should be sufficiently severe to affect large multinational corporations. In certain economies, statutory sanction ceilings of a few million euros have even been found to be insufficient (OECD ACN, 2015[240]). While such high levels of fines may not appear relevant given the limited size of many companies in Albania, the law should provide the option of applying adequate sanctions in the event of a large business player engaging in corruption.
- **Monitor and analyse the investigation, prosecution and adjudication of high-level corruption cases** to identify and mitigate the factors behind the discrepancy between the large number of investigations and the small number of convictions. Several factors may lead to the failure of the majority of investigations to result in prosecutions and convictions, including inadequate qualifications or numbers of investigators and/or public prosecutors, inefficiencies stemming from procedural and/or substantive law, obstacles in international legal co-operation, weak case management and poor prioritisation of work, or even deliberate obstruction by some enforcement or prosecutorial officials, etc. The scope of this analysis does not allow specific conclusions to be drawn on the impact of these or other factors on combatting high-level corruption in Albania. However, a fair and transparent assessment of the obstacles is essential for raising the efficiency of the fight against corruption in the future. Box 20.20 gives some examples from other countries.

### Box 20.20. Performance monitoring and measuring of public prosecution bodies

In Portugal, statistical indicators are used to assess the quantity and quality of the work performed by public prosecutors. Regarding criminal investigation, data are available on the number of cases lodged, the number of cases closed, the number of cases leading to accusation or to dismissal, and cases where one of the simplified and consensual forms of proceedings, as laid down in the Criminal Procedure Code, has been used. There is also an overall control of all criminal inquiries highlighting those where a criminal investigation took longer than eight months. It is possible to ascertain the number of lodged and closed cases according to the complexity and type of crime and how many of them were against unknown perpetrators.

In Finland, the government has a performance guidance system. This means that the parliament grants a common operating budget appropriation to certain operations, e.g. the prosecution service, and sets general targets that the operations should achieve. Both qualitative and quantitative targets are set for the prosecution service. The most important quantitative targets are related to the time it takes to consider charges. Charges should be considered quickly and no case should remain under consideration for more than six months or a year. Qualitative targets relate to co-operation between the prosecutor and pre-trial investigation authority during pre-trial investigations, increasing the level of knowledge on certain criminal phenomena.

In Sweden, information management in the judicial system involves 11 authorities. The government uses several indicators to assess the performance of the authorities, presented in the annual Budget Bill. Indicators for crime investigation and prosecution directly concerning the prosecution services are:

- the number and percentage of suspected crimes resulting in prosecution (or summary imposition of a fine)
- the number and percentage of suspects being prosecuted (or receiving a summary imposition of a fine)
- case handling time.

Source: Abridged from OECD (2021), *Performance of the Prosecution Services in Latvia: A Comparative Study*, OECD Publishing, Paris, https://doi.org/10.1787/c0113907-en.

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## Notes

[1] A person from the Ministry of Finance and Economy who co-ordinates the whole assessment in Albania.

[2] Staff from the Institute of Statistics of Albania (INSTAT) who co-ordinate the statistical data collection.

[3] Key legislation regulating businesses include the Entrepreneurs and Commercial Companies Law, the Bankruptcy Law, the Environmental Law, Law on Corporate and Municipal Bonds, Transport Law, Maritime Code, Secured Transactions Law, Taxation Procedures Law, Banking Law, Insurance and Reinsurance Law, Mining Law, Energy Law, etc.

[4] Article 9 of the Foreign Investment Law.

[5] The Law on Expropriation introduces the concept of temporary use of private property for works and services in the function of the public interest, as well as for coping with needs and emergencies in events of force majeure, state of emergency or war. As with expropriation, the temporary use of private property must be respected and compensated for in value by-third parties.]

[6] Albania has signed 45 international investment agreements (IIAs).

[7] The law is aligned with Directive 2008/52/EC "On certain aspects of mediation in civil and commercial matters".

[8] Albania ranks 53rd on the starting a business dimension of the World Bank's Doing Business Index, while ranking 82nd out of 190 economies overall.

[9] A state-funded central body operating under the auspices of the Prime Minister.

[10] National Plan for Trade Policy Coordination and Trade Facilitation (2017-2020).

[11] Goods and services tax is the broad category, which includes VAT and excise taxes.

[12] Unlike some other WB6 economies that were more integrated into global value chains, which have had to cope with supply shortages due to broken supply chains.

[13] Economic Reform Program 2018-2020 and Economic Reform Program 2020-2022.

[14] These principles include avoiding quantitative restrictions on imports and exports, export subsidies, and all kinds of export taxes and export bans.

[15] Prime Minister's Order No.25, dated February 2nd 2018 "On the establishment of the inter-institutional group for coordination of trade policy and trade facilitation".

[16] The committee's main objectives as outlined in the law are to act as a forum for improving trade policies and their implementation, facilitating trade, and defining the main directions of trade facilitation. It is organised and functions based on the following principles: The principle of transparency by publishing on the committee's website any decision of the committee or any recommendation addressed to the Prime Minister or special ministers; The principle of conflict-of-interest prevention in any decision by the committee according to the provisions of Law no. 9367 dated April 7th 2005 "On the prevention of conflict of interest in the exercise of public functions"; The principle of protecting the public interest and business rights, encouraging involvement and enabling the business voice to be heard by decision-making and executive bodies in the country; The principle of proportionality and non-discrimination, by treating equally the interest and demands of the business community.

[17] Prime Minister's Order No.25.

[18] The Working Group has monthly meetings on trade policy. Its members include the Ministry of Europe and Foreign Affairs, Ministry of Agriculture and Rural Development, Ministry of Energy and Industry, General Directorate of Customs, Ministry of Defence and the Institute of Statistics.

[19] Law No. 146/2014.

[20] The public has access to draft and final trade documents. The law states that 1) institutions must publish all draft legal acts on the ministry's website; and 2) every draft legal act affecting the business community can be consulted 60 days prior to its approval in formal meetings. The time, place and manner in which the interested parties can submit recommendations are specified in the notice of commencement of the public consultation process.

[21] https://www.konsultimipublik.gov.al/

[22] Article 20 of Law no. 146/2014.

[23] Law no. 146/2014 "On public notification and consultation"; law no. 119/2014 "On the right to information"; and the Regulation of the Council of Ministers approved by decision no. 584, dated August 28th 2003 of the Council of Ministers.

[24] OECD Member states and partner economies: Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

[25] The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member states and partners states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.

[26] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[27] Ligj nr. 46/2015 "On Postal Services in the Republic of Albania".

[28] Ligj nr.7980, datë 27.07.1995, "Për shitblerjen e trojeve", Offical gazette 1995/18, last updated 26.11.1997, articles 5,6.

[29] Ligji Nr. 9901, datë 14.04.2008, « Për tregtarët dhe shoqëritë tregtare », Official gazette 2008/60, last updated 02.10.2014. Articles 115, 118.

[30] Law 108/2013 "On foreigners", Article 85 d). The entry of foreign nationals into the labour market in the economy is subject to a labour market test. Foreign nationals transferred within the enterprise according to letter d) of article 85 of law 108/2013 "On foreigners", as amended, are exempt from this obligation.

[31] Ligj Nr.108/2013 « Për të huaj », Official gazette 2013/48, last updated 30.03.2020, articles 22.

[32] Ligj Nr. 9643, datë 20.11.2006, « Për prokurimin publik », Official gazette 2006/133, last updated 13.12.2018.

[33] Currently, the thresholds are etablished by the Council of Ministers' decision on the application of rules of public procurement, nr. 914, of 29.12.2014 « Per miratimin e rregullave te prokurimit publik », official gazette 2014/208.

[34] In general, foreign investments are subject to the same regulations as domestic investments. There are no thresholds in place. However, Law no. 55/2015 “On Strategic Investment in the Republic of Albania” (Article 8) establishes the criteria that must be met for investments to be considered strategic. The Strategic Investment Law, as amended by Law No. 102/2018 2018 "On some additions to law no. 55/2015 "On Strategic Investments in the Republic of Albania ", added additional prudential conditions, none of which are discriminatory towards foreign suppliers and all follow good prudential practice.

[35] In order to facilitate comparison with OECD Member States that have undergone the Services Trade Restrictiveness Index exercise, the paragraphs below have been drafted in accordance with the methodology of the STRI project publications. The OECD Member’s Country Notes, as well as the Sector Notes, are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/

[36] Directive 2000/31/EC on electronic commerce.

[37] Only 40% of upper-middle class households have a bank account in Albania. This figure drops to 28% for the poorest households.

**Notes: Access to finance (Dimension 3)**

[38] Basel II is an international business standard developed prior to the 2008/09 crisis by the Basel Committee on Banking Supervision. It requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.

[39] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks’ risk management.

[40] Article 127 of the Banking Law of Albania from 2006 – the articule stipulats that “The Bank of Albania maintains the Credit Registry”.

[41] At the time of drafting, the AASF was in the process of becoming the Agro-Tourism Facility, awaiting ratification from the parliament. To increase the uptake it is foreseen that the EU will provide for the EBRD an investment incentive grants for a total EUR 3 million to cover 10% reimbursement of investment values in agri-tourism related businesses.

[42] For details see http://euforinnovation.al/.

[43] A white paper is created by the founders and/or developers to guide investors with charts and technically focused information on how to address and solve issues that might be encountered in the chain.

[44] Law no. 62/2020 on Capital Markets.

[45] The OECD Database on General Competition Statistics (OECD CompStats) contains general statistics about competition agencies, including data on enforcement and information on advocacy initiatives. In 2020, it included data from competition agencies in 56 jurisdictions, including 37 OECD countries (36 OECD countries and the European Union), i.e. Argentina, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas): Australia, Brazil, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other). See (OECD, 2020[407]).

[46] The SOE figures included in this profile are based on data provided by the Albanian authorities for this assessment. The figures were gathered by a working group comprising representatives of the Albanian Institute of Statistics (INSTAT), the Ministry of Finance and Economy and the Bank of Albania. The national authorities included in their reporting all public entities classified, in national nomenclature and in line with the European System of Accounts, as extra-budgetary units, public non-financial corporations and public financial corporations. Several entities reported by the authorities as SOEs have been excluded from this profile's figures because they are only minority-owned by the central or municipal governments, and thus not considered SOEs according to OECD definitions.

[47] The English names for SOEs in Albania are unofficial translations employed to facilitate an understanding of the types of companies that are state-owned.

[48] This estimate is based on a reported total number of SOE employees in 2020 of 19 667 and a total employed population in 2018 of 1 230 000 as reported in INSTAT (2018), http://www.instat.gov.al/en/Home.aspx

[49] SOEs' estimated share of total national employment in Albania for SOEs at all levels of government is as illustrated in (IMF, 2019[80]), page 8 "Figure 4. Evolution of SOE Footprint (2005-2016)".

[50] For example, media reports in 2019 highlighted that three individuals with close personal connections to the mayor of Tirana had been accorded positions on the boards of SOEs. His spouse was serving on the board of OSSHE (the Public Operator for the Distribution of Energy) and two journalists with alleged close personal connections to the mayor were serving on the board of Tirana Water Supply Directorate.

[51] According to the law regulating audit and accounting practices in Albania, an external audit of financial statements must be performed for companies which exceed two of the following indicators for two consecutive years: balance sheet assets of ALL 50 million (~EUR 400 000); income of ALL 100 million (~EUR 800 000); or an average of 30 employees during the accounting period.

[52] The information concerning audit practices in several large SOEs is based on the independent assessment conducted for the 2018 edition of the *Competitiveness Outlook* (OECD, 2018[60]).

[53] The privately-owned Albanian Stock Exchange is operational, but only sells government securities.

[54] A fourth SOE, the *Fruit Market of Shkodër* is 67.21%-owned by the central government, but the remaining shares are owned by the municipality, so the enterprise is considered 100% state-owned.

[55] See, for example, (US Department of State, 2019[408]).

[56] The Consultation and Transparency Committee is established by the Minister of Finance and Economy and comprises the following representatives of departments within the ministry: the Deputy Minister of Finance and Economy (who serves as Chairman of the Committee); one representative of the General Directorate of Regulation and Compliance; two representatives of the General Directorate of Economy Affairs and Support Services and a representative of the Audit Directorate.

[57] The information on impediments to competition in the energy is drawn largely from a European Commission staff document dated 29 May 2019 (European Commission, 2019).

[58] The new curriculum includes programmes for children aged 3-4, 4-5 and 5-6 years old.

[59] For the purpose of this profile, instruction system refers to teaching and learning processes that takes place in school education. It generally consists of curriculum, standards for schools and student learning, assessment and evaluation frameworks and other elements that support instruction.

[60] The policy priorities in the Albanian Pre-University Education Development Strategy 2014-2020 are: improving leadership and management capacities of pre-university education system resources; quality and inclusive learning; quality assurance based on comparable standards with EU countries; and modern teacher training and development.

[61] Introduced in 2015-16, the VANAF serves as Albania's national assessment instrument and is taken each year by all Grade 5 students.

[62] The Ministry of Education, Sport and Youth established the Centre for School Leadership in 2018, with the support of the Albanian-American Development Foundation.

[63] The Teachers for Albania portal. https://mesuespershqiperine.al/

[64] In 2017, the pass rate for all tests of the National Basic Education Examination was 99.2%, which indicates that the National Basic Education Examination is not a barrier for entry into upper secondary education

[65] According to data provided for this assessment, the number of private universities in Albania grew rapidly in the early 2000s, reaching a peak of around 45 institutions in 2012. Today, Albania has 26 private and 14 public universities. Only around 18% of tertiary students are enrolled in private institutions – a share that is slightly lower than the Western Balkan average (UIS, 2020[83]).

[66] Law No. 80/2015, On Higher Education and Scientific Research in Higher Education Institutions in the Republic of Albania.

[67] Selection into higher education requires successful completion of upper-secondary education, a minimum grade point average and score on the State Matra examination. Specific requirements are set by individual higher education institutions.

[68] Financial aid to students in Albania is based on academic merit, students who plan to study in areas of national priority and students from disadvantaged social groups (as defined by the Council of Ministers).

[69] Examples of disaggregated data include enrolment and completion by age, gender and socio-economic background.

[70] Academic Senates within higher education institutions are comprised mainly of faculty members and students, although other representatives may participate if allowed for by the institutions statute, which determines the number of members, modes of operation and representation (Government of Albania, 2015[335]).

[71]The 2019 evaluation of Albania's pre-university education strategy was supported by UNICEF. While there are no comprehensive annual reports on the performance of the education system, there is a statistical yearbook on education, sports and youth and technical agencies prepare annual reports based on their respective programmes of work. Albania also produces thematic reviews and evaluations of specific policies.

[72] (WIIW, World Bank, 2020[127]) (INSTAT, n.d.[105]) and (Eurostat, n.d.[104]). Activity rate was 71.2% on average in Bulgaria, Croatia, Hungary, Romania and Slovenia.

[73] The activity rate of those aged 65+ was 11.7% for women and 19.8% for men in 2019.

[74] Stakeholder assessment collected by the independent expert.

[75] Updates provided by Instat.

[76] Updates provided by the Government of Albania.

[77] Information provided by external expert.

[78] Law nr.7961 dated 12.07.1995 "Labor Code of the Republic of Albania".

[79] DCM No.108, dated 15.2.2017 "On the approval of the regulation on the protection of children at work".

[80] The framework of the project "Measures to Protect Children from Trafficking, Exploitation for Work and Unsafe Migration" is funded by the governments of Italy, Germany and France.

[81] Government answer to questionnaire.

[82] Information provided by independent expert.

[83] During 2019, the Labour Inspectorate undertook more than 14 000 labour inspections; 357 inspected entities were fined and 160 main administrative fines were imposed. This means that less than 5% of labour inspections resulted into fines in 2019. As a comparison in Austria irregularities have been detected in nearly half of all inspections. See https://www.arbeitsinspektion.gv.at/Service/Taetigkeitsberichte-_Unfallberichte/Taetigkeitsberichte.html

[84] The State Labour Inspectorate is evaluating the historical data of inspections, the frequency of inspections per entity, the type of economic activity that the entity carries out, the reasons for previous inspections, etc. By assessing the coefficients for data from the inspection it aims to generate the "Penalty matrix", the level of risk for each subject (information provided by the government).

[85] With less than 50 employees.

[86] Information provided by independent expert.

[87] According to our calculations.

[88] According to stakeholders' assessment.

[89] Government response to the questionnaire.

[90] Information received by Albania.

[91] Similarly, the Adult Skills Survey of 2017 shows a participation in formal and non-formal learning of 9.2%.

[92] World Bank and WIIW, 2020: Jobs Gateway Database, based on data provided by national statistical offices and Eurostat, WIIW (own calculations).

[93] Highest wages are earned in the information and communication sector and in the financial services. Wages in public administration and defence; compulsory social security; education; human health and social work activities are 6% higher than wages in real estate activities; professional, scientific and technical activities; administrative and support service activities. (INSTAT, n.d.[126])

[94] Instat and Eurostat (unadjusted gender pay gap). There are no data available for the EU gender pay gap in 2019.

[95] According to administrative data from the tax office, women's employment in the construction sector is 14% whilst the Labour Force Survey reports only 3%. The very low figure identified by the LFS might be due to under-reporting in the survey as a result of either technical survey issues or women's self-perception. A large share of women employed in the construction sector work as accountants, economists, HR specialists, or lawyers, and therefore might not identify with the notion of being engaged in "construction" as such.

[96] Government's response to questionnaire.

[97] For example, the organisation Different and Equal helps integrate the victims of human trafficking into the labour market, the Centre for Human Rights in Democracy promotes victims of domestic violence in the labour market, as well as Women's Center Light Steps, etc.

[98] An important role here is played also by the Community Development Center "Today for the Future", throught its projects it has supported 1 391 beneficiaries in the districts of Shkodra, Lezha and Korça, starting from 2014; 67% of them are integrated and re-integrated into the formal labor market (through employment and self-employment.); 139 women and girls on the Durres region are supported with formalisation of work, especially in the field of services and manufacturing enterprises, where a focus was given to the provision of salaries, especially in cases where informal payments were provided to them below the minimum wage and the coverage of social insurance, making them moving from informal work and payment under the minimum wage (Information provided by Albania).

[99] In France and Germany, for comparison, the average caseload of hard-to-place jobseekers is around 70 jobseekers per employment counsellor, though the caseload may vary in these countries between 100 and 350, depending on how many jobseekers need individual guidance and their autonomy in using self-help guidance tools (OECD, 2015[342]; Manoudi et al., 2014[343]; Pôle emploi, n.d.[344]).

[100] Envelope wages occur when an employee receives an official declared salary based on a formal written contract and an additional undeclared ("envelope") wage. This envelope wage is based on an unwritten verbal contract, which supersedes the formal written contract.

[101] Instat uses the following definition of informal employment: The informal employment is the sum of employed in agriculture and non-agricultural sector. Informal employment in non-agricultural sector include: employees who do not benefit from paid annual leave; employees who benefit from paid annual leave but do not benefit from paid sick leave in case of illness; employees who benefit from paid annual leave and paid sick leave, but their employers do not pay social security contributions for them; contributing family workers; self-employed persons who work in small enterprises with five or less persons employed (including employer), their workplace is alternatively their own home, the client's/employer's home, a structure attached to their home, a fixed stall in the market or on the street, or a changing location. Informal employment in agricultural sector includes contributing family workers.

[102] Information provided by independent expert.

[103] Government's response to the questionnaire.

[104] INSTAT estimates the number of emigrants and immigrants based on the integrated migration module in the Labour Force Survey since 2015. http://databaza.instat.gov.al/pxweb/sq/DST/START__MM/EM_01/?rxid=dddc8d19-1d0a-4cc4-aa83-2674b798872e.

[105] Government's answers to questionnaire.

[106] Horizon 2020 is the European Union's biggest framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument. (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020).

[107] Eureka is the largest intergovernmental network for co-operation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and innovation and offers advice through various programmes (such as EUREKA Clusters, Globalstars, InvestHorizon) (https://www.eurekanetwork.org/).

[108] The European Research Area (ERA) reflects an ambition to create a unified research area open to the world, based on the EU Internal Market, that enables free circulation of researchers, scientific knowledge and technology (https://ec.europa.eu/info/research-and-innovation/strategy/era_en).

[109] EURAXESS - Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU Member States and associated countries. It supports researcher mobility and career development and enhances scientific collaboration (https://euraxess.ec.europa.eu/).

[110] European Cooperation in Science and Technology (COST) is a is an EU-funded, intergovernmental framework, currently comprising 38 Members and 1 Cooperating Member. It is a funding organisation for the creation of research networks (COST Actions), which offer an open space for collaboration among scientists across economies. COST funding is intended for collaboration activities and complements national research funds (https://www.cost.eu/who-we-are/about-cost/).

[111] Marie Skłodowska-Curie Actions (MSCA) is an EU programme which provides grants to support research careers and encourages transnational, intersectoral and interdisciplinary mobility. (https://ec.europa.eu/programmes/horizon2020/en/h2020-section/marie-sklodowska-curie-actions; https://ec.europa.eu/research/mariecurieactions/msca-actions_en).

[112] Only quarterly data for 2019 and 2020 have been released by the Albanian Institute of Statistics at the time of writing this text (26/01/2021).

[113] The project includes an initial grant of EUR 520 000 followed by a potential investment loan of more than EUR 18 million from WBIF and another EUR 24 million from the European Investment Bank (EIB) (https://wbif.eu/project/PRJ-ALB-DII-001).

[114] The results of the Feasibility Study and CBA were presented during the closing workshop of the project on 28 July 2020 (https://eeas.europa.eu/delegations/albania/83464/regional-broadband-infrastructure-development-albania-closing-workshop_en).

[115] The draft Law on Open Data was prepared by the Ministry of Infrastructure and Energy in co-operation with the Commissioner for the Right to Information and Protection of Personal Data. The legal package includes the draft law, an explanatory report, a compliance chart and a Regulatory Impact Assessment. The draft law has already passed through the consultation process and has been approved by the Council of Ministers. At the time of writing, it had been passed to the National Assembly for adoption (October 2020) and will come into force two years after its adoption. Regulations delineating how the law will be implemented are planned for after its adoption.

[116] The Open Government Data Portal of Albania (http://opendata.gov.al/).

[117] Portal of the Partnership for Open Government Initiative (PQH/OGP) (http://ogp.gov.al/).

[118] Open Government Partnership (OGP) is an international agreement aiming to increase transparency, civic participation and the use of new technologies in achieving a more open, effective and accountable government. Currently, 78 governments are members of the partnership (https://www.opengovpartnership.org/about/approach/).

[119] The Electronic Register of Public Notifications and Consultations (https://konsultimipublik.gov.al/)

[120] See https://www.shqiperiaqeduam.al/.

[121] TechSpace was launched in February 2019 and by mid-2020 it had more than 1100 registered young people and more than 100 startup-business ideas in the field of ICT (https://techspace.al/).

[122] The Agency for the Delivery of Integrated Services Albania (ADISA) is an agency of the Albanian Government under the supervision of the Prime Minister's Office. ADISA was created to provide Albanian citizens with efficient, high-quality and transparent public services (https://adisa.gov.al/).

[123] European IPA Twinning project “Institution-building for alignment with the EU acquis and enhanced ability to meet economic criteria”. Twining activity will be performed with the Italian Personal Data Protection Authority, in co-operation with the “Institute of Human Rights” Austria and the “Consorzio per il Sistema Informativo”, Italy. The beneficiary is the Office of the Commissioner for Right of Information and Data Protection (IDP). The project started implementation on 1st October 2020.

[124] Pursuant to the Law No. 137, dated 16.11.2020 "On 2021 budget", with the Decision of the Parliament of the Republic of Albania no. 84/2020 “On some addenda and amendments to Decision no. 86/2018 "On the approval of the structure, organization and classification of salaries of the Information and Data Protection Commissioner” the amended structure and organization of the Office of the Commissioner was approved and became effective on 1 January 2021. Out of 11 new staff members requested by the Commissioner’s Office since 2016, only 4 were approved until 2020.

[125] Full transposition of the eIDAS Regulation (EU 910/2014) is planned for 2022.

[126] The Internet Safety Awareness Campaign for children was conducted by AKCESK and the Ministry of Education, Sports & Youth in co-operation with UNICEF (https://www.unicef.org/albania/press-releases/children-albania-lead-internet-safety-awareness-campaign).

[127] A single project pipeline (SPP) is a list of projects developed based on a strategic tool for project planning to avoid an ad-hoc approach to planning preparation and implementation of investment projects. The SPP helps to ensure strong project prioritisation, to enable systematic and timely planning of resources, to provide a reliable basis for defining the proper sequencing of the priority axis and actions per sector, and to help link investment planning and programme budgeting.

[128] This information system consists of the following components: the Albanian Financial Management Information System (AFMIS), the Financial Information system of the Government (SIFQ), the Electronic Notice Register and Public Consultations (RENNKP), the Archive System of the Centre of Official Publication (BQZ System), and the Database of Statistical Data.

[129]The government has provided the following information on 46% of the legislation needed to be harmonised with the TCT: 7% is fully transposed and implemented, 13% is partially transposed and implemented, 25% has not been transported and implemented yet, and 1% is currently not applicable to the Government of Albania. The government has not provided responses for the remaining 64% of legislation. At the same time, responses have been fully provided for TEN-T development (50% transposed and implemented, and 50% partially transposed and implemented), and for railway transport (0% fully transposed and implemented, 14% partially transposed and implemented and 86% not transposed yet).

[130] The Rio markers were originally designed to help members prepare their National Communications or National Reports to the Rio Conventions, by identifying activities that mainstream the Conventions’ objectives into development co-operation. For more information, please see: https://www.oecd.org/dac/environment-development/Revised%20climate%20marker%20handbook_FINAL.pdf.

[131] It covers disqualification or conviction by a final court decision for any of the following criminal offences: a) participation in a structured criminal group, criminal organisation, armed gang, terrorist organisation; b) corruption; c) fraud; c) money laundering or terrorist financing; d) acts with terrorist intent or criminal offenses related to terrorist activities; dh) organization, direction or financing of the activity of production and sale of narcotics, as well as of the activity of narcotics trafficking; e) forging; e) Exploitation of the work of minors and other forms of trafficking in human beings. Conflict of interest, confidential information and bid security have been also amended in 2017 to the Law.

[132] A one-stop shop (OSS) is a business or office where multiple services are offered; i.e., customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one location, instead of having to "drive all over town" to attain related services at different stores. A one-stop shop is a way of facilitating trade.

[133] An appropriate definition of “asset management” for the roads sector is that proposed by the OECD in 2001: “A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organized and flexible approach to making the decisions necessary to achieve the public’s expectations”. (OECD, 2001[357]).

[134] The first survey took place only in the regions of Tirana and Korçe and covered a network of about 780 kms. The second survey (2008-09) covered about 1 570 kms in various regions. In total, the two inventory surveys covered about 2 350 km (of a total of about 3 700 km of national roads). The inventory included 11 road features such as: carriageway, shoulder, road markings (lines), protection walls etc. as well as road characteristics such as horizontal curvature, surrounding area etc.

[135] Through implementation of the Guideline of the Minister No. 1362, dated 2016, on rules for setting airport charges in accordance with relevant provisions of the Concession Agreement signed between the Council of Ministers of the Republic of Albania and the concessionaire "Tirana Airport Partners”.

[136] The Local Single Sky Implementation (LSSIP) documents are the yearly expression of commitment of civil and military national organisations (regulators and national supervisory authorities), service providers and airport operators, towards the implementation of the European ATM Master Plan.

[137] Safety culture is a civil aviation safety programme. The State Safety Program (SSP) is an integrated set of regulations and activities aiming to improve safety (e.g. safety risk management, safety assurance).

[138] Some of the indicators include traffic flows, IRI coefficient for heavy goods vehicles (daily traffic divided by axis/axle weight), and data for populating the new asset management system being developed for the road sector.

[139] Additional indicators that would be useful to measure road network performance include average user costs, travel time satisfaction level i.e. reliability, value of assets, market research and customer feedback, forecasted value of assets, audit programme, quality of user information, allocation of resources, long-term programmes for investment, maintenance and operations, lowering of overhead percentage, etc.

[140] For more details see (Transport Community / CEFTA, 2020[358]), (Transport Community, 2020[196]), (Government of Serbia, 2019[359]), (Estonia Border, n.d.[360]), and the border queue management system in Baltic countries (example from Estonia) at https://www.estonianborder.eu/yphis/index.action.

[141] Adopted by the Decree of the Council of Ministers No. 125, dated 23 February 2011.

[142] Regulations resulting from the strategy are related to driving licences, tunnel safety, crash data system, tachographs, blood alcohol concentration, usage of narcotics, seatbelts, helmets for motorcycles and pedestrians including children, etc.

[143] The main sources of information on road accidents in Albania are the Albanian Traffic Police (data collection in the field) and the Ministry of Health (collection of information on injured persons).

[144] It consists of a standalone, Microsoft Office Access database. It also lacks a data linking capability with other databases in Albania, such as those of the Ministry of Health, Road Authorities, etc.

[145] The form to be used by Traffic Police will especially be compliant with the minimum set of standardized data elements of the Common Accident Data Set (CADaS) recommended by the European Commission.

[146] Combined transport refers to the transport of goods between Member States where the lorry, trailer, semi-trailer (with or without tractor unit, swap body or container of 20 feet or more) uses the road on the initial or final leg of the journey and rail or inland waterway or maritime services on the other leg, where this section exceeds 100 km as the crow flies (Combined Transport Directive 92/106EC, amended by the Directive 2013/22/EU).

[147] These include: 1) establishing a National Intermodal Centre in Tirana and two affiliated interoperation centres; 2) a strategic project in the Albanian Port of Saranda; 3) Integration of APD2 programme at Romano port area; 4) an intermodal project for linking the ports of Durres to the port of Piraeus with CB Railways; 5) deployment of the pilot intelligent transport system; 6) a railway and combined transport project linking Ports of Vlora s.a. and Petrolifera to the Energetic park at Romano port, through a logistic Interport project; 7) digitalisation of master plans for Shengjini port; 8) an integrated master plan for the AL landlord ports; 9) promotion of IWW and Railway in TEN-T MED through the Shkoder and Prespa and Ohrid lakes; 10) promoting a MOU on Milot-Kosovo railways (PPP); 11) a National R & I Railways Strategy for Albania; 12) Digitalisation rail and maritime training centre; 13) a sustainable smart mobility strategy for Albania, including the municipalities and line ministries; 14) a smart specialisation strategy for railways as in the SST; 15) an integrated storm awareness system and railways and maritime joint investigation body; and 16) 20 priority actions for competitiveness.

[148] Timeliness of shipments in reaching destination within the scheduled or expected delivery time.

[149] Quality of trade and transport related infrastructure (e.g. ports, railways, road, information technologies).

[151] This is based on a government response to an enquiry to question 1.1.4 within the Competitiveness Outlook assessment questionnaire.

[152] At this stage it is too soon to state when this emission market will be in place. The deployment of such a market is complex as it will require an extensive monitoring, verification and reporting system as well as training for stakeholders.

[153] Furthermore, ERE has not been able to unbundle Operatori i Shpërndarjes së Energjisë Elektrike SH.A (see the unbundling section), which would suggest an inability to use its independence to implement legislation and regulation in line with international best practice.

[154] Apart from the area governing the wholesale market, which is currently absent (Energy Community Secretariat, 2020[199]; Energy Community Secretariat, 2020[201]).

[155] The TAP pipeline is a natural gas pipeline running from the Turkish border, through Greece and Albania and eventually ending in Italy. For more information, please see https://www.tap-ag.com/about-tap.

[156] The IAP pipeline is a project intended to connect Croatia and Montenegro via Albania with the TAP pipeline, opening these countries to international supply of natural gas. For more information, please see https://www.energy-community.org/regionalinitiatives/infrastructure/PLIMA/Gas16.html.

[157] The current tariffs are: EUR 50.35 per MWh for hydropower (for plants with a capacity of up to 15 MW), EUR 100 per MWh for solar (with capacity of up to 2MW), and EUR 76 per MWh for wind (with capacity of up to 2 MW).

[158] For a list of laws on energy efficiency please see https://www.infrastruktura.gov.al/ligje/.

[159]This score reflects sustainability, which encompasses energy efficiency. Since this assessment was made by the Energy Community Secretariat, Albania has made progress by adopting several important regulations. Moreover, it is expected that this year Albania will adopt the Rules on the approval of Minimum Energy Performance Requirements on buildings and its elements, the Rules on the approval of the National Calculation Methodology for energy performance in building, and the Rules on the approval of the procedures and conditions for energy performance certification of buildings, as well as creating a database on building stock and energy performance.

[160] For the reports, please see https://www.energy-community.org/implementation/Albania/reporting.html.

[161] A regional project funded by the GIZ-ORF fund for South East Europe aims to support the deployment of a Monitoring and Verification Platform. For more details, please see https://www.giz.de/en/worldwide/31746.html.

[162] It is too early to assess the state of regional integration for the natural gas market as without a natural gas market, integration can only progress so far. Nonetheless, there is positive development with regard to regional pipeline network (as part of the TAP, IAP; and Albania-1244 interconnector) in which Albania is a central stakeholder.

[163] "A CONTROL BLOCK comprises one or more CONTROL AREAS, working together in the SECONDARY CONTROL function, with respect to the other CONTROL BLOCKS of the SYNCHRONOUS AREA it belongs to" (ENTSOE, 2004[409]). An alternative explanation can be found under Emission-EUETS (Emissions-EUETS, 2019[410]).

[164] Lowest cost refers to that Korporata Elektroenergjitike Shqiptare operates a hydro power generation fleet that has been depreciated substantially and that hydro power generation does not have variable fuel cost associated with the generation of electricity.

[165] Whereby consumers would look for and sign contracts with supply companies that can obtain electricity from the wholesale market.

[166] The plan includes nine measures, some of which focus on reducing energy consumtpion and developing environmentally-friendly transport modes. Some measures have direct on energy savings and pollutant reduction (e.g. renewal of the car fleet stimulated by efficiency-based fees and incentives).

[167] These measures comprise: identification and implementation of adaptation response measures in the Drin-Mati river deltas; strengthening local communities living nearby the Kune-Vain Lagoon System to adapt to the adverse effects of climate change using ecosystem-based adaptation approaches; water and irrigation reserve project aimed at preparing the National Strategy for Integrated Water Resources Management; vulnerability assessment and adaptation plan for the city of Tirana, which sets the basis for mainstreaming climate change adaptation into the city planning processes; and Flood Risk Management Plan for Shkodra Region.

[168] In November 2019 Albania was hit by one of the most devastating earthquakes in the last several decades with a magnitude of 6.3 on the Richter scale at a depth of 38 km. The earthquake affected a total of 202 291 people, with 17 000 citizens displaced due to the loss of their homes, and caused EUR 985.1 million damage, equivalent to 6.4% of the 2018 GDP in damage and to 1.1% of GDP in losses (EU, UN and World Bank, n.d.[372]). The extent of the damage demonstrated the main issues related to the preparedness for natural hazards, such as the lack of modern and homogenous equipment for the operational forces, the lack of skilled human resources, as well as the insufficient training in emergency co-ordination (Ibid.).

[169] The Government of Albania approved a Master Plan in January 2020 that outlined the creation of 10 waste areas, created as a result of closing most of the illegal dumpsites, rehabilitating other sites (where there is only one site in the municipality it must be rehabilitated) and building new landfills.

[170] More information on EU waste policy and legislation at https://ec.europa.eu/environment/legal/law/6/pdf/02_aile_eU_waste_legal_framework_speakers_notes.pdf.

[171] In August 2020, Nisma Thurje, a civil society organisation, filed a report with the Special Anti-Corruption Prosecutor's Office (SPAK) against the Fier waste incinerator, concerning allegations that the "principle of equality in public procurements" had been breached in the deals. https://balkaninsight.com/2020/09/28/the-incinerator-how-a-politically-connected-albanian-built-an-empire-on-waste/

[172] Separate collection has only been introduced to date within the frame of several pilot projects funded by intergovernmental and non-governmental organisations (UNECE, 2018[214]).

[173] The DMC transposes the following EU directives: Directive 2000/60/ EC of the European Parliament and of the Council of 23 October 2000 "Establishing a legal framework for community action in the field of water policy", as amended by Decision 2455/2001 / EC, Directive 2008/32 / EC and Directive 2008/105 / EC; Directive 2009/90/ EC laying down, pursuant to Directive 2000/60/EC of the European Parliament and of the Council, technical specifications for chemical analysis and monitoring of water status; Directive 2006/118/ EC "On the Protection of Groundwater against Pollution and Deterioration"; and Directive 2007/60 / EC "On the Assessment and Management of Flood Risks".

[174] The Water Resources Management Agency is responsible for designing and implementing policies, strategies, plans, programmes and projects aimed at the integrated management of water resources, quantitative and qualitative conservation, as well as their further consolidation. The Ministry of Agriculture and Rural Development is in charge of managing irrigation and drainage activities. The Ministry of Infrastructure and Energy (MIE) prepares policies and strategies for the water supply sector and for the collection and treatment of wastewater. The National Water Supply and Sewerage Agency is an institution that reports to MIE, and specialises in drinking water supply, collection and treatment of wastewater. The Ministry of Health is also responsible for co-designing and implementing quality policies and strategies related to drinking water supply. The Ministry of Defence oversees the Agency of Civil Emergencies, which implements the National Plan for Civil Emergencies. The National Environmental Agency (NEA), under the

auspices of the Ministry of Tourism and Environment, is responsible for quality and quantitative monitoring of water resources. Finally, the Albanian Geological Survey, National Regulatory Authority for Water Supply and Wastewater Treatment, National Agency for Protected Areas, River Basin Administration Offices, and local municipalities are all also in charge of water-related matters.

[175] EU Regulation (EU) 511/2014 "On compliance measures for users of the Nagoya Protocol on access to genetic resources and fair and equitable sharing of derived benefits from their use in the EU ", which provides the provisions for the implementation of the Nagoya Protocol in the European Union.

[176] High nature value (HNV) forestry is a comparatively new term used to describe some of the oldest and most biodiversity rich forestry systems in Europe, many of which are now under threat. On this HNV land, for hundreds or even thousands of years, semi-natural habitats and wild species have been interdependent with low-intensity management by local communities (Düll et al., 2018[120]).

[177] Vjosa-Narta is a protected lanscapte area in southwestern Albania. Vjosa is considered to be Europe's last wild river. The International Union for Conservation of Nature(IUCN) has listed the park as Category VI. It is also listed as an important Bird and Plant Area, because it supports significant bird and plant species (Düll et al., 2018[120]).

[178] Fine particulate matter ($PM_{2.5}$) is the air pollutant that poses the greatest risk to health globally, affecting more people than any other pollutant. This becomes of even greater concern in the context of the COVID-19 pandemic knowing that exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to COVID-19 (OECD, 2020[74]).

[179] Although data quality could be improved on various levels, the NPAQM states that "there is no doubt that traffic is by far the most important source of air pollution in Tirana" and recommends that the measures to improve air quality in Zone A should concentrate on traffic.

[180] Key government bodies include the Ministry of Tourism and Environment, line ministries responsible for infrastructure and energy, urban development, transport and industry (MIE), agriculture and rural development, health and social protection (MHSP), finance and economy, the National Environment Agency and its regional agencies of environment in 12 districts, the State Inspectorate of Environment.

[181] Vegetables constitute about 21% of all agri-food exports, marking a significant increase on 2005 when it was less than 3%. However, low prices for vegetable products remain a crucial issue for producers. One of the main reasons is that Albanian products are not standardised and are rarely certified (e.g. with Global GAP certification is made up of interlinking mechanisms that ensure the proper development, implementation, improvement, integrity, transparency and harmonisation of our certificates).

[182] Safety, hygienic and quality standards are lacking in most of the livestock producers. Cooperation between the actors of the value chain and other stakeholders is limited and weak. Product diversification and introduction of new products, together with marketing, labelling and other marketing tools are lacking or are very sporadic, which have inhibited the growth of the sector.

[183] The responsibilities of the Agency of Water Resource Management are 1) the implementation of international agreements and conventions on national water resources and transboundary waters to which the Republic of Albania is a party and 2) the coordination and control of local water management bodies.

[184] Together they cover 1) rural development interventions; 2) national interventions related to income support to farmers, development of rural infrastructure and ensuring equal opportunities; and 3) institutional development, regulation and enforcement.

[185] The responsibilities for the agricultural support policy are divided among the: 1) MARD, responsible for drafting and implementing policies for the sustainable growth of agricultural and livestock production; 2) Managing Authority responsible for preparing and implementing the IPARD programme; 3) Agricultural and Rural Development Agency/IPARD Agency responsible for implementing (including financial disbursement) agricultural policies and rural development; and 4) Regional Agricultural Extension Agencies responsible for providing information and assisting farmers to benefit from national support schemes, IPARD and other projects in the field of agriculture and rural development.

[186] HACCP is a United States-based system that identifies, assesses and controls significant biological, chemical and physical hazards with regard to food safety and determines critical points for their control.

[187] The key players in the agriculture innovation system are the: 1) Academy of Sciences, which contributes and promotes the achievements of scientific research and proposes new scientific and study fields in line with the economy's development priorities; 2) Agricultural University of Tirana, whose research institute conducts basic and applied scientific research in agriculture; 3) Agriculture Faculty of Korca that offers teaching and some applied research projects in management and marketing of agricultural and livestock products; and the 4) Agricultural Technology Transfer Centres (ATTC), responsible for farm level research and testing for problems raised by farmers in the region.

[188] Available at: https://turizmi.gov.al/wp-content/uploads/2019/12/National-Tourism-Strategy-2019-2023-EN.pdf.

[189] SRD is a programme implemented by GIZ, funded by BMZ (German Federal Ministry of Economic Cooperation and Development), which aims to diversify the rural economy, especially sustainable tourism development and growth of competition in the agricultural sector. The programme identifies issues faced by businesses and companies in the tourism industry related to the COVID-19 pandemic and emergency situation in Albania.

[190] The Thematic Group was established by the Order of the Prime Minister, dated 22.10.2018.

[191] The first tourism development strategy was prepared in 1992.

[192] More information at https://www.investment.com.al/investment-council/.

[193] The Republic of Albania launched electronic visas on 2 November 2020. Electronic visa are now functional in addition to the stamp visa currently in use. The e-Visa can be accessed through https://e-visa.al/ portal.

[194] Pursuant to Order no. 267, dated 24.07.2019 "On the approval of the regulation on the manner, criteria, and procedures for categorization of accommodation structures", as amended.

[195] Under the Economic Reform Program 2019-2021, Albania committed itself towards standardisation of tourism services, including registration of all types of accommodation (including private apartments and rooms).

[196] Document of Strategic Policies for the Protection of Biodiversity in Albania – DCM no. 31, date 20.1.2016, Law 81/2017 "On Protected Areas".

[197] For example: see Slovenia's Green Scheme: https://www.slovenia.info/en/business/green-scheme-of-slovenian-tourism.

[198] Website of the Ministry of Justice: https://drejtesia.gov.al/strategjia-ndersektoriale-kunder-korrupsionit/

[199] Website of the HIDAACI: http://www.ildkpki.al/guida-dhe-manuale/

[200] Website Open Spending Albania: http://spending.data.al/en/moneypower/list

[201] Website of the High Judicial Council: http://klgj.al/vende-vakante-ne-pushtetin-gjyqesor/

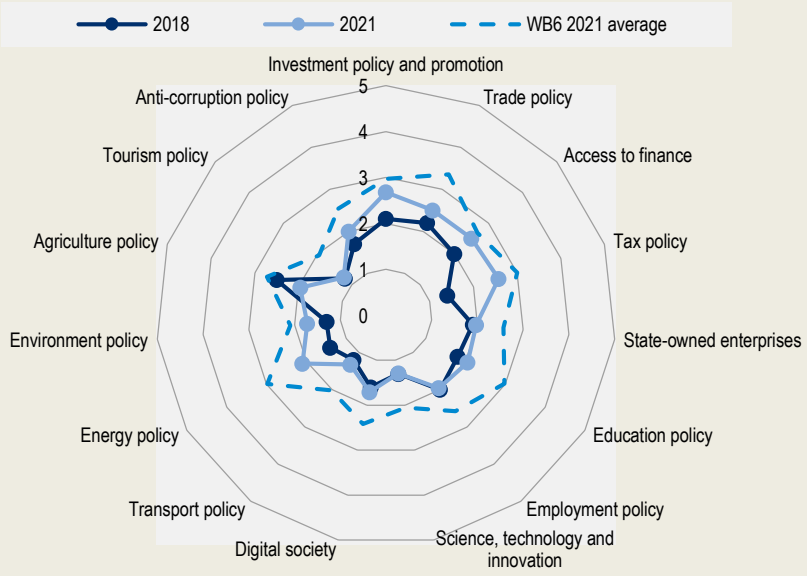
[202] Website of the Extractive Industries Transparency Initiative: https://eiti.org/countries

[203] Website of the SPAK: https://spak.al/2020/04/30/mbi-aktivitetin-e-prokurorise-se-posacme-ne-periudhen-09-03-2020-deri-30-04-2020/

# 21 Bosnia and Herzegovina profile

# Key findings

## Figure 21.1. Scores for Bosnia and Herzegovina (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See Scoring approach section for information on the assessment methodology. Scores for Dimension 5 (Competition policy) are not included in the figure due to different scoring methodology (see Scoring approach).

Since the 2018 Competitiveness Outlook, Bosnia and Herzegovina has improved its performance in 11 of the 15 policy dimensions[1] scored in the assessment (Figure 21.1). Although this clearly indicates progress in the design of policies to enhance its competitiveness – at least in about two-thirds of the dimensions covered in this assessment – if they are to have a lasting impact then their effective and continuous implementation, monitoring and upgrading should remain a key priority. The biggest improvement in scores since the previous assessment have been in the dimensions of tax policy, trade policy, investment policy and promotion, education policy, and energy policy, for which Bosnia and Herzegovina also achieved the highest scores. These improved scores are explained by the following key achievements:

- **Tax policy has been strengthened, with greater international co-operation and easier administrative procedures.** Bosnia and Herzegovina has increased its international co-operation on tax matters by joining international instruments such as the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS, and the Convention on Mutual Administrative Assistance in Tax Matters. Both entities – the Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH) – have adopted laws on free zones, providing investors with substantial tax incentives. Authorities at all levels have made efforts to digitalise filing procedures for taxpayers (e-filing). At the state level, e-filing has been mandatory for value-added tax (VAT) and excise duties since 2019. In the entities, the share of electronically filed taxes seems to be increasing. For example, in the RS 57% of tax returns were filed electronically over January-April 2020, compared to 43% in 2019. This should help increase the efficiency of the tax administration and speed up procedures for taxpayers.

- **Trade policy has also seen greater regional co-operation and stronger public consultation procedures.** Bosnia and Herzegovina signed the Central European Free Trade Agreement (CEFTA) Additional Protocol 6 along with the other WB6 economies in December 2019, thereby committing to liberalising trade in services with the other parties. Co-ordination between the public and private sectors over trade has also been improved, most notably through the establishment of the state-level Trade Facilitation Committee in 2018, as well as an e-consultations website in 2017, where the public can comment on draft legislation before it is adopted.
- **The investment climate for foreign investors has improved,** though significant challenges to attracting foreign investment remain. The complex legal and regulatory system is difficult for foreign investors to navigate, though some progress has been made in this area. At the entity level, the RS has established district commercial courts to improve local contract enforcement. This saw the case backlog fall to 3 935 in 2019, down from 7 910 in 2017. The RS has also eased business registration procedures, reducing the time needed from 23 days to 3 and the number of procedures from 11 to 5, as well as reducing the cost. Both state-level and entity-level institutions have been targeting foreign investors through proactive campaigns. There have also been efforts to encourage investment for green growth, such as the adoption of the Law on the Use of Renewable Energy Sources and Efficient Cogeneration at the state level in 2014, which encourages private investment in electricity production. The entities have also been active in this area, with the FBiH adopting several laws and regulations, including the Law on Electricity and the Regulation on Incentive Fees to Promote Electricity from Renewable Energy Sources, while the RS has used the state-level law to strengthen its green growth framework.
- **Frameworks for developing pre-university education have been improved.** Most notably, Bosnia and Herzegovina developed a common core curriculum for pre-university education in 2018, which should provide a common framework for the development of curricula across the economy. A new state-level strategy on vocational education and training (VET) is being developed. Its adoption is greatly needed since the last VET strategy expired in 2015. It would provide for policies to strengthen VET curricula and standards to be co-ordinated across the economy's education systems. Another significant positive development was Bosnia and Herzegovina's participation in the 2018 Programme for International Student Assessment (PISA), providing essential information to measure student learning outcomes and the performance of the education system.
- **Efforts have been made to improve energy security and promote renewables.** By investing in key natural gas infrastructure expansion projects, Bosnia and Herzegovina aims to increase energy security by diversifying its import routes for natural gas, reducing its reliance on a single route. The economy has also strengthened its legislative and policy frameworks for developing non-hydro renewable energy generation, for which it has significant potential. New wind and solar projects were connected to the grid for the first time in 2018 and 2019 and are expected to increase the share of non-hydro renewables in the electricity generation mix. This should further strengthen energy supply security by increasing domestic generation. Progress reports monitoring the implementation of the National Renewable Energy Action Plan (adopted in 2016) were published in 2017 and 2019 and Bosnia and Herzegovina is in the process of drafting its National Energy and Climate Plan. This should integrate energy and climate objectives and ought to be adopted by the end of 2021.

### Priorities

Despite these achievements, Bosnia and Herzegovina has made the least progress since the previous assessment and its performance is the lowest overall of all the WB6 economies. Priority dimensions for improvement are tourism policy; environment policy; science, technology and innovation; transport

policy; and digital society. In order to improve its performance in those areas Bosnia and Herzegovina should consider the following:

- **Improve tourism governance frameworks.** Tourism is becoming increasingly important for Bosnia and Herzegovina – its direct and indirect contribution to GDP increased by 6.85% from 2017 to 2019. The authorities will need to undertake key reforms to make the sector more competitive and to capitalise on its rapid growth. Vertical co-ordination and co-operation between the state level and entities in tourism policy making is weak, despite efforts to improve it (i.e. the creation of the Tourism Working Group in 2007). Many municipalities lack the financial resources to fully exploit their tourism potential and engagement with private sector stakeholders remains insufficient both at the state and local levels. Lack of policy co-ordination also means that the economy lacks an overall international tourism marketing strategy, reducing its global visibility as a tourist destination. The availability of a qualified workforce is also a challenge, contributing to Bosnia and Herzegovina's low rank in the Travel and Tourism Competitiveness Index (for example it fell six places in the human resources and labour market category in 2019). Tourism policy should thus also focus on education, specifically strengthening VET for tourism.
- **Do more to improve the environmental quality of life.** Even though Bosnia and Herzegovina has made some progress in the environment policy dimension since the last assessment, it continues to underperform and has the lowest score of the WB6 economies. Quality of life is affected by outdated water infrastructure, sometimes containing hazardous materials. Air quality is also poor; Bosnia and Herzegovina has one of the highest concentrations of air pollution in Europe. The mean annual exposure to particulate matter ($PM_{2.5}$) of 30 micrograms per cubic metre ($\mu g/m^3$) is more than twice the World Health Organization's recommended highest levels (10 $\mu g/m^3$), and higher than the averages in the EU (13.1 $\mu g/m^3$), the OECD (12.5 $\mu g/m^3$) and the WB6 economies (25.77 $\mu g/m^3$). These factors have a negative impact on the health and general well-being of the population, and should be urgently addressed. The energy and transport sectors are heavy polluters, as well as the primary sources of Bosnia and Herzegovina's greenhouse gas emissions (70% and 23% of $CO_2$ emissions respectively). Reducing emissions from these sectors will thus be key to improving the environmental quality of life for Bosnia and Herzegovina's residents, as well as meeting its international commitments under the Paris Agreement.
- **Improve co-ordination on science, technology and innovation across all levels of government.** A variety of factors explain Bosnia and Herzegovina's underperformance in this policy dimension, but most notable is the lack of co-ordination and co-operation across the various government levels (state, entities and cantons). This factor also hampers the public financing of research and innovation as the absence of a clear co-ordinated policy framework makes it difficult to identify and optimise public investment opportunities. Overall, gross domestic spending on research and development has remained low, at 0.2% of GDP, in recent years. Increased co-operation between the entities and the state level should help to better co-ordinate international co-operation efforts and improve the allocation of funding. Brain drain is reducing human capital for research and development and efforts to counter this should be increased, including additional funding incentives.
- **Develop a tool to identify, select, prioritise and implement transport investment projects.** Although Bosnia and Herzegovina has a single project pipeline for transport projects, it needs further development, as it has not been updated since 2018. There are no economy-wide cost-benefit analysis guidelines for transport projects, or any accompanying survey, analysis and technical instructions. These need to be developed and updated every few years to help prioritise and control investment.

- **Increase digitalisation efforts.** The information and communication technology (ICT) sector in Bosnia and Herzegovina has significant potential but is challenged by a lack of qualified professionals. While this can partly be attributed to brain drain, the authorities should ensure that education curricula include relevant ICT skills and competencies. Bosnia and Herzegovina has done little to align with the EU's digital competence framework for students and professionals. There is also a lack of policy documents and support programmes for ICT promotion by the private sector. In order to stimulate the economic potential of the ICT sector, the authorities should look to develop such strategies and support programmes.

1: Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses different scoring model (See the Scoring approach section for information on the assessment methodology).

## Economic context

### *Key economic features*

Bosnia and Herzegovina (BiH) is a small open economy with a diversified production and export base. Services account for the largest share of the Bosnian economy, contributing 55.7% to gross domestic product (GDP) and responsible for 50.3% of employment. Wholesale and retail trade dominate the services industry, along with public administration. At nearly 9.4% of GDP, the public sector in BiH is the largest in the region (United Nations, n.d.[1]). Industry contributes 23.9% to GDP and is responsible for 31.7% of employment, with the highest contribution coming from the manufacturing sector (15.3% of GDP and 17.7% of employment) (United Nations, n.d.[1]; ILO, 2020[2]). Agriculture, forestry and fishing contributed only 5.6% to GDP in 2019, but still account for 18% of employment, which shows there is significant scope to boost agricultural productivity and achieve economy-wide productivity gains through the reallocation of labour from agriculture to other more productive sectors (World Bank, 2020[3]).

Over the past decade, the growth drivers of Bosnia and Herzegovina's economy have diversified, but the economy remains mostly consumption driven, with strong contribution from the public sector. Between 2010 and 2020, the contribution of exports to GDP grew from 29.7% to 32%, driven by the growth in machinery and power exports, as well as higher service exports, including construction and tourism (European Commission, 2019[4]; United Nations, n.d.[1]). This led to a decline in the current account deficit from 9.5% of GDP in 2011 to 3% in 2019. The high growth in exports also led to a decline in consumption's share of GDP, although it remained high compared to regional and global peers, with public consumption accounting for 19.5% of GDP and private consumption 76% of GDP in 2019 (World Bank, 2021[5]). The large public sector, inflated by the complex political and economic structure and the still significant state-owned enterprise (SOE) sector, represents a drag on the economy (see Structural economic challenges).

Over the past decade, the contribution of investment to GDP has been stagnant at below 20%, lower than most economies in the region. Bosnia and Herzegovina was also the lowest recipient of foreign direct investment (FDI) in the region over the past five years (2% of GDP between 2015 and 2019), The largest share of FDI inflows went into the non-tradable sector, including financial services, wholesale and retail trade, energy, and real estate; while export-oriented FDI went mainly to raw materials with limited value-added (Central Bank of Bosnia and Herzegovina, 2020[6]). Moreover, most FDI inflows in recent years have been reinvested earnings into existing FDI investments, while greenfield investment has been very low and concentrated mainly in the tourism sector (European Commission, 2019[4]). As a result, the structural transformation of the economy has been relatively limited over the past decade.

Bosnia and Herzegovina's economy is characterised by relatively weak productivity. Across all sectors, labour productivity, measured as output per worker, is less than one-third of the European Union (EU) average (World Bank, 2020[3]). Moreover, the growth in productivity has slowed down considerably, reflecting limited gains from the reallocation of labour from less to more productive sectors, as well as

weaker sector productivity growth. This shows that significant structural constraints are preventing the flow of capital and other inputs to the most productive sectors and firms. These constraints include a fragmented market and challenging business environment, lack of skills, infrastructure gaps, and limited access to finance (see Structural economic challenges). Low productivity combined with high wage growth in the public and private sector have resulted in the weakening of labour cost competitiveness.

### Table 21.1. Bosnia and Herzegovina: Main macroeconomic indicators (2015-2020)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 4.1 | 3.4 | 3.0 | 3.1 | 2.9 | -4.5 |
| GDP per capita[2] | Current international $ | 12.0 | 13.1 | 13.8 | 14.9 | 15.8 | 15.6 |
| National GDP[2] | USD billion | 16.2 | 16.9 | 18.1 | 20.2 | 20.2 | 19.8 |
| Inflation[1] | Consumer price index, annual % change | -1.0 | -1.1 | 1.3 | 1.4 | 0.6 | -1.1 |
| Current account balance[1] | % of GDP | -4.9 | -4.6 | -4.7 | -3.3 | -3.0 | -3.1 |
| Exports of goods and services[1] | % of GDP | 34.2 | 35.0 | 39.3 | 41.5 | 39.8 | 32.1 |
| Imports of goods and services[1] | % of GDP | 51.7 | 51.0 | 54.9 | 55.9 | 54.3 | 45.9 |
| Net FDI[1] | % of GDP | 1.7 | 1.8 | 2.2 | 2.9 | 1.9 | 1.8 |
| Public and publicly guaranteed debt[3] | % of GDP | 41.9 | 42.3 | 37.7 | 35.6 | 34.5 | 39.6* |
| External debt[4] | % of GDP | 62.9 | 63.8 | 72.0 | 64.5 | 65.4 | … |
| Unemployment[1] | % of total labour force | 27.7 | 25.4 | 20.5 | 18.4 | 15.7 | 18.0 |
| Youth unemployment[2] | % of total labour force ages 15-24 | 63.2 | 55.0 | 46.5 | 39.3 | 34.0 | … |
| International reserves[1] | in months of imports of G&S | 6.8 | 7.2 | 7.1 | 7.3 | 7.8 | 10.0 |
| Exchange rate (if applicable local currency/euro) [1] | Value | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 | 1.96 |
| Remittance inflows[2] | % of GDP | 11.1 | 10.9 | 11.2 | 11.2 | 11.2 | 9.2 |
| Lending interest rate[5] | % annual average | 5.79 | 5.24 | 4.38 | 3.79 | 3.29 | 3.07 |
| Stock markets (if applicable) [1] | Average index | 701 | 692 | 627 | 621 | 772 | 769 |

Note: G&S = goods and services; *estimates for 2020.

1. (EC, 2021[7]) EU Candidate Countries' and Potential Candidates' Economic Quarterly (CEEQ) Q1 2021, https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf.
2. (World Bank, 2021[8]) World Bank WDI data https://databank.worldbank.org/source/world-development-indicators.
3. (World Bank, 2020[9])World Bank Western Balkans Regular Economic Report https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report.
4. (EBRD, 2020[10]) *Transition Report 2020-21*, https://2020.tr-ebrd.com/countries.
5. (IMF, n.d.[11]) IMF Data https://data.imf.org/regular.aspx?key=61545855.

Labour market performance has been improving in Bosnia and Herzegovina, but the outcomes are still weak relative to OECD and EU benchmarks. Employment remains low at just 38.5%, particularly for women (30.4%), whose labour force participation is also very limited at 37.44%. Unemployment (18%) is one of the highest in the region, and there is a very high share of long-term unemployed (76% as of 2019). Meanwhile, the share of youth not in education, employment or training (NEET) is 21.2% (World Bank, 2020[3]). Weak job creation and limited opportunities are fuelling significant emigration, especially of young and highly educated people, which is further exacerbating skills gaps and limiting long-term growth perspectives.

To create more robust, sustainable and inclusive growth over the coming decade, Bosnia and Herzegovina needs to address the significant structural challenges that undermine domestic and foreign investment, global value chain (GVC) integration, and innovation. This includes reducing the fragmentation of the domestic market, improving the business climate, strengthening the skills of the population and reducing outstanding infrastructure gaps.

### *Sustainable development*

Over the past decade, Bosnia and Herzegovina has made progress in reaching the targets of the United Nations' Sustainable Development Goal (SDG) Agenda 2030, but considerable challenges remain (Table 21.2). On the positive side, Bosnia and Herzegovina has achieved the 2030 SDG target in one area: poverty (SDG 1), where the headcount ratios (the proportion of the population living below the poverty threshold, which are set at USD 1.90 and USD 3.20 per day in BiH) below the 2030 targets. In all other areas, moderate or significant progress is still needed to reach the SDG targets by the end of this decade (Sachs et al., 2021[12]).

**Table 21.2. Bosnia and Herzegovina's progress towards achieving the SDGs**

| SDG | Current assessment | Trends |
|---|---|---|
| 1 – No poverty | SDG achieved | On track or maintaining SDG achievement |
| 2 – Zero hunger | Significant challenges remain | Stagnating |
| 3 – Good health and well-being | Significant challenges remain | Moderately improving |
| 4 – Quality education | Information unavailable | Information unavailable |
| 5 – Gender equality | Significant challenges remain | Moderately improving |
| 6 - Clean water and sanitation | Significant challenges remain | Moderately improving |
| 7 - Affordable and clean energy | Significant challenges remain | Moderately improving |
| 8 - Decent work and economic growth | Significant challenges remain | Moderately improving |
| 9 - Industry, innovation and infrastructure | Significant challenges remain | Stagnating |
| 10 - Reduced inequalities | Significant challenges remain | Information unavailable |
| 11 - Sustainable cities and communities | Major challenges remain | Stagnating |
| 12 - Responsible consumption and production | Significant challenges remain | Information unavailable |
| 13 - Climate action | Significant challenges remain | Stagnating |
| 14 - Life below water | Challenges remain | Moderately improving |
| 15 - Life on land | Significant challenges remain | Stagnating |
| 16 - Peace, justice and strong institutions | Significant challenges remain | Moderately improving |
| 17 - Partnerships for the goals | Challenges remain | On track or maintaining SDG achievement |

Source: (Sachs et al., 2021[12]), *Sustainable Development Report 2021: the Decade of Action for the Sustainable* Development Goals, https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

Moderate challenges remain in two SDG areas: life below water (SDG 14) and partnerships for the goals (SDG 17). While marine biodiversity has improved, progress is needed to reduce marine pollution and improve the sustainability of fishing practices. With respect to partnerships for the goals, moderate progress is also needed to strengthen Bosnia and Herzegovina's national statistical system (Sachs et al., 2021[12]).

Significant gaps remain in all other areas. This includes the SDG on hunger (SDG 2), where more progress is needed to reduce high and rising obesity levels and the high use of nitrogen fertiliser in crop production. In the area of health and well-being (SDG 3), performance is impacted by, for example, gaps in health coverage, the high prevalence of non-communicable diseases, high death rates attributable to air and ambient air pollution, and high traffic-related deaths. Regarding the SDG on clean water and sanitation (SDG 6), significant progress is needed to improve wastewater treatment, and some progress is needed to achieve universal access to basic drinking water services. In the area of affordable and clean energy (SDG 7), significant gaps remain regarding access to clean fuels and the emissions associated with the production of electricity and heating for households. Relatedly, the high emissions associated with energy consumption have a significant negative impact on sustainable cities and communities (SDG 11) and the climate-related SDG (SDG 13). High unemployment limits performance regarding the SDG on decent work and economic growth (SDG 8), while the SDG on industry, innovation and infrastructure (SDG 9) is negatively impacted by weaknesses in the trade and transport infrastructure, as well as low investment in research and development (R&D). Inequality (SDG 11), as measured by the Gini coefficient and the Palma ratio, remains above the SDG target (Sachs et al., 2021[12]).

### *Structural economic challenges*

Bosnia and Herzegovina faces a number of key structural challenges that undermine its competitiveness, investment and GVC integration.

#### *Better skills are needed to foster economic upgrading and a competitive export-oriented economy*

Bosnia and Herzegovina's economy suffers from deficiencies in human capital, which reflect weaknesses in the quality of education and its relevance to labour market needs.

- **Low education quality** is exemplified in student performance on international assessments such as the Programme for International Student Assessment (PISA), where Bosnia and Herzegovina is in the bottom quartile of participating economies (62 out of 78 economies). Fewer than half of BiH students attained the minimum level of proficiency across the three testing subjects (only 46% for reading, 42% for mathematics and 43% for science), which is well below the OECD average of over 75% for all three subjects (OECD, 2018[13]).
- **High spending on education and very low student-to-teacher ratios** have not led to improved education quality. There is also high spending on non-teaching staff, who account for one-third of all staff in primary schools (World Bank, 2020[14]). Therefore, more efficient and better targeted spending on education is needed to improve education outcomes.
- **Low enrolment rates relative to peer economies across all education levels**, from early childhood education to tertiary education, also negatively affect outcomes (Agency for Statistics of Bosnia and Herzegovina, n.d.[15]).
- **There is a lack of alignment of education with labour market needs**. In the latest Business Environment and Enterprise Performance Survey (BEEPS), 24% of firms identified an inadequately educated workforce as a major constraint (World Bank, 2019[16]). Meanwhile, in the 2019 Balkan Barometer survey, 30% of respondents noted that the skills acquired during their education did not meet the needs of their job. The most deficient skills noted in the survey included digital skills (32% of respondents), communication skills (30%) and other cognitive skills, including the ability to learn on the job (27%), and creativity, innovation and risk taking (27%) (Regional Cooperation Council, 2019[17]). These gaps reflect deficiencies in education quality and relevance, especially in vocational education and training (VET) and tertiary education, as well as an underdeveloped adult education system to support the upskilling and reskilling of the population.
- **High emigration and brain drain** exacerbate skills gaps challenges, as does **low labour force participation** among certain groups, such as women and youth.

#### *The fragmented market and complex business environment undermine investment and increase the costs of doing business*

Over the past decade, BiH has made progress in reducing the regulatory and administrative burden on businesses; however, there are still many outstanding challenges that result in the relatively low ranking in the World Bank's Doing Business assessment relative to peer economies (90 out of 191 economies globally) (World Bank, 2020[18]):

- **The fragmentation of the market** creates considerable additional administrative and operational burdens for businesses in Bosnia and Herzegovina. If a business wants to operate at the level of the entire economy, it must be registered in both entities – the Federation of Bosnia and Herzegovina (FBiH) and Republika Srpska (RS) – and the Brčko District. Depending on the business, it may also need to obtain the same type of licence or other documentation multiple times to meet the legal and regulatory requirements of each entity. Doing business is further complicated by differing legislation across cantons within the same entity. For example, each of the ten cantons

in the FBiH have different regulations and administrative procedures (World Bank, 2017[19]). Different quality control rules and procedures also make it more challenging to trade between entities, and progress on creating a single economic area has stalled due to political disagreements (European Commission, 2019[4]).

- **The difficulties involved in starting a business and obtaining licences and permits** reflect the complexities of the market fragmentation described above. Starting a business in BiH is much more cumbersome and costly than in most economies in the world. According to the latest World Bank Doing Business assessment, where BiH is ranked 184 out of 190 economies on the indicator for starting a business, it takes on average about twice as many procedures to register a business in BiH than in peer economies in the Europe and Central Asia (ECA) region. Starting a business also takes eight times as long in BiH (80 days in BiH compared to 12 days for the ECA) and costs three times as much as in the average ECA economy (14% of income per capita in BiH compared to 4% in the ECA). Likewise, obtaining a construction permit is lengthier and costlier in BiH than in most global economies, and as a result BiH is ranked 173 out of 190 economies on this indicator in the Doing Business index (World Bank, 2020[20]).
- **Contract enforcement is slow, costly and unreliable**. Contract enforcement takes on average 595 days, which is slower than the ECA average (495 days), and well behind global leaders (120 days). The process is slowed down by the overburdened court system, which has a significant backlog of cases, as well as the lack of specialised commercial courts (European Commission, 2019[4]). The lack of alternative methods of dispute resolution also negatively impacts the speed and cost of enforcement. The cost of enforcement is high in BiH at 36% of the claim value, compared to the ECA average of 26.6% (World Bank, 2017[19]).
- **Confidence is lacking in the judicial system's fair and impartial decision making**, which raises uncertainty in contract enforcement. In the latest Regional Cooperation Council (RCC) barometer survey, 60% of respondents stated that they do not trust the court system, while 70% stated that they do not believe that the judiciary is independent of political influence. Likewise, 76% of respondents stated that they do not believe the law is applied equally to everyone (Regional Cooperation Council, 2019[17]).

### *Transport infrastructure deficiencies undermine investment, trade and GVC integration*

- **Road and railway density is low compared to regional peers and the EU**, and the quality of infrastructure in both transport modes is relatively weak due to considerable underinvestment and inadequate maintenance (Eurostat, n.d.[21]). Road infrastructure projects have been poorly selected and implemented (Atoyan et al., 2018[22]). Underinvestment in the expansion, maintenance and upgrading of the outdated rail infrastructure is partly due to the lack of unbundling, whereby the two highly indebted, overstaffed and inefficient publically owned railway companies remain in charge of both the infrastructure and operations of the railways. The poor infrastructure also prevents the opening of the market for private operators (European Commission, 2019[4]).
- **Access to finance** remains a significant obstacle to the investment, innovation and internationalisation of small and medium-sized enterprises (SMEs), as in most economies in the region. Over the past decade, improvements in macroeconomic and financial sector stability have helped credit growth in the private sector; however, although large enterprises and established SMEs are well served by the banking sector and have benefitted from lower interest rates and better lending conditions, most micro and small enterprises, as well as start-ups, remain under-served. Thus, even though over 95% of SMEs in Bosnia and Herzegovina own a bank account, only about 50% have a bank loan. The financing gap is particularly large for micro-enterprises, nearly 50% of which need, but are unable to get, external financing (World Bank, 2018[23]). These enterprises usually cannot meet banks' stringent loan requirements, including high collateral requirements at over 212% of the loan amount (World Bank, 2020[24]). Meanwhile, alternatives to bank lending are either very limited or non-existent – see Access to finance (Dimension 3).

*Cross-cutting and sector-specific constraints undermine the growth of key sectors*

- **Agriculture:** Agriculture is an important sector in Bosnia and Herzegovina, but its contribution to GDP is undermined by weak productivity. Agriculture, forestry and fisheries account for just 5.6% of GDP, but 18% of employment. As a result, output per agricultural worker in BiH is just over one-fifth of the output per worker in the EU. Productivity is undermined by high land fragmentation, limited access to technology and inadequate (rural) infrastructure – see Agriculture policy (Dimension 14).
- **Manufacturing**: Upgrading and diversifying the manufacturing sector could play a key role in boosting exports and GVC integration. Analyses of the capabilities embodied in the current export basket reveal considerable long-term potential for growth in the automotive industry (vehicle and engine parts), machinery and metal processing. Over the short to medium term there is growth potential in boosting exports of agro-food, chemicals, metal, and wood and paper products (OECD, 2019[25]). The growth of the manufacturing sector is constrained by, for example, gaps in infrastructure, customs and logistics, lack of skills, and the business environment.
- **Information and communication technology (ICT) services:** This sector is relatively small, contributing just 5% to BiH's GDP, but has strong potential for further growth. As in other regional economies, it is constrained by, for example, the limited size of the domestic market, insufficient supply of skilled workers, weak collaboration between the sector and relevant educational institutions, and lack of access to finance, particularly financing for start-ups and high-risk venture capital.

*The well-being of current and future generations is strongly impacted by environmental factors*

- **Air pollution** is a critical challenge in urban centres in Bosnia and Herzegovina. Citizens are exposed to the second highest level of air pollution in the Western Balkan region, after North Macedonia, and Sarajevo suffers from one of the highest levels of air pollution in Europe. Air pollution is particularly acute in the winter months when heating from burning solid fuels compounds the polluting effects from other sources. The large share of old vehicles on the road further contributes to the pollution problem (OECD, n.d.[26]).
- **Climate change** exacerbates the natural hazards to which Bosnia and Herzegovina is vulnerable. It is also expected to have a significant economic impact on the agriculture, water and hydropower sectors. However, the transition to a low-carbon economy is slow. Despite high potential in numerous renewable energy sources, including hydro, solar and wind power, Bosnia and Herzegovina remains highly dependent on fossil fuels for its energy supply. In 2017, coal accounted for over 60% of total primary energy generation. Moreover, the efficiency of energy consumption is relatively low, and estimates indicate that energy consumption could be reduced by 60% through energy efficiency related refurbishments in public and commercial buildings (World Bank, 2020[14]).

*More inclusive growth is needed to improve the well-being of all citizens*

- Despite robust growth and poverty reduction over the past two decades, Bosnia and Herzegovina still faces many well-being challenges. Inequality has increased and poverty remains an important issue, with 17% of the population living below the national poverty line (World Bank, 2020[3]). Regional disparities in poverty, access to services and well-being outcomes are also quite stark. Certain minority groups, such as the Roma, face considerable gaps in, for example, access to education and educational outcomes, access to health and public services, and adequate housing (UNICEF, n.d.[27]).

*COVID-19 has exacerbated structural challenges*

Bosnia and Herzegovina's economy has been strongly impacted by the COVID-19 pandemic. In 2020, real GDP declined by 4.5%, driven by a sharp decline in exports (-7.6%), investment (-6.0%) and private consumption (-4.0%). The contraction was moderated by the decline in imports (-13.3%) and higher government spending (European Commission, 2021[28]). The sectors most critically affected by the pandemic include wholesale and retail trade, transport, and accommodation services (Agency for Statistics of Bosnia and Herzegovina, 2020[29]).

The labour market was also strongly affected by the crisis, even if the impact was moderated by fiscal support measures implemented by the government. The unemployment rate rose from 15.4% in 209 to 18% in 2020 reversing almost entirely the gains of the previous year. Employment, meanwhile, declined by 2.8% due to the impact on the trade, accommodation and manufacturing sectors, continuing the decline of the previous year (European Commission, 2021[28]).

Many of the abovementioned structural challenges have played a role in either amplifying the impact of the COVID-19 pandemic or limiting the scope of the policy responses to assuage its impact. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** Governments around the world have taken rapid and unprecedented action to address the health crisis and the fall in economic activity caused by the outbreak of COVID-19. Containing and mitigating the spread of the virus has been the priority of many governments. With containment measures in place, immediate policy reactions have focused on alleviating hardships and maintaining the productive capacity of the economy (OECD, 2020[30]). Among its responses to the COVID-19 pandemic, Bosnia and Herzegovina carried out a number of tax policies:
  - Flexible tax debt payments for companies that experienced more than a 20% drop in revenue as a result of COVID-19.
  - Wage subsidy scheme paid to the employer of BAM 245 (Bosnian mark; EUR 120) per month, per employee. To benefit from this scheme, businesses must have suffered a 20% drop of revenue as a result of COVID-19.
  - Exemption of corporate income tax (CIT) and personal income tax (PIT) payments for 2020.
  - Deferral of the interest rate for late payments of tax debts and suspension of enforcement proceedings until 30 July 2020.
  - Support for individuals and businesses that encounter difficulties for loan repayments due to COVID-19. Measures include a moratorium until the end of the state of emergency, a six month grace period and the approval of additional amounts to overcome liquidity difficulties.
  - Establishment of a public loan guarantee scheme with initial reserves of up to BAM 80 million (EUR 40 million).
  - Exemption of value-added tax (VAT), customs duties and other indirect taxes for imported vaccines, medicines and medical material.
  - Social security contribution (SSC) subsidy scheme of BAM 244 per employee for companies until the end of the state of emergency.
  - When comparing the six Western Balkan (WB6) economies, Bosnia and Herzegovina implemented a relatively wide set of responses to COVID-19. Its comprehensive COVID-19 response package broadly aligns with practices of OECD/G20 countries (OECD, 2020[30]), which widely implemented wage subsidy schemes, public loan guarantee schemes or deferral of loan payments. This fiscal response has been critical in preventing a significant economic fallout from COVID-19, especially on labour market outcomes, but has resulted in considerable narrowing of the fiscal space. In the context of weaker prospective revenue in the wake of the crisis, particularly if recovery is slow, the need to improve the efficiency of public spending will be critical over the coming months, as will be the prioritisation of expenditure that can support

recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This includes increasing public investment, which has suffered significantly due to high and rising current expenditure. The crisis has also highlighted the importance of rebuilding fiscal buffers in the post-crisis period, which will involve the better management of expenditure and tackling some of the structural constraints that undermine revenue performance.

- **Innovation and technology adoption:** The COVID-19 crisis has starkly demonstrated the importance of firm adaptability to meet new challenges and changing circumstances. It has also revealed the advantages that firms have when they embrace digitalisation and modern practices. The resilience of the post-COVID-19 recovery will therefore depend on the extent to which the structural issues limiting firm innovation and technology adoption are addressed (see Structural economic challenges), and how much digitalisation and digital skills become mainstreamed.
- **Access to finance:** The crisis has highlighted the significance of having a well-developed and diversified financial sector that can respond to the financing needs of enterprises not only in times of crisis, but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis came via support from the government through subsidised lending or lending guarantees. A robust financial sector comprised of diversified financial institutions that can provide financing for riskier and innovative ventures, not just established enterprises, will be very important during the recovery phase and beyond.
- **Informality:** The large size of the informal sector, and significant informal employment within the formal sector, have limited the scope of the measures aimed to protect the income and employment of those in the most affected sectors (ILO, 2020[31]). Informality is widespread in the sectors most affected by the crisis, including retail trade and tourism (ILO, 2020[31]), and those involved have not been able to benefit from government subsidies, favourable loan terms and loan guarantees, and other support measures. Developing a more resilient economy also depends on how incentives for formalisation can be enhanced, and the oversight and sanctioning of non-compliance can be improved.

### *EU accession process*

Bosnia and Herzegovina began the process of EU accession in July 2008 with the signing of the Stabilisation and Association Agreement (SAA) and the entry into force of the Interim Agreement on Trade. The SAA entered into force in June 2015, and Bosnia and Herzegovina submitted its EU membership application in February 2016. Bosnia and Herzegovina currently holds the status of “potential candidate country for EU accession”.

The European Commission adopted its Opinion on Bosnia and Herzegovina’s EU membership application in May 2019, identifying 14 key priorities for the economy to fulfil to open EU accession negotiations. The EU Council endorsed the Opinion and key priorities in December 2019. The Opinion constitutes a comprehensive roadmap for deep reforms in the areas of democracy/functionality, the rule of law, fundamental rights and public administration reform (European Commission, n.d.[32]). The EU and BiH authorities meet annually to discuss a wide range of policy issues and agree on follow-up actions. Progress reports assess the readiness of BiH to move closer to the EU. The findings and recommendations published in this Competitiveness Outlook provide the monitoring and guidance needed for Bosnia and Herzegovina to prepare and meet the requirements of its candidate status, and provide a good basis for assessing the critical challenges that the economy faces as a starting point for the development of its Economic Reform Programme (Box 21.1).

### Box 21.1. Economic reform programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[33]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[34]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

*EU financial and development support*

The EU represents the largest source of external financial assistance in Bosnia and Herzegovina. Since 2007, the EU has provided EUR 1.19 billion in assistance aimed at, for example, strengthening democracy and the rule of law; competitiveness, innovation, agriculture and rural development; and education, employment and social policy. EUR 2.4 billion has also been provided through loans from the European Investment Bank (EIB) since 1999. The Western Balkans Investment Framework (WBIF) has provided EUR 284.3 million in grants that have leveraged investments of an estimated EUR 3.6 billion (European Commission, 2021[35]).

In addition to grant funding and lending, the EU also provides important support through guarantees that support public and private investment by reducing the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade (European Commission, 2020[36]).

The EU's Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the WBIF, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment in support of better connectivity in the Western Balkan region. It also represents the first step in the implementation of the flagship projects under the EU's Economic and Investment Plan for the region, from which Bosnia and Herzegovina is expected to receive up to EUR 144.3 million between 2021 and 2024 (European Commission, 2020[37]).

The EU has also been instrumental in supporting Bosnia and Herzegovina's response to the COVID-19 pandemic. EUR 80.5 million in bilateral assistance from the Instrument for Pre-Accession Assistance (IPA) 2014-2020 was provided to BiH to cover the urgent needs of the health sector and to support the economic and social recovery following the crisis. EUR 455 million was also provided to support economic recovery through the regional economic reactivation package. BiH and other Western Balkan economies have also received aid to access COVID-19 vaccines (EUR 70 million), as well as EUR 7 million of European Commission/World Health Organization joint assistance to support vaccination readiness and health sector resilience (European Commission, 2021[35]).

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced Bosnia and Herzegovina's Competitiveness Outlook State-level, Entity and Statistical Office Co-ordinators[2] to the new digitalised assessment frameworks (see Assessment methodology and process chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, the Ministry of Foreign Trade and Economic Relations disseminated the materials among all Policy Dimension Co-ordinators and Statistical Office contact points at the state level, in the FBiH and the RS. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess

the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from the Ministry of Foreign Trade and Economic Relations, Policy Dimension Co-ordinators, and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders (including chambers of commerce, academia and NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook State-level Co-ordinator, Entity Co-ordinators,[3] Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 10 February 2021. The draft Competitiveness Outlook economy profile of Bosnia and Herzegovina was made available to the authorities in Bosnia and Herzegovina for their review and feedback from late-February to mid-March 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 21.3).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Assessment methodology and process chapter.

**Table 21.3. Competitiveness Outlook scoring system**

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

#### *Exceptions*

Unlike the other 15 policy dimensions, competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time, are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

Bosnia and Herzegovina's performance in the investment dimension has improved since the last assessment (Figure 21.1). The economy's score has increased from 2.2 in the 2018 Competitiveness Outlook to 2.7 in the 2021 assessment, with progress made on both investment policy and investment promotion and facilitation. However, Bosnia and Herzegovina still scores low in comparison to the other WB6 economies, ranking fifth before Kosovo (Table 21.4).

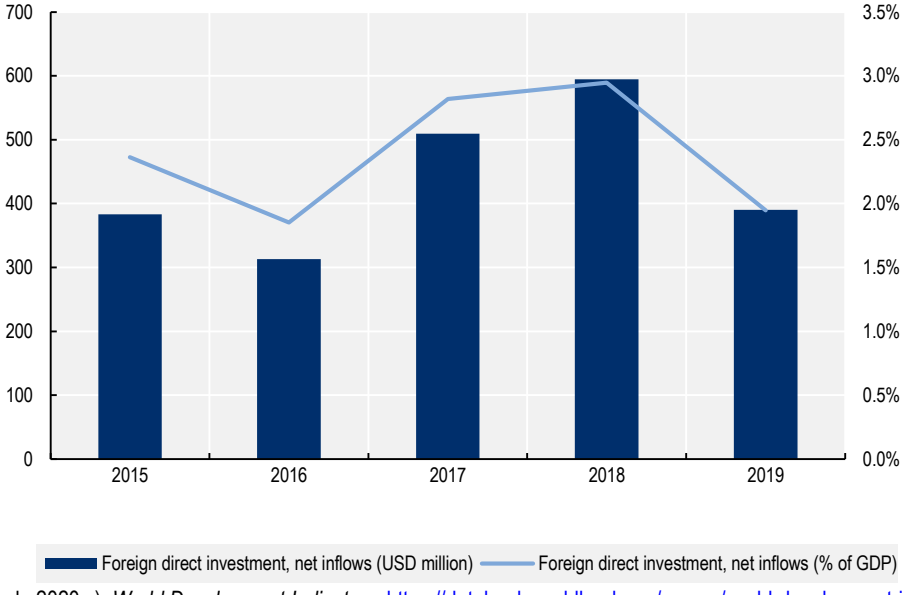
### Table 21.4. Bosnia and Herzegovina's scores for investment policy and promotion

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1: Investment policy framework | 2.9 | 3.2 |
| | Sub-dimension 1.2: Investment promotion and facilitation | 2.7 | 3.0 |
| | Sub-dimension 1.3: Investment for green growth | 2.0 | 2.0 |
| **Bosnia and Herzegovina's overall score** | | **2.7** | **3.0** |

### *State of play and key developments*

In 2019, Bosnia and Herzegovina attracted USD 390 million in net FDI inflows, representing 1.9% of its GDP (Figure 21.2). In relative terms, this performance is well below other WB6 economies: Montenegro (8.4%), Serbia (8.3%), Albania (8.2%), and Kosovo and North Macedonia (3.8%). However, the performance of BiH remains slightly better than similar "upper middle-income" economies,[4] which average 1.6% of GDP, and the OECD average of 1.5%. The stock of portfolio investment in 2019 totalled USD 8.8 billion. Manufacturing (34% of total FDI stock) and banking (25%) are the largest beneficiaries of FDI, followed by telecommunications and trade (12% each). In terms of the origin of FDI, most investment originates in Austria, Croatia, Serbia, Slovenia and the Netherlands (World Bank, 2020[3]).

### Figure 21.2. Net FDI inflows to Bosnia and Herzegovina (2015-19)




Source: (World Bank, 2020[3]), *World Development Indicators*, https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934255475

*Sub-dimension 1.1: Investment policy framework*

Overall, Bosnia and Herzegovina's **legal framework for investment** activities and conduct of business is complex and lacking clarity. The economy is decentralised and entities have a high degree of autonomy in setting their own investment policies, regulations and institutions. The economy's framework for attracting FDI is harmonised and coherent overall, as the Law on Foreign Direct Investment in Bosnia Herzegovina and the entities' foreign investment laws are aligned on key principals, and the three laws are virtually uniform (UNCTAD, 2015[38]). Entity-level foreign investment laws provide more detailed provisions to facilitate implementation. However, secondary legislation and regulations affecting business activities can differ at the entity and canton levels for both local and foreign investors.

The economy is trying to improve the regulatory framework at both the state and entity level. At the state level, the Ministry of Foreign Trade and Economic Relations (MoFTER) implements FDI policy reforms, undertakes activities to remove regulatory and administrative barriers to doing business, monitors FDI flows, and undertakes activities to improve the investment climate in order to create a more favourable business environment for foreign investors. At the entity level, the Ministry of Economy and Entrepreneurship of Republika Srpska, which is also responsible for activities aimed at stimulating foreign investment, is notably implementing a regulatory impact assessment procedure for its legislation that includes the impact of legislation on the business environment.

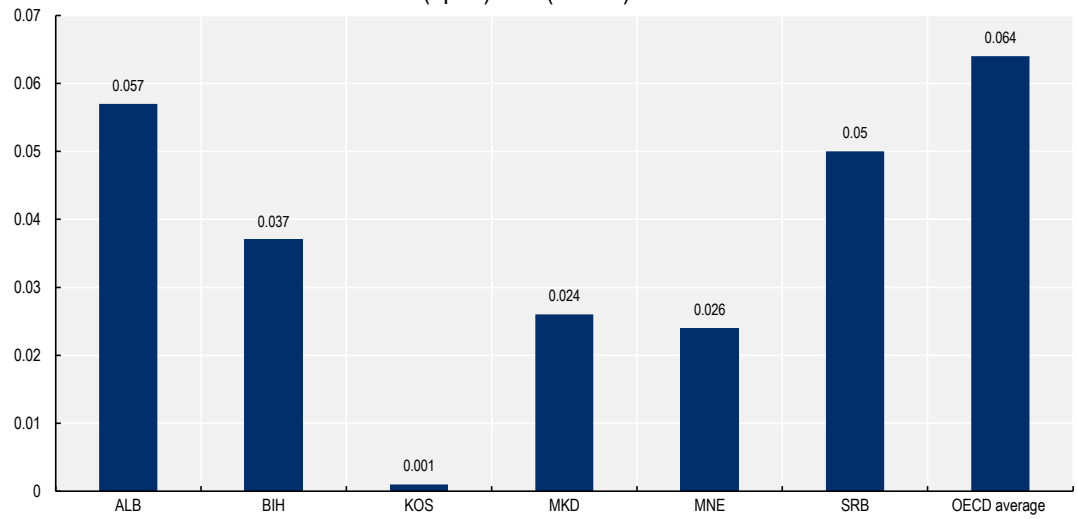
Public involvement in policy making varies, as the legal framework is uneven across the economy and is not applied consistently. The meaningful and systematic participation of stakeholders in policy making is hindered by the absence of a strategic framework for co-operation with civil society. Although public consultations and debates are organised for each law to enhance public oversight in Republika Srpska, the European Commission reports that transparency and access to information are lacking in the general economy, as "the legislative framework does not fully establish standards for monitoring and reporting on key government planning documents at each level of government, thus preventing public scrutiny over government work" (Bosnia and Herzegovina, EU report, 2020) (European Commission, 2020[39]).

In Bosnia and Herzegovina, the market is open and **exceptions to national treatment** are limited. The economy's score in the OECD FDI Regulatory Restrictiveness Index (Figure 21.3), which assesses and benchmarks market access and exceptions to national treatment, was 0.037 in 2019, below the OECD average of 0.064 (a low score indicates a less restrictive regime). The economy's rules regarding foreign investors are unlikely to constitute a major impediment to attracting investments. The economy maintains some restrictions, primarily for arms production in the military and in the media sector, where foreign ownership should not exceed 49% of equity. However, if the government finds that investment in these sectors has not violated the economy's security, the amount of investment may go over 49%. Real estate remains another restrictive sector, as the economy maintains discriminatory restrictions to real estate ownership by legal entities established abroad. Foreigners must register as a local company to purchase property, or be a citizen of an economy with a reciprocal land ownership agreement. The ownership of agricultural land is not permitted for either domestic or foreign investors.

The state and the entities do not provide a negative list of activities that are restricted or conditioned for foreign investors, and the economy could benefit from clarifications and improvement of the legibility of the legal framework for foreign investors that outline which discriminatory conditions apply. Foreign investors still need to review many sectoral laws and regulations to understand the applicable market access and treatment conditions, and English versions of legislation are not always available on the official websites.

## Figure 21.3. FDI Regulatory Restrictiveness Index (2019)

Restrictions are evaluated on a scale of 0 (open) to 1 (closed)




Source: (OECD, 2020[40]), *FDI Regulatory Restrictiveness Index (database)*, http://www.oecd.org/investment/fdiindex.htm.

**Investor protection against expropriation** without fair compensation is guaranteed at the state level by the Law on the Policy of Foreign Direct Investment of Bosnia, which stipulates that expropriation can occur only when in the public's interest. Additional protection is also enshrined in the Constitution of Republika Srpska and its Law on Foreign Investment, and the Law on Foreign Investment for the Federation of Bosnia and Herzegovina.[5] The economy has also signed a large number of bilateral investment treaties that constitute an additional layer of protection for foreign investors.

Expropriations are under the competence of the entities, which provide additional details on the execution of expropriation, compensation fees and judicial resources in their legislation. The laws on expropriation[6] at the entity level clearly define the modalities and procedures of the expropriation, as well as the calculation of compensation and recourses. For instance, in the FBiH the Law on Expropriation stipulates that before making a decision on expropriation, the body in charge of the expropriation shall hear the owner of the real estate about the related facts. It also provides for a two-month deadline to agree on a compensation fee before the matter is transferred to a competent court. Meanwhile, RS recognises the concept of indirect expropriation in its Law on Expropriation and its Law on Out-of-Court Procedure, which regulates the procedure for determining compensation for expropriated real estate if the parties do not reach an agreement on the amount of compensation in accordance with the Law on Expropriation.

The business community does not perceive unlawful expropriation to be a major concern in Bosnia and Herzegovina. Risks for companies are mostly related to the unpredictability of the legal framework, the inconsistent application of laws and, at times, the modification of existing contracts with foreign companies by the authorities. Concerns have been raised over land or property ownership, where disputes can arise due to the lack of clarity of titles and cadastres. While this does not lead to expropriation risks, it weakens the overall environment for property protection and sends a less reassuring signal to prospective investors. However, relevant institutions in Republika Srpska are making additional efforts to reduce inconsistencies and clarifications on ownership and real estate through the establishment of a single, reliable and up-to-date record on real estate and ownership rights. Although efforts have been made to establish a single register since the adoption of the Law on Survey and Cadastre of Republika Srpska in 2012, there is no update on implementation progress for this assessment cycle.

Foreign investors have the same rights and remedies before the national court system as domestic investors. The justice system has been going through a comprehensive and thorough overhaul to align with EU standards. A 2014-2018 strategy for justice reform was adopted that included reforms aimed at supporting economic growth by improving the effectiveness, efficiency and transparency of the judiciary to ensure the faster registration of business entities and resolution of disputes between business entities, as

well as the improvement of areas defining issues of bankruptcy and liquidation of business entities and protection of property rights. However, progress implementing this strategy has been difficult as it has encountered resistance from political actors and the judiciary itself.

Commercial courts and justice departments often lack sufficient resources and adequately trained judges to handle specialised commercial cases. Procedures for enforcing contracts remain overly bureaucratic and cumbersome, and contract disputes are often not resolved quickly or cost effectively. This is illustrated by the economy's ranking in the enforcing contracts dimension of the 2020 Doing Business index (93 out 190 economies) (World Bank, 2020[3]). The judiciary also suffers from a substantial backlog in court cases and problems establishing property rights, in particular real estate registration in some areas (European Commission, 2020[39]).

Some progress at the entity level to improve contract enforcement has been recorded. For instance, Republika Srpska has established six district commercial courts that, among other things, have jurisdiction over property rights and SMEs in the entity. Meanwhile the Law on Civil Procedure regulates the small claims procedure if the claim does not exceed BAM 5 000 (approximately USD 3 000) in cash. In 2019, the number of backlogged cases in the business department of the district commercial courts was 3 935, down from 6 240 in 2018 and 7 910 in 2017. The percentage of unresolved cases in relation to the total number of pending cases in 2019 was 33.3%. Republika Srpska states that judges in commercial district courts must have at least five years' experience as a judge, prosecutor, lawyer or other relevant legal experience after passing the bar examination. Judges and public prosecutors are regularly trained at a public institution, the Centre for Education of Judges and Public Prosecutors, on the topic of commercial disputes.

Bosnia and Herzegovina's legislation offers **dispute settlement** options including alternative dispute resolution mechanisms and has shown a pro-arbitration stance, which is likely to reassure foreign investors that they can easily enforce their rights and contracts in the event of a dispute**.** The economy has ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), which means that foreign arbitral awards are recognised in the economy. There have only been four cases of investor-state dispute being brought before international arbitration, mainly involving large investors.

Bosnia and Herzegovina has 39 bilateral investment treaties in place, most of which were concluded around 15-20 years ago and do not contain modern provisions such as the right of the state to regulate, more precise definitions of fair and equitable treatment or indirect expropriation, transparency in arbitral procedures, exceptions from free transfers, standards of labour, health and environment, corporate social responsibility, and promotion of foreign investment (UNCTAD, 2020[41]). The Council of Ministers has set up a moratorium on the conclusion of new investment treaties until the model treaty is revised to reflect modern provisions, including those related to the investment-state dispute mechanism (in line with EU standards and international best practice). Bosnia and Herzegovina has also established a Permanent Negotiating Body for the Peaceful Resolution of International Investment Disputes, prior to which the economy attempted to address the problems and concerns of investors in aftercare programmes, or ad hoc.

At the entity level, additional measures are provided for alternative dispute mechanisms, but their use remains very low. In Republika Srpska, foreign courts, foreign commercial courts and foreign arbitrations are recognised by the competent district courts. In addition to the Law on Civil Procedure, the Law on the Chamber of Commerce established the Foreign Trade Arbitration, the Arbitration and the Court of Honour to handle investor disputes. Moreover, Article 25 of the Law on Foreign Investments of Republika Srpska stipulates that foreign investment disputes should be resolved before these competent courts unless it is otherwise agreed to use arbitration or substitute courts. However, the overall use of alternative dispute mechanisms in the economy remains low, and further alignment with EU standards and best practices is necessary (European Commission, 2020[39]).

Bosnia and Herzegovina has a sound **intellectual property (IP) rights legal framework**. It is a member of the World Intellectual Property Organization (WIPO) and adheres to the main international treaties and conventions on IP rights, such as the Patent Co-operation Treaty, the Paris Convention, the Madrid Protocol and the Hague Agreement. It has progressively introduced IP-specific legislation over the past ten years to align with EU standards and requirements. Regarding copyright and neighbouring rights, the legislative framework is largely aligned with the EU *acquis* (European Commission, 2020[39]). The Institute for Intellectual Property of Bosnia and Herzegovina (IIP) operates as an independent administrative body and is the main body responsible for IP implementation and promotion. The institute has a large mandate that includes IP registration, participation in IP policy, legislation making and awareness raising. It is also tasked with the co-ordination of IP implementation and enforcement in the economy. The IIP operates in compliance with the main international conventions and agreements on intellectual property ratified by the economy, and its operations are comparable to international standards. For example, a patent can be obtained within 2.5 to 4 years from the date of filing, the registration of the trademark right is 18 months and the time for the registration of industrial designs is below 6 months. The institute operates an online platform available in English for submitting applications and payments of fees and costs, a help desk, and a database for searching. Its website also contains key legislation, the necessary information related to intellectual property protection procedures, and examples of patent applications. The IIP keeps a separate register for each of the publicly available industrial property rights.

**IP implementation and enforcement** remains challenging in Bosnia and Herzegovina. IP enforcement is particularly problematic as enforcement agencies and the judicial system have insufficient capacity and resources, and there is limited co-operation. In 2019, the economy adopted the Strategy for the Enforcement of Intellectual Property Rights in Bosnia and Herzegovina for the period 2018-2022, which sets out guidelines and measures to reinforce the development and improvement of the legislative and institutional framework for IP enforcement, as well as the establishment of inter-institutional co-operation. In February 2020, the Council of Ministers adopted a decision to establish an Inter-agency Co-operation Body for the Acquisition and Enforcement of IP Rights. However, progress to mobilise the body has been slow as the strategy has yet to be implemented, and prosecutors, judges and court panels handling cases involving intellectual property law need to be more specialised to handle them more efficiently and consistently (European Commission, 2020[39]).

**Intellectual property rights awareness raising and access to information** is lacking in the economy. There is generally little awareness of IP rights and obligations in Bosnia and Herzegovina. The IIP regularly organises ad hoc awareness-raising workshops on IP rights and protection matters, but lacks the resources and capacity to do so on a systematic or far-reaching basis.

### *Sub-dimension 1.2: Investment promotion and facilitation*

Bosnia and Herzegovina's **investment promotion agency structure and strategy** needs streamlining, and there needs to be better inter-institutional co-operation between the entities. The Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA) is a state agency mandated with investment promotion. According to the law that established FIPA, the agency reports to the Council of Ministers. The FIPA Steering Board is composed of nine members: two representatives of the Council of Ministers, one member of each entity, one representative of the foreign trade chamber, two representatives of the business community of each entity and two representatives of foreign investors. It proposes the strategic goals of the agency in co-operation with the Ministry of Foreign Trade and Economic Relations of Bosnia and Herzegovina, entity governments, and the Brčko District. The board also proposes business and action plans and oversees strategy implementation. FIPA prepares medium-term plans and annual work plans with specific goals and objectives, and reports on the realisation of planned activities. These plans and reports are approved by the Council of Ministers.

FIPA is understaffed, with only seven staff members working on investment promotion activities. Staff report that the top three challenges they face in the execution of their mission are inadequate resources,

lack of political support and inadequacy/instability of mandate. The agency's work also suffers from the absence of formal co-ordination mechanisms between the relevant and numerous bodies involved in FDI attraction activities, including the Ministry of Foreign Affairs, MoFTER, the foreign trade chamber, and entity governments and ministries. The Ministry of Economy and Entrepreneurship of Republika Srpska also lacks sufficient resources to cover its investment promotion duties; however, it is a member of the FIPA steering board and regularly submits updated information on reform projects, promotion projects and promotional materials.

Investment promotion activities are conducted at state and entity levels. For instance, the Ministry of Economy and Entrepreneurship of Republika Srpska conducts investment promotion and export promotion activities that include attracting foreign investment, post-investment care, monitoring and evaluation of realised investments, and the creation and maintenance of a single database with resources (projects/locations) attractive to foreign investors.

FIPA assists foreign investors seeking partnerships with local firms or local suppliers on an ad hoc basis. It provides investors with useful sectoral information and data, and organises events connecting foreign and local firms. However, creating and reinforcing linkages between foreign affiliates and local enterprises is primarily conducted at the entity level. For instance, the Strategy for the Development of Small and Medium Enterprises of Republika Srpska for the period 2016-2020 supports cluster development through the identification of potential cluster initiatives,[7] and supports their development and functioning by reinforcing linkages with foreign firms and universities.

**Investment facilitation services and activities** can improve the relatively complex business environment in Bosnia and Herzegovina, but there are challenges involved as regulations differ among the entities and between cantons. This is reflected in the 2020 World Bank's Doing Business Index, which ranks BiH 90 out of 190 economies, well behind other WB6 economies. Establishing a business in BiH can be an extremely burdensome and time-consuming process for investors. Based on the Index, the economy is among the most difficult environments in the world with regards to starting a business (ranking 184 out of 190 economies) (World Bank, 2020[3]). For example, it takes 80 days to start a business in Bosnia and Herzegovina compared to 15 days in North Macedonia, 7 days in Serbia and 4.5 days in Albania. Investors also report difficulties dealing with construction permits and registering property, as entities, cantons and municipal levels of government each establish their own laws and regulations on business operations, which creates redundant and inconsistent procedures that lead to inefficiencies and corruption.

At the state level, government efforts have included the recent reduction of costs related to the establishment of businesses, as well as the acceleration of the creation of one-stop shops in all administrative units. FIPA has a limited investment facilitation role as it does not have a mandate to register a company for an investor or obtain permits and licences, but acts as an intermediary body to help investors navigate the economy's complex administration system. The agency does, however, play an important role in promoting and maintaining public-private dialogue and collecting private sector feedback, notably regarding the business environment and the challenges faced by businesses.

Key efforts and investment facilitation activities are operated by the entities. For instance, Republika Srpska has operated a business registration one-stop shop at the Agency for Intermediary, IT and Financial Services since 2013, and through its 11 regional offices. Ongoing reforms have led to a significant reduction in the time necessary for business registration, from 23 to 3 days, as well as a reduction in the number of procedures from 11 to 5. The cost of starting a business has also been reduced. For instance, for a single-member limited liability company, registration costs range from EUR 50 to 100, down from EUR 600 to 750. The online registration of business entities (for limited liability companies and entrepreneurs) is in the final stage of development. Republika Srpska has also developed a comprehensive electronic database of administrative procedures and formalities for business activities, and all legislation is subject to a regulatory impact assessment process, which, since 2019, pays attention

to administrative burdens for business entities and invites the Ministry of Economy and Entrepreneurship to provide an opinion on the implementation of regulation in this context.

Bosnia and Herzegovina has developed solid **investor targeting** strategies and actions plans. FIPA focuses primarily on promoting the image of the economy as an attractive investment destination for foreign investors. Using the network of embassies and representations, FIPA conducts missions abroad aimed at economy branding and promoting key economic sectors in general, while initiating contacts with potential investors. In co-operation with the International Financial Corporation and the World Bank, FIPA and the FBiH launched an outreach programme in 2016 targeting investment in the agriculture and automotive industries. At the state level, Bosnia and Herzegovina has successfully conducted three outreach missions to Italy, Germany and the Netherlands, with one more postponed due to COVID-19. FIPA aids the FBiH with the implementation of investor targeting programmes and aftercare support, while RS conducts outreach missions independently.

Investor targeting activities are more actively conducted at the entity level. For instance, Republika Srpska defined key sectors for attracting foreign investment, namely agriculture and food, industry, renewable energy, tourism and ICT, in its Investment Strategy 2016-2020. In 2017, it began a more targeted approach through outreach campaigns, for example in the fruit and vegetable processing sector, where it targeted German companies in 2017 and Austrian companies in 2018. The Ministry of Economy and Entrepreneurship also organised training for local self-government units in investor outreach and proactive investor aftercare in 2018, and is co-operating with World Bank training in this area.

Bosnia and Herzegovina's **investor incentives** regime is complex and multi-layered. At the state level, incentives provided to investors are limited and primarily concern customs exemptions on the import of foreign investors' equipment[8] as part of shared capital. Most incentives are managed at the entity level. Tax incentives for investment are not consolidated under the authority of one government body, as incentives related to indirect taxation are at the state level of responsibility and incentives for direct taxation are under the competence of the entities. The economy has nevertheless established some mechanisms aimed at avoiding overlaps and inconsistencies in the application of tax incentive policies. At the state level, the State Aid Council publishes information on the amount of state aid provided every year, but statements on the individual names or companies of the largest beneficiaries are not available.

At the entity level, the Federation of Bosnia and Herzegovina provides tax incentives for investors in its four active free economic zones, which function as fully private organisations. Free trade zones are part of the customs territory of FBiH and have the status of a legal entity. The users of free zones do not pay taxes and contributions, except those related to salaries and wages. Investors are free to invest capital in the free zone, transfer their profit and re-transfer capital with no charge. To ensure the development objective of existing free zones, investors must submit annual reports on operations to the entity ministries and MoFTER. The ministries check if companies based in the free zones meet the requirement that the percentage of exported goods must be over 50%.

In Republika Srpska, the Law on Free Zones was adopted in February 2021. In addition to this law, Republika Srpska provides a wide range of investment incentives to investors. All incentives are listed on the website of the Ministry of Economy and Entrepreneurship and include: 1) funds for the development of the economy, including incentives for increasing the salaries of employees in business entities and incentives for direct investments; 2) incentives provided through the programme of support for employment; 3) tax incentives provided in the Law on Income Tax and the Law on Corporate Income Tax; 4) banking privileges, including subsidised loans; 5) sectoral incentives provided by line ministries; and 6) municipal-level incentives. The Ministry of Finance evaluates the cost and benefits of investment incentives when they are proposed, and this evaluation is part of the mandatory clarification before the incentive is adopted by the government and the National Assembly. A register of incentives that aims to provide a clear and comprehensive overview of planned, approved and implemented incentives for the economy of Republika Srpska, is being developed.

Overall, the incentive regime remains overly complex, and distinct incentives are applied in the different entities. This makes the overall incentive scheme confusing for investors and may lead to harmful internal and regional tax competition. It should also be noted that the renewal of incentives is often permitted without appropriate scrutiny.

FIPA has an active but limited role in providing **aftercare services,** and seems more focused on policy advocacy and high-level public-private partnership (PPP) dialogue than direct firm assistance. Post-investment investor support is recognised as a key component of the agency's mandate, along with policy advocacy and drafting proposals for legislation and legal measures aimed at promoting investment conditions. The agency plays an active role in maintaining public-private dialogue, and in conducting surveys and visits to firms to evaluate their needs and report the problems they face. Under the aftercare programme, FIPA has provided post-investment support since 2013. Through the programme, existing investors are provided with an integrated mechanism to systematically support their business on a long-term basis. The feedback from investors is used to inform policy development, design and implementation. FIPA prepares the "Proposals for Improving the Business Environment and Investment Conditions in Bosnia and Herzegovina" report every year, with suggestions for changes to existing legislation and recommendations for resolving business barriers. This report is submitted to the BiH Council of Ministers, the entities and the canton governments.

Substantial aftercare support is also provided at the entity level. For instance, the Ministry of Economy and Entrepreneurship of Republika Srpska has been implementing the Post-Investment Support Programme for investors since 2013. Ten local self-government units have joined the programme and there are currently 28 members in the Collaborative Network, which is a system of representatives at the canton level that exchanges experience and information regarding the identification of issues, and potential solutions, related to investors. The network holds four annual meetings. Through this network, several training courses for self-government units on attracting and retaining investors have been organised. Between 2016 and 2019, joint teams including representatives from ministries and local self-government units visited around 135 companies and discussed the difficulties that investors face, some of which are solved immediately while others are addressed in co-operation with the competent institutions and ministries. The government of Republika Srpska is presented with information on aftercare activities annually, including the problems that investors face in their business. The government then instructs line ministries to systematically approach and find solutions to these issues.

### *Sub-dimension 1.3: Investment for green growth*

Bosnia and Herzegovina is reinforcing its **green investment policy and promotion** activities, notably in the context of aligning its energy and environment standards with the EU. The economy has developed multiple strategies and action plans over the past decade to promote green economic growth, including low-carbon development, affordable energy from clean sources, green economic growth, health and well-being, industrial growth, and climate protection. For example, the National Action Plan for the Use of Renewable Energy in BiH (NREAP BiH) included ambitious targets such as a 40% share of renewable energy sources in gross final energy consumption for all energy resources, and a 10% share of biofuels in transport for 2020. The National Action Plan for Energy Efficiency aims to reduce primary energy consumption by 12%.

MoFTER has initiated activities related to the development of the Integrated Energy and Climate Plan of Bosnia and Herzegovina (NECP BiH) for the period 2021-2030. By drafting this document, BiH is applying, for the first time, an integrated approach to drafting a document as it includes the electricity sector in the parts related to market security, supply, energy efficiency, renewable energy sources, innovation, development, competitiveness and emissions. The plan includes an innovative financing strategy and mechanisms for climate adaptation investments to be developed and tested in four to five selected municipalities.

The framework for green investment respects core investment principles such as investor protection, intellectual property rights protection and non-discrimination in areas likely to attract green investment. However, it is overly complex and difficult to navigate for investors, who must go through numerous sectoral laws and regulations, as well as the authorisation systems and incentive regimes at national and entity levels. The legal framework for green investment is regulated at the state level by the Law on the Use of Renewable Energy Sources and Efficient Cogeneration that was adopted in 2014 and encourages private investment in electricity production. At the entity level, in the FBiH the framework for green growth has been reinforced by the adoption of several laws and regulations, including the Law on Electricity and the Regulation on Incentive Fees to Promote Electricity from Renewable Energy Sources. Meanwhile, the Law on Renewable Energy Sources and Efficient Cogeneration has strengthened the green growth framework in Republika Srpska.

Bosnia and Herzegovina remains only partially harmonised with EU regulations due to its complex constitutional structure. The economy lacks clear and standardised legislation on green investments, and there is little transparency regarding the publication of summary information. The legal protection system concerning green investments is inconsistent, which may create legal security concerns for private investors.

Making and implementing the choice of **public and private partnerships for green growth** is only partially encouraged in Bosnia and Herzegovina. At the state level, there are no dedicated PPP laws, and while Republika Srspka and each canton of FBiH have adopted their own laws separately, they do not explicitly define investment in green growth but rather contain principles of environmental protection that define PPP criteria. In addition, the choice of PPP procurement for green projects is limited by the absence of an institutional arrangement with solid political backing and multidisciplinary capacity, whereby responsibilities are clearly assigned for promoting, implementing, monitoring and managing PPP projects.

### *The way forward for investment policy and promotion*

Bosnia and Herzegovina is not yet fulfilling its potential in attracting FDI as its investment climate is still hampered by complexities. Improving the investment climate requires the following reforms:

- **Improve the clarity and predictability of the legal frameworks for investment, including for foreign investors.** The key prerequisites for investment policy include respect for the rule of law, quality regulation, transparency and openness, and integrity. Effective action across these dimensions will encourage investment and reduce the costs of doing business. Strong institutions with clear mandates will also help maintain a predictable and transparent environment for investors.
- **Improve the transparency and inclusiveness of policy making**. More open and inclusive policy-making processes help ensure that policies better match the needs and expectations of citizens and businesses. The greater participation of stakeholders in policy design and implementation leads to better targeted and more effective policies. Potential actions include improving access to information by developing a portal that gathers all business-related legislation at different levels of government and providing versions in English. Improving the consultation process and mechanisms with stakeholders, including foreign investors, through raising awareness of consultation methods in the economy would also prove useful.
- **Accelerate justice reform efforts, particularly those related to commercial matters, and dedicate more effort to improving the rule of law and easing the process of enforcing contracts.** This also requires providing judges with sufficient resources and adequate training to help them understand the specificities of commercial cases. The effectiveness and independence of the judicial systems are a prerequisite for creating a business-friendly environment, building trust and promoting investment. A justice system that ensures appropriate and timely contract enforcement and reduces the backlog in court cases could positively impact the investment climate, as well as the productivity and competitiveness of businesses in Bosnia and Herzegovina.

- **Promote arbitration as a recognised alternative dispute resolution mechanism**. Bosnia and Herzegovina could consider introducing arbitration and mediation laws that are aligned with international standards. These mechanisms can help alleviate the pressure on the judiciary system, build trust and create a more business-friendly environment for conflict resolution. State- and entity-level laws should ensure that domestic courts recognise and enforce these decisions in accordance with applicable international standards.
- **Enforce IP rights and raising IP awareness.** Enforcing institutions should be adequately staffed and trained and a co-ordinating body should be established. More resources should also be allocated to IP awareness-raising activities and access to information. A strong IP system can promote innovation and reinforce linkages between multinational firms and local companies, as the strength of the intellectual property regime influences the willingness of foreign technology holders to invest and transfer technology and proprietary knowledge to local SMEs.
- **Reinforce FIPA's resources and capacity so that it can effectively fulfil its mandate and establish stronger co-ordination mechanisms to avoid overlaps and conflicts in investment promotion and facilitation activities.** Success in attracting investment requires a whole-of-government approach to investment promotion and facilitation. Effective co-ordination among various authorities with investment promotion mandates must be built, including at local government levels and with implementing agencies. It is therefore crucial to have an investment promotion agency with strong capacity and the resources to co-ordinate investment promotion tasks and ensure consistency with state- and entity-level development plans.
- **Improve investment facilitating activities, including those related to starting a business.** Uncoordinated institutional frameworks make it complicated and cumbersome for investors to become established, as well as increases their transaction costs. FIPA could play a crucial role in providing investors with much needed clarity regarding public administration and policies.
- **Promote and unify legislation encouraging green investment,** while increasing transparency through the publication of summary information in one place. Bosnia and Herzegovina should also develop a solid and harmonised PPP legal and institutional framework that encourages promoting, implementing, monitoring and managing green PPP projects.

## Trade policy (Dimension 2)

### *Introduction*

Bosnia and Herzegovina's performance on the trade policy dimension has improved, albeit moderately, since the last assessment (Figure 21.1). The economy's score has increased from 2.2 in the 2018 Competitiveness Outlook to 2.5 in the 2021 edition (Table 21.5). This is largely due to the establishment of the Trade Facilitation Committee of Bosnia and Herzegovina in 2018, which aims to aid and improve the adoption of reforms through an effective co-operation mechanism between the public and private sectors. The climate in which the private sector operates has continued to improve. There is, however, room for improvement regarding legislation on public consultations, which is uneven across the economy in terms of implementation and consolidation, despite efforts such as the adoption of new legislation at the state level on public consultation standards and the introduction of the eConsultation website, which allows the public to submit remarks and comments on all draft regulations.

Significant improvements have been made to open services trade through the signing of Central European Free Trade Agreement (CEFTA) Additional Protocol 6 in December 2019. Bosnia and Herzegovina is, however, still the most restrictive economy in the WB6 region. Nevertheless, some small progress has been made in improving economic policies. The economy has not reported any protectionist legal changes. This is particularly important in a context where recent OECD studies on member economies have tended to show a growth in the number of regulations restricting services in 2020 (OECD, 2020[42]). Restrictions are especially present in the areas of the movement of people, foreign entry and company regulations, which negatively affect foreign entities wishing to invest and operate in Bosnia and Herzegovina.

In terms of the digital trade in goods and services, the e-commerce framework in the economy is not evolved enough as no new laws on electronic communication and electronic media have been implemented and little progress has been made on implementation (Table 21.5).

### Table 21.5. Bosnia and Herzegovina's scores for trade policy

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 2.8 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 2.0 | 3.1 |
| **Bosnia and Herzegovina's overall score** | | **2.5** | **3.4** |

### *State of play and key developments*

Bosnia and Herzegovina's exports of goods and services have been steadily growing since 2015, before decreasing slightly in 2019. Overall foreign trade declined from 99.2% of GDP in 2018 to 95.2% in 2019 (in real terms), after having continuously grown since 2015, when it was 88.2%.

BiH's exports of goods reached EUR 5.5 billion in 2019, while imports reached EUR 9.4 billion. The external deficit on trade in goods and services accounted for 15.6% of the economy's GDP (World Bank). Bosnia and Herzegovina's exports of goods and services account for 40.06% of GDP and imports represent 55.8% of GDP. The economy is a net exporter of commercial services, with commercial exports accounting for EUR 1.9 billion vs. EUR 622 million in imports.

In 2018 and 2019, BiH's main export partner was Germany, which accounted for 14.9% of the economy's total exports, followed by Croatia (11.5%) and Italy (11.4%). Bosnia and Herzegovina's main suppliers are Germany (11.9%), Italy (11.4%) and Serbia (11%).

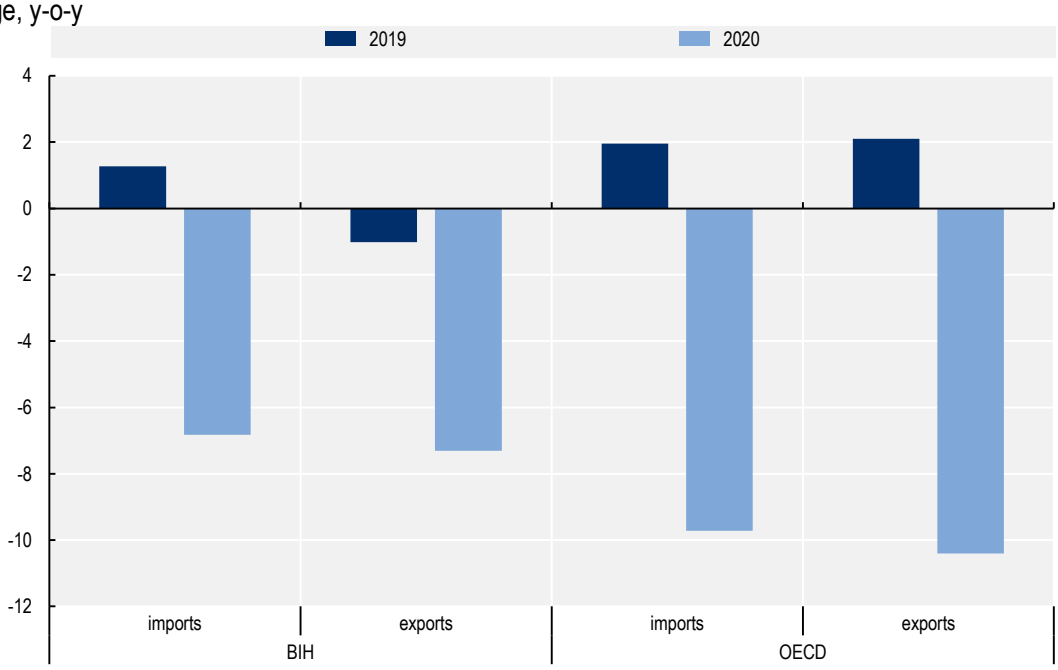
In November 2018, Kosovo imposed a 100% tariff rate on goods originating from Bosnia and Herzegovina, which severely impeded bilateral trade between the two economies. These tariffs were lifted in April 2020 and the flow of goods is in the process of resuming.

Like all economies, Bosnia and Herzegovina was heavily affected by the COVID-19 pandemic. The low level of new import and export orders prior to the crisis, combined with pandemic-related export bans, restrictions on the movement of people, and closures of shops and services, led to a significant decline in imports and exports, and a sharp decline in consumption and investment in Q2 and Q3 2020. Bosnia and Herzegovina was not the most severely affected WB6 economy, but faced a decline of -6% in imports and -7% in exports, which is below the average fall seen in OECD member states.

Industry in the WB6 economies was affected by the supply shock caused by COVID-19 and the resulting slowdown in trade flows. The decline in exports from Bosnia and Herzegovina was primarily a consequence of the breakdown of GVCs. WB6 economies with a higher level of integration into GVCs and an existing share of manufacture, such as Bosnia and Herzegovina, felt the immediate effects more severely, but have also seen trade flows decline less than the OECD average, as displayed in Figure 21.4.

### Figure 21.4. Impact of COVID-19 on trade, Bosnia and Herzegovina versus the OECD (2019-20)

% change, y-o-y




Source: (IMF, 2020[43]), *World Economic Outlook*, https://www.imf.org/en/Publications/WEO/weo-database/2020/October; (OECD, 2020[44]), *OECD Economic Outlook, June*, http://www.oecd.org/economic-outlook/june-2020/.

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The region's relatively low level of development and sophistication limits most economies to backwards linkages, mainly as assembly centres (IMF, 2020[43]). For BiH in particular, the leading cause of the decline in exports is the disruption of supply chains resulting from the manufacturing slowdown in China and reduced demand in the United States and notably the EU, its main trading partner. In the region, and particularly in Bosnia and Herzegovina, GVCs are concentrated in a few sectors (automotive, electrical equipment, machinery, chemicals and metals) and are located around a few European economies (OECD, 2019[25]). In Bosnia and Herzegovina, those most affected by the slowdown are the producers of machinery and equipment, and machinery and mechanical appliances, which are the most integrated in trade with Europe through GVCs. However, given the relatively high import content of Bosnia and Herzegovina's goods exports, the volume of trade in the economy is expected to recover once production resumes, in parallel with the revival of GVCs and demand, especially in the EU.

The closure of EU borders to non-EU citizens and other regulatory responses to the pandemic, combined with the existing logistical challenges of the Western Balkans, have particularly affected freight transport services. The WB6 set up the CEFTA co-ordinating body to exchange information on trade in goods at the

beginning of the pandemic. They also set up priority "green lanes" with the EU and “green corridors” within the WB6 to facilitate the free movement of essential goods through priority "green" border/customs crossings (within the WB6 and with the EU). At the peak of the crisis (April to May 2020), most road transport in WB6 economies passed through these green lanes and corridors. These have helped to maintain a certain degree of international trade in goods in the region. In fact, only about 20% of the goods benefitting from the green lanes and corridors regimes were basic necessities, the rest being regular trade. Such inclusive regional co-operation has proven to be very efficient in mitigating the consequences of the COVID-19 pandemic and helping the region’s economies to recover.

### *Sub-dimension 2.1: Trade policy framework*

Improvements have been made regarding **institutional co-ordination mechanisms** for trade policy development in Bosnia and Herzegovina since the last cycle of assessment. Trade policy development falls under state competency in the FBiH, whereas RS has its own mechanism under its Law on Trade (Invest in Srpska, 2020[45]). MoFTER is the key institution involved in formulating and implementing Bosnia and Herzegovina's foreign trade policy.[9] The ministry includes two administrative organisations: the Veterinary Office and the Plant Health Administration, and eight departments responsible for individual areas of trade policy.[10] Each department is responsible for co-ordinating and supervising the formulation and implementation of sectoral policies that fall under the competence of the state level of BiH. In RS, the Ministry of Trade and Tourism is responsible for trade policy development.

Some improvements have been made in aligning BiH with its trade-related international obligations.[11] BiH state-level institutions created the Trade Facilitation Committee of Bosnia and Herzegovina in 2018. The committee's board consists of 20 members from various institutions of Bosnia and Herzegovina involved in the implementation of customs and other border procedures related to international cross-border trade in goods. Representatives of the private sector, and their associations, engaged in activities related to imports, exports or the transit of goods are also members. The primary role of the committee is to improve the preparation and implementation of trade facilitation reforms through a co-ordination mechanism between the public and private sectors.

Although efforts to co-ordinate trade-related initiatives and strategies exist at state and entity levels, a formal inter-ministerial co-ordination mechanism has yet to be adopted at the state level, and no progress has been made in this regard since the previous Competitiveness Outlook publication. There is a formal inter-ministerial co-ordination mechanism framework in RS, which has been strengthened since the last reporting cycle with the introduction of new regulations in 2018.[12] At the state level, all draft laws, regulations or international agreements being drafted or negotiated upon must go through legal procedures that involve the establishment of an ad hoc working group. These working groups consist of representatives of all relevant institutions from all levels of the state government. Moreover, all BiH agencies/bodies are obliged to submit annual reports to the Council of Ministers on the implementation of existing regulations, as well as their programmes of work for the next year, in co-ordination with the relevant MoFTER department. The main difficulty with this mode of operation is its ad hoc nature, which is not systematised by solid regulations. Consequently, and in the absence of *ex post* analysis, it is impossible to establish the quality and uniformity of the work of the working groups. At the entity level, RS’s Ministry of Trade and Tourism holds constant consultations with other ministries, agencies and stakeholders involved in the trade sector during the development of strategic documents, laws and by-law acts.[13] However, a concrete procedure for monitoring trade policy making is yet to be implemented in both entities or at the state level to improve *ex post* impact assessments.

Legislation on **public consultations** is uneven across the economy**,** and there is no strategic framework for co-operation with civil society at the state level or in either entity. However, progress has been made in adopting regulations for the implementation of public consultation standards at the state level. The 2017 Regulation of Consultations in Legislative Drafting[14] contains a provision on the minimum obligations for conducting consultations from the earliest stage of drafting. According to the regulation, BiH institutions

at the state level are obliged to post preliminary draft regulations and acts on a dedicated website (eKonsultacije, 2020[46]) (eConsultation) that enables the public to submit proposals and remarks. This procedure is the only part of the adoption process that allows direct public comments. The eConsultation website has been increasingly used by the institutions of BiH in recent years, and all institutions have appointed consultation co-ordinators and deputies.[15] There is no similar mechanism in Republika Srpska, but the regulatory framework mandates that relevant institutions must make draft regulations and all related documents publicly available.[16] At the state level, acts are posted on the website for 15 or 30 days, depending on the significance of public interest, which is determined in a pre-assessment of impact. This regulation does not include a mandated maximum time for the relevant institution to respond to comments; however, acts cannot be submitted for further procedure without all questions or comments being answered by the proponent.[17] To participate in the consultation process, the public needs to register as a user of the eConsultation website and register for the specific consultation.[18] If the regulations are adopted through the Parliamentary Assembly procedure the public can also provide comments as part of the amendment procedure. Despite the web platform being operational since 2017, it is still not wildly used by the private sector,[19] and there is potential to raise awareness about various forms of consultation. Chambers of commerce are the most active institutions involved in direct consultations; however, there is no access to statistics regarding other stakeholders involved in this process. In Republika Srpska, the Ministry of Trade and Tourism does not have accurate information regarding participation in the legislative process. The use of fast-track or emergency procedures not subject to public consultation remains a widespread issue in the legislative process at all levels, especially in the FBiH, which affects the trade decision-making process.[20]

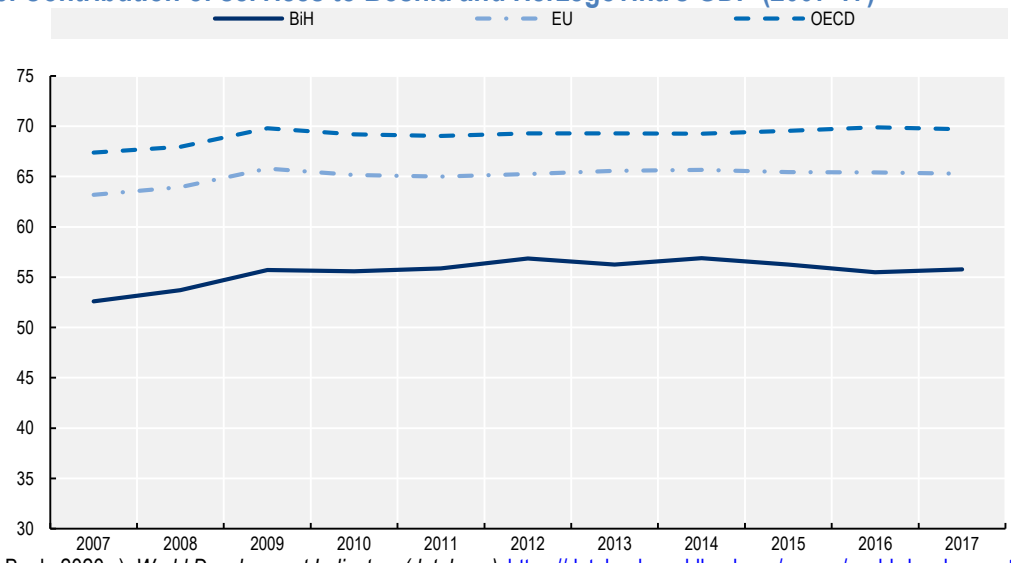
Regarding **bilateral and multilateral free trade agreements,** no progress has been made in Bosnia and Herzegovina's World Trade Organization (WTO) accession since the last review cycle. While the economy has been a member of CEFTA since 2007, it has yet to ratify Additional Protocol 5 and 6 to the agreement. Both the European Free Trade Agreement (EFTA) and the Stabilisation and Association Agreement (SAA) were ratified by Bosnia and Herzegovina in 2015.

Bosnia and Herzegovina has only one bilateral trade agreement, with the Republic of Turkey, which entered into force in 2003. A revised free trade agreement with Turkey was signed in 2019 and the ratification process is underway, after which the previous agreement and protocol will cease to be valid.

### *Sub-dimension 2.2: Services trade restrictiveness*

Services contribute close to two-thirds of GDP in WB6 economies, which highlights how strongly economic growth, innovation and job creation depend on effective policies on services that promote open and competitive markets. In Bosnia and Herzegovina, services account for 55.5% of GDP (Figure 21.5) and more than 52.5% of employment.

## Figure 21.5. Contribution of services to Bosnia and Herzegovina's GDP (2007-17)




Source: (World Bank, 2020[3]), *World Development Indicators (database)*, https://databank.worldbank.org/source/world-development-indicators.

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Enhancing the openness of trade in services can improve domestic firms' efficiency and productivity (OECD, 2018[47]). Trade in services allows economies to specialise according to their comparative advantages in services and skills. The potential gains from liberalisation in services trade are significant because increased domestic and foreign competition, complemented by effective regulation, can enhance performance and lower costs related to trade in services (Box 21.2).

### Box 21.2. The costs of regulatory barriers to trade in services

Recent OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[48]). Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rule-making. The costs resulting from barriers to trade in services are much higher than those of trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services. Even exporting to the most liberal economies still requires compliance with regulation at a cost that correspond to around 30% of the export value in most sectors and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are at around 10% in most sectors and around 32% for financial services.

Source: (Benz and Jaax, 2020[49]), *The costs of regulatory barriers to trade in services: New estimates of ad valorem tariff equivalents*, http://dx.doi.org/10.1787/bae97f98-en; (Rouzet and Spinelli, 2016[48]), *Services Trade Restrictiveness, Mark-Ups and Competition*, https://dx.doi.org/10.1787/5jln7dlm3931-en.

The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse barriers to trade for 12 services sectors** in Bosnia and Herzegovina.[21] The OECD STRI project is a unique, evidence-based diagnostic tool that inventories trade restrictions in 48 economies,[22] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions and prioritise reform efforts. For this Competitiveness Outlook assessment cycle, the 12 services sectors are grouped into four clusters:

1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

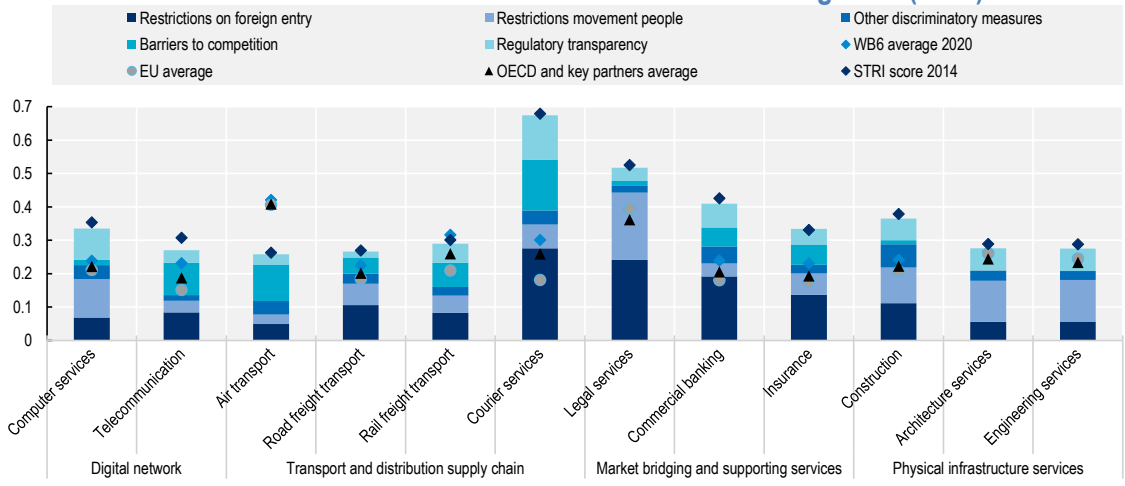
Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices quantify restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[23]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[24] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[50]).

Figure 21.6 shows the STRI indices for each of the sectors, as well as the average scores for the WB6, EU and OECD. Compared to the STRI project member states, Bosnia and Herzegovina is in the high range in terms of the degree of restrictiveness of its services sectors. This has a negative impact on the attraction of investment and competition in the economy. Within the WB6 region, Bosnia and Herzegovina has a lower STRI score than the WB6 average in 2 out of 12 sectors. Air transport services and rail freight transport services are the two sectors with the lowest score relative to the WB6 average. Courier services and Legal services are the two sectors with the highest score relative to the WB6 average.

It is important to note that although some relevant competencies in the following sectors might be shared between the state level and the entity level in Bosnia and Herzegovina, BiH is scored as a single economy for the purposes of the STRI.

## Figure 21.6. Services Trade Restrictiveness Index for Bosnia and Herzegovina (2020)




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[51]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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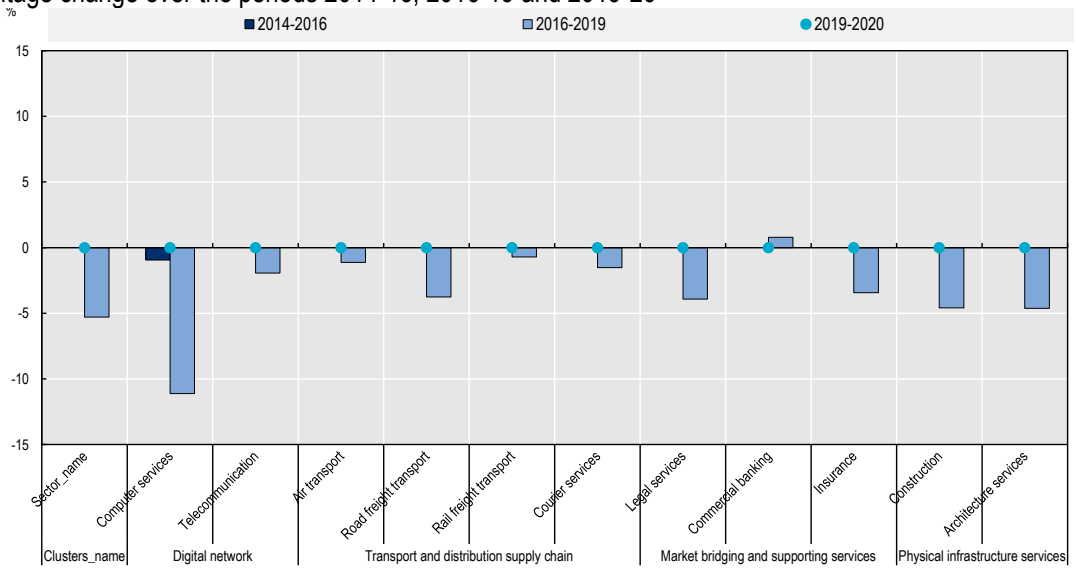
The economy has made regulatory efforts to reduce its degree of restrictiveness by introducing policies to open its market to foreign service providers. However, although the economy has not increased its degree of restrictiveness, the limited number of concrete sectoral reforms to open up the services sectors since the last evaluation round has meant that the variation in degrees of openness has been small. This is

particularly important given that recent OECD studies on member economies have tended to show a growth in the number of regulations restricting services sectors in 2020 (OECD, 2021[52]).

Figure 21.7 displays the evolution of Bosnia's STRI indices by sector and period in percentage changes.

## Figure 21.7. Evolution of STRI scores by sector in Bosnia and Herzegovina (2014-20)

Percentage change over the periods 2014-16, 2016-19 and 2019-20




Note: Values are expressed in percentage change, with negative values indicating a reduction in restrictiveness of the economy's trade regulatory environment.

Source: (OECD, 2020[51]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255551

The following analysis starts with the horizontal measures included in all sectors that hamper services trade in the economy as a whole, particularly in the areas of general business regulation, restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. The STRI scores are then explained by sector with information on what drives the results and a brief description of the most common restrictions and good practices.

### General business regulations affect firms' ability to operate in Bosnia and Herzegovina

There are a number of areas in which Bosnia and Herzegovina could improve its company regulations, such as in the acquisition or use of land and real estate by foreigners, which is restricted. This restriction mainly affects foreign companies' ability to establish offices in the economy and operate a business, and particularly affects the services sectors, which are highly dependent on 3 modes of supply (commercial presence) (see Box 21.3).

For a commercial company to be constituted and registered, a minimum capital requirement must be paid, which further affects foreign companies and consequently makes BiH less competitive compared to economies that do not impose such a requirement. This is the case even if the obligation is applied regardless of whether the company is local or foreign. Extremely lengthy procedures for obtaining business visas and cumbersome, lengthy and costly procedures for registering a company also limit investment opportunities.

### Box 21.3. Examples of the four services supply modes

The definition of trade in services under the GATS has four components (modes), depending on the territorial presence of the foreign service provider and the consumer at the time of the transaction. Pursuant to Article I:2, the GATS covers services supplied.

**Mode 1: Cross-border:** Services are provided from the territory of one member into the territory of any other member.

*Example*: A consumer in economy A receives services from abroad through its telecommunications or courier infrastructure. Such supplies may include any type of consultancy, legal advice, architectural services or computer related services.

**Mode 2: Consumption abroad:** Services are provided in the territory of one economy to the service consumer of any other economy.

*Example*: Nationals of economy A have moved abroad as tourists, students or patients to use the respective services.

**Mode 3: Commercial presence:** Services are provided by a supplier of one economy, through commercial presence, in the territory of any other economy.

*Example*: The service is provided within economy A by a locally established subsidiary, or representative office of a foreign-owned and controlled company (bank or insurance company, air company, construction firm, etc.).

**Mode 4: Movement of natural persons:** Services are provided by a foreign supplier through the presence of natural persons of an economy in the territory of any other economy.

*Example*: A foreign national provides a service within economy A as an independent supplier (e.g. IT consultant) or employee of a service supplier (e.g. IT consultancy firm).

Source: (WTO, 1995[52]), *Article 1.3: Definition of Services Trade and Modes of* Supply, https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm.

*Restrictions on the movement of people* are an issue in Bosnia and Herzegovina. Although significant progress has been made in easing the conditions for the movement of persons between the CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA agreement, persons from economies outside CEFTA or the EU are subject to restrictive requirements. Bosnia and Herzegovina applies quotas for work permits issued to third-country nationals, although intra-corporate transferees are exempted. Contractual and independent services suppliers, including intra-corporate transferees, are subject to labour market tests. The length of stay of these categories of foreigners is limited to 12 months for contract and independent services suppliers, and 36 months for intra-corporate transferees. Procedures for obtaining business visas and registering a company are all considerably more numerous, costly or time-consuming than is best practice.

Standards for the *cross-border transfer of personal data* are set at the EU level. Transfers to non-European Economic Area economies may take place when an adequate level of data protection is ensured or, failing that, where appropriate safeguards (e.g. binding corporate rules or standard data protection clauses) are in place.

*Restrictions on public procurement* include a local price preference regarding tenders that applies a reduction for local suppliers, which affects negatively the STRI score of BiH. Furthermore, the economy's public procurement regulation does not contain an explicit reference to the prohibition of discrimination towards foreigners. The procurement law includes thresholds above which a tender is mandated, but there is no procurement regime applied to foreign suppliers below the value thresholds.

In terms of the *screening of foreign investments*, the laws and regulations of Bosnia and Herzegovina do not mandate the consideration of economic motives or interests in the review of foreign investments, although it is not explicitly ruled out.

Box 21.3 presents the modes of supply of trade in services as defined by the World Trade Organization's General Agreement on Trade in Services (GATS) and used in the OECD STRI.

### There are several restrictions in specific services sectors

Beyond regulatory measures that affect Bosnia and Herzegovina's trade in services in a horizontal manner, there are a number of sector-specific restrictions in the 12 sectors analysed, which are explored below.[25]

**Air transport services** are defined as passenger and freight air transport carried domestically or internationally (code 51 under the International Standard Industrial Classification – ISIC - Revision 4). The STRI for this sector covers commercial establishments only. Given the range of air transport subsectors, the approach in the STRI project is to focus on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant in so far as regulations enacted by relevant authorities can have an impact on the ability of foreign carriers to transport passengers and goods between points.

The STRI scores can range from 0 to 1, with 0 signalling a completely open sector and 1 indicating a sector closed for foreign service suppliers. The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601. With a score of 0.258, Bosnia and Herzegovina is the second-least restrictive WB6 economy. It scores lower than the EU (0.407), OECD (0.409) and WB6 (0.421) averages.

*Regarding restrictions on foreign entry*, unlike most economies, Bosnia and Herzegovina does not impose foreign equity restrictions, which facilitates the entry of foreign capital in this sector. There is no limit to the maximum equity share allowed. There are also no regulatory limits to the proportion of shares that can be acquired by foreign investors in publicly controlled firms. There are no prohibitions or restrictions on the lease of foreign aircraft either with or without crew (wet or dry lease). The lack of such restrictions makes the economy very attractive in this sector.

Bosnia and Herzegovina again differs from other economies regarding *barriers to competition* as there is no public ownership in the aviation sector through a national airline. Air carriers are not allowed to retain allocated slots from one season to the next. Operational centres of airports are responsible for allocating slots using discretionary authorisation based on transparent, unbiased and non-discriminatory rules. However, air carriers are not allowed to commercially exchange slots and there is no schedule for airport use, which contributes negatively to Bosnia's score in this sector, although marginally.

**Road freight transport** (ISIC Rev 4 code 4293). The STRI for this sector covers commercial establishment only. Cross-border trade is governed by a system of bilateral and plurilateral agreements that provide for permits, quotas and other regulations.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.124 and 0.624. With a score of 0.266, Bosnia and Herzegovina is the second most restrictive WB6 economy. It performs worse than the EU (0.184), OECD (0.201) averages, but lower than the WB6 average (0.421).

Due to the specificity of this sector, the score is negatively affected by horizontal measures that affect the whole economy, particularly those related to the movement of people and visa requirements. In Bosnia and Herzegovina, the procedures for registering a company are much more costly, lengthy and cumbersome than international best practice, which contributes to the sector's restrictiveness.

There are few restrictions regarding sector specific regulations, as Bosnia and Herzegovina does not impose many sector specific laws that would hamper the given sector. As regards *foreign entry restrictions*, licensing/permits are subject to quotas for domestic traffic, which is the main contributor to Bosnia and Herzegovina's negative score. In the area of barriers to competition, fees are set by the

government for transportation, management certification, issuing of licences, licence copy statements, licences for international carriage of goods, and special permits for foreign carriers. The ministry, at the proposal of the Association of Carriers at the Chamber of Commerce of the Federation of Bosnia and Herzegovina, has established minimum prices for road freight transport services.

**Rail transport** (ISIC Rev 4 code 4912) is provided over a dedicated network where the market structure may take different forms, the two most common being: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between infrastructure management and operations. Regardless of the market structure, there are well-established best practice regulations that also consider competition from other modes of transport, particularly road transport.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.129 and 1. With a score of 0.290, Bosnia and Herzegovina is the second-most restrictive WB6 economy. It scores higher than the EU (0.210) and OECD (0.260) averages, but lower than the WB6 average (0.316). In terms of foreign entry restrictions, unlike many economies, Bosnia and Herzegovina provides transit rights for international rail transport, as well as access rights for international combined transport and rail transport, which positively affects the STRI score. However, under Republika Srpska law, a local establishment is required to obtain a licence to operate rail transport services.

*Regarding restrictions on the movement of people*, licences are required to practice, and laws have established a process for recognising qualifications gained abroad. The Railway Regulatory Board (RRB) of BiH operates within the Ministry of Communications and Transport of Bosnia and Herzegovina, and the law gives it powers to issue instructions for the safety and interoperability of the railway system according to the EU-Bosnia Stabilization and Association Agreement and its Protocol 3.

*Barriers to competition* significantly contribute to Bosnia and Herzegovina's STRI performance in rail transport services. Access to railway infrastructure is mandated at the national level, and access fees are regulated. Republika Srpska law explicitly prohibits the transfer and trading of infrastructure capacity. FBiH law makes no distinction between private and public railway infrastructure, but RS law does. However, in practice, the public company operates the infrastructure.

Following the Dayton Peace Accords of 1995, the state railway company was divided into two entity-owned companies, Zeljeznice Federacije Bosne i Herzegovine (ZFBH) and Zeljeznice Republike Srpske (ZRS). Maintaining a state-owned enterprise in this sector negatively affects its STRI scoring.

**The courier services sector** (ISIC Rev 4 code 53) includes postal and courier activities. While courier services have traditionally been important means for communication, the rise of modern ICT has contributed to a less frequent use of letters between individuals for communication.

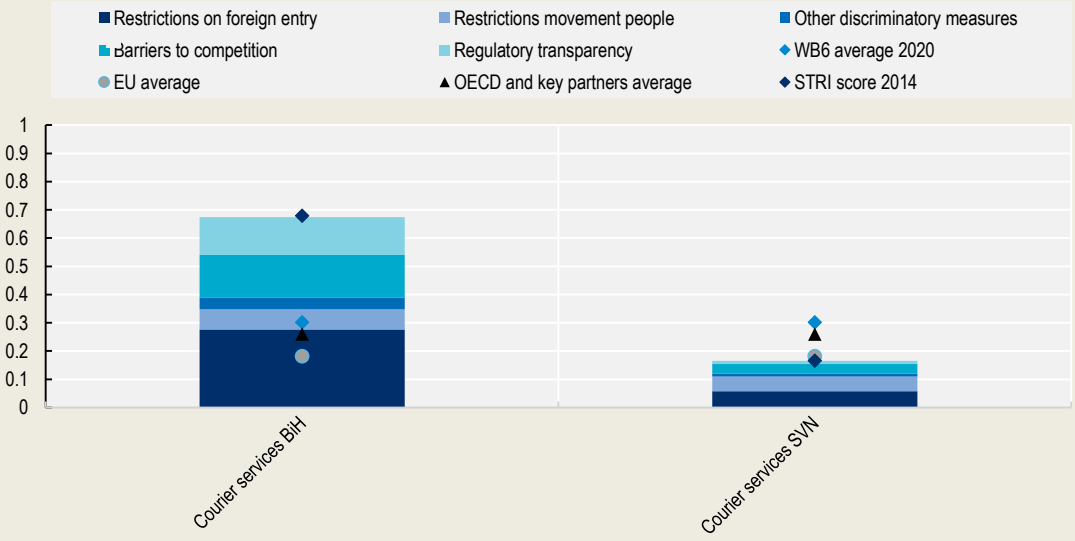
The 2020 scores for all OECD member states and STRI partners are between 0.106 and 0.881. With a score of 0.674, Bosnia and Herzegovina is the most restrictive WB6 economy. It is considerably more restrictive than the EU (0.182), OECD (0.259) and WB6 (0.301) averages. The degree of restrictions in the courier sector in Bosnia and Herzegovina is particularly visible when benchmarked against top European performers like Slovenia (Box 21.4). However, the restrictiveness could be largely lessened as it appears to be concentrated in a series of particularly limiting regulatory measures.

In terms of restrictions on the movement of people, a licence is required to practice as a postal operator. To obtain a licence from the regulator, postal operators need to provide proof of having a "sufficient number of qualified employees".

## Box 21.4. Identifying regulatory bottlenecks and increasing the attractiveness of courier services in Bosnia and Herzegovina

The joint use of STRI tools helps to identify the regulatory elements that affect the restrictiveness index, and consequently the degree of openness of a sector. The comparative study of the STRI 2020 indices of Slovenia and BiH highlights certain elements that could help to identify regulatory bottlenecks and increase the attractiveness of courier services in Bosnia and Herzegovina.

### Figure 21.8. STRI courier services – comparison between Bosnia and Herzegovina and Slovenia




Note: 0=no restrictions, 1=fully restricted; average represents the WB6 average for 2020
Source: (OECD, 2020[51]); *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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Bosnia and Herzegovina has a high score in the courier services sector compared to other OECD STRI participants. The economy is also the most restrictive WB6 economy, with a score higher than the EU, WB6 and OECD averages. In contrast, Slovenia has a very open and liberal courier services market, scoring among the lowest STRI indices in this sector. The Postal Act of 1997 brought Slovenian legislation in the postal sector partially in line with the EU *acquis*. The complete liberalisation of postal services was achieved with the adoption the new Postal Services Act in April 2002 and secondary acts in 2003. Currently, courier services are Slovenia's least restrictive STRI sector. The economy maintains only a small number of sector-specific restrictions, such as the existence of a state-owned designated postal operator and limits to the proportion of shares that can be acquired by foreign investors.

Upon comparing both economies using the STRI policy stimulator, only a limited number of regulatory measures appear to dictate the weight difference between Slovenia and BiH STRI scores. This suggests that Bosnia and Herzegovina could substantially reduce its restrictiveness index to the average levels found in the STRI by focusing on lifting the following specific restrictions:

In the area of restrictions to movement of people, the score of both economies is largely impacted by quotas on foreign services suppliers. Additionally, both economies maintain a very short duration of stay for foreign service providers. However, Slovenia and Bosnia and Herzegovina have aligned their regulatory environments with international good practice regarding the length of stay of intra-corporate transferees. Overall, lifting limitations on the movement of people could decrease the BiH courier restrictiveness index value by 0.052.

In the barriers to competition category, Slovenia does not apply any preferential tax or subsidy treatment to the national DPO, a limitation still present in the Bosnian regulatory framework. Lifting this restriction could decrease BiH's courier index value by 0.011.

Slovenia has incorporated a specific dispute resolution system into its regulatory environment governing the postal sector. In Bosnia and Herzegovina, such a mechanism is absent from the legislation. By creating such a procedure, BiH could lower its degree of restrictiveness by 0.011.

In its 2002 reform of the postal market, Slovenia abolished all reserved services in the sector. This regulatory change is the most significant difference with Bosnia and Herzegovina, which maintains certain postal services reserved under the universal postal services. Following Slovenia's example, the removal of these restrictions could potentially reduce BiH's index value by 0.468.

Source: (OECD, 2017[53]), *Services Trade Policies and the Global economy*, https://doi.org/10.1787/9789264275232-en.

*Foreign entry restrictions* contribute significantly to performance in many economies, including Bosnia and Herzegovina. The economy imposes limits on the proportion of shares that can be acquired by foreign investors in publicly controlled firms. Local presence is required for the cross-border supply of courier services through registration to the court registry. Restrictions are also present in the form of a licence requirement to enter the market. Designated postal operator (DPOs), which are publicly controlled, have a monopoly on letters weighing up to 1 kg and parcels weighing up to 10 kg. The law designates three publicly owned DPOs: the Postal Traffic Company RS AD Banja Luka, JPBH Post d.o.o. Sarajevo, and HP Mostar d.o.o.

*Regarding barriers to competition*, there is no dispute resolution mechanism available. The three DPOs provide universal and other services in the economy, but there is at least one other dominant provider in the courier services market. The regulator establishes a unified price policy for reserved services. The law enables the state or entity governments to subsidise the DPOs if they cannot finance their activities. These subsidies are limited to the reserved postal services, and cross-subsidising is prohibited.

**Legal services** (ISIC Rev 4 code 691) cover advisory and representation services in domestic and international law. International law includes advisory services in home country law, third-country law, international law, as well as the right to appear in international commercial arbitration. Domestic law extends to advising and representing clients before a court or judicial body in the law of the host country.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.141 and 1; the OECD average is 0.360, the EU average is 0.394 and the WB6 average is 0.391. With a score of 0.517, Bosnia and Herzegovina is the most restrictive WB6 economy. However, it must be noted that the legal services sector in BiH is not completely closed to foreign legal services providers, as is the case in some EU member states (OECD, 2020[51]).

*Restrictions on the movement of people* have a considerable negative effect on the STRI score of Bosnia and Herzegovina as there are many restrictions in place in the legal sector, for example a licence is required to practise domestic law. Regarding international law, foreign citizens in FBiH who are registered as lawyers in their home country may give legal advice on matters concerning the law of their economy. In Republika Srpska, the use of foreign lawyers is unrestricted in arbitration courts dealing with matters of international law. RS law allows for exemptions to the nationality requirement that a licence is needed to practise domestic law; however, FBiH law provides for these exemptions on the basis of reciprocity, which negatively affects the STRI scoring. Foreigners do not have an option to obtain a temporary permit as there is no temporary licensing system in Bosnia and Herzegovina, which further restricts foreign lawyers' ability to operate in the economy.

*Regarding restrictions on foreign entry* into Bosnia and Herzegovina, both local and commercial presence is required for the cross-border supply of legal services. There are also localisation requirements in place for professional liability insurance. Under RS law, a foreign lawyer registered in the Bar Association's B

register (register of Foreign Lawyers) must practice with a local lawyer for at least three years after registration. In FBiH, the Bar Association's Code of Ethics explicitly prohibits lawyers from being permanent representatives of foreign law firms. There is also a restriction on the acquisition and use of land and real estate by foreigners, which negatively impacts the economy's STRI score. However, this law includes a reciprocity clause for the successor states of the former Yugoslavia.

*Regarding barriers to competition*, both FBiH and RS provide a recommended minimum and maximum fee for locally licensed lawyers. The two entities take different approaches to restrictions on law advertising. Under RS law advertising is prohibited, whereas FBiH law provides conditions for permitted advertising determined by the Statute of the Federal Bar Association.

**Commercial banking** (ISIC Rev 4 divisions 64-66) includes deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of dynamic economies as they provide financing for investment and trade across productive activities, which underly all value chains.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.131 and 0.517; the OECD average is 0.205, the EU average is 0.180 and the WB6 average is 0.239. With a score of 0.409, Bosnia and Herzegovina is the most restrictive WB6 economy. In terms of foreign entry restrictions, in RS the branch network of a foreign bank cannot be established if it undermines the ability of local banks to operate. However, a subsidiary may be established as a separate legal entity, subject to prior approval by the Banking Agency of Republika Srpska. Only banks registered in Republika Srpska and branches of banks registered in FBiH (that operate on RS territory, if approved by the regulator) can establish an ATM network in Republika Srpska.

A bank must be registered in BiH and operate under a licence by the regulator. Only banks can undertake deposit-taking, lending and other activities prescribed by the law. Banks may establish representative offices to deal with non-banking activities. According to FBiH and RS laws, banks from one entity can open branches in the other entity upon approval of the relevant banking agency. There is no mention of branches of foreign banks in the laws of either entity. The criteria to obtain a licence are more stringent for foreign companies, which has a negative impact on the STRI score. For example, the regulator can refuse a licence request if the performance of the supervisory function of the Agency could be hindered or impeded by the connection of the bank with other legal or natural persons established, domiciled or domiciled in another economy. Since 2017 there has been a requirement that at least one member of the Supervisory Board must have active knowledge of one of the languages in official use in BiH and residency in one of the entities or in BiH in general. As mentioned above in legal services, BiH imposes a restriction on the legal form as the law defines a bank as a joint-stock company.

Although BiH is not a member of the Basel Committee on Banking Supervision, which is the main global standards setter for banks, significant provisions on risk weighting exist within both entities' banking laws. Credits in foreign currency are forbidden, except for legal persons and entrepreneurs seeking to pay to import goods from abroad. To take deposits in foreign currency the bank may open a non-resident account in convertible marks, i.e. foreign currency, on which convertible marks or foreign currency acquired by the non-resident in accordance with the law are kept. A non-resident deposit account can be on-demand or term, with or without notice, with special purpose or without purpose. It is forbidden to grant non-residents financial loans with a maturity of less than one year, except for the granting of loans from banks and residents for the purpose of establishing lasting economic relations. Lending in local currency between a resident and a non-resident is not allowed.

*Regarding barriers to competition*, default interest rates on loans are regulated, and the licence strictly regulates the services a bank may provide. The Ministry of Finance in the FBiH owns a majority share of Union Banka, which is a major firm in the sector. While the law provides an extensive list of reasons for declining a licence application, there is no explicit requirement to inform the applicant of the reason for denial. Moreover, the law allows the regulator to define additional reasons for refusal at its discretion. This form of legal uncertainty heavily affects the scoring in this sector.

**Insurance services** (ISIC Rev 4 code 651 and 652) include life insurance, property and casualty insurance, reinsurance, and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.104 and 0.565. The WB6 average is 0.231, EU and OECD averages are lower at 0.175 and 0.193, respectively. With a score of 0.334, Bosnia and Herzegovina is the most restrictive WB6 economy. Restrictions to the movement of people are visible in the form of licence requirements, but criteria to obtain a licence are not more stringent for foreign companies. While the law provides no condition on residency, it requires the passing of a professional exam that does require residency in Bosnia and Herzegovina. In RS, foreign professional exams are recognised.

*Regarding restrictions to foreign entry*, RS law restricts cross-border mergers and acquisitions for non-life insurance and reinsurance. Both RS and FBiH laws require that foreign insurance and reinsurance companies establish branches that have the quality of legal persons. Furthermore, the laws of both entities include a local availability test for cross-border trade in the field of non-life insurance. As part of the licensing process, foreign companies must appoint a local representative, which negatively affects the STRI score. As of 2017, the FBiH law only mentions the possibility of foreign insurance companies opening branches, there is no mention of reinsurers. There are legal form restrictions on the cumulative activity of a branch of a company practising both non-life and life insurance. RS law includes a reciprocity clause for the establishment of branches of foreign insurance companies. Until 2017, the FBiH law also had such a clause, and its removal facilitates the activity of foreign insurers on FBiH jurisdiction. FBiH law, however, imposes various restrictions on managers. Such categories of foreigner must have a work permit, and at least one manager must be a resident of the economy.

*Regarding barriers to competition*, there are restrictions on asset holdings. The new FBiH Insurance law empowers the regulator to approve new insurance premiums. However, this is not the case in RS. The FBiH maintains a certain form of state-owned enterprise in the sector as the largest shareholder of the Sarajevo Insurance JSC, which provides both life and non-life insurance. RS has no shares in life insurance companies, but it does hold a minority share of 34.9% in Krajina Insurance. However, this company only provides non-life insurance and has a market share of 2.3%. RS provides no restrictive laws on insurance advertising; however, BiH is still scored as restrictive in this area due to the new law in FBiH, which mandates that the advertiser must submit advertising material containing information about the company's financial and market situation for review before publishing.

**Construction** includes buildings (residential and non-residential) and construction work for civil engineering (ISIC Rev 4 codes 41 and 42). Construction services have historically played an important role in the functioning of economies, providing the infrastructure for other industries. These services account for a significant share of GDP and employment in most economies. Public works, such as roads and public buildings, account for about half of the market for construction services. Therefore, the STRI for construction services covers detailed information on public procurement procedures.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464. The WB6 average is 0.242, the OECD average is 0.222 and the EU average is 0.207. With a score of 0.365, Bosnia and Herzegovina is the most restrictive WB6 economy.

*The movement of people* is restricted by the imposition of licensing requirements that need to be respected to provide engineering services in Bosnia and Herzegovina. While RS regulation recognises an acquired amount of ECTS in engineering studies as a possible precondition for passing the licensing exam, there is no such mention in FBiH regulation. At least one engineer must be licenced for the issuance of construction permits in the economy.

*Regarding restrictions on foreign entry*, the STRI score is negatively affected by the existence of restrictions on cross-border mergers and acquisitions. If a company is fully merged with a foreign entity it will lose its incorporated status and thus its licence to operate. Construction services must be performed by licenced

and registered companies, meaning that they must be incorporated in BiH. Given the federal structure of FBiH, the STRI methodology uses the Sarajevo canton for reference whenever there is no federal law or regulation applicable to the measure in question. Local presence is also required, and foreign branches are prohibited.

*Barriers to competition*, as defined by the STRI, include cases in which public authorities hold control (i.e. at least a blocking minority or a preferred share) in one of the 10 largest companies in the service sector analysed. It is believed that the presence of an SOE in a given sector could distort competition and act as a deterrent to market entry by foreign operators. In the construction sector, the FBiH maintains the ownership of FBIH Motorways, considered the largest construction company in terms of revenue.

**Architecture services** also include related technical consultancy (ISIC Rev 4 code 711). These services constitute the backbone of the construction sector, with key roles in building design and urban planning. An important feature is the regulatory complementarity between architecture, engineering and construction services, which are often combined into projects offered by one company, and sometimes subsumed into the building and construction sector.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.113 and 0.684. The WB6 average is 0.265, the EU average is 0.260 and the OECD average is 0.244. With a score of 0.275, Bosnia and Herzegovina is the second-most restrictive WB6 economy, scoring marginally higher than the WB6 average.

*Restrictions on the movement of people* mean that a licence or authorisation is required to practice in BiH, and there is no temporary licensing system in place. Qualified foreign physical and legal persons can request a licence for producing architecture documents from the ministry.

*Regarding restrictions on foreign entry*, both local and commercial presence is required for the cross-border supply of architecture services. Foreign suppliers must have a registered business unit in BiH to obtain a licence. Although it is not clearly stated in the company laws, the alien laws state that a foreign natural person may perform work in the territory only based on their work permit. To obtain a work permit, a foreign natural person must first be granted a residence permit. Given that managers are registered with the court registry and may perform work only upon the employment agreement with the employer (for foreign persons a work permit is mandatory), a manager must have registered residence in BiH.

**Engineering services** (ISIC Rev 4 code 711) covers several related activities, such as engineering and integrated engineering services, and engineering related scientific and technical consulting services.

The 2020 scores for all OECD member states and STRI partners range between 0.118 and 0.575. The WB6 average is 0.244, the EU average is 0.245 and the OECD average is 0.233. With a score of 0.274, Bosnia and Herzegovina is the most restrictive WB6 economy.

*Restrictions on the movement of people* are present in the form of licensing requirements to provide engineering services in Bosnia and Herzegovina. RS regulation recognises an acquired amount of ECTS in engineering studies as a possible precondition for passing the licensing exam, but there is no such mention in the FBiH regulation. At least one engineer must be licensed for the issuance of construction permits in the economy.

*Regarding restrictions on foreign entry*, the STRI score is negatively affected by the restrictions on cross-border mergers and acquisitions. If a company is fully merged with a foreign entity, it will lose its incorporated status and thus its licence to operate. Engineering services must be performed by licensed and registered companies, meaning that they must be incorporated in BiH. Given the federal structure of FBiH, the STRI methodology uses the Sarajevo canton for reference wherever there is no federal law or regulation applicable to the measure in question. Local presence is also required, and foreign branches are prohibited.

**Computer services** are defined as computer programming, consultancy and related activities and information service activities (ISIC Rev 4 codes 62 and 63).

The 2020 scores for all OECD member states and STRI partners range between 0.123 and 0.448. The WB6 average is 0.239, the EU average is 0.211 and the OECD average is 0.221. With a score of 0.355, Bosnia and Herzegovina is the most restrictive WB6 economy.

This sector is very rarely regulated by sectoral legislation; instead, Bosnia and Herzegovina subjects computer services to general laws that apply to the whole economy. The sector also requires highly skilled workers who are often sought after in third countries, which means that measures affecting the mobility of service providers have a significant impact on the degree of openness in this sector. For this reason, horizontal restrictions on the movement of people account for one-third of the total score in computer services (Figure 21.7).

**The telecommunications sector** comprises wired and wireless telecommunications activities (ISIC Rev 4 codes 611 and 612). These services are at the core of the information society and provide the network over which other services including computer services, audio-visual services and professional services are traded.

The 2020 scores for all OECD member states and STRI partners range between 0.108 and 0.682. The WB6 average is 0.231, the EU average is 0.151 and the OECD average is 0.188. With a score of 0.270, Bosnia and Herzegovina is the most restrictive WB6 economy.

In the telecommunications sector, the results are mostly affected by two policy areas: restrictions on foreign entry and barriers to competition. In all STRI economies, barriers to competition account for 30% of the STRI score in the telecommunications sector. This reflects the characteristics of the sector, as well as the policy environment in which it operates. It is a capital-intensive network industry and its strategic importance has led many economies to restrict foreign investment and activity.

In order to ensure fair competition in the telecommunications market, Bosnia and Herzegovina has an independent telecommunications regulator, the Communications Regulatory Agency (RAK), which operates at the state level. RAK has published a regulation setting out the requirement of number portability and regulated time and conditions for porting. It also regulates interconnection. Bosnia and Herzegovina is restricted in this sector partly because it does not apply a "use-it-or-lose-it" policy to frequency bands, which can prevent incumbent operators from over-holding valuable frequency licences and free tradable spectrum and telecom services. Mtel a.d. Banja Luka, BH Telekom d.d. Sarajevo and HT d.o.o. Mostar were declared the significant market power operators in the leased lines market in 2012.

*Ex ante* regulations on granting access, price control and publication of reference offers apply, which is in-line with best practice and EU regulations. All reference interconnection offers and licensing agreements are published on RAK's website. The FBiH is the majority shareholder of both BH Telecoms d.d. and JP HT d.d. Mostar, both of which operate fixed and mobile networks. As in most sectors, maintaining SOEs is a competition liability in the telecommunications sector.

*Regarding restrictions to foreign entry*, both commercial and local presence are required to provide cross-border services in the telecommunications sector. Furthermore, a licence is required to practise. RAK appoints a service provider for universal services. While this appointment procedure must adhere to the principles of objectivity, transparency, non-discrimination and proportionality, the description of the procedure is not elaborate enough to qualify it as competitive.

In absolute terms, the regulatory framework of the telecommunications sector in Bosnia and Herzegovina is competitive and constrained only by some sector-specific measures and horizontal regulations that apply to the economy as a whole, most notably the movement of people. Cumbersome procedures to obtain visas and register companies also negatively affect the sector to some extent.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring about significant gains for businesses, and is positively related to firms' process innovation. It enlarges businesses' market scope, reduces operational costs at various stages of business

activities and lowers barriers to entry, thus intensifying competition (OECD, 2020[42]). E-commerce also benefits consumers by providing information on goods and services, helping consumers identify sellers and comparing prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (López González and Jouanjean, 2017[55]).

In the context of COVID-19, e-commerce appears to have been essential for maintaining trade flows despite the restrictions put in place to preserve public health. Indeed, buying online rather than in person reduces the risk of infection. Continuing to sell in locked down economies preserves jobs, despite the demands of social distancing and movement restrictions. E-commerce increases the acceptance of prolonged physical distancing among the population and allows them to maintain a certain level of consumption.

2020 will be a turning point in e-commerce. The digital transformation underlines the importance of adopting a more holistic approach to policies, as well as more international co-operation (Ferencz, 2019[54]; OECD, 2020[55]). This sub-dimension assesses the policies implemented in parallel and in addition to those of the Digital society (Dimension 10). It is mostly focused on the trade in digitally enabled services given its rapid growth in the region.

Modern e-commerce regulations should focus on several key elements such as electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property regulations, and intermediary liability. An attractive regulatory environment should refrain from maintaining disproportionately restrictive measures such as licensing requirements for e-commerce platforms, limitations on the types of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows.

The **e-commerce framework** in Bosnia and Herzegovina is underdeveloped. BiH citizens and business people generally do not shop or conduct business on the Internet, and ordering online remains very rare. The financial sector, however, leads the way as it is generally in line with good international practice in terms of the regulations necessary to operate e-commerce. Many commercial banks offer e-banking to their clients.

The regulatory policy framework on e-commerce in Bosnia and Herzegovina is still at an early stage of preparation. There have not been any substantive changes in the framework since the last assessment cycle, and very little progress has been made on implementation.

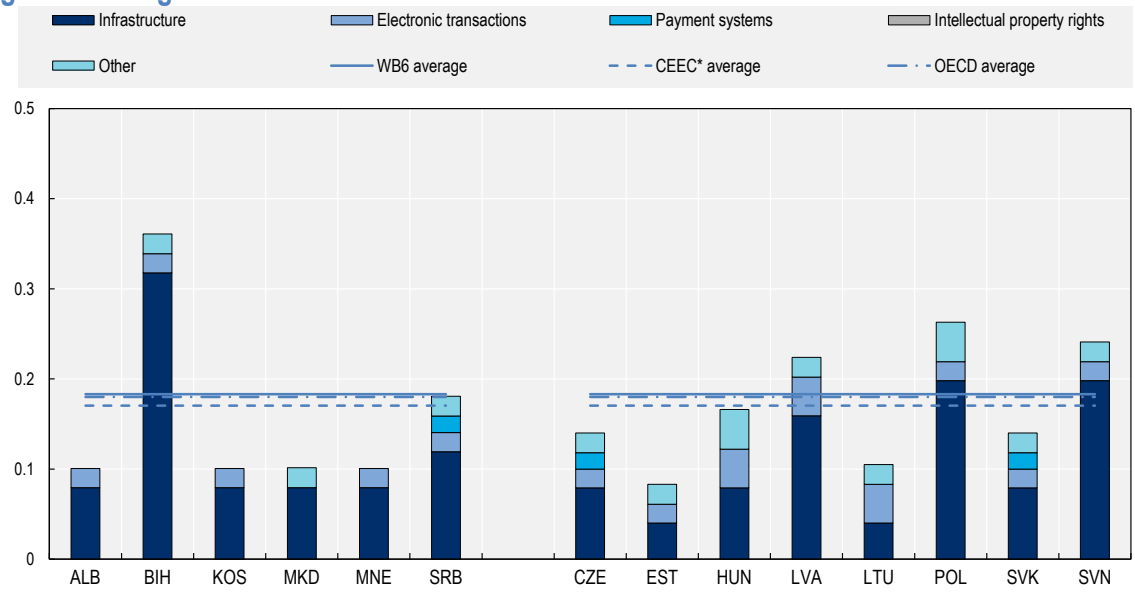
E-commerce falls under the jurisdiction of the state's MoFTER and Republika Srpska's Ministry of Trade and Tourism. The economy has made no progress in adopting a new law on electronic communications and electronic media in line with the 2018 EU regulatory framework. Regulations currently in force are the Law on Electronic and Legal Business Transactions (2007) at the state level and the Law on Electronic Business (2009 amended 2016) in Republika Srpska. In Republika Sprska, certain aspects of e-commerce are also regulated by the Law on Trade (2019) and the Rulebook on the Ways and Forms of Conducting Distance Selling, which was last updated in 2021.[26] Different ministries, such those in charge of finance, education or science development, are responsible for the implementation of the laws related to e-commerce. At the state level, the Office for Supervision and Accreditation was established in October 2019 within the Ministry of Communication and Transport of Bosnia and Herzegovina, and regulates the conditions for the application of the Law on Electronic Signatures and the issuance of verified electronic signatures in Bosnia and Herzegovina.

Bosnia and Herzegovina adopted the 2017-2021 Policy for Development of the Information Society in May 2017 (Sluzbenilist BiH, 2017[56]); however there has been no progress made in adopting a state-wide strategy and associated action plans on e-commerce related matters. Only Republika Srpska has implemented a legal framework addressing consumer protection in e-commerce.

The OECD Digital STRI captures the **restrictiveness of digitally enabled services** by identifying cross-cutting barriers that inhibit or completely prohibit firms' ability to supply services using electronic networks, irrespective of the sector in which they operate. The regulatory data underlying the Digital STRI were

extracted from the existing OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. In accordance with OECD STRI methodology, Digital STRI scoring uses a binary system. Scores are assigned with a value of 0 when there are no trade restrictions and a value of 1 when restrictions are in place. The rating takes into account the specific regulatory and market characteristics, as well as the links and hierarchies between regulatory measures affecting digitally enabled services (López González and Jouanjean, 2017[57]). Figure 21.9 shows Bosnia and Herzegovina's score on the Digital STRI index.

## Figure 21.9. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[51]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255589

The 2020 Digital STRI scores for all OECD member states in this sector range between 0.043 and 0.488; the WB6 average is 0.183. With a score of 0.361, Bosnia and Herzegovina is the most restrictive WB6 economy in the digital sector. The economy's score has not changed since 2014.

Results in most Digital STRI economies are regularly driven by infrastructure and connectivity measures due to the lack of effective interconnection regulation. Although BiH has stricter rules than the OECD guidelines in this area, it does not impose excessive conditions on cross-border data flows beyond those put in place to ensure the protection and security of personal data. However, the economy, like the other 11 Digital STRI economies, requires that some types of data are stored locally, although copies can be transferred abroad if the authorities can have direct access to the data upon request.

No specific licences or authorisations for e-commerce activities, beyond ordinary commercial licences, are required. However, there must be a local presence to operate an e-commerce business.

The implementation of international standards for electronic contracts and key electronic authentication measures, such as recognition of electronic signatures, are generally in place; however, BiH lacks a proper dispute settlement mechanism to resolve litigations arising from cross-border digital trade.

Policy areas relating to intellectual property rights and payment systems account for a smaller share of the scores of economies participating in the Digital STRI. BiH is relatively open in this category from a regulatory point of view as it follows the precepts of European regulations in this field.

Regulations are in place which state that foreigners should be treated no less favourably than nationals in terms of intellectual property protection. Moreover, all necessary regulations related to payments systems are in place, although their use is limited in practice.

### *The way forward for trade policy*

Some important steps have been taken to improve institutional co-ordination mechanisms for trade, especially in the area of public consultations. However, Bosnia and Herzegovina could improve its competitiveness by paying attention to the following:

- **Create a formal inter-ministerial co-ordination mechanism** based around a specific action plan on improving overall trade performance to boost co-operation between different ministries and government bodies.
- **Collect data on stakeholders involved in consultations for monitoring and evaluation purposes**. This will allow for adjustments depending on the results and the broader participation of stakeholders on the eConsultation website (Box 21.5). More effort is also needed to raise awareness of various forms of public consultation.
- **Set up a process for regularly reviewing consultation frameworks** according to established goals of effectiveness, efficiency, inclusiveness and transparency, as well as performance indicators. Create, mechanisms for evaluating public-private consultations to regularly assess the degree of openness and transparency of consultations. Ideally, a monitoring programme with adequate budget and an independent office would be introduced to allow for systematic evaluations. Training could be provided on the use of various quantitative and qualitative approaches to measure compliance with the minimum standards set by regulatory frameworks for public consultations.
- **Broaden trade in services beyond regional trade agreements**. Significant improvements have been made among the WB6 economies to open services trade through the conclusion of CEFTA Additional Protocol 6 in December 2019. Nonetheless, the STRI analysis in this section has provided some insights into where domestic reforms could help attract new businesses and improve competitiveness:
    - **Ease conditions on the temporary movement of natural persons.** This would further encourage innovation and knowledge transfer, and contribute to economic growth. A starting point could be to remove the remaining quotas and labour market tests for foreign services suppliers.
    - **Reduce the remaining barriers to market entry and competition in the courier, commercial banking and insurance sectors**. Regarding the courier sector, as presented in Box 21.4, abolishing the limits on the proportion of shares that can be acquired by foreign investors in publicly controlled firms would attract investment. In addition, a dispute resolution mechanism should be established. Regarding commercial banking, the restrictions on legal form and local presence requirements to provide cross-border services should be reconsidered to make the sector less restrictive. For the insurance sector, existing restrictions on cross-border mergers and acquisitions should be lifted, along with restrictions on the cumulative activity of a branch of a foreign company.

### Box 21.5. Stakeholder engagement throughout the European Commission policy cycle

Following the adoption of the 2015 Better Regulation Guidelines, the European Commission has extended its range of consultation methods to enable stakeholders to express their view over the entire lifecycle of a policy. It uses a range of different tools to engage with stakeholders at different points in the policy process. Feedback and consultation input is taken into account by the Commission when further developing the legislative proposal or delegated/implementing act, and when evaluating existing regulation.

At the initial stage of policy development, the public has the possibility to provide feedback on the Commission's policy plans through roadmaps and inception impact assessments (IIA), including data and information they may possess on all aspects of the intended initiative and impact assessment. Feedback is taken into account by the Commission services when further developing the policy proposal. The feedback period for roadmaps and IIAs is four weeks.

As a second step, a consultation strategy is prepared setting out consultation objectives, targeted stakeholders and the consultation activities for each initiative. For most major policy initiatives, a 12-week public consultation is conducted through the website “Your voice in Europe” and may be accompanied by other consultation methods. The consultation activities allow stakeholders to express their views on the key aspects of the proposal and main elements of the impact assessment under preparation.

Stakeholders can provide feedback to the Commission on its proposals and their accompanying final impact assessments once they are adopted by the College. Stakeholder feedback is presented to the European Parliament and Council and aims to feed into the further legislative process. The consultation period for adopted proposals is 8 weeks. Draft delegated acts and important implementing acts are also published for stakeholder feedback on the European Commission’s website for a period of 4 weeks. At the end of the consultation work, an overall synopsis report should be drawn up covering the results of the different consultation activities that took place.

Finally, the Commission also consults stakeholders as part of the ex post evaluation of existing EU regulation. This includes feedback on evaluation roadmaps for the review of existing initiatives, and public consultations on evaluations of individual regulations and “fitness checks” (i.e. “comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose”). Stakeholders can also provide their views on existing EU regulation at any time on the website “Lighten the load – Have your say”.

Source: (OECD, 2017[58]), *OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy*, www.oecd.org/gov/regulatory-policy/public-consultation-best-practice-principles-on-stakeholder-engagement.htm; (OECD, 2016[59]), *Pilot database on stakeholder engagement practices in regulatory policy: Second set of practice examples*, https://one.oecd.org/document/GOV/RPC/RD(2016)5/en/pdf; (European Commission, 2015[60]), *Better Regulation Guidelines*, https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

- **Reinforce the regulatory framework on e-commerce** by finalising the drafting of the Law on Electronic Communication and Electronic Media and adopting new legislation on electronic identification and trust services for electronic transactions (e-signature). Overall, BiH needs to do more to align e-commerce legislation with the European e-commerce directive.[27] A good step could be to establish a national online dispute resolution (ODR) platform based on the model of the EU ODR platform (see Box 21.6). The platform should be designed to resolve disputes over the online purchase of goods and services without the intervention of a national court. This resolution process is known as alternative dispute resolution and, as such, is faster and cheaper than a court case. The ODR platform should not be affiliated with any merchant but should provide an independent body that could be called upon at any time to deal with a complaint from any party regarding an e-commerce contract. The dispute resolution body should be an impartial organisation or person that helps consumers and online traders and is independent of, but approved by, the authorities. It should meet the quality standards of fairness, transparency, efficiency and accessibility.

### Box 21.6. The European Online Dispute Resolution (ODR) platform

The EU ODR platform is provided to make online shopping safer and fairer through access to quality dispute resolution tools. Regulation (EU) 524/2013 provides the framework for online dispute resolution, the creation of the EU ODR platform and the date (1 September 2016) by which every e-shop in the European Union must provide a link to the platform on its website so that European consumers can electronically submit their complaints to an alternative dispute resolution entity. All online retailers and traders in the EU, Iceland, Liechtenstein and Norway must provide an email address and an easily accessible link to the ODR platform.

The EU ODR platform can be used to solve the problem directly with the trader, and initially acts as an intermediary between the parties in the dispute by informing the trader of the notification. If the requested trader is willing to discuss, the platform allows the exchange of messages directly via a dashboard. Attachments such as product photos can be sent using the dashboard, and an online meeting can be scheduled. If the dispute cannot be resolved amicably within 90 days, or if requested by the parties involved, the ODR platform refers the dispute to a dispute resolution body. Although the model is mainly aimed at disputes initiated by a consumer, some European economies allow traders to file a complaint against a consumer if they reside in Belgium, Germany, Luxembourg or Poland.

Source: (EUR-Lex, 2013[61]), *Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR)*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R0524; (European Commission, 2009[62]), *The European Online Dispute Resolution (ODR) platform*, https://ec.europa.eu/consumers/odr/main/?event=main.trader.register.

## Access to finance (Dimension 3)

### *Introduction*

Bosnia and Herzegovina has made progress in the access to finance dimension due to the harmonisation of the legal framework in both entities (Figure 21.1). The biggest progress has been recorded under the sub-dimension on access to alternative financing sources, and in particular regarding factoring with the adoption of new regulations in the FBiH (2017) and Republika Srpska (2020). Overall, the economy's performance has increased from 1.9 to 2.3 since the previous assessment (Table 21.6).

**Table 21.6. Bosnia and Herzegovina's scores for access to finance**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Access to finance dimension** | Sub-dimension 3.1: Access to bank finance | 3.1 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 1.6 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 3.0 | 2.8 |
| **Bosnia and Herzegovina's overall score** | | **2.3** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

Bosnia and Herzegovina's financial sector is dominated by banks, which account for around 89% of overall financial sector assets, considerably more than in the euro area (around 45%). At the end of 2019, 23 commercial banks were operating in the economy. One bank is majority state-owned, while foreign banks own more than 80% of the banking sector. Two supervising bodies operate in the territory, one in each entity: the Banking Agency of the FBiH and the Banking Agency of Republika Srpska. According to the regulations in both entities, the screening and approval procedures are the same for all banks regardless of ownership, and banks are subject to the same supervisory and regulation rules.

In Bosnia and Herzegovina, regulation for the **banking industry** falls under the competence of the entities' banking supervisory authorities. The regulation authorities in both entities have been harmonising their regulatory frameworks with EU regulations since the last assessment. Notably, the minimum capital adequacy ratio was transposed in both entities in 2018, meaning that Bosnia and Herzegovina's regulatory framework is largely compliant with Basel III[28] requirements.

In the FBiH and RS, the law on foreign exchange operations encourages local currency lending. Banks are not allowed to lend in foreign exchange to a resident, except to enable a resident legal person or entrepreneur to pay for imported goods and services. Banks are obliged to have a methodology in place to calculate internal capital requirements for foreign exchange credit risk.

In Bosnia and Herzegovina, each entity administers its own cadastres to **register** properties, and both are accessible online. Property registration is compulsory. The ownership of pledges on registered fixed assets are fully documented, and both cadastres provide full coverage of the territory. However, in practice the land plot numbers in the Cadastral Books and the land plot numbers in the Land Registry do not appear to often match; moreover, the data are not harmonised among entities as the registries are not linked and verified systematically. Consequently, as a follow-up to the Land Registration Project, implemented between April 2007 and June 2012 in co-operation with the World Bank, a project to support the development of a sustainable real estate registration system with harmonised land registry and cadastre records in urban areas of both the FBiH and the RS was signed in March 2020.

**Collateral requirements** remain strict, meaning that access to bank loans is challenging for businesses in Bosnia and Herzegovina. Around 67% of loans require collateral, higher than the OECD average (58%), while 212% of the borrowed amount is required as collateral in Bosnia and Herzegovina, more than double the average in OECD economies (88%) and the highest in the Western Balkan region (World Bank,

2019[16]). In both entities, regulations are largely harmonised and allow the use of fixed and non-fixed assets by businesses to secure loans. However, the list of non-fixed assets is limited to specific machinery and passenger and freight vehicles, which means that the haircuts[29] imposed by the regulatory framework remain relatively high at 60% for passenger vehicles, and between 70% and 90% for machinery. This limits the number of potential businesses that can apply for a bank loan.

A public **credit information** system is in place, governed by the Central Bank of Bosnia and Herzegovina. In 2019, a new decision on the Central Registry entered into force which implements the International Financial Reporting Standards (IFRS) 9 norms.[30] Credit data are collected directly by the Central Bank from all banks, leasing companies, microcredit organisations and other financial institutions operating in BiH. Both negative and positive information is collected and made available to financial institutions and the public on request. In both entities, legislation provides consumer rights and procedures for correcting mistakes. In the FBiH there is also an operational private credit information system. However, there is no specific regulation that regulates the operation of private credit bureaus in Bosnia and Herzegovina.

**Credit guarantee schemes** fall under the competence of entities. There were no credit guarantee schemes in the FBiH before the COVID-19 pandemic; however, in May 2020 the authorities established a guarantee fund under the law on the mitigation of the negative economic consequences of the pandemic. Consequently, the FBIH Development Bank set up a guarantee fund with initial reserves of up to BAM 80 million (~EUR 40 million) to maintain and improve the liquidity of companies. Republika Srpska amended the Law on Guarantee Funds in 2019 and 2020 to expand its competences due to the COVID-19 pandemic. The fund targets entrepreneurs, businesses operating in agriculture and manufacturing sectors, and activities focused on exports and preserving employment. It can issue individual and portfolio guarantees. Individual guarantees are issued for up to 50% of the amount (70% in specific situations), while the limit for portfolio guarantees is 25%. Up to May 2020, a total of EUR 17.6 million had been issued as guarantee to 145 companies operating in Republika Srpska.

### *Sub-dimension 3.2: Access to alternative financing sources*

The **factoring** market is still in an early stage of development in Bosnia and Herzegovina and is regulated at the entity level. A dedicated law on factoring in the FBiH was adopted in 2017. The legal treatment of factoring services is clearly defined; however, foreign factors cannot operate directly in the local market, which limits their potential penetration. According to the Law on Corporate Income, interest on factoring is deductible, and value-added tax (VAT) is only applied on service fees, which reduces the cost of factoring.

In Republika Srpska, the Ministry of Finance adopted a new law on factoring in December 2020 and six by-laws in 2021 to improve the factoring market. Before the adoption of this law, two regulations, the Law on Obligatory Relations and the Banking Law, explicitly recognised factoring activities and allowed only banks to perform such activities. The potential effects of the new law and by-laws will be assessed in the next assessment process.

The **leasing** market is relatively small but has been growing since 2017 in terms of nominal value. Notably, the total assets value increased by 24.4% between 2017 and 2019 to reach BAM 323.7 million (around EUR 165 million), which represents 0.9% of total financial assets (0.8% in 2017). Financial leasing accounts for 85% of the value of lease agreements.

In Bosnia and Herzegovina, leasing is regulated by two laws: The Law on Leasing of the FBiH and The Law on Leasing of the RS. Both clearly define information on the subjects of the leasing contract, the lease terms, the contract value and leasing time, the total leasing amount, the possibilities of redemption or renewal of the leasing contract, and the right to lease the subject to another entity. At the end of 2019, five leasing companies were operating in Bosnia and Herzegovina under the supervision of the banking agencies of each entity. In 2019, leasing in the RS was mainly used by the business sector, mainly for vehicles (70% of the total financial leasing) and machinery and equipment (29%). No such information has been provided by the FBiH or a national body, and it remains unclear to what extent this data is collected.

There is no dedicated legislation targeting **private equity investment funds, venture capital** and **business angel networks** in Bosnia and Herzegovina. Nevertheless, the laws on investment funds in the FBiH and RS allow venture capital operations. Neither entity government performs any review of the regulatory framework to address the needs of private venture capital funds, and there are no plans nor any initiatives from institutions to stimulate creation or establish venture capital schemes. Similarly, there are no business angel networks operating in Bosnia and Herzegovina. Some minor initiatives exist in RS, such as the Innovation Centre Banja Luka, which is a full-time member of the European Banking Angels Network; however, no activity could be identified during the assessment period. Overall, there are no initiatives to develop this form of financial support in Bosnia and Herzegovina.

No activity has been reported on **crowdfunding** and **initial coin offering** during the assessment period. In March 2016, the RS Securities Commission and in February 2018 the Banking Agency of Republika Srpska issued official warnings for interested investors to be aware of risks related to cryptocurrency investments as they are not regulated. Meanwhile, the purchase of cryptocurrency remains legal in Bosnia and Herzegovina.

### *Sub-dimension 3.3: Mobilisation of long-term financing*

**Public-private partnerships** (PPPs) are underdeveloped and legally not unified, which prevents the investment in infrastructure projects required to develop the economy. In Bosnia and Herzegovina, legislation related to PPPs is adopted at the entity and/or canton level. There is a dedicated law on PPPs in the RS, while in the FBiH all ten cantons have adopted (non-concession) PPP laws.

At the national level, the Law on Concessions of Bosnia and Herzegovina governs concessions. The two entities also have separate laws on concessions. The Law on Public Procurement from 2014 clearly states that non-concession and concession PPP contracts are awarded in-line with PPP/concession legislation; however, in practice co-ordination remains challenging, which potentially leads to overlapping and conflicting implementation solutions due to the very complex legal system. In FBiH, data on the total number of PPPs are not centralised at the federation level and not publicly available. Only data from three cantons could be gathered through publicly available sources during the assessment period.[31]

In 2020, Republika Srpska amended the law to facilitate the use of PPPs and clearly regulate that the working relationship between public and private partners should be intended to fulfil a public need. The law also includes provisions on rights allocation and obligations of both contracting parties, including the obligation to provide a guaranteed service to users and dispute settlement mechanisms. Since 2010, a limited number of PPP projects have been awarded in Bosnia and Herzegovina.[32] Most of these projects are in the fields of energy, transport, and social and health. However, no concession has been awarded at the national level nor in the Republika Srpska since 2015. Thus, data regarding the number and value of the aforementioned PPP projects is unknown. Due to the lack of projects, the effectiveness of the laws cannot be fully assessed. A better transactional record is required to assess the functionality of the legal framework for PPPs (EBRD, 2018[63]).

Bosnia and Herzegovina's domestic **institutional investor** base remains underdeveloped, which limits capital market development. The regulatory framework is under the entities' competences. Both entities have adopted a dedicated legal framework on securities market and investment funds, and both have a securities market regulator called the Securities Commission. The legal framework is well-developed in the RS and covers conditions for institutional investors to exercise voting rights attached to the share held on behalf of their clients, conflict of interest, and prohibitions related to insider trading and market manipulation. The legal framework in the FBIH does not cover provisions such as the voting rights attached to the share held on behalf of their clients, transparency of fees nor prohibitions related to insider trading.

As of January 2020, 36 investment funds were operating in BiH: 23 open-end investment funds and 13 closed-end investment funds. The total value of net assets of investment funds represented around BAM 852 million (~EUR 426 million) at the end of 2019, around 4% less than the previous year. In the RS,

19 investment funds were operating out of the top five firms, representing a total asset under management of EUR 183 million (1.6% of GDP). One development and investment bank operating in the RS is fully owned by the RS government. In the FBiH, 17 investment funds are operating; however, no further statistical information was reported during the assessment period.

**Capital markets** have been in place in Bosnia and Herzegovina since 2001. Both entities have their own **stock markets**: the Sarajevo Stock Exchange (SASE) in FBiH and the Banja Luka Stock Exchange (BLSE) in the RS. Both stock exchanges joined the SEE Link in 2017, which is the regional platform for cross-market trading supported by the European Bank for Reconstruction and Development. The stock market is more active in FBiH, while the bond market records higher turnovers in RS. However, in both entities the contribution of capital markets to financing the economy is limited. In 2019, with a 3.6% increase compared to 2018, the SASE registered a total turnover of securities in amount of BAM 144 million (~EUR 72 million), from which the turnover of shares totalled BAM 136 million (~EUR 68 million) (94.4% of total securities), while bonds totalled BAM 7.35 million (~ EUR 3.65 million) (5.1% of total securities). Over the same period, with an increase of 10.3% compared to 2018, the BLSE registered a total turnover of securities of BAM 472 million (~EUR 236 million), from which the turnover of shares totalled BAM 76.6 million (~EUR 36.1 million) (16.2% of total securities), while bonds totalled BAM 355.6 million (~EUR 181.8 million) (75.3% of total securities).

Overall, the legal frameworks related to capital markets are aligned in both entities. The listing procedures for companies operating in both entities are clearly defined in their respective laws on securities markets and are organised on the same regulatory principles, while the listing rules slightly differ (Table 21.7). Neither entity offers a separate market for low capitalisation firms.

### Table 21.7. Listing rules in Bosnia and Herzegovina

| | Federation of Bosnia and Herzegovina | Republika Srpska |
|---|---|---|
| Minimum business operations | 3 years | 2 years |
| Financial statements | Audited financial report for the minimum last 3 years | Positive or unqualified audit report |
| Minimum amount of market capitalisation | BAM 1 million | BAM 1 million |
| Number of shareholders | 150 | 50 |

In 2019, 17 bond offerings were recorded on both stock exchanges and the treasury bills sector, while in 2018, 5 issuings were recorded on the same basis. In 2019, the FBiH government issued six long-term bonds with a nominal value of BAM 200 million, a maturity of three to ten years and interest rates ranging from 0.05% to 0.80%. It also organised an auction of treasury bills with a total nominal amount of BAM 20 million, a maturity of nine months and an interest rate of -0.1950%. Over the same period the RS government issued eight bonds for a total amount of BAM 271.8 million, a maturity of five to ten years and interest rates between 2.3% and 4%. It also realised two treasury issue bills of BAM 40 million with a maturity of six months and interest rates ranging from 0.0% to 0.0993%.

The regulatory framework is in place in both entities concerning **bond markets**; however the market is shallow and illiquid, especially in terms of corporate bonds. The legal framework of both entities allows the emission of treasury securities, municipal bonds, corporate bonds and zero-coupon bonds. Both regulations clearly stipulate the maturity of the obligation of the issuer and the manner of exercising the right to interest; however, bond ratings are not published. Both entities have no plans nor any specific incentives to facilitate the use of the bond market.

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finances, policy makers should:

- **Continue efforts to align banking regulation with international standards**. Given the economic shock caused by the COVID-19 pandemic, the resilience of the banking sector to absorb shocks has become even more vital. Therefore, regularly monitoring and revisiting the respective

regulation in line with internationally agreed norms would further enhance the capacity of the banking sector.

- **Continue efforts to build a business environment by diversifying financing sources**. Given the limited success of business angel networks and venture capital, adopting dedicated legal frameworks to crowdfunding such as the Lithuanian model (Box 21.7) would help to increase the number of potential financing sources, especially for smaller companies.
- **Enhance the transactional record to assess the functionality of the PPP legal framework**. The economy's needs and current institutional context should be taken into account to enhance transactional records.
- **Facilitate market-based long-term debt financing for businesses**. Firms need access to fit-for-purpose financing that meets their needs at various stages of their growth trajectory and development. This will be even more important to recover from the COVID-19 crisis in the long term. Considering the dependence on bank financing, a more extensive use of corporate bond financing could help lengthen maturities, increase resilience and facilitate long-term investments in Bosnia and Herzegovina. This could be achieved by creating an appropriate credit rating mechanism. Models such as those where central banks play a key role in providing rating services could be assessed as a credible and reliable mechanism. The government could also consider introducing a special framework for private bond placements by smaller companies, following a recent and successful example of creating alternative financing options for SMEs in the Italian mini-bond market framework (Box 21.8).

### Box 21.7. The Lithuanian crowdfunding model

While Lithuania's crowdfunding market is smaller than other European fintech hubs, the economy is only one of 11 EU Member States with dedicated domestic legislation for crowdfunding platforms and boasts a mature and comprehensive regulatory framework for crowdfunding. Although its crowdfunding is in its infancy, Lithuania currently has 15 registered crowdfunding platforms. There has been a positive increase in the total value of crowdfunding platform loan portfolios, from EUR 6.6 million in 2019 to EUR 9.13 million in the first half of 2020 (Bank of Lithuania, 2020[64]).

Lithuania adopted its Law on Crowdfunding in 2016 with the aim of providing a hospitable, clear and transparent setting for cross-border crowdfunding platforms. The law adopted all aspects of the European Commission's Regulation for European Crowdfunding Service Providers, allowing for a seamless transition once the EU Directive[1] comes into force. It was established through a multiple stakeholder consultation process and provides better protection and guarantees for investors through information disclosure obligations, governance rules, risk management and a coherent supervision mechanism. The law covers equity, real-estate and debt-based crowdfunding models, while donation and rewards models continue to fall under the Civil Code of the Republic of Lithuania.

Transparency regulations for crowdfunding platforms help mitigate misinformation and legal risk to better protect investors. Platforms must be included on the Public List of Crowdfunding Platform Operators and subject to an efficient reliability assessment conducted by the Bank of Lithuania's supervisory authority within 30 days. Platform operators, board members and significant stakeholders also undergo a criminal record check, while platforms must instate measures to avoid, identify and address any conflicts of interest that would prejudicially benefit the funder or project owner.

In addition to the EUR 40 000 minimum capital requirement, platform owners are required to put up 10% of starting capital themselves. In the case of offerings between EUR 100 000 and EUR 5 million, platform operators are obligated to publish a light prospectus, while offerings over EUR 5 million require a full prospectus detailing the project and project owner characteristics, proportion of own funds used, details of the offering, security measures, and the existence of secondary markets.

In all cases, Lithuania's crowdfunding regulations require platforms to publish wide-ranging information on their websites for investors, including data on the company, risks associated with investment, project selection criteria, conditions and procedures for repayment of funds, disclaimers on tax and insurance information, and monthly and yearly progress reports.

Lithuania is continuously improving its innovative business environment to give financial institutions and crowdfunding platforms more investment opportunities. In 2016, the economy began allowing the use of remote identity verification via qualified electronic signatures and video streaming/transmission, and is harmonising itself with the EU Regulation on electronic identification. Lithuania has also recently amended its Law on the Legal Status of Aliens to include an e-residency programme that allows foreigners to set up companies, open bank accounts and declare taxes through digital identification. This will further financing opportunities for its fintech platforms.

Note: Please note that the European Commission's Regulation for European Crowdfunding Service Providers refers to the European Commission (2018), Impact Assessment of the Council on European Crowdfunding Service Providers. In October 2020, the EU adopted the ECSP Regulation 2020/1503 on European crowdfunding service providers for business.
1: European Commission (2018), Impact Assessment of the Council on European Crowdfunding Service Providers (ECSP) For Business https://op.europa.eu/fr/publication-detail/-/publication/2eb8abc0-22cb-11e8-ac73-01aa75ed71a1.
Source: (European Commission, 2017[65]), *Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU: Final report*, https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf; (Bank of Lithuania, 2019[66]), *Consumer Credit Market Review*, https://www.lb.lt/lt/leidiniai/vartojimo-kredito-rinkos-apzvalga-2019-m; (Bank of Lithuania, 2020[64]), *List of Crowdfunding Platform Operators*, https://www.lb.lt/lt/finansu-rinku-dalyviai?list=36.

## Box 21.8. The Italian "Mini-bond" market

In 2012, the Italian Government introduced a series of laws[1] to initiate a mini-bond framework for unlisted companies to enable them to issue corporate bonds. The mini-bond framework provides a simplified process whereby unlisted companies with more than 10 employees and an annual turnover and/or assets in excess of EUR 2 million (except micro-enterprises and banks) can issue bonds that are available only to qualified investors. Firms are not required to publish a prospectus – an admission document is sufficient.

In response to this new regulatory framework, Borsa Italiana introduced the ExtraMOT PRO segment in 2013, dedicated to the listing of bonds whose trading is only permitted to professional investors. Since its introduction, the mini-bond market has seen steady growth, with the number of issuances increasing from 16 in 2013 to 171 in 2018. The cumulated proceeds during this period amounted to EUR 10.6 billion, 25% of which was raised in 2018. Moreover, mini-bonds have also been securitised through special purpose vehicles which have created a diversified pool of mini-bond issuers available for institutional investors.

In 2019, the government introduced mini-bond placements on equity crowdfunding platforms. In October 2019, the operating rules for equity crowdfunding platforms willing to place mini-bonds were published by the competent authority (Consob). These rules include that offers must be published on specific sections of the platforms; issuers are limited to joint stock companies; and eligible investors are required to hold financial assets of at least EUR 250 000, invest at least EUR 100 000 in the mini-bond, or be a client of an asset management company. The first offerings were published on crowdfunding platforms in January 2020.

1: Law Decree No.83/2012 and its subsequent amendments (Law Decree No. 179/2012; Law Decree No. 145/2013), Law Decree No: 91/2014; Law Decree No: 157/2019, (Fiscal Decree 2020) and Law Decree No: 160/2019 (Budget Law 2020) which created the possibility for unlisted companies to issue corporate bonds through the so-called mini-bond framework.
Source: (OECD, 2020[67]), *OECD Capital Market Review of Italy: Creating Growth Opportunities for Italian Companies and Savers*, http://www.oecd.org/corporate/OECD-Capital-Market-Review-Italy.htm; (Politecnico di Milano, 2020[68]), *Osservatorio Minibond: 2020 Italian Minibond Industry Report*, https://www.minibond.tv/files/siti/minibond.tv/osservatorio-minibond/202005-italia-minibond-industry-report.pdf.

## Tax policy (Dimension 4)

### *Introduction*

Table 21.8 shows Bosnia and Herzegovina's scores on two tax policy sub-dimensions and compares them to the WB average. Regarding the first sub-dimension, the tax policy framework, Bosnia and Herzegovina scores below the WB6 average due to its low score for the "tax expenditure reporting" indicator. On the second dimension, tax administration, Bosnia and Herzegovina scores below the WB6 average due to its low score for the "independence and transparency" indicator.

**Table 21.8. Bosnia and Herzegovina's scores for tax policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 2.9 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 2.4 | 3.3 |
| | Sub-dimension 4.3: International co-operation | n.a. | n.a. |
| **Bosnia and Herzegovina's overall score** | | **2.6** | **3.0** |

Note: For comparability with the previous assessment, the new sub-dimension (4.3) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

Bosnia and Herzegovina raises significant tax revenue relative to its GDP (Table 21.9). Tax revenue as a share of GDP was 36.3% in 2019, which exceeds the OECD average (33.8%) and the average of other WB6 economies (28.3%). Bosnia and Herzegovina's tax mix is highly concentrated on SSCs and taxes on goods and services, which accounted for 88.1% of total tax revenue in 2019 (the highest joined total among WB6 economies). This ratio is above the WB6 average (80% in 2019) and the OECD average (58.4% in 2018). Consequently, other taxes play a smaller role. Among OECD economies, CIT and PIT account for a third of total tax revenue, on average (33.5% in 2018). However, in Bosnia and Herzegovina these taxes combined accounted for only 10.4% of total tax revenue in 2019. There is therefore scope to rebalance the tax mix. SSCs account for 43% of total tax revenue, which is far above the WB6 average (32% in 2019). The heavy reliance on SSCs supports the direct funding of the welfare system and prevents the need for social welfare funds to be funded partly from general tax revenues, which would create challenges from a budgeting perspective. However, high SSCs can place a significant tax burden on labour income, reducing incentives to work and making it expensive for employers to hire workers, especially low-income and low-skilled workers (OECD, 2018[47]). Bosnia and Herzegovina has a relatively large informal economy, estimated at 25-35% of GDP (European Commission, 2020[39]), which may partly be linked to the high labour tax cost. Revenue from taxes on goods and services as a share of total taxes is 45.1%, which is slightly below the WB6 average (48% in 2019). The economy could rebalance the tax mix by strengthening taxes on personal or corporate income, as well as environmental taxes and recurrent taxes on immovable property.

### Table 21.9. Bosnia and Herzegovina's tax revenue as a percentage of GDP

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| Bosnia and Herzegovina | 1.8% | 2.7% | 15.6% | 16.4% | 36.3% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 10.9% | 33.8% |

Note: The ratios for Bosnia and Herzegovina were calculated on the basis of data received in the CO2021 questionnaire for the Federation of Bosnia and Herzegovina and Republika Srpska, with complementary data from the Agency of Statistics of Bosnia and Herzegovina for the Brčko District. Based on the Brčko District's share of Bosnia and Herzegovina's GDP, tax revenues were computed under the assumption that tax/GDP ratios in the Brčko District were similar to the combined average ratios found in the other entities. With the tax revenues computed under this assumption, tax/GDP ratios were then calculated for the integrated economy.
Source: (OECD, 2020[69]) OECD.Stat, https://stats.oecd.org/ (OECD average on overall tax/GDP ratio, 2018 for specific tax/GDP ratio.)

The standard CIT rate is levied at 10%, which is below the WB6 average (11.5% in 2020) and the OECD average (23.3% in 2020). This relatively low CIT rate is reflected in BiH tax revenue: CIT revenue accounted for 1.8% of GDP in 2020, which is similar to the WB6 average (1.8% in 2019) but below the OECD average (3.1% in 2018). Despite a low CIT rate, Bosnia and Herzegovina has a similar ratio of CIT revenue to GDP compared to other WB6 economies (Table 21.10). Regarding the taxation of capital income, capital gains are considered as business income and are taxed at a rate of 10%, while dividend income is excluded from the CIT base. Upon dividend distribution, no withholding tax is paid by the company if dividends are distributed to a resident individual. However, withholding taxes are levied on income generated by a non-resident business and paid to a foreign entity.[33] Concerning the taxation of international business income, Bosnia and Herzegovina operates a worldwide taxation system in which resident corporations are liable for taxes on their worldwide income, while non-residents only pay taxes on domestically sourced income. A worldwide taxation system is currently adopted in all WB6 economies. However, such systems are increasingly less common among OECD economies, particularly for small, open economies. The economy may wish to re-evaluate the advantages and disadvantages of worldwide taxation systems, possibly in collaboration with other WB6 economies.

### Table 21.10. Selected tax rates in Bosnia and Herzegovina

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| Bosnia and Herzegovina | 10.0% | 10.0% | 37.1% | 17.0% |
| WB6 | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT and PIT averages are based on top statutory rates.
Source: (OECD, 2020[69]), OECD.stat, https://stats.oecd.org/ (Statistics on OECD average for CIT and VAT (2020), PIT and SSCs (2019).)

Corporate investment in Bosnia and Herzegovina is incentivised through profit-based and cost-based **tax incentives**. Cost-based tax incentives lower the cost of investment, and the value of the benefit increases with the size of the investment undertaken. The value of profit-based tax incentives increases with the profits made by the business, and depends less on the amount of investment. In the FBiH, a number of such incentives exist. For example, companies investing their resources in production equipment may benefit from a 30% CIT relief, and companies undertaking a minimum investment in production equipment for five consecutive years benefit from a 50% CIT tax relief for five years.[34] The FBiH also provides a full CIT deduction for business expenses used for R&D activities. An employment incentive scheme provides CIT relief that is double the amount of gross salaries paid for companies employing new workers.[35] FBiH also allows provisions for future expenses aimed at environmental protection that are up to 30% of taxable income. Following a 2019 CIT reform, Republika Srpska provides a CIT reduction that is equivalent to the value of the investment undertaken for taxpayers investing in manufacturing equipment. In general, cost-based incentives are better targeted at stimulating investment than profit-based tax incentives, which favour companies with high profits (UNCTAD, 2015[70]). Given the economy's competitive CIT rate, profit-based incentives may not be needed. Overall, Bosnia and Herzegovina has a mix of cost-based and profit-based tax incentives that are aligned with practice in other WB economies. Whether these tax incentives

create significant "additional" investment beyond what would have taken place without the tax incentives requires further empirical analysis.

Regarding **tax revenue**, PIT revenues as a share of GDP are relatively low in Bosnia and Herzegovina, which is common in the region. In 2019, PIT as a share of GDP was 2%, slightly below the 2.2% average of WB6 economies and significantly below the 8.1% OECD average in 2018. The relatively low PIT revenues are partly explained by the economy's low PIT rate. In Bosnia and Herzegovina, PIT is levied at a 10% flat rate, which broadly aligns with the 9.8% average rate found in other WB6 economies that implement a flat-rate PIT system. Similar to most OECD economies, a minimum amount of income is exempt from PIT through an annual personal basic tax allowance. This allowance equals BAM 3 600 (EUR 1 840) in the FBiH and BAM 6 000 (EUR 2 560) in Republika Srpska. These allowances are relatively high, at 31% of the average net wage in FBiH and 43% in the RS (FIPA, 2021[71]). Under a reform proposed for 2021, the FBiH plans to move from the current flat PIT rate to a progressive PIT rate schedule, with rates at 0%, 10% and 13%. Introducing a progressive PIT rate schedule in Bosnia and Herzegovina would increase tax progressivity and, depending on the tax brackets and income distribution, could contribute to raising more PIT revenue. This would help rebalance the tax mix away from SSCs and towards PIT. Regarding the taxation of personal capital income, dividends and interest are tax exempt, while capital gains, royalties or rental income are included in the PIT base. The tax exemption of dividends and interest creates an incentive for entrepreneurs to incorporate and receive income in the form of capital income rather than salaries.

Bosnia and Herzegovina relies heavily on revenue from SSCs, to a greater extent than other WB6 economies. In 2019, SSC revenue amounted to 15.6% of Bosnia and Herzegovina's GDP, which is by far the highest ratio among WB6 economies (9.3% on average, second highest is Serbia with 12.5%). This reliance on revenue from SSCs also exceeds average levels found in OECD economies (9% in 2018). The high SSC revenues are a result of high SSC rates. In the FBiH, employee SSC rates are currently 31%, while employer SSC rates are 10.5%, leading to a total SSC rate of 41.5%. In Republika Srpska, only employees are liable for SSC payments at a rate of 32.8%. These rates are high compared to the rates levied on average in the OECD (9.8% for employees and 17.8% for employers in 2020). Compared to regional averages, the total SSC rate exceeds the average rate in other WB6 economies (29.4% in 2020). OECD research shows that high SSC rates can place a significant tax burden on labour income, which can reduce incentives to work and make it expensive for employers to hire workers, especially low-income and low-skilled workers (OECD, 2018[47]). As SSCs are levied at the same rate for all income levels, they do not contribute to making the taxation of labour income more progressive (OECD, 2018[47]). As part of the aforementioned proposed reform, the FBiH plans to lower the SSC rate from 41.5% to 32.5% in 2021.

Taxes on goods and services as a share of GDP are relatively high in Bosnia and Herzegovina. Revenue from these taxes accounted for 16.4% of Bosnia and Herzegovina's GDP in 2019, which is above the WB6 average (14% in 2019) and OECD average (10.9% in 2018). VAT revenue is relatively high, linked to a relatively high VAT rate of 17%. Nevertheless, this rate is the lowest among WB6 economies and below average levels found in OECD (19.3%) and WB6 economies (19%) in 2020. Bosnia and Herzegovina does not have a reduced VAT rate, which is atypical in the region (it does have a zero VAT rate, but this only applies to exports). However, activities in the public interest are exempted from VAT.[36] OECD research generally does not recommend adopting reduced VAT rates as they are an ineffective way to provide support to those on a low income, as those on a higher income benefit more from the reduced rate. The VAT registration threshold is BAM 50 000 (EUR 25 600), which is relatively low compared to levels found in other WB6 economies. Regarding other taxes on goods and services, Bosnia and Herzegovina levies excise duties on gasoline and diesel fuel. The economy does not levy a carbon tax or other environmental taxes. This high reliance on taxes on goods and services and SSCs suggests a low level of progressivity in Bosnia and Herzegovina's tax system.

Despite its extensive set of tax incentives, Bosnia and Herzegovina does not publish an annual **tax expenditure report**, unlike several other WB6 economies. For example, Albania published a tax expenditure report in 2019, while Montenegro and North Macedonia are currently in the process of publishing such a report. Bosnia and Herzegovina should publish a regular tax expenditure report to increase transparency and accountability and allow the economy to monitor the use and effectiveness of tax incentives, along with forgone tax revenue (OECD, 2010[72]). The report should identify, measure and report the cost of tax expenditure in a way that enables the comparison of the monetary value of tax incentives with that of direct spending programmes (IMF, 2019[73]). A cost-benefit analysis could also be conducted to evaluate whether specific tax incentives meet their stated objectives and, if not, whether they should be abolished or replaced.

Regarding **modelling and forecasting**, the Ministry of Finance of Bosnia and Herzegovina uses macro-simulation models to forecast aggregated tax revenues for all types of tax. This function is carried out by the Macroeconomic Analysis Unit, which produces estimates of budgetary revenue trends on a yearly basis, as well as the medium-term forecasting of all public revenue. In both entities, micro-simulation models are used to analyse the impact of taxes and tax reforms, including their distributional impact, for CIT, PIT and SSCs.

### *Sub-dimension 4.2 Tax administration*

Bosnia and Herzegovina does not have a unified administrative body that oversees all taxes. The **functions and organisation** of the tax administration is divided between the two entities and the Brčko District, which are each responsible for collecting direct taxes at their level. The Indirect Taxation Authority is responsible for all indirect taxes at the state level. In the FBiH, tax administration uses a mixture of taxpayer and functions approaches – tax registration, submission and processing of tax returns, payment of investigation and services rendered to the taxpayer are based on a functions approach, while supervision/audit is based on a taxpayer group approach, with separate units for large taxpayers and other taxpayers. In Republika Srpska, the tax administration head office is in charge of co-ordination, surveillance and control over operations, as well as the unified implementation of tax policy. RS tax administration regional centres are in charge of a wide range of functions including desk and field audits, taxpayer assistance with the application of tax regulations, tax collection, and the management of tax arrears. RS tax administration local offices receive and process documents received from taxpayers, including tax declarations. They also formally check the information provided and calculate tax liability.

With regards to **compliance assessment and risk management**, Bosnia and Herzegovina follows a risk-based approach. At the state level, the Risk Analysis and Management Department within the Ministry of Finance and Economy prepares a monthly control plan based on a parametric risk model that ranks taxpayers according to risk points. In Republika Srpska, a monthly audit plan has been developed with a focus on large taxpayers, and an automated system for the selection of high-risk taxpayers is currently under development. For the FBiH, an annual audit plan has been developed that has a wide set of criteria,[37] including the business activity of the taxpayer, the time passed since the last audit and the number of employees. OECD research shows that risk-based selection is a key element of effective and efficient compliance programmes as it allows administrations to make effective trade-off decisions and make the best use of scarce resources (OECD, 2018[47]). Tax administrations at the state and entity level in BiH carry out similar audit tasks, ranging from simple checks to in-depth inspections of taxpayer premises.[38] Both RS and the FBiH have special audit divisions for large taxpayers. With regards to VAT compliance, Bosnia and Herzegovina has implemented the Indirect Tax Compliance Strategy 2019-2021, which includes specific programmes for addressing the various risks of tax compliance.[39]

In Republika Srpska, the **transparency and independence** of tax administration is established by the Law on Tax Procedure; however, the FBiH has not adopted a policy to establish an independent management board of the tax authority. In both RS and the FBiH, the operational budget of the tax administration is fixed by annual budgetary procedures and does not depend on the amount of collected revenue. In RS, a

regulatory framework is in place to guarantee sanctions in case of misconduct by a member of the tax administration, which is not the case in the FBiH. OECD research suggests that corruption among tax administration employees may deter individual taxpayers from paying taxes, or may lead to them opting to pay a bribe or enter the informal economy (OECD, 2018[47]). Implementing strong procedural safeguards that guarantee the independence of the tax administration is therefore crucial for tax collection purposes.

Regarding **tax filing and payment procedures**, e-filing has been mandatory for VAT and excise duties since 2019 (the state level is only responsible for indirect taxes). In the FBiH, e-filing is possible for CIT, PIT and SSCs, but only 55% of tax returns are filed electronically. In RS, e-filing is available for all taxes, and seems to be increasing: 43% of tax returns were filled electronically in 2019, compared to 57% from January to April 2020. The Audit Office of Bosnia and Herzegovina, an independent body, performs regular audits of the functioning of the Indirect Taxation Authority. In 2018, the process was assessed by the independent body of the Tax Administration Diagnostic Assessment Tool (TADAT), but the results are not publicly available. The RS tax administration submits semi-annual and annual reports to the government of Republika Srpska. In the FBiH, the tax administration reports once a year to the entity-level Ministry of Finance.

Various **taxpayer services** are at the public's disposal in Bosnia and Herzegovina. State and entity levels all provide online access to information, electronic communications and in-person enquiries. The Federation of Bosnia and Herzegovina has an Ombudsman, which is an independent state body available for all citizens that taxpayers can refer to. Its mission is to protect the rights of citizens and control the work of administrative bodies.

### *Sub-dimension 4.3: International co-operation*

Similar to most WB6 economies, Bosnia and Herzegovina has strengthened its involvement with the **international tax** community and carried out several initiatives to align its tax system with recent international tax trends since the last CO assessment. It became a member of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) in July 2019 and has been proactive in implementing initiatives regarding the four BEPS minimum standards: harmful tax practices (Action 5); prevention of tax treaty abuse (Action 6); economy by economy reporting (Action 13); and mutual agreement procedures (Action 14). Furthermore, Bosnia and Herzegovina signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS in October 2019 and the Convention on Mutual Administrative Assistance in Tax Matters at the 10th Global Forum plenary meeting in November 2019. Both conventions entered into force in January 2021. With regards to exchange of information, a peer review by the OECD Global Forum on exchange of information on request is scheduled for the second half of 2022. The economy's transfer pricing legislation has been drafted based on OECD transfer pricing guidelines.

Bosnia and Herzegovina could strengthen its efforts with regards to **digital taxation**. While the economy has not formally implemented international guidelines on VAT or goods and services tax (GST), it levies cross-border digital services at the place where the service recipient is established. This resembles the destination principle, which is the "cornerstone" of international VAT/GST guidelines. However, the economy has indicated that its VAT legislation is not fully compliant with the EU VAT Directive. Personal income received from digital platforms is excluded from the PIT base. Bosnia and Herzegovina has appointed representatives to the OECD's Tax Challenges Arising from Digitalisation project, which aims to find a consensual solution to specific tax challenges through two pillars focused on nexus and profit allocation (Pillar 1), and a global minimum tax (Pillar 2). These developments taking place at the OECD level, especially those under Pillar 2 and the expected global minimum tax on corporate profits, might have an impact on the economy's taxation of corporate income. While a global minimum tax rate has not been set and depends on ongoing discussions, Bosnia and Herzegovina's 10% CIT rate is low, below both WB6 and OECD averages. If the global minimum rate were set higher than 10%, Bosnia and Herzegovina would be faced with the choice of either raising its rate to the minimum tax rate or risk forgoing tax revenue to

foreign jurisdictions. Pillar 2 might also incentivise the economy to redesign its investment incentives to offer attractive tax rates. Bosnia and Herzegovina may wish to carefully assess its position on this issue and draft an action plan in case consensus is reached among BEPS members.

Bosnia and Herzegovina is engaged in modest **regional co-operation** with other WB6 economies. At the state level, the Ministry of Finance and the Treasury of Bosnia and Herzegovina participate in workshops organised by the Centre for Excellence in Finances, which have been delivered as part of the Supporting Capacity Development of Tax Administrations in South East Europe Project.[40] Republika Srpska is also engaged in independent initiatives and signed an agreement on mutual co-operation in March 2011 with Slovenia, Montenegro, Serbia and the FBiH. Republika Srpska also joined the Intra-European Organization of Tax Administrations in June 2004.

### *The way forward for tax policy*

To enhance Bosnia and Herzegovina's tax policy framework and achieve objectives, policy makers should:

- **Continue to support the economy in light of COVID-19**. Bosnia and Herzegovina implemented a comprehensive set of measures to mitigate the effects of COVID-19 on its economy and citizens. It may wish to continue its efforts, while focusing on measures that could spark an economic recovery.
- **Diversify the tax mix and increase progressivity in the tax system**. Bosnia and Herzegovina levies 88.1% of its total tax revenue from taxes on goods and services and SSCs, which means that most revenue is levied at the same rate across income levels. PIT and CIT, also currently levied at flat rates, could be redesigned to diversify the tax mix and introduce progressivity in the tax system.
- **Rebalance the taxation of labour income by shifting revenue away from SSCs and towards PIT**. The high tax burden on labour income could distort the functioning of the labour market, in particular for low-income and low-skilled workers, and create tax-induced incentives to operate in the informal economy. Lowering SSC rates and redesigning PIT by introducing a progressive rate schedule could be explored as a policy option.
- **Evaluate whether the imbalance between the tax burden on capital and labour income distorts the economy and creates tax-induced incentives for entrepreneurs to incorporate.** The incentive for entrepreneurs to incorporate allows them to shift highly taxed labour income to lower taxed capital income.
- **Strengthen tools and capacities to assess the effects of tax policies on the economy**. Tax transparency and accountability could be strengthened through the annual publication of a tax expenditure report. Micro-simulation models should be used to assess the distributive effects of tax reforms and forecast tax revenue.
- **Turn profit-based tax incentives into cost-based tax incentives.** Evaluate whether tax incentives create "additional" investment or just provide windfall gains to investors.
- **Strengthen the use of e-filling.** The use of e-filing remains low in Bosnia and Herzegovina compared to other WB6 economies. BiH should consider mandatory e-filing as used in some economies, such as Albania.
- **Implement a policy that guarantees the independence of all tax administrations.** Although there is a law that establishes the independence and transparency of Republika Srpska's tax administration, the Federation of Bosnia and Herzegovina has not established an independent board for its tax administration. An independent and transparent tax administration is crucial for taxpayer trust in the tax system, which is in turn crucial for tax collection.
- **Define an action plan regarding BEPS Pillar's 2 global minimum tax rate in case consensus on this rate is found among members of the OECD/G20 Inclusive Framework on BEPS.** The global minimum tax rate, if agreed, is likely to be lower than the current statutory CIT rate in BiH.

However, the economy's set of CIT investment incentives could lower effective tax rates on corporate profits to a level below the expected minimum rate. In this case, Bosnia and Herzegovina would be faced with a choice of either redesigning its investment tax incentives or risk forgoing tax revenue to foreign jurisdictions. The economy should evaluate its position on this issue and prepare an action plan accordingly.

- **Continue to engage with the international tax community and implement international best practices.** Since the last CO report, Bosnia and Herzegovina has strengthened its involvement in international tax matters, and this approach should be continued.
- **Carry out a cost-benefit analysis on the merits of a worldwide taxation system for resident corporations**. For small open economies such as Bosnia and Herzegovina, worldwide taxation may entail high administrative costs without raising significant revenue.
- **Foster regional co-operation and co-ordination on common tax issues within the WB6 region.** Bosnia and Herzegovina shares common challenges with other WB6 economies, and enhanced collaboration might be favourable for all economies involved. Areas such as tax compliance, the training of tax officials and the exchange of information would greatly benefit from a co-ordinated regional approach.

## Competition policy (Dimension 5)

### *Introduction*

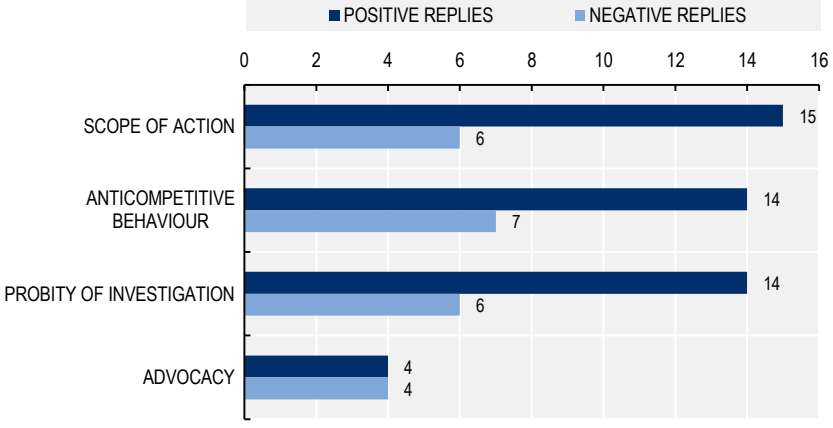
The legislative framework on anti-trust and mergers is broadly aligned with EU competition rules and has not been significantly modified in recent years. The Law on Competition of Bosnia and Herzegovina largely mirrors the relevant provisions of the Treaty on the Functioning of the European Union in terms of restrictive agreements (Article 101) and the abuse of dominant position (Article 102). It also provides for the *ex ante* control of the effects on competition of mergers above certain turnover thresholds, in line with the principles of the EU Merger Regulation.

Responsibility for implementing the Law on Competition, approved in 2001, rests with the Competition Council (CC), an operationally independent public body established in 2004 that has exclusive competence and decision-making power in competition matters. The CC is composed of six members appointed from legal and economic experts by the Council of Ministers and entity governments to reflect the ethnic composition of the economy.

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas (i.e., scope of action, anticompetitive behaviour, probity of investigation and advocacy, plus a new area: implementation). Scoring is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administered by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy areas has a different number of possible criteria that can be stated as having been adopted. Each policy area is assessed through data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

Figure 21.10 shows the number of positive (aligned with good practice) and negative answers to the questionnaire for each policy area.

### Figure 21.10. Bosnia and Herzegovina's legal and institutional competition framework




Source: Based on the OECD assessment.

Regarding the implementation of competition rules, the impact of anti-trust and merger cases carried out by the CC is still limited, and the related fines do not seem to ensure strong deterrence. The leniency system is not effective in supporting cartel detection.

Advocacy action could be expanded to embed competition principles in the legislation and spread a competition culture.

## *State of play and key developments*

### *Sub-dimension 5.1: Scope of action*

The Competition Council implements the Law on Competition in Bosnia and Herzegovina. It consists of six members appointed for a six-year term of office, with the possibility of one reappointment. Three members are designated by the Council of Ministers of Bosnia and Herzegovina, two members by the Government of the Federation of Bosnia and Herzegovina and one member by the Government of Republika Srpska. Every year the Council of Ministers of Bosnia and Herzegovina appoints one CC member as the President of the CC for a one-year term. Decisions can be taken by majority rule, but at least one member from each of the three constituent ethnic groups must vote in favour.

In addition to the headquarters in Sarajevo, the CC holds two smaller offices in Mostar and Banja Luka. There are 20 staff in total, in addition to the council members. All employees deal with competition matters and are not organised into departments specialised by sector or type of infringement.

It is possible to compare the CC with other competition authorities using the OECD CompStats database,[41] which has data from competition agencies in 56 jurisdictions. Of particular use are the 15 competition authorities operating in small economies (with a population lower than 7.5 million). In 2019, the average total number of staff in these 15 competition authorities was 114, of whom 43 were working on competition.

The budget of the CC has decreased, as in several other national public institutions, from EUR 700 000 in 2017 to EUR 650 000 in 2019. Even considering the small size of the economy, this amount is very low when compared internationally. In 2019, the average budget of the 15 competition authorities in small economies that participated in the OECD CompStats database was EUR 5.4 million.

The Law on Competition of Bosnia and Herzegovina ensures competitive neutrality insofar as it stipulates that the **competences** of the CC encompass any natural and legal persons active in the production, sale or trade of goods and services, or involved in the trade of goods and services that have or may have an influence on competition in BiH. This includes public bodies, regardless of ownership, seat or residence.

The CC has appropriate **powers to investigate** and **powers to sanction** possible anti-trust infringements, i.e. restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms. It can impose cease and desist orders and remedies on firms that have committed anti-trust infringements. It can also adopt interim measures in case the alleged competition breach poses a risk of irreparable damages, either on its own initiative or following a request by the parties involved. It can accept commitments offered by the parties to remove the competition concerns and close the investigation.

The CC can compel investigated firms and third parties to provide relevant information and can perform unannounced inspections (dawn raids) on the premises of the parties, subject to a warrant by the competent court. The assessment of alleged anticompetitive conduct follows a thorough scrutiny of the collected evidence, which may include an economic analysis of the competitive effects of vertical agreements or possible exclusionary conduct. The CC can impose fines of up to 10% of the aggregate turnover of the undertaking.

The Law on Competition provides for a leniency programme that grants total or partial immunity from sanctions to firms that report to the CC the existence of an agreement and submit appropriate evidence. The Law on Competition also provides for the *ex ante* control of mergers, following the principles of the EU Merger Regulation.

The CC must prohibit concentrations that significantly restrict effective competition, in particular by creating or strengthening a dominant position. It can authorise the transaction subject to structural and/or behavioural remedies suitable to address the competition concerns, such as divestiture of assets and/or obligations to act or refrain from acting in a certain way.

The investigative powers of the CC for merger review are similar to those related to anti-trust proceedings; namely, it can compel merging firms and third parties to provide relevant information, and may perform

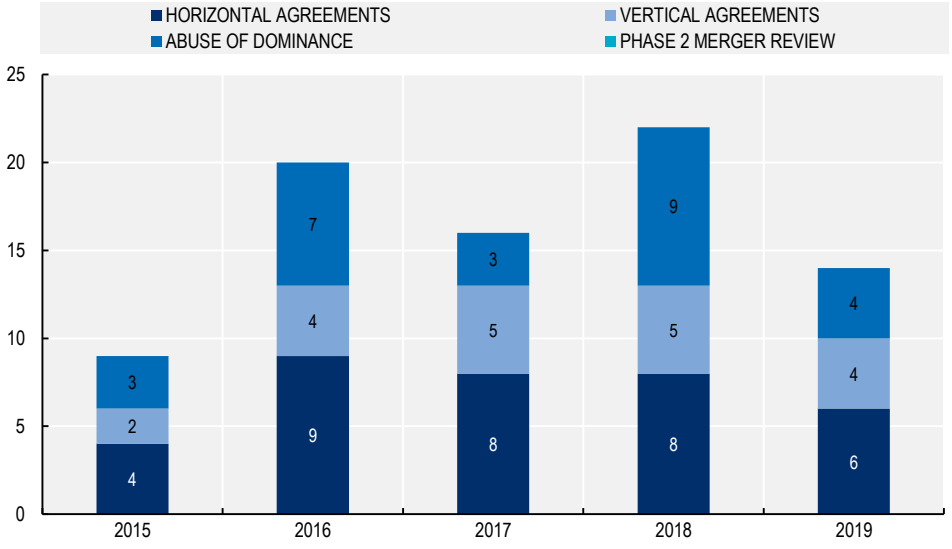
unannounced inspections on the premises of the parties. The assessment of notified mergers must follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration.

In Bosnia and Herzegovina, **private enforcement** cannot be actioned to seek damages from firms that have committed anti-trust infringements.

*Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. The impact of competition enforcement in Bosnia and Herzegovina is limited, despite a high number of decisions adopted by the CC in recent years (Figure 21.11).

**Figure 21.11. Competition decisions in Bosnia and Herzegovina (2015-19)**




Source: Data provided by the authorities.

In 2019 the CC took six decisions on **horizontal agreements** and four decisions on **vertical** agreements. These figures were even higher in 2017 and 2018, when there was eight horizontal decisions and five vertical decisions. However, it should be noted that most decisions have been related to the non-opening of formal proceedings, and no significant fines have been imposed over the last five years for prohibited agreements.

In 2019 the CC also adopted four decisions on **exclusionary conduct** (abuse of dominance), down from nine decisions in 2018. Again, these figures include several decisions not to pursue or to drop the case, which means that sanctions following infringement decisions were negligible. One fine was imposed in 2018 following an investigation on the delivery of heating energy which meant that the amount of fines peaked at around EUR 230 000; however, it dropped close to zero again in 2019.

No leniency application has been submitted to the CC, which has never performed an unannounced inspection.

In the period 2015-2019, the CC received a limited number of **merger** notifications, from a minimum of 15 in 2016 to a maximum of 35 in 2018. In 2019, the CC took 21 merger decisions, with all mergers unconditionally cleared in Phase I (i.e. without the need for an in-depth review in Phase II).

### *Sub-dimension 5.3: Probity of investigation*

The CC is an **independent** public body mandated to ensure implementation of the Law on Competition. It has exclusive competence to decide on competition infringements in Bosnia and Herzegovina. Nevertheless, as mentioned the appointment of CC members and the decision-making process is influenced by ethnic-based procedures, which risk introducing other considerations to decisions that should solely rely on a technical assessment.

The CC is **accountable** to the Council of Ministers, to which it submits a performance report and an annual report for adoption.

In terms of **procedural fairness**, the Law on Competition stipulates that the decisions of the CC must be submitted to the parties to the proceedings and published in the national Official Gazettes. The decisions must indicate the parties to the proceedings, the main contents and the outcome of the investigation, while specifying the relevant legal basis.

In line with EU rules, the decisions of the Competition Council can be challenged and an appeal can be launched before the Court of Bosnia and Herzegovina. Unlike in most jurisdictions, there are not two levels of appeal.

Prior to the adoption of a final anti-trust decision, the CC must inform the party on the relevant facts, evidence and other elements on which the decision is based and enable the party to submit a defence. The parties have the right to be heard before the CC takes a final decision. In managing confidential data or business secrets, the CC has the duty to protect the legitimate business interests of the economic entities involved, in accordance with the relevant regulations.

If the CC intends to prohibit a merger transaction, it must inform the merging parties about the evidence and conclusions on which the decision is based and enable them to submit their remarks and possible remedies.

The CC has not published guidelines to clarify substantive or procedural issues.

### *Sub-dimension 5.4: Advocacy*

The CC is entrusted by the Law on Competition to provide opinions and recommendations on competition issues and principles, either *ex officio* or upon request of the state authorities, economic entities or companies. The CC is also empowered to issue opinions on drafts laws and regulations that have an impact on competition. Proponents are required to submit the drafts to the CC and verify their compliance with the Law on Competition.

Between 2015 and 2019 the CC did not issue any formal opinions to the government or parliament on draft or existing laws or regulations. However, the CC co-operates with public institutions on competition matters and expresses its views on industry practices that may restrict competition. For example, in 2019 the CC made observations on general conditions for the supply of thermal energy and on price setting for driving lessons. Upon request by the Agency for Public Procurement, the CC has also been analysing the rules on public tenders.

It should be highlighted that unlike most competition authorities, the CC cannot conduct market studies, which represent a key tool to gain an in-depth understanding of restrictions to competition in crucial sectors.

The CC has organised some advocacy events aimed at developing competition culture. A project for summer courses on competition policy, in co-operation with the Faculty of Law of the University of Sarajevo, was suspended due to COVID-19.

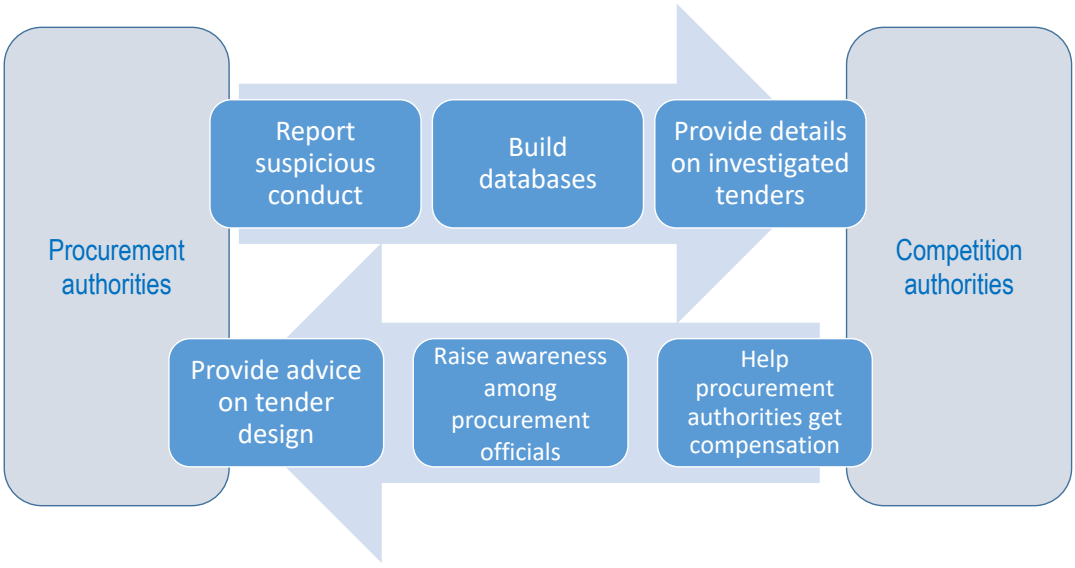
### *The way forward for competition policy*

Despite a legal framework on competition broadly aligned with international standards, there is still room for improvement regarding competition enforcement in Bosnia and Herzegovina. The efforts of the CC in tackling prohibited agreements and the abuse of dominant positions have not resulted in strong decisions with significant fines, which are necessary to ensure deterrence and encourage competition compliance by firms.

The CC should engage in a set of advocacy initiatives to promote competition principles and foster competition culture. Importantly, the CC cannot carry out market studies. To enhance Bosnia and Herzegovina's competition framework and achieve objectives, policy makers should:

- **Prioritise boosting cartel enforcement and imposing high fines**. Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. CC efforts should be focused on detecting cartels and imposing heavy fines on infringers to deliver a strong message that firms engaging in collusion risk severe punishment. If the fine amount sufficiently exceeds illicit gains, offences can be deterred even when the probability of paying a fine is low. Concern of fines is also a key driver for leniency applications, thus fostering the effectiveness of the leniency programme – which has been unproductive in Bosnia and Herzegovina so far – and further boosting detection. The CC could expand its detection skills by, for example, further strengthening the fight against bid rigging (see below), and start using its power to perform on-site inspections to collect evidence.
- **Pay specific attention to public procurement, particularly during the COVID-19 crisis**. Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm to the public budget and taxpayers, dampening innovation and creating inefficiencies. The CC should extend its co-operation with the Agency for Public Procurement and with procurement bodies to carefully design the procurement process so that it reduces the risks of bid rigging and detects bid-rigging conspiracies. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012[74]) calls for governments to assess their public procurement laws and practices at all levels of government in order to promote more effective procurement and reduce the risk of bid rigging in public tenders. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[75]), which form part of the recommendation, are designed to reduce the risks of bid rigging and detect bid rigging conspiracies through the careful design of the procurement process. Figure 21.12 shows how co-operation between competition and procurement authorities can help detect and avoid bid rigging. The OECD could also provide assistance to Bosnia and Herzegovina through a project aimed at assessing the main rules governing the procurement of public works and the procurement practices of major public buyers and providing recommendations to design competitive procurement and fight bid rigging in accordance with international good practice. Training to both competition and public procurement officials based on the Guidelines on Fighting Bid Rigging in Public Procurement could also be offered.

### Figure 21.12. Example of co-operation between competition and procurement authorities




- **Ensure that the CC regularly speaks out against laws and regulations that restrict competition.** Competition authorities can help governments eliminate barriers to competition by identifying unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives. The OECD's Competition Assessment Toolkit is a practical methodology that supports competition authorities in this task (OECD, 2015[76]). Where a detrimental impact is discovered, the toolkit helps to develop alternative ways to achieve the same objectives, with minimal harm to competition. In the past, OECD economy projects have proved very helpful in boosting competition advocacy and competition assessment in several jurisdictions, including in Eastern Europe. On top of establishing a competition mindset and culture within an economy, competition advocacy would strengthen the CC's standing and reputation when it enforces against anti-competitive restrictions by private firms.
- **Give the CC the power to perform market studies, as in most competition authorities in the world.** Market studies are a tool used to assess how competition in a sector or industry is functioning, detect the source of any competition problems, and identify potential solutions. Competition problems that can be uncovered in market studies include regulatory barriers to competition and demand-side factors that impair market functioning. Because market studies are a versatile tool that allow the examination of a broader set of issues than competition enforcement, their use is growing. International organisations, notably the OECD and the International Competition Network (ICN), have developed a wide range of documents on market studies, including the OECD Market Studies Guide for Competition Authorities (OECD, 2018[77]). The OECD's Competition Division could also assist competition authorities, regulators, ministries and policy makers with market study projects. This could be particularly valuable in Bosnia and Herzegovina, where the CC and policy makers have limited experience with such tools.
- **Increase international co-operation and targeted training initiatives to successfully address a fast-moving economic environment.** In the face of increasing complexity of anti-trust issues and the frequent cross-border nature of competition infringements, the management and staff of the CC should have frequent opportunities to meet and share good practices with international competition experts and colleagues from other jurisdictions. International organisations such as the OECD, the ICN and the United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities to this end, including the OECD-GVH Regional Centre for Competition in Budapest. The CC is already a regular participant in the centre's events and would benefit from actively continuing. Additional training initiatives would further enable CC staff to reach their full potential.

## State-owned enterprises (Dimension 6)

### *Introduction*

Responsibilities for Bosnia and Herzegovina's approximately 80 SOEs are dispersed across the public administration and often exercised by line ministries also involved in sectoral development policy. Some elements of centralisation are in place for SOEs as part of the Share Fund of Republika Srpska. External assessments of SOEs' financial statements point to low profitability and insufficient investments in infrastructure, among other performance issues (Parodi and Cegar, 2019[78]). As a result of weak ownership arrangements and underperformance, Bosnia and Herzegovina achieves a relatively low score in terms of governance and efficiency. A higher score is accorded for transparency and accountability, reflecting the fact that most SOEs are required to prepare annual financial statements that are often publicly available. Bosnia and Herzegovina achieves a below average score in terms of ensuring a level playing field with private companies, which reflects legal differences for SOEs incorporated as statutory entities, as well as the fact that SOEs' overall under-performance distorts market efficiency (Table 21.11). Bosnia and Herzegovina's performance in the state-owned enterprise dimension has not changed significantly since the 2018 Competitiveness Outlook, reflecting the absence of significant state ownership reforms since then (Figure 21.1). However, both the Federation of Bosnia and Herzegovina and Republika Srpska have announced plans to establish central co-ordinating units to monitor SOEs, which, if implemented, could improve the economy's score going forward.

**Table 21.11. Bosnia and Herzegovina's scores for state-owned enterprises**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 1.6 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 2.5 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 2.0 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising SOEs | n.a. | n.a. |
| **Bosnia and Herzegovina's overall score** | | **2.0** | **2.6** |

Note: For comparability with the previous assessment, the new sub-dimension (6.4) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

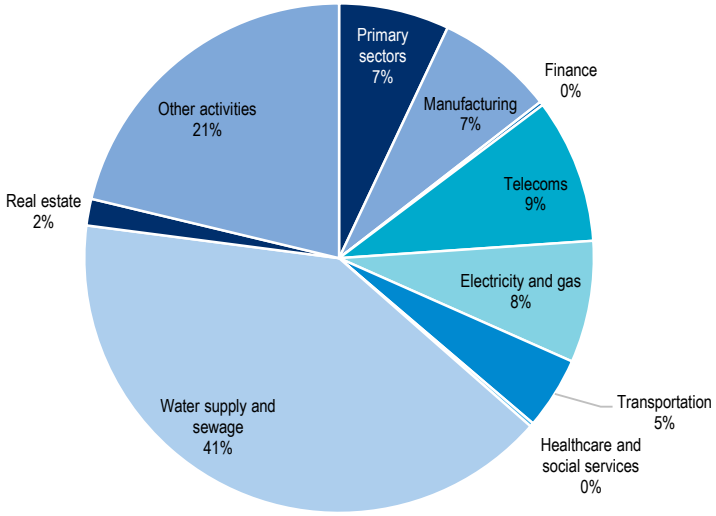
The national-level entities of Bosnia and Herzegovina together own approximately 80 SOEs (53 owned by the FBiH and 27 owned by the Share Fund of RS).[42] In addition, the FBiH's 10 cantons and 80 municipalities own approximately 128 SOEs, while the municipalities of Republika Srpska own over 100 SOEs.[43] This assessment will focus mostly on entities held by the central levels of FBiH and RS rather than cantons and municipalities.

There is no publicly available dataset presenting the overall size and sectoral distribution of SOEs in Bosnia and Herzegovina, and authorities did not provide comparable sectoral data for this assessment. However, an assessment by an International Monetary Fund (IMF) team published in 2019 sheds light on the characteristics of a selection of 414 enterprises owned by all levels of government in Bosnia and Herzegovina (Parodi and Cegar, 2019[78]).[44] The underpinning data are not limited to the portfolios of the central levels of government, which this assessment focuses on, meaning that the figures presented are therefore simply provided to give a general idea of the characteristics of SOEs in BiH. According to the IMF assessment, SOEs in Bosnia and Herzegovina, as measured by employment, are highly concentrated in the primary sector (27% of all SOE employees), followed by electricity and gas (23%), transportation (16%), and other public utilities including water supply, sewage and waste management companies (14%) (Figure 21.13, Figure 21.14).[45] SOEs are also present in sectors with a

less obvious state-ownership rationale. For example, state-owned manufacturing enterprises account for 6% of all SOE employment, while SOEs classified in the "other activities" sectors – including construction, accommodation and food services – similarly account for 6% of all SOE employment.

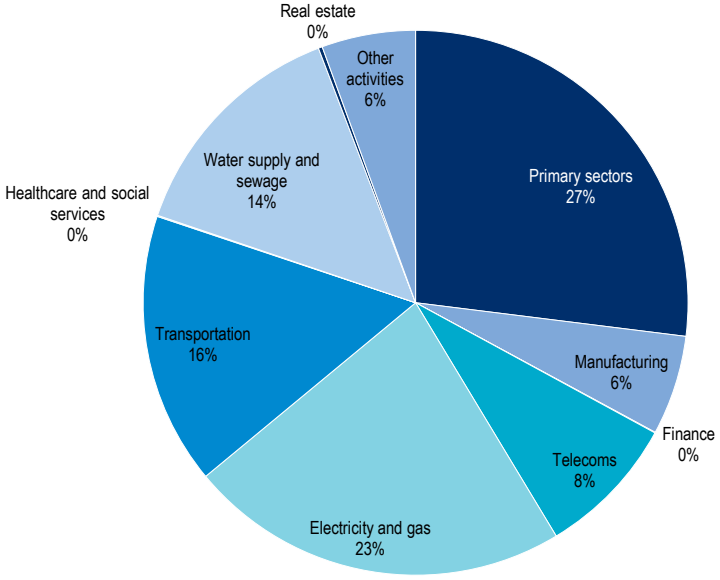
In addition to enterprises that are majority or wholly owned by the state (which are considered SOEs), the FBiH holds minority shares in four enterprises, while the Share Fund of RS holds minority shares in 13.

## Figure 21.13. Sectoral distribution of SOEs by number of enterprises (2017)




Source: Author calculations based on data provided in (Parodi and Cegar, 2019[78]), *State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight*, https://www.imf.org/en/Publications/WP/Issues/2019/09/20/State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight-48621. The figures used in the IMF study have been transferred into a different sectoral classification system, to allow for an alignment with the OECD's recurrent SOE data collection exercise (OECD, 2017[79]), *The Size and Sectoral Distribution of State-Owned Enterprises*, https://doi.org/10.1787/9789264280663-en.

## Figure 21.14. Sectoral distribution of SOEs by employment (2017)




Source: Author calculations based on data provided in (Parodi and Cegar, 2019[78]), *State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight*, https://www.imf.org/en/Publications/WP/Issues/2019/09/20/State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight-48621. The figures used in the IMF study have been transferred into a different sectoral classification system, to allow for an alignment with the OECD's recurrent SOE data collection exercise (OECD, 2017[79]), *The Size and Sectoral Distribution of State-Owned Enterprises*, https://doi.org/10.1787/9789264280663-en.

SOEs in Bosnia and Herzegovina employ approximately 80 000 people, accounting for an estimated 11% of national employment (Parodi and Cegar, 2019[78]). This is above OECD average and high compared to other WB economies. However, the size is overstated through the inclusion of sub-national SOEs in this figure, as internationally comparative data are mostly limited to central-level SOEs (OECD, 2017[79]). The prevalence of SOEs in systemically important sectors – notably electricity and gas, transportation, and public utilities – gives them a decisive influence on broader market efficiency. A review of the financial statements of 414 SOEs found that they have very low returns overall, for example they averaged a -0.3% return on equity for the 2015-17 period (Parodi and Cegar, 2019[78]).

Concerning the **clarification of ownership policy and rationale**, neither the FBiH nor RS have developed an ownership policy that outlines the rationale for the state ownership of enterprises. Although this may be implicitly gleaned from other government policy documents, there is a problematic absence of any overarching policy explaining why the government owns companies and what it expects those companies to achieve. The rationale for state ownership is implicitly presented in the Law on Public Enterprises in force in each entity. In FBiH, the Law on Public Enterprises establishes that a "public enterprise" is one that performs "public interest activities in the field of energy, communications, utilities, management of public resources and other public interest activities". This implies that the purpose of state ownership in FBiH is to serve the public interest by offering public goods and services in these, and possibly other, sectors. Similarly, in RS the Law on Public Enterprises establishes that a "public enterprise" is any joint-stock or limited-liability company that is at least majority owned by Republika Srpska or local government unitsand is established to perform "activities of common interest". This implies that the purpose of state ownership in Republika Srpska is to serve the "common interest". However, many SOEs in both FBiH and RS do not have an obvious public interest activity, which underscores the lack of clarity regarding why the state owns certain companies. In a similar vein, in RS the state maintains ownership in 42 largely inactive companies that have not been registered as companies in accordance with applicable legislation. In these companies, the rationale for continued state ownership is particularly unclear.

At the time of writing, the FBiH government was in the process of preparing an ownership policy for the SOEs under its remit, which is expected to clarify the entity's rationale for owning companies and its expectations of the SOEs in its portfolio.

Efforts to **professionalise state ownership** practices are relatively limited in BiH, as ownership responsibilities are often exercised in a decentralised manner by various line ministries, subject to almost no central co-ordination. In both BiH government entities, while the government as a whole is by law responsible for exercising state ownership rights, in practice SOEs are mostly under the jurisdiction of line ministers who play a strong role in their operational oversight. This is problematic for several reasons, partly because it leads to a mixing of the state's roles – ownership roles, regulatory roles and policy development roles – which can lead to conflicting or unclear objectives.

Concerning specific practices at the level of each entity, the FBiH government is by law accorded state ownership rights, which it can exercise directly or through federal authorities, including ministries. In practice, many state ownership decisions are made directly by the government (e.g. appointing and dismissing board members). All of the FBiH's 53 SOEs are under the explicit jurisdiction of several individual line ministries, according to a list provided by the authorities. This indicates that there is limited co-ordination of ownership practices and limited separation of ownership from regulatory functions. Independent regulators, notably in the energy sector, establish some degree of separation of functions, but this is not the case in all sectors. The authorities report that an informal co-ordinating unit is in place in the Prime Minister's Office, but additional steps are needed to give this unit the formal authority to co-ordinate ownership decisions across the FBiH.

Similarly, in RS the government is by law responsible for exercising ownership rights in fully state-owned enterprises, with these rights delegated by decisions of the government either to the Share Fund (which is managed by the Investment Development Bank of Republika Srpska) or to line ministries. Although the Share Fund's ownership responsibilities would seem to indicate a stronger separation of ownership and

regulatory functions in RS, in practice the SOEs in the Share Fund's portfolio are also subject to oversight by relevant line ministries, indicating a mixing of the state's ownership and regulatory roles among these SOEs. The Share Fund's portfolio includes all SOEs in RS that are incorporated as joint-stock or limited-liability companies. SOEs incorporated under the separate legal form of "public enterprise" are held by the government as a whole and are under the jurisdiction of individual line ministries. In these companies, the government makes ownership decisions at the annual general meeting (AGM) based on recommendations and information provided by the responsible line ministries.

Concerning the SOE **board nomination framework**, and in the context of BiH's predominantly decentralised ownership arrangements, there are minimal elements of a common approach to board nominations, namely that they are subject to general requirements set forth in legislation applicable to governmental appointments in both entities. However, these general requirements cannot really be considered to constitute an SOE board nomination framework as they apply to all governmental appointments and not specifically to SOEs. This also indicates the broader issue that SOEs often appear to be run as arms of the public administration, rather than as corporate entities operating under independent boards of directors with private sector expertise. Even if strong corporate boards with private sector expertise were put in place in BiH, the current level of SOE policy development would make it difficult for boards to effectively oversee enterprise strategy and management decisions given the absence of clear financial and non-financial performance objectives communicated by the state.

Concerning the basic board nomination frameworks in place in each entity, in FBiH the Law on Ministerial, Governmental and Other Appointments outlines the general requirements for SOE board member nominations, notably establishing that an open competitive procedure must be carried out to fill relevant positions. Dedicated qualifications criteria are defined for each board vacancy; however, in the absence of a public document outlining the necessary professional qualifications for SOE board members, the procedure can be considered as lacking transparency.

Similarly, in RS the Law on Ministerial, Government and Other Appointments establishes that board nominations must be subject to a public competition. The law covers basic requirements, including that such appointments can only be made to persons aged over 18 who have not been dismissed from the civil service as a result of a disciplinary measure. The authorities of RS also reference the Law on Companies and the Law on Public Enterprises as setting forth information on the board nomination process, pointing to a complexity of requirements and the likelihood of a piecemeal approach to SOE board nominations. The Law on Public Enterprises only sets forth minimal elements regarding the legal responsibilities for board nomination, such as stating that the general meeting of shareholders is responsible for appointing supervisory board members, and that the aforementioned Law on Ministerial, Government and Other Appointments must be respected in the process. Specific requirements are developed for individual board nominations, but no formal documents exist on how those criteria are established, so the process can be considered as lacking transparency.

The authorities have not established criteria to promote **independent and professional boards** in SOEs. In both entities, boards are generally perceived to operate as arms of ownership ministries, rather than as independent corporate oversight organs. In the worst cases, there is also a perception that individual SOEs are essentially under the control of political parties, which increases risks of corruption and mismanagement (US Department of State, 2019[80]). This perception was confirmed by stakeholders interviewed for this assessment, as well as by several local media reports, for example by the Centre for Investigative Reporting. One such report indicated a perception that executive director appointments in one of the economy's largest SOEs, BH Telecom, are accorded based on political affiliations rather than professional qualifications (CIN, 2018[81]). Despite these shortcomings, it should be highlighted that SOE boards are not staffed predominantly by civil servants but by experts appointed via dedicated nomination procedures. In this sense, BiH differs from many economies around the world, where SOE boards are often predominantly composed of civil servants who may not have the appropriate private sector expertise to oversee corporate strategy.

In FBiH, the state's strong role is SOE corporate oversight is evidenced by the requirement that the chair of the supervisory board submits three-monthly reports to the government on its work, indicating the state's strong involvement in SOE management oversight. There does not seem to be any practice of requiring independent members on boards, although some basic requirements confer independence from management, for example the chief executive officer (CEO) cannot also be the chair of the supervisory board. Concerning duties and liability, SOE board members in FBiH are required by company law to act in the best interest of the enterprise, with specific legislative provisions stipulating that any damages to the company brought about by the CEO or a supervisory board member owing to "non-performance or disorderly performance of their duties" must be compensated. The company law also establishes fines in case the chair or CEO does not perform certain duties such as convening the AGM. Separately, a Government Decree on Executing Authorities in Companies with State Capital Share establishes that the CEO and supervisory board members must act in the interests of the capital owner (the state shareholder). This is supported by the requirement that the supervisory board chair submits at least once every three months a written report on the work of the supervisory board. This document applies equally to fully state-owned enterprises and to those with minority shareholders, pointing to weaknesses in the equal treatment of all shareholders. If SOE boards are explicitly expected to act (only) in the interests of the state shareholder, then there may be instances when corporate decisions are made to serve the state's interests at the expense of minority shareholder interests. This could include politically expedient decisions that may jeopardise the commercial viability of SOEs.

The state's strong role in SOE management oversight – and the concomitant weakness of SOE boards of directors – is similarly evident in RS, where SOEs operate primarily under the Law on Public Enterprises and are subject to close direct oversight by the public administration, including the state audit office. In RS, the strong role of the state in corporate decision making is somewhat mitigated by the fact that SOE boards are reportedly not predominantly staffed with civil servants but with experts in relevant fields, including law, economics and technical sciences.[46] The authorities report that civil servants can serve on SOE boards in exceptional cases, but that it is not common practice. There are no requirements for non-executive or independent members on SOE boards (except for stock-exchange listed companies whose boards must comprise a majority of non-executive directors, of which two must be independent). However, the Law on Public Enterprises of RS – which also sets forth SOE board duties – establishes the principle that board members must avoid any conflicts of interest that could go against the interest of the enterprise or prevent them from fulfilling their duties.

### *Sub-dimension 6.2: Transparency and accountability practices*

Concerning **financial and non-financial reporting**, SOEs in both entities are required, by various laws, to submit financial reports to various state entities. According to the IMF study, SOEs do not consistently comply with related reporting requirements, for example several do not make their financial statements available in a timely manner (Parodi and Cegar, 2019[78]). A local media organisation representative interviewed for this assessment echoed the conclusion that many SOEs do not publish financial statements and are in general not transparent about their activities or performance. Limited information was provided by the authorities concerning SOEs' non-financial reporting practices for this assessment, indicating that producing annual reports with non-financial information is either not required of SOEs or is not a widespread practice. Nonetheless, the RS authorities report that SOEs regularly include some non-financial information in their annual reporting to the government.

Concerning the precise requirements and practices in place in each entity, in FBiH SOEs are required by the Law on Public Enterprises to prepare accounting records and financial reports in accordance with the Law on Accounting and Audit. It is not clear whether financial statements must be made publicly available; the Law on Public Enterprises requires that the AGM of SOEs submits "reports on their operations" to the municipal council, cantonal assembly or parliament at least once a year, and that these reports are made publicly available, but these are not financial statements. The authorities report that approximately two-thirds of SOEs are required by various laws to publish annual reports, but limited information was

provided on the content of these annual reports and whether they discuss SOEs' public policy activities or other non-financial information.

In RS, SOEs' reporting requirements are also mostly established through the Law on Public Enterprises, which notably requires that SOEs prepare financial reports in accordance with applicable laws on accounting and auditing, as well as three-year "business plans" that are submitted to both the Auditor General and the competent ministry. According to the Law on Public Enterprises, SOE management boards are responsible for drafting and supervising the implementation of these business plans, which include some basic non-financial reporting, for example concerning issues related to environmental protection and labour force trends. However, they are not required to be made publicly available, so do not constitute the "annual reports" traditionally produced by companies.

Concerning **auditing practices**, certain categories of SOE in BiH are required to have their financial statements audited by an independent external auditor. In FBiH, independent external audits are only required for SOEs that exceed certain size thresholds, in accordance with the Law on Accounting and Audit. Audited financial statements should be presented to the AGM with an external audit report. In RS, SOEs' financial statements are, according to the Law on Public Enterprises, adopted by the AGM along with an independent auditor's report. The independent auditor must submit a statement of independence with the audit report. In RS, SOEs are also subject to close oversight by the Auditor General, which reviews SOEs' three-year business plans. This indicates a general financial oversight system that mirrors more closely the public administration system (e.g. through public budget planning processes) rather than the systems of privately owned corporations. There is limited information on the quality and credibility of SOEs' financial statements in both entities, which, alongside the limited compliance of many SOEs' with existing reporting requirements, indicates that an in-depth review of SOEs' reporting practices may be warranted.

The **protection of minority shareholders** of SOEs is particularly pertinent in BiH, given the significant proportion of SOEs that have minority non-state shareholders. In FBiH, approximately half of the SOEs held by the central government have non-state minority shareholders and are listed on the national stock exchange.[47] Similarly, In RS nearly half of the companies in the Share Fund's portfolio include non-state minority shareholders (12 out of 27 companies). Some of these SOEs are systemically important, such as the postal services operator (Pošta Srpske, 65% state-owned), RS Railways (Željeznice Republike Srpske, (63.92% state-owned) and RS airport (Aerodromi RS, 64.69% state-owned). Separately, in FBiH the state is itself a minority shareholder in 4 enterprises where full privatisations have been unsuccessful, while the Share Fund of RS is a minority shareholder in 13 companies.[48] As is the case in most WB economies, SOEs are not exempt from the application of basic company law provisions to protect minority shareholders, including the right to equitable treatment and the possibility for redress through the courts in case of alleged violations of those rights. However, external assessments indicate that there is room to improve these basic legal protections accorded to minority investors in BiH, with the World Bank's Doing Business 2020 report according BiH a lower score than its Western Balkan neighbours for the protection of minority shareholders (World Bank, 2020[82]). Some elements of the company law in both entities do accord minority shareholders specific potential channels to participate in corporate decision making, for example shareholders that hold at least 5% of capital have the right to appoint one supervisory board member, which could help ensure that corporate decision making takes into account all shareholders' interests (and not just the state's interests). According to FBiH authorities, minority shareholders with over 5% capital in SOEs do usually exercise this right. The RS authorities report that in some cases, minority shareholders are less active in this respect and do not propose board representatives at the AGM. Limited information was provided by the authorities on recent disputes involving minority shareholders, but FBiH authorities indicated that the state and minority shareholders do sometimes disagree on corporate decisions, for example whether to reinvest profits or distribute them as dividends.

*Sub-dimension 6.3: Ensuring a level playing field*

Concerning **legal and regulatory treatment**, most SOEs in both entities are incorporated according to general company law (as joint-stock or limited-liability companies), although 11 SOEs in FBiH and 6 SOEs in RS have not been incorporated as companies (they are "public enterprises", *javno preduzeće/*JP) and operate primarily subject to enterprise-specific legislation and the Law on Public Enterprises. The authorities of both entities report that SOEs are generally subject to the same tax, competition and other regulatory treatment as private enterprises. While a separate Law on Public Enterprises regulates SOEs in both entities (meaning that SOEs operating as joint-stock or limited-liability companies are subject to a company law and an SOE-specific law), it does not appear to introduce major differences in legal treatment that would create specific advantages or disadvantages in the competitive marketplace. In fact, the SOE-specific law in each entity establishes several basic principles related to ensuring fair competition in the marketplace.

Concerning the legislative framework in each entity, in FBiH the Law on Public Enterprises establishes some basic principles aimed at ensuring a level playing field between SOEs and private competitors. It notably establishes that there must be sufficient supervision of state aid to ensure that it does not distort fair competition. In this sense, although a separate law applicable to SOEs may create different legal treatment, it does take steps towards minimising differences in treatment between SOEs and private companies. In RS, the Law on Public Enterprises similarly establishes several principles related to avoiding distortions to fair competition in the marketplace, such as prohibiting abuses of dominant positions, liberalising services of general interest to prevent monopolies, and prohibiting agreements by public enterprises that could prevent, distort or restrict competition in the marketplace.

However, the presence of a separate legal form ("public enterprises") for some SOEs raises concerns regarding their operational treatment. In general, it is considered good practice to ensure that SOEs undertaking predominantly commercial activities are incorporated according to the general company law. Information provided by the authorities of FBiH also points to some potential disadvantages that SOEs face owing to their state ownership, which may be shared by SOEs operating in RS. These disadvantages include the fact that SOEs are by law subject to the same public procurement procedures applicable to government bodies, which can create an operational burden that private competitors do not face. Such issues can be particularly acute in sectors that were previously monopolistic but where competition has been introduced (e.g. the postal services and telecommunications sectors). SOEs may also face advantages in such situations due to their historically dominant market share and regulatory leniency owing to their state ownership. SOEs' competitive position in markets where competition has been recently introduced should be continuously assessed to minimise market distortions.

Concerning **access to finance**, the authorities of both entities have limited formal information on whether SOEs benefit from favourable terms in accessing commercial credit. It is likely that as in other economies around the world, SOEs in BiH benefit from at least an implicit state guarantee that many commercial lenders use to justify more favourable credit terms. It does not appear that explicit guarantees on SOEs' commercial debt are commonplace, but FBiH authorities report that they are sometimes accorded to SOEs, particularly when engaged in large infrastructure projects that often receive financing from international financial institutions. The Law on Debt requires that such guarantees are approved by parliament. In RS, the authorities report that there have been cases where the government issued explicit guarantees on SOE debt, but that this is no longer common practice. SOEs in BiH often do not earn economically significant rates of return, which effectively constitutes a cost of equity capital that is not market consistent. For example, persistent losses posted by RS Railways – which is currently undergoing a restructuring process – has led the company to incur large unpaid debts to the tax office. External assessments have found that many SOEs have similar unpaid debts to state authorities, including for example health and pension contributions (US Department of State, 2020[83]). It is likely that SOEs face some leniency concerning unpaid debts owed to the relevant authorities, pointing to their unequal treatment compared to private enterprises. Overall, SOEs' underperformance creates a situation where economic resources are not

channeled into the most productive activities, which in the long term can crowd out private sector activity and lead to inefficient market outcomes.

*Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

Concerning recent **SOE reform**, the current FBiH government reform agenda includes a section devoted to SOEs that focuses on improving their performance, depoliticising management, and strengthening their transparency. As mentioned earlier, at the time of writing the FBiH government was in the process of developing an ownership policy expected to be completed in 2020. There are also plans to formalise the Prime Minister's Office's (currently informal) SOE monitoring unit to strengthen central monitoring of SOEs and harmonise ownership practices across the FBiH. In RS, recent reforms have mostly involved the financial and organisational restructuring of individual large SOEs such as RS Railways to create a self-sustaining company. The restructuring process has so far led to staff reductions of over 800. RS authorities have recently established an SOE working group to undertake an analysis of SOE operations and reform priorities, with the support of the World Bank.[49] Similar to developments in the FBiH, RS authorities intend to establish a state ownership monitoring unit within the Cabinet of the Prime Minister.

Concerning the impact of the COVID-19 pandemic, FBiH authorities reported that several companies under the purview of the Ministry of Energy, Mining and Industry have suffered losses due to the crisis, and that the ministry is currently working on an overview of the financial state of its SOEs for the FBiH government. RS authorities did not report any specific measures taken for SOEs related to COVID-19.

**Privatisation** efforts continue in both entities, although some recent planned privatisations have been unsuccessful in RS. According to external assessments, SOEs can often be unattractive investments to potential private buyers due to, for example, their high unpaid debts that must be paid post-privatisation and/or requirements to maintain staff contracts after privatisation (US Department of State, 2020[83]). At the time of writing, eight SOEs had recently been transferred to the FBiH Privatisation Agency for planned privatisation. The privatisation list in FBiH emerged from a 2015 review of all SOEs that classified companies into three broad categories: 1) strategic companies that should remain in state ownership and not be privatised; 2) companies with business difficulties that should be restructured; and 3) companies that should be privatised. On the basis of this list, the government instructed the FBiH Privatisation Agency to prepare a Privatisation Plan, with proposals for models and methods of privatisation for eight companies. Privatisations undertaken by the agency are in accordance with the Law on Privatisation of Companies, which also regulates privatisations undertaken by ten cantonal privatisation agencies. Since 2010, 24 SOEs owned by the FBiH have been privatised, all operating in the manufacturing sector. The latest privatisations took place in 2016, when the state relinquished its remaining minority ownership shares in the Sarajevo Tobacco Factory and the pharmaceutical company Bosnalijek.[50] In RS, the Investment-Development Bank adopts a privatisation plan as part of its annual work plan, which lists the companies slated for privatisation, together with the current state ownership share. The 2020 plan includes three SOEs lined up for privatisation. These SOEs undertake activities related to radar and missile systems, manufacturing parts for aircraft engines, and chemical corn processing. Recently, some planned privatisations in RS were not successful, including the planned stock-exchange auction of Ljubija a.d. Prijedor and a tender for the sale of Novi mermer a.d. Šekovići. The planned stock-exchange auction of the state's 65% shareholding in Ljubija a.d. Prijedor was reportedly unsuccessful due to the absence of qualified investors interested in the purchase, while the tender for the fully state-owned Novi mermer a.d. Šekovići resulted in only one bid, the terms of which the government determined unsatisfactory.

## *The way forward for state-owned enterprises*

SOEs operate at the nexus of the public and private sectors and, as such, their operations are affected by both the quality of public governance and the prevailing corporate and boardroom culture. As in most Western Balkan economies, ensuring that SOEs in Bosnia and Herzegovina operate efficiently, transparently and on a level playing field with private companies will necessitate reforms in multiple policy

areas that cannot be undertaken all at once. Choosing the appropriate sequencing of reforms is just as important as the content of the reforms, and largely depends on the political climate and current reform priorities.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[84]) provide a guidepost for reforms that the BiH authorities can use to inform their policy efforts in this domain. Based on the state of play of SOE policy development in BiH, the following priority reform areas – which are in line with the OECD SOE Guidelines – could offer a basis for discussions with the authorities.

- **Develop a state ownership policy and improve the central monitoring of SOEs**. In the context of BiH's decentralised ownership arrangements, a state ownership policy should be elaborated to guide ownership decisions and practices. It should clearly outline why the government owns companies and what it expects those companies to achieve. The ownership policy could provide a useful foundation for eventually developing enterprise-specific financial and non-financial performance objectives, the implementation of which could be monitored and used to guide structural changes to improve SOE efficiency. The authorities of both entities should centralise data on SOEs to ensure that the development of policy priorities and performance objectives are evidence based.
- **Strengthen SOE board competencies by improving the nomination framework**. There is a perception that many SOE board seats in BiH are granted to individuals based on their personal or political connections, rather than professional merit. While the legislation in place seeks to ensure that boards are not subject to conflicts of interest, there appears to be scope to improve their professionalism and private sector expertise. The authorities should consider strengthening and publishing the professional criteria applicable to SOE board appointees with a view to ensuring that members have a sufficient diversity of expertise (e.g., financial, corporate strategy and industry-specific expertise) to effectively oversee necessary strategic and structural decision making within SOEs. The board nomination framework should be transparent and merit based.
- **Ensure a level playing field when SOEs compete in the marketplace**. While some SOEs are tasked primarily with public policy objectives, others operate commercially and compete with private companies in the marketplace. In some cases, SOEs operating commercially may face competitive advantages, such as their dominant market share coupled with public support, while in other cases they may face disadvantages, such as public-procurement procedures that private competitors do not face.[51] The authorities should review SOEs' operational requirements to identify any regulatory or operational differences that hinder healthy competition in the markets in which they operate. The authorities should also consider fully corporatising SOEs that undertake primarily commercial activities but are still organised under the separate legal form of "public enterprise". In a similar vein, the authorities should move forward with the necessary liquidations of SOEs that are no longer active, in particular in Republika Srpska, where 32 SOEs are currently undergoing bankruptcy/liquidiation and 42 are not registered as companies in accordance with applicable legislation and are reportedly no longer undertaking commercial activities.
- **Review minority shareholder rights and participation in SOE decision-making bodies**. A significant proportion of SOEs in BiH are partly owned by minority private investors, underscoring the need to ensure that their interests are credibly and consistently taken into account in corporate decision making so that SOEs can continue to benefit from needed private capital. An in-depth review of the strength of minority shareholder protections in practice goes beyond the scope of this assessment but would be a useful undertaking for the authorities to consider as they seek to continue broadening SOE ownership to include private investors. According to a recent review of implementation of the OECD SOE Guidelines in 31 economies, many have recently taken steps to strengthen the rights of SOE minority shareholders, for example through updates of corporate governance codes (which are applicable to listed SOEs), SOE-specific codes or guidelines (OECD, 2020[85]). These practices, summarised in the aforementioned report, could provide useful inspiration for the BiH authorities.

- **Improve transparency at the level of SOEs and the state as owner**. The authorities of both entities in BiH have established basic financial reporting requirements for SOEs, but compliance is not consistent across the SOE sector. There is also scope for SOEs to go beyond financial reporting and produce more detailed reports on their non-financial performance, particularly SOEs engaged in public interest activities. The authorities should undertake an in-depth review of SOEs' reporting practices to identify and address weaknesses in their financial and non-financial reporting practices. The state as an owner should begin producing publicly available reports on the performance of the SOE sector as a whole using the information collected from individual SOEs.

## Education policy (Dimension 7)

### *Introduction*

Table 21.12 shows Bosnia and Herzegovina's scores for the four education policy sub-dimensions and the cross-cutting dimension on system governance, and compares them to the WB6 average. Bosnia and Herzegovina scores below the WB6 average in all sub-dimensions except for the tertiary education sub-dimension. However, it has seen modest improvements in its scores since the 2018 Competitiveness Outlook assessment (for indicators that allow for comparisons) (Figure 21.1). Despite these signs of progress, Bosnia and Herzegovina's complex education governance system, whereby responsibilities for education are shared among actors at the state, entity, canton and district level, continue to create challenges in terms of setting strategic objectives, policy co-ordination and reform implementation. As a result, the scores in this policy profile should be interpreted with caution as they represent a composite, with the scores for the state and its entities often varying.

**Table 21.12. Bosnia and Herzegovina's scores for education policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 2.2 | 3.0 |
| | Sub-dimension 7.2: Teachers | 1.5 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 2.0 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 2.8 | 2.8 |
| | Cross-cutting dimension: System governance | 1.5 | 3.3 |
| **Bosnia and Herzegovina's overall score** | | **2.1** | **3.0** |

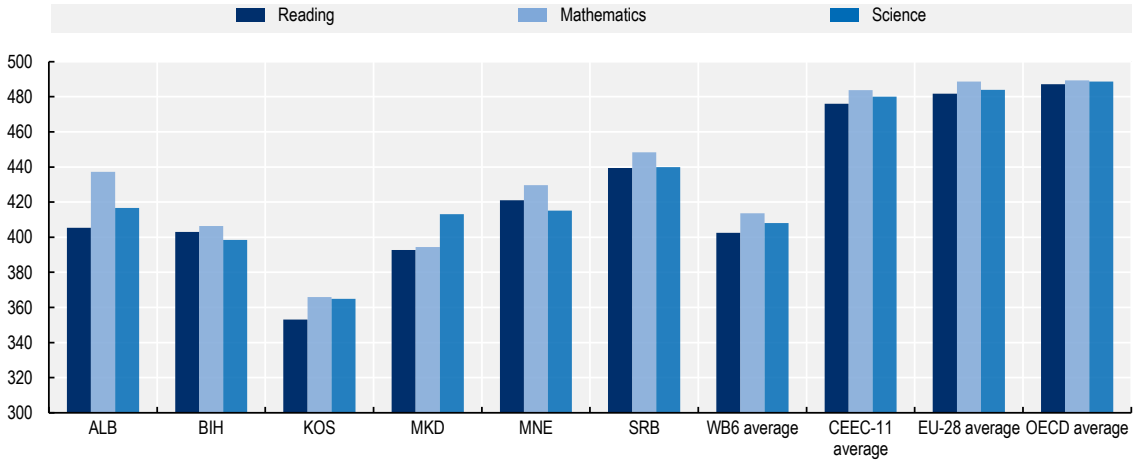
### *State of play and key developments*

Similar to economies around the world, Bosnia and Herzegovina was faced with a rapid shift from classroom to remote learning in 2020 to help slow the spread of COVID-19. Working with donor agencies, education authorities introduced a variety of distance-learning opportunities for the different education levels; however, some children and youth, especially those from Roma communities, have not had adequate access to ICT and the Internet. Education authorities in different jurisdictions opted for local-specific quality assurance mechanisms during the COVID-19 pandemic and developed a diversity of approaches to distance learning (United Nations, 2020[86]).

One major achievement since the 2018 assessment has been the introduction of the common core curriculum for pre-university education in 2018, which established a common framework for curriculum development. Since the last CO assessment, Bosnia and Herzegovina has received its first results from PISA, filling a notable gap in available information about student learning outcomes.[52] These results reveal that overall performance was around the regional average in reading, mathematics and science, but lower than the EU and OECD averages (Figure 21.15). PISA 2018 findings also show that around 41% of students in Bosnia and Herzegovina did not achieve the minimum skills (Level 2) in all three PISA subjects, which is higher than the average among OECD economies (13.4%) and the Western Balkan average (38.7%) (OECD, 2018[87]). These results suggest that basic learning outcomes are still not achieved by many students in BiH, which has implications for its long-term economic development, as students without basic skills are less likely to attain well-paying and rewarding jobs.

## Figure 21.15. Performance in reading, mathematics and science in Western Balkan education systems, 2018

PISA mean scores




Note: CEEC – Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (OECD, 2018[87]), *PISA 2018 Database*, Tables I.B1.4, I.B1.5 and I.B1.6, https://www.oecd.org/pisa/data/2018database/.

StatLink https://doi.org/10.1787/888934255608

### *Sub-dimension 7.1: Early childhood and school education*

Bosnia and Herzegovina's score in this sub-dimension is slightly lower than the Western Balkan average, and there are significant score differences across the entities and the state level. According to data from the Agency for Statistics of Bosnia and Herzegovina, the economy's net enrolment rate was around 85% for primary and 82% for lower secondary education in 2019. These rates have been generally declining since 2014, partly as a result of demographic decline. At the upper secondary level, net enrolment was nearly 79% (UIS, 2021[88]).[53] There are signs that participation in education is inequitable in Bosnia and Herzegovina, especially for children from Roma communities and those from poor and rural backgrounds (World Bank, 2019[89]).

Participation in **early childhood education** (ECE) in Bosnia and Herzegovina is low, as it was in 2018, with the gross enrolment ratio in pre-primary education standing at 25%, the lowest in the WB6 region[54] (UIS, 2021[88]). This could be due to a lack of infrastructure and limited funding directed at ECE institutions, especially in urban areas where demand is high. For example, there are waiting lists for preschool matriculation in urban areas such as Sarajevo, Banja Luka, Brčko and Mostar; and 30 of BiH's 143 municipalities do not have a school that offers preschool programmes (World Bank, 2019[89]).

Bosnia and Herzegovina has taken steps to raise the quality of ECE. Notably, the Agency for Preschool, Primary and Secondary Education (APOSO) developed Quality of Work Standards for educators, pedagogues and principals in preschool education. In 2018 it also introduced curriculum guidelines based on learning outcomes to help ensure continuity in children's transition from ECE to primary education. There are also several strategies and legal frameworks that establish goals for the sector. In particular, the state-level Platform for the Development of Preschool Education for 2017-2022 aims to harmonise preschool policies with international standards and sets out activities related to increasing coverage, quality assurance, financing and inclusion. However, entities and cantons are responsible for determining their own laws and budgets to operationalise ECE policy, which leads to inconsistencies. For example, the Framework Law on Preschool Education requires competent authorities to harmonise their legislation to provide compulsory and free preschool education; however, several years after entering into force not all cantons in the FBiH have made one year of preschool preparatory education compulsory, and it is only recommend in the RS, which risks undermining the goal of ensuring that all young children have access to ECE. Donor-led initiatives continue to play an important role in implementing policy initiatives and monitoring and supporting the ECE sector in Bosnia and Herzegovina.

The **instructional system**[55] in Bosnia and Herzegovina rates slightly below the regional average for this indicator. This is primarily because of the significant differences across education authorities, which contribute to fragmented education policies and resource inefficiencies. There is a Framework Law for Primary and Secondary Education, which require various education authorities to coordinate and align policies with EU standards and principles but unlike the ECE Platform, there is no comprehensive state-level education strategy for the school sector. Instead, the FBiH and some individual cantons have policies regarding instructional quality and equity but the RS is the only authority that has prepared a comprehensive strategic document.[56] School quality standards and evaluations, in addition to school leader policies also vary across entities and cantons.

Despite Bosnia and Herzegovina's rather fragmented approach to school education, an important achievement since the 2018 assessment is the introduction of the common core curriculum, which sets out a framework for learning outcomes that competent education authorities can use to develop their own curricula. The curriculum aims to strengthen students' knowledge and skills, as well as the acquisition of attitudes that will help them in their daily lives and work. However, the extent to which authorities have implemented the common core curriculum varies, and there are no state-level assessments or examinations to help determine the extent to which students are achieving learning standards. At the same time, there are examples of student assessment policies within Bosnia and Herzegovina that align with policies in EU and OECD countries. For example, *Matura* exams that mark the end of secondary education can be found in RS and some cantons (e.g. Tuzla). Unlike many other economies, however, these various tests are managed by their respective education authorities rather than a central examination centre. Bosnia and Herzegovina's state-level evaluation centre, APOSO, manages the economy's participation in international assessments such as PISA and the Trends In International Mathematics And Science Study (TIMSS), which since 2018 have filled a major void in the instructional system by generating information on student learning outcomes.

Responsibilities for **preventing early school leaving** in Bosnia and Herzegovina are under the remit of entity and cantonal ministries of education. As a result, prevention and intervention measures vary. While there is no state-level strategy or policy that explicitly addresses early school leaving, the Ministry of Civil Affairs adopted the Recommendations for Inclusive Education in Bosnia and Herzegovina in 2019, which calls for measures and activities aimed at keeping (retaining) children and young people in education. APOSO also developed state-level guidelines for inclusive education in 2020. Respective authorities collect their own data to monitor early school leaving, and the FBiH, which has studied this issue in-depth, found that Roma children are especially vulnerable to leaving school early. Overall, the data available are limited and not collected using consistent definitions across jurisdictions, which makes it difficult to accurately report on this issue and understand contributing factors. Nevertheless, the Agency of Statistics reports that Bosnia and Herzegovina's early school leaving rate was around 4% in 2019.

### *Sub-dimension 7.2: Teachers*

Teacher policy in Bosnia and Herzegovina is under the responsibility of each entity and canton government, and the overall score in this sub-dimension is below the Western Balkan average. While the RS education strategy identifies improving **initial teacher education (ITE)** as a goal, the FBiH does not have a strategy or policy that addresses ITE, as related policies are managed at the canton level. Nevertheless, both entities report that improvements to working conditions have been adopted to help increase the competitiveness of the profession; the RS also has increased teacher salaries and professional autonomy to make teaching a more attractive career option. Some features of Bosnia and Herzegovina's ITE system are similar to those of EU and OECD economies. For example, most teachers are required to pass a professional examination before working in schools, and all education systems require candidate teachers to undergo a one-year teaching internship under the supervision of a mentor. However, none of the jurisdictions have minimum requirements for selecting candidates for ITE because higher education institutions across the economy have full autonomy to determine these criteria.

There is also a lack of programme-specific accreditation processes, meaning that providers do not have to demonstrate how they help candidates develop competences specific to teaching.

Despite entity and canton governments having responsibility for teacher policy, there have been some efforts at the state-level (via APOSO) to assess the **professional development and management** of teachers in Bosnia and Herzegovina and provide steps for improving the systems involved. Professional development is required in both entities; however, the duration and forms of training vary, and teachers sometimes have to pay for training out of pocket, which implies issues around access. Positively, the Ministry of Education and Science (FBiH) has implemented annual programmes since 2017 to finance or co-finance projects related to supporting the professional development and lifelong learning of teachers. However, this programme was not implemented in 2020 because of budget cuts related to COVID-19. Similar to many OECD and EU countries, some education authorities in Bosnia and Herzegovina have different categories of teacher that align with passing an appraisal process; however, these do not seem aligned with professional teacher standards. Actors in Bosnia and Herzegovina report using a range of sources to determine teacher professional development needs, but there are no accreditation processes to help ensure the quality of training providers.

### *Sub-dimension 7.3: Vocational education and training*

Bosnia and Herzegovina's score in the sub-dimension on vocational education and training (VET) is below the Western Balkan average. Professionally oriented education starts at the secondary (ISCED 3) level, when students attend schools offering either a general, vocational, arts, religious or other type of curricular programme. As of 2019, some 77% of all upper secondary students in Bosnia and Herzegovina were enrolled in VET programmes, which is similar to Serbia (around 74%) but much higher than other Western Balkan economies with available data, as well as higher than the EU average (48.4% in 2018) (ETF, 2020[90]). Despite the high share of participation in VET, there is evidence that programmes do not align with labour market needs (World Bank, 2019[89]). As in other economies, data from PISA 2018 show that students in Bosnia and Herzegovina's VET programmes are more likely to be low performers[57] than their peers in general education. Improving the foundational skills of students who pursue VET will be important if Bosnia and Herzegovina is to raise the quality and relevance of the sector and support individuals in the transition from school to work.

As with the broader political and governance structure of Bosnia and Herzegovina, the **governance of VET** is complex and involves a wide range of actors. There has been no state-level VET strategy since the previous one expired in 2015, but a new strategy for the sector is being developed. The Framework Law on Secondary Vocational Education and Training regulates the VET system by defining basic principles and standards, based on recommendations from the EU, and requiring competent education authorities to adjust their own regulations in accordance. However, how governments engage social partners and provide career guidance for learners varies across the economy. In some jurisdictions, VET providers are subject to regular evaluations or inspections, which is positive; however, there are currently no formal accreditation processes for VET providers at the entity or state level. Effective VET governance needs reliable data to inform programme development and balance the supply and demand of skills. While some state-level bodies collect data on the completion rates of VET, and basic information on schools, students and programmes, more robust and comparable sector-level data is limited.

The new state-level VET strategy is expected to recognise the importance of **work-based learning** (WBL) in all forms. There are no clear regulations that determine the structure of WBL at the state level, and access to WBL and practical training in companies has not been harmonised throughout Bosnia and Herzegovina. Guidelines and supporting documents (checklists and forms) have been developed to support actors in the preparation, execution, evaluation, monitoring and improvement of WBL, but schools and companies usually organise WBL arrangements on their own. Neither entity has dedicated career service or placement centres to help match learners with WBL places, but both use broad public awareness campaigns as a matching mechanism, with RS organising presentations to social

partners and posting WBL opportunities on an online portal. There are only sporadic incentives for employers to provide WBL, which are organised at the level of local communities. However, RS reports having a rulebook that sets out possible employer incentives. In terms of data, there are no mechanisms for tracking and collecting information about WBL at the state nor FBiH entity level. RS collects information about the location and type of WBL opportunities, completion rates from WBL programmes and the number of learners hired after completing an apprenticeship, but information about the earnings of VET graduates and WBL participants is limited.

### *Sub-dimension 7.4: Tertiary education*

Bosnia and Herzegovina's score in the tertiary education sub-dimension is similar to the Western Balkan average. The sector is mostly private, with 10 public and around 38 private tertiary institutions. The share of Bosnia and Herzegovina's labour force (aged 15+) who have attained some form of tertiary education (ISCED 5-8) has been relatively stable since 2015 at around 15-16%; however, this is the lowest rate among Western Balkan economies and is below the EU average (33.6% in 2019) (ETF, 2020[90]). Participation in higher education is increasing as higher educational attainment is correlated with higher earning potential in Bosnia and Herzegovina; however, the economy faces substantial "brain drain", and graduates face a difficult transition into the labour market (World Bank, 2019[89]; ETF, 2018[91]). In 2019, the share of youth not in employment, education or training (NEET) was around 21%, more than double the EU average (around 10%), although this share has been decreasing steadily since 2010 (ETF, 2020[90]).

At the state level, the Framework Law on Higher Education stipulates basic principles and standards of higher education in Bosnia and Herzegovina, which are in accordance with internationally recognised legal instruments and prevent discrimination on the basis of characteristics such as sex, disability or language. While this law can help facilitate more **equitable access to higher education,** there are limited comparable and disaggregated data to monitor and address access. State level agencies, in addition to entity and cantonal governments, collect some relevant data (e.g. enrolment by age and gender); however, only RS has proxies for socio-economic background and other factors that may impact an individual's access to higher education. In terms of student selection, higher education institutions typically determine entry requirements drawing on examinations and school results. Some of this information is also used to award merit-based loans and scholarships. Both entities and cantons provide financial support to vulnerable individuals, including those with disabilities and those from the Roma community.

Bosnia and Herzegovina's Priorities for Higher Education Development 2016-26, which was developed with IPA funding from the European Union, sets out key strategic goals for the sector, including strengthening connections between higher education institutions and the labour market. The economy has several features that support the **labour market relevance and outcomes** of higher education. For example, there are several initiatives to support the internationalisation of higher education, both at the state level, such as participation in the EU Erasmus Plus programme, and at the level of entities and individual institutions.

Some mechanisms also help align higher education with labour market demands, such as allocating scholarships for in-demand areas or involving industry stakeholders in the design of curricula. However, there is some information that such mechanisms are not effective, which together with longstanding disputes between the two higher education accreditation agencies (one at the state level and one in RS) has a negative impact on the overall quality and relevance of higher education programmes (European Commission, 2020[39]). While there are data that can help inform higher education programmes about the needs of the labour market, neither entities use quantitative forecasting models to better understand the supply and demand of skills. Moreover, there is limited research to help align the learning outcomes, curricula and assessment methods of higher education with the labour market.

*Cross-cutting dimension: System governance*

It is difficult to assess Bosnia and Herzegovina in the area of **system governance** given the economy's complex political structure. While there has not been a state-level education strategy since 2015, there are several framework laws that aim to harmonise education systems and align them with EU standards and principles. Bosnia and Herzegovina has a Baseline Qualifications Framework that is being aligned with European qualifications, and several education authorities within the economy have governance features resembling those of other European economies. For example, RS has its own education strategy and an online platform to share information about the performance of the education system. However, at the state level, Bosnia and Herzegovina performs below the Western Balkan average for this cross-cutting dimension, mainly because of challenges related to policy co-ordination. The complex governance structure perpetuates inefficiencies and inequities across levels of education (World Bank, 2019[89]).

A major challenge to system governance in Bosnia and Herzegovina is the limited amount of comparative data about the education sector. While several actors collect education data, they may use different definitions of indicators, which undermines the reliability of the data and limits Bosnia and Herzegovina's presence in international education datasets. The economy's recent participation in PISA and TIMSS filled an important gap in information about student learning outcomes, but there are no local standardised assessments that help monitor implementation of the new common core learning outcomes and provide more timely and contextualised results to inform education policy. Finally, there are some assessments and evaluations of the education system that can inform system governance, but these are often supported by donor agencies rather than an internal demand for research to systematically monitor, identify and address challenges facing the education system.

## *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education in Bosnia and Herzegovina can help increase regional competitiveness and create opportunities for more individuals to develop the competences needed for sustainable development and social cohesion. Officials will need to reflect on the economy's political, social and fiscal environment to determine how best to achieve their education goals. While deeper analysis of education policies is needed to provide more detailed recommendations for Bosnia and Herzegovina, the following considerations can provide insights for discussions on the way forward to enhancing education:

- **Strengthen evaluation and assessment policies across the system**. Education authorities across Bosnia and Herzegovina already have education management information systems, but these are mainly used for administrative purposes rather than to support education policy reforms and inform decision making. Republika Srpska produces quarterly reports on progress towards its education goals and has platforms to communicate information with the general public. Some cantons within FBiH also conduct analysis for their respective jurisdictions. However, there are limited internationally comparable statistical data and analysis at the state level. Bosnia and Herzegovina should consider producing a regular analytical report on system-wide progress that pulls together individual work programmes and statistics into a prominent state of education report. Germany and Canada provide such reports, along with other reporting materials, for their education systems (Box 21.9). Such efforts could build on the initiatives of individual authorities at the entity and canton level to help analyse and review state-level education data and policy initiatives, such as the implementation of the common core curricula.
- **Establish a technical accreditation system for initial teacher education**. Both entities in Bosnia and Herzegovina could benefit from setting out specific accreditation criteria and quality standards that require providers of initial teacher education to demonstrate how they help candidates develop competencies specific to teaching. In particular, Republika Srpska's Ministry of Education and Culture should work with the Ministry of Scientific and Technological Development, Higher Education and Information Society, which is responsible for ITE, to develop

standards of professional competencies for teachers and integrate these into an accreditation process. While the FBiH already has accreditation procedures for higher education institutes, there are no specific criteria for ITE programmes, which should be considered to help raise the quality of teacher preparation.

- **Prioritise supporting students, especially those in the VET sector, to achieve basic numeracy and literacy skills**. Considering that students who struggle to master basic skills are more likely to attend vocational programmes in Bosnia and Herzegovina (OECD, 2020[92]), governments should take steps to prioritise reducing the number of low performers – both within VET programmes but also earlier in the education system when achievement gaps start to appear. This will help ensure that students are equipped with the skills they need to succeed in further studies or in the labour market.
- **Consider developing a state-level standardised assessment and set targets for improving student learning outcomes**. Many Western Balkan education systems have, or are developing, standardised assessment systems to help monitor the implementation of curricula and focus actors across the system on improving student learning standards. While it is important for Bosnia and Herzegovina to continue participating in international assessments such as PISA, TIMSS and PIRLS, which produce valuable information about the education system that can also be disaggregated to capture entity-level results, developing a state-level assessment instrument would provide more timely and contextualised data to help ensure that all students are achieving the common core learning standards. The data generated by assessments should be used to conduct research on the quality of educational processes and institutions.

### Box 21.9. Annual analytical reports on the education system: Germany and Canada

Every two years, Germany produces a national report on education that covers the entire German education system, from early childhood education and school education to vocational training, higher education and adult education. The data compare developments over time broken down by federal state (*Länder*) and compared internationally. Each report provides information about the general conditions, features, results and output of education processes. While these reports do not include assessments of the data and recommendations for system improvement, they are a valuable tool that provide consistent and reliable information across Germany's decentralised education system.

In Canada, the Pan-Canadian Education Indicators Program provides statistical portraits of the elementary, secondary and postsecondary education systems. Through a series of public materials, including tables, factsheets and reports, education data from Canadian education systems is brought together to summarise key trends data and compare provincial and territorial systems with state-level averages and international peers.

Source: (Nationaler Bildungsbericht, 2020[93]), *Education in Germany*, https://www.bildungsbericht.de/en/the-national-report-on-education/education-in-germany; (Statistics Canada, 2020[94]), *Education Indicators in Canada: Report of the Pan-Canadian Education Indicators Program*, https://www150.statcan.gc.ca/n1/pub/81-582-x/2020002/ab-ap-eng.htm.

## Employment policy (Dimension 8)

### *Introduction*

Bosnia and Herzegovina's central government does not have competency over labour, employment and social policy, or social protection, which according to the Constitution fall under the remit of the two entities and the Brčko District. The Ministry of Civil Affairs of Bosnia and Herzegovina is assigned only a co-ordinating role when representing the economy's interests abroad. The possibility of working groups to

develop strategies at the state level has been discussed, as has the possibility of developing and adopting employment strategies at the level of both entities. In this dimension the state level and the two territorial entities are looked at separately. In the Federation of Bosnia and Herzegovina, the 10 cantons are highly autonomous in policy areas concerning employment (employment policy, education policy, welfare policies, etc).

Since the last Competitiveness Outlook assessment in 2018, progress has been uneven in the territories. Both entities have started to harmonise their regulatory framework for employment, but major efforts are still needed. RS has made moderate progress in tackling skills mismatches, while the FBiH has not made significant progress in this area. RS has made significant progress in the area of women's employment. Moderate progress has been made in strengthening the capacity of the public employment service (PES). Compared to other economies in the region, the regulatory and policy framework and the institutional capacity to address employment-related issues remain weak (Table 21.13).

### Table 21.13. Bosnia and Herzegovina's scores for employment policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 2.1 | 2.6 |
| | Sub-dimension 8.2: Skills | 1.1 | 2.2 |
| | Sub-dimension 8.3: Job quality | 1.9 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 2.4 | 2.9 |
| **Bosnia and Herzegovina's overall score** | | **2.0** | **2.6** |

## *State of play and key developments*

### Table 21.14. Key labour market indicators for Bosnia and Herzegovina (2015 and 2019)

| | Bosnia and Herzegovina | | WB6 average | EU average |
|---|---|---|---|---|
| | 2015 | 2019 | 2019 | 2019 |
| **Activity rate (15-64)** | 54.6% | 55.5% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 39.2% | 46.4% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 27.7% | 16.4% | 16.3% | 6.4% |

Note: WB6 average rates are based on author's own calculations using simple averages. Unemployment rate in 2015 refers to the 15+ age group.
Source: (Agency for Statistics of Bosnia and Herzegovina, 2020[95]), *Labour Force Survey 2019*, http://www.bhas.ba/data/Publikacije/Bilteni/2019/LAB_00_2019_TB_0_HR.pdf; (World Bank and WIIW, 2020[96]), Western Balkans Labour Market Trends 2020, https://wiiw.ac.at/western-balkans-labor-market-trends-2020-dlp-5300.pdf; (Eurostat, 2020[97]), Labour Force Survey data base, https://ec.europa.eu/eurostat/web/main/data/database.

The activity rate of the population aged 15-64 was 55.5% in 2019, which was below the EU average and WB6 average (Eurostat, 2020[98]; World Bank and WIIW, 2020[96]).[58] In contrast to most economies in the region, the activity rate did not increase between 2015 and 2018 (World Bank and WIIW, 2020[96]). Over the same period the number of employed aged 15-64 increased constantly (by 13% between 2015 and Q2 2019) (World Bank and WIIW, 2020[96]). Between 2015 and 2019, the employment rate of those aged 15-64 increased by 7.2 percentage points, but remained well below the EU average (Eurostat, 2020[99]). In 2019, the employment rate in BiH was the second lowest in the region (after Kosovo). The activity rate and employment rate were higher in RS than in the FBiH (by 8.7 and 10.3 percentage points, respectively), and the unemployment rate was lower (by 6.7 percentage points) (Agency for Statistics of Bosnia and Herzegovina, 2019[100]).[59]

As a result of the COVID-19 pandemic, GDP in Bosnia and Herzegovina fell by 9.3% between Q1 and Q2 2020. The impact on the labour market has been sizeable, although less dramatic than the fall in GDP. The level of registered employed fell by 2.2% in Q2 2020 (equating to 18 500 fewer employed people) compared to Q2 2019, while in Q1 2020 employment grew by 1.1% compared to the previous year. Employment in Q2 2020 fell mainly in retail trade, manufacturing and accommodation, and food

services. In contrast, employment rose slightly in the health and construction sectors. The pandemic has reversed the previous trend of shrinking unemployment, and in July 2020 the number of registered unemployed had risen by 4.7% compared to the previous year. This brought the unemployment rate (according to administrative data) to 34.7% in July 2020, compared to 32.4% at the end of Q1 2020, the highest since December 2018. Youth unemployment remains about twice as high as the overall unemployment rate, while the share of long-term unemployed (those without employment for more than 12 months) is still around three-quarters of the total number of unemployed individuals (European Commission, 2018[101]).

The International Labour Organization (ILO) estimates that the COVID-19 pandemic constitutes an employment risk for 88% of informal workers. High-risk sectors in terms of exposure to the employment impact of COVID-19 are wholesale and retail trade, repair of motor vehicles, manufacturing, accommodation and food services, real estate, and administrative activities. In these sectors, the share of informal employment is 13%. The informal employment rate is highest (32%) in medium- to high-risk sectors, which include arts, entertainment, domestic workers, transport storage and communication. Some 14.4% of female informal workers and 37.2% of male informal workers work in these sectors. Most informally employed women (66.6%) work in the agricultural sector, which is at low-medium risk, as well as education, health, social services and public administration, which are also considered as low-medium risk (ILO, 2019[102]).

Measures were put in place to mitigate the impact of the crisis on workers. The FBiH covered minimum salary contributions from March 2020 until one month after the end of the emergency measures. In June, the FBiH adopted a Programme of Economic Stabilisation 2020-2021, which included measures to preserve jobs. The RS reserved funds from its Solidarity Fund to support employees directly affected by COVID-19. In both entities, one of two employed parents (as well as single parents) with children under the age of 10 could be released from work during the crisis period as a justified absence.[60]

### *Sub-dimension 8.1: Labour market governance*

As stressed by the European Commission in 2019, Bosnia and Herzegovina does not have a programme for the adoption of the *acquis*, or similar strategic document, as required under the SAA. This should be developed as a priority. BiH also does not have sufficient horizontal and vertical mechanisms to ensure that approximation with EU directives is properly made (European Commission, 2019[103])The state level has no overview on how well legislation in the economy is aligned with EU directives.

The **regulatory framework** in FBiH consists of the Labour Law of 2016 and latest amendments from 2018.[61] This reflects the start of the harmonisation of domestic legislation with EU directives, mainly in the area of working time, pregnant women, workers' rights in case of mergers and acquisitions, and some health and safety issues.[62] There is still a long way to go to align the whole legislative framework in the area of employment. There is no legislative framework for temporary agency work.

A new Law on Occupational Safety[63] was adopted in FBiH on 1 October 2020 to replace a law enacted over 30 years ago, and to comply with EU law.[64] The new legislation foresees the establishment of a tripartite Council for Occupational Safety[65] to monitor, analyse and evaluate the occupational health and safety system and policy, as well as monitor the effects of the application of the law and feedback to the government of FBiH. The related strategy for occupational health and safety has not been adopted at the time of writing.

The Law on Labour of 2016 and 2018,[66] as well as the Law on Safety at Work of 2008 and 2010[67] and related rulebooks, form the pillars of the regulatory framework for employment conditions in Republika Srpska. Safety legislation is periodically updated to decrease (fatal) injuries at work.

The process of harmonising RS law with EU directives has begun, but it is not clear how close RS is to aligning with the EU *acquis* in the area of labour. The government considers that the *acquis* is stricter in many areas than current RS rules and has concerns over harmonisation given the different economic

contexts.[68] The new Labour Law of 2016 has reduced rigidity in hiring procedures and eased dismissals, although employers have still complained that the labour legislation is not sufficiently flexible (Bosnia and Herzegovina, 2019[104]).The share of those temporarily employed can be used as an indicator of the strictness of employment protection legislation (employers may prefer using temporary contracts to evade costs of rigidity). In BiH, the share of those temporarily employed is 16.1%, which is well below WB6 average (22.1%) in Q2 2019. The share constantly increased in FBiH between 2010 and 2018, but fell in the first half of 2019 (World Bank and WIIW, 2020[96]). As there are no data for RS it is difficult to assess whether the change in law has had a positive impact on concluding permanent employment contracts. The labour legislation does not define the legal status of solo self-employed individuals and there is no regulation that would prohibit bogus self-employment. The self-employed need to register as entrepreneurs according to local rules. They must also be registered with the social security system (health insurance, pension and disability insurance, unemployment insurance). It is not clear how many self-employed individuals are actually registered as data on non-standard forms of employment are not collected.

Regarding **labour inspectorates**, in FBiH the federal administration and the cantonal administrations for inspection affairs – Labour and Occupational Safety Inspectorates – have the competence[69] to supervise implementation of the Law on Occupational Safety, as well as the regulations, technical regulations and standards related to occupational health and safety and general acts in the field of safety and health at work.[70] Federal labour inspectorates visit companies of interest to the FBiH, while cantonal inspectors carry out inspections in all other companies and entities. In addition to inspections at the employers' premises, labour inspectors consult employers and workers on the implementation of the law. The Ministry of Labour and Social Policies does not have insights into the budget of the federal and cantonal labour inspectorates, the co-ordination of different agencies at the federal and local level, nor access to monitoring data. The inspectors must inform the competent administrative bodies of deficiencies not specifically defined by existing legal regulations, and the inspectorates must co-operate with other administrative bodies, employers and employers' and workers' associations; however, there is no information on whether co-operation happens and is effective. In cases of misconduct and infringement of the labour law, inspectors can impose fines. The imposing of fines should be monitored, and activity reports published. Labour inspections are confronted with the challenge of a very high share of small and micro enterprises in both entities (like in other economies in the region). In 2017, there were around 30 000 SMEs (99.1% of all businesses) operating in BiH, with most (77.7%) micro enterprises (OECD, 2019[105]).

In RS, the labour inspectorate is one of 13 inspectorates within the administration for the inspection of jobs (Republika Srpska Inspectorate, 2021[106]).[71] There is no separate budget for labour inspectors. In 2019, there were 32 employees working as labour inspectors,[72] which equates to one labour inspector for 8 600 employees. Labour inspectorates carry out controls in the area of occupational health and safety (OHS) and employment conditions according to the labour legislation. They also keep records. Inspectors can give warnings and impose fines. Monitoring data indicate that irregularities are found in around 30% of inspections, while 10% involve sanctions for a minor offence.[73] There is no assessment or monitoring of the influence of labour inspectorates on employment and working conditions. There is also no evidence of systematic co-operation and file sharing with tax authorities, which are also key actors in reducing informal employment. There is no key strategy or action plan for labour inspectorates, but there are plans to set up a strategy.[74,75] In FBiH, there is no publicly available monitoring of the activities and results of labour inspectors.

Regarding the **employment policy framework**, an FBiH Employment Strategy (2018-2021) was prepared in 2018 but had not been adopted by parliament at the time of writing. However, in RS there is a policy framework through the Employment Strategy 2016-2020 and previous employment strategies.[76] The main focus of employment policies relate to public employment services and active labour market programmes (ALMPs) for the unemployed. In this area some progress has been made. Action plans from 2017 and 2018 included the objective to prepare reforms and to redefine the role of PES, which resulted in the formation of an inter-departmental working group that actively includes representatives of social partners. The reform process has stopped as it would also imply reforming the healthcare system for unemployed

individuals. However, progress on the draft law on health insurance could not be made (Bosnia and Herzegovina, 2019[104]). Progress has been made in creating partnerships between key stakeholders relevant for employment at the local level. The National Action Plan for 2019 aims to improve the link between education and employment (see Sub-dimension 8.2: Skills).

In RS, the statutory retirement age is 65 for men and 58 for women. The retirement age for women is fairly low by European standards (OECD, 2020[42]). To be eligible for an old-age pension a person needs to have been insured for 15 years. A full pension is available for those insured for 40 years. Combining work, old-age and disability pension is only possible until age 65 in RS. In the FBiH, a new Law on Pension and Disability Insurance entered into force in 2018, which gradually reduces the possibility of retiring early. An insured person is entitled to an old-age pension when they reach 65 years of age and have at least 15 years of insurance service. In 2018, an insured man was also entitled to an old-age pension when he reached 35 years and 6 months of pensionable service and was at least 60 years and 6 months old. The number of required pensionable years and minimum age are being increased to 39 years and 6 months and 64 years and 6 months by 2026. For women, the respective minimum length of pensionable service is being increased from 30 years and 6 months in 2018 to 61 years and 6 months by 2030, and the minimum age from 55 years and 6 months to 61 years and 6 months.

There is a social dialogue framework in both entities, but implementation is weak. In FBiH there is a legal framework on employees' rights to join a trade union and on employee councils.[77] The Law on Labour stipulates that collective agreements may be concluded as general (for FBiH), branch (for cantons or FBIH) and at the level of the employer. The Ministry of Labour and Social Policy is responsible for keeping a register of collective agreements concluded in the FBiH. At the time of writing, four collective agreements had been concluded at this level (in mining, electricity industry, postal traffic, and administrative bodies and judicial authorities). Information on collective agreements concluded at the cantonal level is not collected at the FBiH level.

**Tripartite social dialogue** in the FBiH takes place through the Economic and Social Council (at the territorial level and the level of the cantons) as an institutionalised form of social dialogue.[78] The most important issues previously discussed at the council include the need to conclude a new general collective agreement, and determining the minimum wage, taxes and social security contributions. The ILO is supporting BiH in strengthening the peaceful mediation of labour disputes (ILO, 2021[107]).

In RS, collective bargaining is conducted by representative trade unions and employers' associations[79] at company and sector levels.[80] A collective agreement has been concluded for the administration, health, education and culture, and social protection sectors, as well as for judges and municipal services. Social partners have failed to conclude a general collective agreement at the entity level. The Works Council Act[81] of 2001 foresees the possibility of establishing works councils at the company level in companies with 15 or more employees.[82] Collective agreements can be concluded only by trade unions.

Collective bargaining also takes place at the entity level within the Economic and Social Council. The law on the Economic and Social Council[83] and the Law on Labour regulate the role of the council in tripartite social dialogue in RS. The government and social partners are members of this council,[84] and there are two permanent working groups and an ad hoc working group. The Economic and Social Council has a network at local levels, and the social partners are experts in the area of employment.

One key task of the Economic and Social Council involves proposing the minimum wage level for the next year. The government then fixes the minimum wage on this basis. If the council cannot agree on a minimum wage, the government of Republika Srpska fixes the minimum wage unilaterally, considering wage development, economic growth and inflation.

### *Sub-dimension 8.2: Skills*

**Skills mismatch** represents a serious challenge for the BiH economy and labour market. The World Bank conducted its Skills Toward Employment and Productivity (STEP) employer survey in BiH between

September 2016 and March 2017.[85] More than half of the interviewed firms stated that general education systems do not equip students with workplace skills (e.g. attitude, discipline), nor the practical skills needed to satisfactorily perform a job. Students from science, technology, engineering and mathematics (STEM) fields at post-secondary and tertiary levels are overall better evaluated than the general education system at large; nevertheless, between 40% and 50% of firms found STEM graduates lacking the necessary skills. In BiH, the highest rated students are from the technical and VET (TVET) system; however, more than a quarter of the firms still found that TVET students lacked the necessary skills (World Bank and WIIW, 2020[96]). Firms also pointed to the lack of skills preventing them from hiring: 62% of surveyed companies reported difficulties in hiring due to lack of skills or experience when looking for workers in "non-routine" jobs, and 52% when looking for "routine" jobs (World Bank and WIIW, 2020[96]).[86] Thus deficits in the quality of the education system harms the employability of the working-age population and creates skills shortages, which prevents companies from growing.

The NEET rate among young people in Bosnia and Herzegovina declined from 27.7% in 2015 to 21.6% in 2018, slightly below the WB6 average (22.1% in 2018) (World Bank and WIIW, 2020[96]). The decline was stronger than on average in the Western Balkans, but still roughly twice the EU average of 10.5% (Eurostat, 2021[108]).

Lower education levels lead to a higher risk of in-work poverty. A European Commission report found that 36.1% of people in Bosnia and Herzegovina with a low education level were at risk of in-work poverty. The in-work poverty risk of those with tertiary level education was only half this rate, but still high at 18.8% in 2015 (Obradović, Jusić and Oruč, 2019[109]).

Skills governance is within the competence of the entities and the Brčko District of Bosnia and Herzegovina. FBiH has implemented some measures for young people to access the labour market. For example, to ease the school-to-work transition, the PES implements ALMPs aimed at helping young people gain their first work experience. In FBiH the Federal Employment Agency is not involved in conducting a skills needs survey among employers, as is done in other economies of the region, and little progress has been made to improve skills governance.

In RS, the Education Development Strategy for 2016-2021 aims to strengthen research-oriented higher education and better link higher education and the labour market. It identifies the perspectives and key obstacles for co-operation between higher education institutions and the business sector. To improve the employability of students, the accreditation of study programmes and higher education institutions is based on an analysis of employment opportunities and on employer surveys about the knowledge and competencies of graduates. When creating a plan for enrolling students in higher education institutions, the Ministry of Scientific and Technological Development, Higher Education and Information Society is guided by data from the Chamber of Commerce of Republika Srpska, the PES and the expressed needs of employers, and data on the number of students in individual study programmes. According to legislation in force since October 2020, employers are represented on the management boards of public universities. This represents an opportunity to better link curricula and the number of study places by educational field to the needs of employers in the future.

In RS, progress has been made in some areas of skills governance. The employment action plan for 2019 included activities to 1) improve the system for vocational guidance and career counselling through providing vocational guidance to pupils (implemented by the PES)[87]; 2) develop local councils for education and employment (including the PES and municipalities; this activity has been implemented[88]; 3) establish partnerships through direct co-operation with associations of employers, the economic chamber, trade unions, some ministries and units of local governments; and 4) develop an internship scheme in middle and high schools. Related activities involve providing necessary equipment to middle schools, training teachers, including companies in the provision of practical training, and the training of instructors from companies to work with pupils. The internship scheme is in the process of being implemented.

According to the World Bank's STEP employer survey, about 31.9% of non-routine workers participated in on-the-job training: 28% in internal and 19.7% in external training. Participation in continuous training for

these workers was higher in BiH than in Albania, Kosovo and Serbia. The participation in training of routine workers (32.3% participated in on-the-job training, 30.2% in internal training and 11.6% in external training) was also higher than in Albania, Kosovo and Serbia (World Bank and WIIW, 2020[96]).

To further **adult learning**, at the state level the Strategic Platform for Adult Education in the Context of Lifelong Learning 2014-2020 presents the strategic basis for the planning and operation of education and other competent authorities at all levels of government. The document is used to initiate, implement and co-ordinate activities in the field of adult education, in line with EU priorities, standards and trends in this area.[89] A strategic platform for a lifelong education approach was first adopted in 2014.

According to data provided by the competent education authorities in 2019, all competent education authorities in Bosnia and Herzegovina (Republika Srpska, ten cantons in the FBiH and the Education Department of the Government of the Brčko District) have enacted their own laws on adult education, thus completing the legislative framework in this area. This indicates the commitment of the competent education authorities to progress in adult education, and the acceptance and implementation of the concept of lifelong learning. There has also been progress regarding the development of strategic documents in the field of adult education. Most competent education authorities have either adopted or are in the process of developing their own strategy, or adult education has been integrated into the development strategies of their administrative units.[90]

Every competent education authority has adopted its own Law on Adult Education and appropriate bylaws. At the state level, the Council of Ministers of Bosnia and Herzegovina adopted two documents in 2014: Principles and Standards in the Field of Adult Education[91] and, as mentioned previously, the Strategic Platform for Adult Education in the Context of Lifelong Learning 2014-2020.[92] Due to a complex constitutional setup, implementation is uneven and varies across educational authorities depending on priorities, capacities, budget, etc.

In RS, an adult education strategy for 2021-2031 was developed in 2019 and is in the consultation process.[93] The proposed strategy is targeted at young people and adults aged 18 and above who have not completed primary education, which is highly relevant as a low level of formal qualification, and therefore an assumed low level of basic competences, increases the risk of being in poor quality or informal employment, or of being unemployed or inactive.

The RS Law on Adult Education[94] sets the framework for the certification and validation of informal and non-formal learning. Adults can take an exam at an examination centre to prove their knowledge, skills and competencies, regardless of how they were acquired. The law also foresees that an employer can organise various forms of training and additional training for employees to help them adjust to market demands and changes, and to new technological and work processes.

The PES of RS is implementing adult learning measures for unemployed individuals through co-operation with the Institute for Adult Education, set up in 2010. Professional training programmes for 46 occupations[95] were defined in 2010, and there is a commission at the Institute for Adult Education composed of representatives of the Chamber of Commerce, the Ministry of Labour, the Ministry of Education and Culture, and employers.

### *Sub-dimension 8.3: Job quality*

Regarding **quality earnings**, the overall in-work-poverty[96] rate was estimated at 24.5% in 2015, meaning that 237 943 employed persons earned less than EUR 104.60 per month and were at risk of in-work poverty. The at-risk-of-poverty threshold is about half of the minimum wage amount in RS and just over half in the FBiH. The in-work poverty rate of self-employed individuals (many of whom are informal workers) was 39%. The public sector offers higher wages and better working conditions than the private sector. According to a survey conducted for the Regional Cooperation Council in 2018, 40% of respondents would prefer to work for the public sector and 41% would prefer to work for public companies, while only 14%

would prefer to work for the private sector. There are no key strategies and action plans addressing very low incomes in BiH.

The average monthly gross wage in BiH was EUR 697 in 2018 (EUR 1 400 in purchasing power parity) which is higher than the WB6 average of EUR 656 (EUR 1 162 in purchasing power parity) (World Bank and WIIW, 2020[96]). There is no available analysis of the wage structure and its link with labour productivity. In FBiH, the government determines the minimum wage after consultations with the Economic and Social Council.[97] Similarly, in RS the minimum wage is fixed upon decision of the Government of Republika Srpska on proposal of the Economic and Social Council. The minimum wage was set at BAM 520 per month in 2020.

The employment rate of women increased from 29.5% in 2015 to 33% in 2018 and 35.6% in Q2 2019. The activity rate of women increased from 42.9% in 2015 to 44.4% in Q2 2019. There was a strong drop in the unemployment rate of women (aged 15+) from 30.7% in 2015 to 20.3% in 2018 and 18.8% in Q2 2019. Despite these recent improvements, the employment rate of women is still very low, at 10.2 percentage points below the WB6 average and 27.7 percentage points below the EU average. The employment rate for women was 19.1 percentage points lower than the rate for men in Q2 2019, while it was 17.5 percentage points lower than the WB6 average (World Bank and WIIW, 2020[96]). The share of women employed on a part-time basis increased from 8% in 2015 to 8.7% in 2018 and 10.3% in Q2 2019.

In terms of **policies to promote female employment**, the third Gender Action Plan 2018-2022 was adopted in 2018 and contains a wide range of highly relevant measures.[98]

In the FBiH there is no comprehensive strategy to promote the employment of women, and there has been no study on the employment barriers that women face, as has been carried out in RS. Nevertheless, women are targeted in some programmes. For example, women aged 40+ are a target group for the Federal Employment Agency, and there is a small entrepreneurship programme 2019 for women.[99] The participation of women in ALMPs is uneven and differs by type of programme. Within the Entrepreneurship for Youth 2019 programme (407 young participants in total), 34% were women, within the Entrepreneurship for All 2019 programme, women represented 22% of participants (out of 672 participants), and in the Second Chance 2019 programme, 48% of participants were women (out of 127 participants).

The FBiH Law on Labour contains certain provisions regarding maternity rights (e.g. the right to work part time until the child reaches the age of 2, for twins and for the third and each subsequent child), while other issues related to reconciliation of work and family life are not within the competence of the Ministry of Labour and Social Policy, but federal and cantonal ministries of education. Therefore, no information was provided for this assessment.

The FBiH Law on Labour contains provisions on the prohibition of discrimination on the grounds of sex in relation to employment conditions, recruitment, working conditions and all employment rights, education, training and advancement, promotion, and termination of employment contracts. However, it is not known how this law is implemented, and whether barriers exist for women to bring discrimination issues to court, nor whether there are specific legal procedures in the case of sexual harassment.

The Gender Centre of Republika Srpska conducted research on gender inequalities throughout the life course in 2016 (Gender Centre, 2016[110]). It addressed the recognition of unpaid house and care work in the home and pointed to strong patriarchal patterns of sharing housework and family care in RS. Women and men do not share equal parental responsibilities, which are largely undertaken by mothers, especially when children are small.[100] Almost half (44.3%) of fathers do not take on any obligation for a small child. In an effort to harmonise family responsibilities with workplace responsibilities, mothers with young children are most exposed to stress and fatigue. While there has been a shift in values for the new generation, a number of inequalities persist, and the double burden for women remains an issue for all age groups. The research highlights sectoral and occupational gender segregation in RS and, linked to that and to career breaks, a wage gap. There are also indications that female children in rural areas are particularly vulnerable to child labour.

Significant efforts have been made in RS to co-ordinate measures and programmes to reduce gender inequality across ministries.[101] A special report on the findings of the above-mentioned research, adopted by the Government of Republika Srpska in 2016,[102] contains wide-ranging and highly relevant recommendations on encouraging the take-up of paternal leave, increasing the supply of affordable family support services, and adapting gender sensitive school curricular and extracurricular activities to reduce stereotypes. These recommendations are in line with EU and OECD good practice and have led to the adoption of the Programme for Early Childhood Growth and Development 2016-2020, which aims to increase quality and access to preschool education in both urban and rural areas. Important progress has been made in tackling gender segregation through vocational guidance, which is a key approach for reducing gender segregation and the gender pay gap.[103]

In RS, the Law on Labour specifically regulates the employment relationship with domestic workers, as well as the minimum salary for this work in cash in the amount of at least 50% of the salary of the employees. This type of work arrangement prescribes the obligation to conclude a contract that regulates the rights and obligations of the contracting parties. While this law forms the legal basis for preventing informal employment in private households, it may be difficult to implement without additional incentives.

Women in Republika Srpska own around 30% of businesses.[104] In 2019, the Strategy for the Development of Women's Entrepreneurship of Republika Srpska for the period 2019-2023 was adopted. The strategy, backed by the Law on the Development of Small and Medium Enterprises, envisages financial support for women's education, as well as support for women's associations, women in crafts and women in rural areas.[105] The Strategic Plan for the Development of Agriculture and Rural Areas of Republika Srpska 2016-2020 incorporates a commitment to the promotion of gender equality, to the visibility of its principles and to the consistent application of these principles by the line ministry.[106]

Regarding employment policies for jobseekers, women are regarded as a vulnerable group and are targeted by the RS Employment Strategy 2016-2020. The Action Plan 2018 specifically introduced a measure targeted at female victims of domestic violence, women aged 55 (three years before reaching retirement age) and women from rural areas. Targeted measures have reached a low number of participants.[107]

### *Sub-dimension 8.4: Activation policies*

**Public employment services** are organised at entity and Brcko District levels, and further decentralised at the cantonal level in the FBiH. The Employment Institute of FBiH co-ordinates the activity of the 10 cantonal PES, which are under the responsibility of the cantonal assembly. In Republika Srpska, the Employment Institute has 7 regional offices and 59 local branch offices. In the Brčko District, the Employment Institute is a department affiliated to the mayor's office. Entity-level PES are involved in the overall co-ordination and methodological development, while local offices are mainly responsible for the implementation of ALMPs and passive labour market policies. The Labour and Employment Agency of BiH co-ordinates the activities of employment institutes in the two entities and the Brčko District.

Some Bosnian regions have a local partnership for employment, which is formal co-operation between labour market actors, schools and key employers who share a common vision of local labour market development (Schárle, 2018[111]). These partnerships are important for implementing approaches to integrate vulnerable groups.

The high share of long-term unemployed in BiH is a key challenge. In 2015, 81.2% of those unemployed were long-term unemployed. This share had fallen to 76% in Q2 2019, but is still above the WB6 average of 67.4% and the EU average of 41.8% (Eurostat, 2020[112]; World Bank and WIIW, 2020[96]). Across the economy there are weaknesses regarding vacancy collection. Moreover, information on vacancies and jobseekers are not shared across the entities, which reduces the potential for effective matching and constrains labour market analysis (Schárle, 2018[111]).

In FBiH, the regulatory framework for the activities of the PES consists of the Law on Mediation in Employment and Social Security of Unemployed Persons[108] and the rulebook on records in the field of employment.[109] These fix the objectives of PES activities and the division of responsibilities between the federal level and the cantons. The cantons have autonomy in running the PES and implementing employment policies, while the main task at the federal level is to ensure that there is a mechanism for employment mediation in place that ensures the establishment of an unemployment benefit system.[110] The federal Employment Agency is tasked with co-ordinating employment services at the federal level. Cantonal employment services are responsible for collecting, exchanging and publishing data on employed persons seeking a change of employment, as well as other data that may be relevant for the performance of the basic activities of the employment service. The Ministry of Labour and Social Policies does not have an overview of the budgets of the federal Employment Service and the cantonal employment services, as determined by their financial plans. The number of actors in the field of employment policy in FBiH, and the variety of adopted policies, reduces the overall efficiency of the labour and employment sector and makes the whole system expensive and dysfunctional.

A strategy for strengthening the mediation function in PES in the FBiH has been formulated. Its main objectives are 1) the separation of active jobseekers from those registered solely for access to health care but who do not report to the PES every 45 days; 2) ensuring adequate counselling intensity and optimising the triage process, developing effective active employment measures, and improving co-operation with employers and other institutions; 3) the development of human resources, improving the performance management system, the development of modern IT support, and the positioning of public employment services as professional and relevant institutions in the labour market.

A profiling system was developed and fixed in the rulebook of 2018 that enables distinguishing three groups of jobseekers according to their employability and distance from the labour market, in line with OECD good practice.[111] An individual action plan is established for those who are unemployed. The Employment Service reassesses and classifies the level of employability of an unemployed person after every 12 months of continuous unemployment. It is advisable to look at longer periods of work history and to take a more differentiated view on employment barriers.

Regulations on the unemployment benefit system in FBiH have been adopted in 2001, 2005 and 2008, but there have been no recent changes. The right to cash benefits is acquired by an unemployed person who, at the time of termination of employment, has at least eight months of uninterrupted work or eight months with interruptions in the last 18 months. The amount of the cash benefit is 40% of the average net salary paid in the FBiH in the last three months before the termination of employment, as published by the Federal Bureau of Statistics, which is a rather low replacement rate. The duration of unemployment benefit receipt varies between 3 months (for those who have worked for less than 5 years) and 24 months (for those who have spent over 35 years in work). Health insurance for unemployed people is provided in accordance with the regulation on health insurance,[112] which sets incentives for inactive and informal workers to register with the PES. This would in principle call for implementing activation requirements for inactive and informal workers, and would require developing measures to support the transition from informal to formal employment, as well as measures to activate inactive workers. In the absence of a clear strategy to reach out to inactive and informal workers it would be better to move to a system of universal basic healthcare coverage. The strategy does not systematically offer activation services to inactive and informal workers, which is in conflict with the objective to raise employment rates and contradicts the principle of mutual obligation. Unemployment benefit recipients need to meet activation requirements, otherwise they get sanctioned. Activation requirements include the obligation to report monthly to the employment service, and to participate in group information sessions and job-search training. It would be advisable to monitor sanctioning. Unemployed people not receiving unemployment benefits, but receiving health insurance through their registration, need to report every 45 days. Unemployed people not receiving any benefit need to report every 120 days. Out of 323 600 unemployed people in 2020, 13 100 received unemployment benefit and 224 700 received health insurance (Employment Agency of FBIH, n.d.[113]).

In FBiH, pension and disability insurance are provided to an unemployed person who lacks up to three years of pension experience until the conditions for an old-age pension are met, in accordance with the relevant regulations. This contradicts OECD recommendations on reducing incentives for early retirement and eliminating early retirement elements in the unemployment benefit scheme (OECD, 2020[42]).

Social assistance in FBiH is provided on the basis of cantonal regulations. No information is provided on the level of social assistance nor on the implementation of the **mutual obligation principle** for social assistance recipients. There is no evidence, strategy nor plan for an integrated approach to the delivery of employment and social services for jobseekers with severe employment barriers. This approach is considered good practice in other EU Member States (Konle-Seidl, 2020[114]), and attempts have been made in some economies of the region.

**Active labour market programmes** are measures to help unemployed people find work. They include employment incentives, support for self-employment, training measures to increase employability (i.e. preparation for work training, vocational training, and advanced training for the needs of the labour market or a specific job), as well as the provision of appropriate information for unemployed persons and employers. In 2020, the main target groups for ALMPs in FBiH included young people, women over the age of 40, the long-term unemployed and other categories of unemployed such as people with disabilities, demobilised combatants, those from the Roma community, and families where no one is employed. However, the monitoring report of the PES for 2019 does not show a strong targeting of young people and women aged over 40. Moreover, the number of participants is low: in 2019, around 9 000 unemployed individuals participated in ALMPs,[113] and 6% of LFS unemployed (149 000 in Q2 2019[114]). Some 10% of ALMP funds are allocated to vocational rehabilitation for people with disabilities. There is an increase in the planned budget for 2020.

The Employment Strategy of Republika Srpska 2016-2020[115] is the key policy document that defines the basic activities and active policy measures of the Employment Institute of Republika Srpska (EIRS).[116] The number of staff in the EIRS has increased since 2015,[117] but the caseload is still extremely high, with more than 1 000 registered unemployed person per PES counsellor in 2019, approximately ten times higher than EU good practice when dealing with vulnerable groups.[118]

Progress has been achieved in developing and implementing news tools in RS. A profiling tool has been developed and is implemented via a 45-minute interview with all unemployed people. However, given the very high caseload it is not clear how this can be effectively implemented. The profiling is based on the following indicators: acquired qualifications, special knowledge and skills, work experience, personal characteristics, social and health opportunities, job search period, professional interests, motivation for active job search, and career management skills. Unemployed people are then segmented into three groups[119] depending on their assessed level of employability, and an individual action plan is developed. A follow-up is made after six months and the plan is revised if necessary. It would be advisable to have a more intense follow-up for those groups with severe employment barriers.

The IT system in RS has been improved to help follow-up on the progress of unemployed people. An application, Calendar of counselling and individual employment plan IPZ, was developed to monitor the effects of new methods of work. In September 2019, the customer relation management application was launched that aims to register unemployed people and employers' needs. Job-search clubs have also been carried out, in line with international good practice.

The number of collected vacancies in RS increased from 2 301 in 2015 to 3 458 in 2019[120]; however, this is still extremely low given the high number of registered unemployed. The Action Plan for Employment 2019 includes activities to establish an annual plan of co-operation with employers and to increase the quality and quantity of collected vacancies in the private sector. However, there is no evidence to show if employer services and the active collection of vacancies have been improved.

Some progress has been made in improving horizontal co-ordination between relevant stakeholders at the local level in RS. Seventeen local councils were formed covered by seven branch offices of the EIRS, with

support of the ILO.[121] These councils hold regular meetings with the aim of improving education and employment. One challenge will be to ensure sustainability after the end of the ILO project.

The RS Action Plan for Employment 2019 foresees activities to intensify counselling services for hard-to-employ jobseekers and to improve co-operation with social services at the local level. In 2019, support from international donors was also received to improve activities to support start-ups and entrepreneurship,[122] as well as youth employment programmes.[123] It will be a challenge to continue these activities and to ensure sustainable financing once donor support ends.

In RS, an unemployed person is entitled to unemployment benefits if their employment has been terminated without his/her request, consent or guilt in terms of labour regulations, and if they have worked at least eight months continuously with unemployment insurance contributions in the last 12 months, or 12 months with interruptions in the last 18 months. They need to register within 30 days to receive benefits. This contradicts international good practice of early intervention, where registration is required within a few days after becoming unemployed, or even when receiving dismissal notification. Benefit duration depends on the previous contribution period and varies between 1 month (12 months of previous employment) and 24 months (over 34 years of previous employment). Compared to international good practice, 24 months is a long period to receive unemployment benefit. There is a danger that this will be used as an early retirement tool or to pave the way to long-term unemployment if not combined with strict job-search requirements. The income replacement rate is 45% for those with less than 15 years of work experience, and 50% for those with more than 15 years of work experience. In 2019, there were 25 721 unemployment benefit recipients, an increase on 2015 and 2017 figures. Those receiving benefits represented 29.4% of all registered unemployed.

Unemployment benefits cannot be lower than 80% of the minimum wage in RS (based on full-time employment). Social protection is determined by the Law on Social Protection and is financed from public revenue provided in the budget of the entity and local self-government units. Certain social services in the mixed social protection system can be financed by donor funds, funds of legal persons or individuals, and contributions from citizens. There are no job-search requirements linked to the receipt of social protection, which contradicts good practice in the EU and OECD (OECD, 2015[115]; Konle-Seidl, 2020[114]). The number of social assistance recipients was 55 415 in 2018, with 51 727 receiving war disability benefits and 2 713 civil disability benefits.[124] It is not known how many of these are registered with the PES and how many have remaining working capacities.

In RS, those registered as unemployed were covered by health insurance until November 2019, when this scheme was reformed.[125] Since January 2020 the right to health insurance of unemployed persons who declare themselves not actively searching for work has been provided through the Health Care Fund.

Expenditure on ALMPs in RS has increased since 2017, from 0.11% of GDP to 0.27% in 2019.[126] However, this is below the OECD average of 0.36%. In 2019, there were 5 664 participants in ALMPs and a budget of BAM 25.4 million, representing only 6.4% of all unemployed. Between 2018 and 2019 the budget for ALMPs increased considerably (BAM 16.3 million for 5 136 participants in 2018).

In 2019, the main target groups of ALMPs in RS were children of fallen soldiers, unemployed demobilised soldiers, disabled war veterans, persons over 40 years of age, women victims of domestic violence and war torture, women from rural areas, persons in the unemployed register for more than six months, children of killed fighters with a university degree without work experience, other persons with a university degree without work experience, young people up to 35 years of age regardless of their level of education, Roma, and active jobseekers with secondary education. Activities undertaken include the promotion of self-employment, employment incentives and training measures. In total, about half of participants participated in programmes earmarked for target groups, although some groups saw low participation, for example the number of participants in the specific project for the employment of Roma people was very low in 2019 (33 people). In addition, only a small part of the budget was directed at training measures, and low-educated individuals seem particularly underserved.

The EIRS analyses and monitors the achieved effects of ALMPs, such as how many persons employed under the programme remained employed after the expiration of the mandatory employment period of 12 months, which is good practice. This is undertaken by checking the status of people employed under the programme in the tax administration database after the end of the subsidised period of employment. All data are publicly available (annual work reports are published on the EIRS website).

The Employment Strategy of RS 2016-2020 aims to strengthen the capacities of social enterprises to integrate unemployed individuals into the labour market. Objectives include the creation and adoption of a platform for social entrepreneurship to strengthen social cohesion and integrate vulnerable groups into the labour market, the adoption of a corresponding law, and concrete support for the establishment of social companies.

### *Cross-cutting policy areas: Informality*

The share of informal employment in total employment was 30.5%, and 17.4% if excluding agriculture, in 2019 (ILO, 2020[31]). Among women informally employed, 16% were employees, 55% were own-account workers, 19% were contributing family members and the rest were employers. Among men, 27% were employees, 51% were own-account workers, 5% were contributing family members and the rest were employers.

In FBiH, the reformed Law on Labour[127] introduced the rule that work contracts must be fixed in a written form, that employment needs to be registered and that proof of social security contributions must be provided within 15 days of signature of contract. In 2016, the rulebook for the implementation of Labour Law was adopted.[128] In order to limit the use of informal work, the rulebook sets the obligation to keep daily records of workers and those engaged in work with the employer. This should help detect informal work and in particular “envelope wages”, which involves workers working and being paid for more hours than they are contracted for to avoid minimum wage and/or social security contributions. In Germany for example, according to the minimum wage law, there is an obligation for daily time records for each employee and these are controlled during labour inspections (General Customs Directorate of Germany, 2021[116]).

In RS, no strategy addressing an informal employment reduction framework was established during the review period. The government has argued that wage increases were intended to increase the incentive to work in the private sector. It should however be considered that this only works if productivity is increased accordingly, otherwise higher wages may set incentives for employers to offer envelope wages, which increases informal employment. The RS government amended the Law on Income Tax in 2016 to increase the non-taxable salary threshold to 500 BAM per month.[129] The main intention of this measure is to reduce the tax burden on work and to direct the funds available through the application of this regulation to increase the net salaries of employees. On 13 June 2019, the Law on Incentives[130] was approved, which enables employers to receive a refund of paid contributions of up to 70% of the paid amount for a possible increase of the non-taxable part of the salary.

### *Cross-cutting policy areas: Brain drain*

Well-educated individuals are most likely to migrate from Bosnia and Herzegovina, and their emigration rate was over 40%, higher than the rate in Serbia, Montenegro and Albania. Migration was also high among low-educated individuals, while medium-educated individuals are significantly less likely to migrate (World Bank and WIIW, 2020[96]).

For RS, labour mediation abroad is realised according to the established procedure and regulations, in co-operation with the BiH Labour and Employment Agency, for economies with which an interstate employment agreement has been signed. The PES in Bosnia and Herzegovina places workers abroad, and employment agreements have been signed with Slovenia, Serbia and Qatar. There is also a signed agreement on mediation regarding the employment of workers from Bosnia and Herzegovina in Germany

for a certain period of time, which applies only to the employment of medical staff (caregivers). Most of the mediation for foreign economies in 2018 and 2019 was related to Slovenia and Germany.[131]

The EIRS assumes that migration negatively affects the labour market. However, there is no strategy in place to mitigate the negative effects of migration.

### *The way forward for employment policy*

The following recommendations are made for all entities and the state level, according to the area of responsibility:

- **Continue efforts to align labour law and OHS regulation to EU directives.** Develop the regulatory framework for non-standard forms of employment (including self-employment, and platform work).
- **Implement adult learning programmes for low-skilled adults.** This includes measures for remedial education. Set incentives for companies to promote continuing training at the company level, in particular at the mid-skills level, to help employees adapt to technological change. Measures implemented in other economies include subsidies to employers, financed study leave, tax credits and individual learning accounts (OECD, 2019[117]). The strategy for adult learning should foresee counselling activities for employees and employers, in particular for SMEs, as in Portugal through the Qualifica Centres (OECD, 2019[118]).
- **Regularly conduct analyses of wages by sector, gender, educational level and occupation.** Improve labour market monitoring data and include data on poverty, the employment situation of specific vulnerable groups (e.g. Roma), informal employment, migration and working conditions, and wage development. Labour productivity should be part of a wider monitoring system. Collect information on non-standard forms of employment.
- **Activate disability pension recipients who have the capacity to work and include them in vocational rehabilitation measures**. Carry out an analysis regarding to what extent social protection supports inactivity. In OECD economies, activating people who receive welfare benefits, including those with reduced work capacities, and designing welfare benefits accordingly has been a central policy area (OECD, 2015[115]; Konle-Seidl, 2020[114]).[132]
- **Strengthen the capacities of the PES** to align with EU and OECD good practice by:
  - Reducing the caseload of PES workers by increasing the number of staff.
  - Continuing efforts to co-operate with relevant stakeholders, in particular chambers and employers at local levels.
  - Furthering efforts to improve employer services and vacancy collection.
  - Increasing efforts to integrate vulnerable groups into the labour market.
  - Carrying out regular surveys on the employability of participants after programme participation.
  - Developing a concept for adult vocational guidance for adults. This could be done by the PES and/or other relevant institutions.
- **Continue efforts to increase the employment rates of women**. Increase access to affordable and quality childcare and implement measures to reduce gender stereotypes in education and the workplace.
- **The FBiH should increase the transparency of the work of labour inspectors at entity and cantonal levels.** It should establish a strategy for the whole FBiH and bring cantons together. Given the administrative complexity, to increase transparency FBiH should also intensify the exchange of practices between cantons and introduce a benchmarking system of inputs and outputs of labour inspections at the entity and canton level.
- **The Federal Employment Agency of FBiH should report to the Ministry of Labour on the budgets for running the PES and for ALMPs at the entity and cantonal level.** A good practice

example can be found in Switzerland, where cantons have a great deal of autonomy, and where the State Secretary for Labour and the Economy (SECO) takes a co-ordinating role. SECO decides on common ALMPs, which can be supplemented by cantonal programmes. A benchmarking exercise is used to help with performance management in the context of the decentralised PES in Switzerland (Eftheia, Budapest Institute and Icon Institut, 2018[119]; Duell et al., 2010[120]).

- **RS should strengthen co-operation between labour inspectorates and tax authorities.** Good practice from other economies shows the benefits of close co-operation and file sharing. In Norway for example, co-operation between different agencies has been formalised, and an internal database to facilitate information exchange between joint offices was created in December 2016. A National Interagency Centre for Analysis and Intelligence was also set up to undertake threat assessments for joint strategic measures against economic crime, for example by delivering intelligence reports, and help decision makers analyse cross-economy trends (European Commission, 2020[121]).
- **Increase incentives to work longer**. Good practice in EU and OECD economies shows that policy reforms seek to lengthen working lives, often up to the age of 67 for both men and women, and set incentives for people to work even longer (OECD, 2020[42]).
- **Support social security contributions for household and care workers employed by private households**. Other economies, such as France, have a voucher system for employing household and care workers and support for their social security contribution (Box 21.10).

### Box 21.10. Universal Service Employment Voucher (Chèque Emploi Service Universel, CESU) in France

The CESU was launched in 2006 as part of a plan for the development of personal services. It replaces the service employment voucher set up in 1994, which was limited to traditional personal services such as housework, childcare in the home and care for the elderly. One major objective of this voucher is to assist in the fight against undeclared work in these services.

There are two formats of CESU:

- The CESU declaration (simply known as “CESU”) is a tool (paper or online) for the declaration of employment to be completed by a personal household service user/employer. The personal household user worker is paid via cash, bank cheque etc., or a pre-financed CESU.
- The pre-financed CESU (“CESU *préfinancé*”) is a voucher that is totally or partially prepaid by a company, local authority etc., and used by the service user/employer as a means of paying a personal household service worker.

The CESU also enables the user to receive a tax benefit, which was extended to non-taxable active persons from 2007 and to inactive persons from 2017. The list of services eligible for tax reduction (small maintenance tasks, yard work, study help, ICT or administrative assistance, etc.) were also broadened in 2017.

Source: (CESU, 2020[122]), *Universal Service Employment Voucher (CESU)*, https://tinyurl.com/hvfuwpcc.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Bosnia and Herzegovina continues to underperform in the area of science, technology and innovation, and, together with Kosovo, has the lowest overall score in the region (Table 21.15). In particular, business-academia collaboration remains nascent, whilst some improvements have been made in the overall STI framework.

**Table 21.15. Bosnia and Herzegovina's scores for science, technology and innovation**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Science, technology and innovation dimension** | Sub-dimension 9.1: STI system | 1.7 | 2.4 |
| | Sub-dimension 9.2: Public research system | 1.2 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 0.9 | 1.6 |
| **Bosnia and Herzegovina's overall score** | | **1.3** | **2.1** |

### *State of play and key developments*

The policy framework for science, technology and innovation in Bosnia and Herzegovina remains at an early stage and is highly fragmented across the different entities. The lack of consistent statistical data adds to the complexity in assessing the overall performance of the sector. Some progress has been made in aligning the STI framework with EU standards, which may result in more comprehensive policy measures in the medium term. The public sector research system remains chronically underfunded, and few incentives are provided to foster business-academia collaboration. However, some efforts have been made to broaden the institutional support structure.

#### *Sub-dimension 9.1: STI system*

In line with the constitutional set-up of Bosnia and Herzegovina, **STI strategy** development predominately falls within the competency framework of Republika Srpska, the Brčko District and the cantons, while the Federation of Bosnia and Herzegovina mainly exercises a co-ordinating role. This has led to a scattered and decentralised approach to STI policy making without clearly identified and harmonised policy priorities. Private sector consultation is not the norm in STI policy development and there are no systemic and comprehensive monitoring and evaluation practices in place.

At the state level, the Revised Strategy on Scientific Research (2017-2022) provides the fundamentals of scientific research and the co-ordination of internal and international co-operation, but falls short of addressing academia-industry collaboration or innovation. In Republika Srpska, STI policy is defined in the 2017-2022 Strategy of Scientific and Technological Development; however, implementation progress of the strategy remains unclear. In FBiH, a draft STI strategy prepared in 2012 has never been adopted. There are plans to prepare a smart specialisation strategy in BiH; however, development remains at an early stage. In November 2020, the Council of Ministers approved the composition of the working group in charge of preparing the strategy.

The **institutional framework** is highly decentralised. At the state level, the Ministry of Civil Affairs co-ordinates STI policy across Bosnia and Herzegovina and represents the economy internationally. There are dedicated ministries in charge of STI policy making at the entity and canton level, as well as a competent department in the Brčko District. However, co-ordination of STI policy remains limited given the lack of a single body accountable for STI policy development. There is also no dedicated innovation or technology agency supporting STI policy implementation. However, in RS there are preliminary plans to establish an Innovation and Science Fund, and assessment studies are currently being planned.

Legislation on the fundamentals of scientific research activity and the co-ordination of scientific research co-operation, which has been in place since 2009, provides the overarching **regulatory framework** for

STI in Bosnia and Herzegovina. Republika Srpska adopted its own STI legislation in 2017, as have three cantons within the FBiH since the last assessment. In contrast, a legislative framework defining STI policy at the FBiH entity level has been pending adoption since 2017. Unified legislation regulating intellectual property (IP) is in place and broadly in line with EU standards, but it is not designed to encourage business-academia collaboration or the commercialisation of IP. While the law enforcement of IP has been strengthened in recent years, co-operation across institutions remains ad hoc, and capacity is limited.

The Ministry of Civil Affairs co-ordinates Bosnia and Herzegovina's **international collaboration** with regards to STI, co-financing (in close co-ordination with entities and cantons), researcher mobility and applications for international research programmes. BiH participates in the EU's Horizon 2020 programme,[133] and shows relatively good performance: by the end of 2020, 67 projects involving 113 Bosnian entities had been approved, receiving EUR 8.56 million in funding, with a rate of retained proposals of 12.3% (only slightly below the Horizon 2020 associated countries' average of 13.5%) (European Commission, 2021[123]). BiH also participates in the Western Balkans Enterprise Development and Innovation Facility (WBEDIF), which has made two investments through the Enterprise Expansion Fund (ENEF) to Bosnian entities. BiH is a full member of European Cooperation in Science and Technology (COST)[134] and has "national information point" status in Eureka,[135] with the application for full membership expected to be submitted soon.

Bosnia and Herzegovina participates in the European Research Area and its polices are broadly **aligned with EU STI policies**. It also participates in the European Strategy Forum on Research Infrastructures (ESFRI), but only Republika Srpska has developed a roadmap for research infrastructure to date. In addition, most BiH higher education institutions have endorsed the EURAXESS[136] Code of Conduct, and three universities have adopted the EURAXESS Human Resources Strategy for Researchers. In contrast, Bosnia and Herzegovina does not participate in the European Innovation Scoreboard due to weak statistical data collection. However, efforts have been made to intensify data collection, which is expected to improve the monitoring and evaluation of STI-supportive policy measures across entities going forward.

### *Sub-dimension 9.2: Public research system*

The **institutional structure of the public research system** remains fragmented, and the lack of a unified and comprehensive framework has hindered the development of a functioning system. The institutional and legal framework governing higher education institutions (HEIs) and research and development institutes (RDIs) predominately rests at the entity and canton level, with the Ministry of Civil Affairs co-ordinating international collaboration. Amid disputes over competencies regarding HEIs and RDIs, there is no harmonised approach to performance management in the sector, and no cross-entity accreditation of HEIs is in place.

The public sector research system remains significantly underfunded, and gross domestic expenditure on research and development (GERD) has remained unchanged at around 0.2% of GDP in recent years (UIS, 2021[124]). **Public research funding** is predominately based on institutional funding. Within the FBiH, funding is evenly allocated across HEIs in all cantons, resulting in significantly underfunded HEIs in key urban areas with larger numbers of students. In addition, budget allocations have been significantly cut amid the outbreak of the COVID-19 pandemic. In both entities, some progress has been made in introducing competitive performance-based funding for the public scientific research sector, albeit small-scale at around EUR 250 000 in the FBiH and EUR 800 000 in the RS in 2019. However, in 2020 funds were re-allocated due to COVID-19. Some competitive project-based funding is available to researchers, which is positive; however, the methodology for project selection does not reflect international best practice of a two-stage, independent evaluation process.

Fostering research excellence does not prominently feature in any of Bosnia and Herzegovina's strategic STI frameworks. Despite increasing brain drain in the sector, there are no measures in place to stimulate the involvement of the diaspora. As a result**, human resources for research and innovation** remain at low capacity. With 667 researchers per 1 million inhabitants, Bosnia and Herzegovina significantly

underperforms compared to regional peers, and a trend of brain drain has become evident in recent years. Particularly in important disciplines such as medical and health, the number of researchers has dropped significantly (UIS, 2021[125]), while no targeted measures have been developed to counterbalance this development. However, there are some support measures to strengthen the capacity of researchers at both entity levels, primarily in the form of financial support to facilitate researchers' participation in international programmes or study visits. In contrast, opportunities provided for researchers to develop their technical skills are limited. Efforts have increased to raise awareness and promote scientific research as a profession. For instance, in 2018 RS introduced financial rewards for "best in class" scientific research published in international journals. It also celebrates a Science Festival each year. There are initial preparations underway to develop a Scientific Research Information System in BiH, which will contribute to enhancing scientific research.

### *Sub-dimension 9.3: Business-academia collaboration*

Integration of scientific research and the private sector is limited in BiH, and the **collaboration promotion framework** remains at a nascent stage. The STI policy framework recognises the need to stimulate academia-industry collaboration but falls short of a comprehensive and concrete set of measures across all institutional levels. As a result, investment in research and development by the private sector is significantly below regional peers, and technology absorption capacity is low.

There have been no innovation voucher schemes or competitive collaboration grant schemes implemented in Bosnia and Herzegovina, and the scope of **financial incentives for collaboration** remains low. Some support mechanisms for the development of a knowledge economy exist; however, these are predominately geared towards the private sector and do not require the participation of academia. In Republika Srpska, the pilot Synergy Programme, aimed at increasing technology transfer and absorption and raising awareness about the potential of academia-industry collaboration, is currently underway. During the first call of this programme in 2019, five projects received financing of around EUR 25 000 each. There are no other financial incentives, such as STI-conducive procurement practices. Similarly, **non-financial incentives for collaboration** are under-developed. There is no legislation in Bosnia and Herzegovina to encourage technology transfer and commercialisation by defining the ownership of intellectual property and the royalty split for publicly funded research, although some centrally co-ordinated support is provided for patent application. Researchers are still assessed against conventional performance criteria and there are no dedicated researcher mobility schemes in place, other than support to participate in international networks and scholarships to facilitate doctoral and post-doctoral research. Nevertheless, by 2019, 41 Bosnian researchers had benefitted from the support provided under the MSCA.

Bosnia and Herzegovina has made progress in developing an infrastructure of **institutional support for collaboration**. A number of science and technology parks operate throughout the FBiH. Most recently, the Posušje Technology Park Foundation was established in 2019, but is not yet fully operational. In Republika Srpska there are plans to build a science and technology park in line with the roadmap for scientific infrastructure, and the Innovation Centre Banja Luka continues to play an important role in supporting innovation more broadly. Whilst the expansion in the number of science and technology parks is a welcoming trend, in reality they often primarily serve as incubation centers for companies not always linked to scientific research. However, a good example of public-private-academia collaboration is the Coordinate Measuring Machine (CMM) Competence Centre in Mostar, which was established in 2019 (Box 21.11).

### Box 21.11. Coordinate Measuring Machine (CMM) Competence Centre

The Coordinate Measuring Machine (CMM) Competence Centre was established in 2019 with support from the United Nations Industrial Development Organization (UNIDO), Slovenia and a Slovenian private company. Located at the Faculty of Mechanical Engineering, Computing and Electrical Engineering of the University of Mostar, the centre provides internationally recognised calibration and testing services, and advanced research in the field of product quality control in collaboration with local industrial companies. The CMM will enable the University of Mostar to build capacity in the area of quality control and precise measurements of complex geometries, and provide expertise sought after by local industries. Inspecting the quality of products and services by using co-ordinate measuring machines is of crucial importance for some of key BiH industries, such as the automotive, aviation, pharmaceutical and metal industries, which suffer from a lack of precise geometrical measurements. Therefore, the new centre is expected to benefit the entire economy in terms of providing new opportunities and enabling access to EU and international markets through internationally recognised measurements and calibrations.

Source: (UNIDO, 2020[126]), *Strengthening the quality system of technology and industrial products and services in Bosnia and Herzegovina: Coordinate Measuring Machine Competence Centre*, https://open.unido.org/projects/BA/projects/160112.

## *The way forward for science, technology and innovation*

Bosnia and Herzegovina's STI policy framework remains below potential, and absorption capacity for technology and innovation is limited amid a highly fragmented institutional set-up, the absence of a clear co-ordination mechanism that would help identify policy priorities, and a lack of investment. Some positive steps include an emerging strategic framework to develop STI policy and several pilot schemes to stimulate collaboration between academia and the private sector.

Specifically, Bosnia and Herzegovina should consider the following priorities:

- **Align strategic priorities and co-ordinate implementation.** Bosnia and Herzegovina should look to harmonise its strategic framework for STI across all institutional levels to identify joint priorities and develop action plans for implementation. Timely and co-ordinated preparation of the economy's first Smart Specialisation Strategy will be imperative to address existing obstacles to STI development.
- **Increase investment in the public sector research system.** Funding availability to strengthen the capacity of scientific research needs to be increased significantly to enable Bosnia and Herzegovina to attract contributions from the research community. An increased focus on performance-based funding will further increase the quality and outcomes of the public research system. In the long term, such measures are expected to pre-empt increasing brain drain in the research sector.
- **Integrate the private sector.** Increased participation of the business community in STI policy development will contribute to the development of more targeted policy measures aimed at academia-industry collaboration. If coupled with well-designed incentive mechanisms, Bosnia and Herzegovina could leverage its existing institutional support structure to stimulate co-operation between research and business communities.

- **Strengthen the enforcement of IP legislation.** Steps should be taken to increase the capacity of enforcement institutions, including by providing specialised training. Awareness-raising activities about the importance of IP among the general public and the research community will further help encourage patenting.
- **Improve the collection of statistical data on science, technology and innovation.** Streamlining data collection and capacity across all institutional levels will improve the monitoring of the progress of STI policy implementation. Bosnia and Herzegovina should also work towards inclusion in the European Innovation Scoreboard.

## Digital society (Dimension 10)

### *Introduction*

Bosnia and Herzegovina scores below the Western Balkan six average across all digital society indicators, and has the lowest overall score among the six economies, as shown in the Table 21.16. The economy has been working to improve its broadband development framework since 2018, moving closer to the adoption of a broadband strategy agreed upon by all government members, which is expected to conclude during 2021. The adoption of the strategy, if coupled with a budgeted action plan, could deliver the promise of an enabling environment that stimulates private sector investment in network infrastructure, and help to leverage donor financing to support rural broadband development, as in other WB6 economies. BiH has achieved consensus among state and entity governments on the adoption of the Strategic Framework for Public Administration Reform 2018-2022 (SFPAR), which is the first significant step towards digital government development. However, agreement on a budgeted action plan is also required to make tangible progress, as the economy is lagging behind the EU and the WB region by only offering a small number of non-transactional e-services to its citizens and businesses. The absence of an overarching ICT strategy has been flagged in this assessment, as much as in the previous round, as a factor holding back ICT sector development. Despite the fact that ICT companies in Bosnia and Herzegovina have significant potential to grow and open new workplaces, they are challenged by the deficit of highly skilled ICT professionals. The situation is exacerbated by the weaknesses of the BiH educational infrastructure, especially when compared to the educational systems in some neighbouring economies, which are gradually increasing their output of ICT professionals. BiH has done little to align with the EU's digital competence framework for students and professionals, and opportunities for practical ICT training and lifelong learning are limited. Progress has also been slow in improving the legal framework and changing public mindsets in matters of personal data protection, e-commerce consumer protection and digital security risk management. Relevant legislation and regulations are perpetually under preparation, and there are no resources set aside for a domestic computer emergency response team and international collaboration in the fight against cybercrime.

**Table 21.16. Bosnia and Herzegovina's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 1.8 | 2.9 |
| | Sub-dimension 10.2: Use | 1.8 | 2.4 |
| | Sub-dimension 10.3: Jobs | 1.7 | 2.3 |
| | Sub-dimension 10.4: Society | 1.5 | 2.1 |
| | Sub-dimension 10.5: Trust | 1.7 | 2.2 |
| **Bosnia and Herzegovina's overall score** | | **1.7** | **2.4** |

### *State of play and key developments*

#### *Sub-dimension 10.1: Access*

Bosnia and Herzegovina has not made significant progress in improving the policy framework for **broadband infrastructure** development since the 2018 assessment cycle. The Policy on the Electronic Communications Sector for 2017-2021, which is aligned with the Digital Agenda of Europe, was adopted in 2017 by the BiH Council of Ministers, but not formally implemented in practice. Given that a concrete action plan was never agreed among the entities and the state, the policy remained a high-level, visionary document. In the meantime, the development of broadband networks across Bosnia and Herzegovina is fuelled by private sector investment based on market competition. Fixed broadband penetration in Bosnia and Herzegovina was 22.6% in 2019, which is the second highest in the region next to Montenegro (28.47%), but still lagging behind EU Member States (ITU, 2019[127]). However, the existing framework does not facilitate network infrastructure investment in rural and remote areas. Additionally, rules and

procedures across entities and different levels of local administration, especially in the FBiH, are not fully harmonised, and network infrastructure development cost reduction models are not yet in place, in accordance with the EU directive on measures to reduce the cost of deploying high-speed electronic communications networks (2014/61/EU). The development of a broadband strategy remains one of the most pressing issues for Bosnia and Herzegovina's broadband development. A working group was formed in 2017 to prepare such a strategy, which is currently in the phase of final adjustments at the level of participating institutions. Positively, representatives of all government entities were invited to take part in this working group and appointed by the Decision of the Ministry of Transport and Communications of BiH, which increases the potential for the practical implementation of the strategy once adopted.

The Communications Regulatory Agency (RAK) has developed a Strategic Development Plan for 2019-2021, as set out in the Policy on the Electronic Communications Sector for 2017-2021, which describes several projects (RAK, 2019[128]). The agency has planned a broadband mapping study to identify "white, grey and black areas"[137] in BiH, in collaboration with relevant stakeholders (i.e. network infrastructure providers). The plan also includes a needs' assessment for financing the development of broadband infrastructure in rural and remote areas. The agency intends to launch a public call to identify and select the most suitable financing model for broadband infrastructure development in "white" areas.

The **ICT policy regulatory framework** is not completely aligned with the EU Regulatory framework. The existing Law on Electronic Communications is outdated, and the new Law on Electronic Communications is still under preparation with an undefined adoption timeframe. Major legislative and regulatory activities are needed to align Bosnia and Herzegovina's regulatory framework with the EU framework.

A TAIEX mission was organised that involved experts from Belgium and Lithuania working with the BiH Ministry of Communications and Transport and RAK to help harmonise the Law on Electronic Communications with EU legislation. The harmonisation process prioritises the transposition of the European Electronic Communications Code into BiH legislation. Republika Srpska's government nominated a working group representative for the preparation of the new law, but this person was not designated by the Decision on Appointment of the Working Group for the Drafting of the Law on Electronic Communications. RS claims that entities' participation in the adoption of important legislation, such as the new Law on Electronic Communications, through an e-consultation process with stakeholders does not ensure the applicability and implementation of the law.

RAK enjoys institutional independence, but its financial independence is not yet fully ensured, despite improvements. The director of RAK is appointed by the Council of Ministers, which does not ensure transparency and openness, nor provide sufficient safeguards against political and economic interference (European Commission, 2019[4]). In March 2019, the Council of Ministers adopted the decision on the conditions for the provision of 4G network services in the economy, and the respective licences were issued by RAK for the three mobile operators in BiH, who launched the service in April 2019 (ITU, 2020[129]). Given the late adoption of 4G and the expected delay in adopting 5G regulations, the assignment of a spectrum for 5G is not expected soon.

Bosnia and Herzegovina has made some progress in adopting a framework for **data accessibility**. RAK has responsibility for the adoption of any regulatory obligation concerning online communication and data related to alignment with the EU *acquis*. The SFPAR, adopted by all members of government, and the Open Government Partnership (OGP) Action Plan for 2019-2021 both refer to data accessibility and openness. While the SFPAR is not yet being implemented, the OGP Action Plan stipulates opening official statistics by the Agency for Statistics of Bosnia and Herzegovina and opening data on public procurement by the Public Procurement Agency. Under this commitment, the Agency for Statistics has increased the availability, openness and use of official statistical data, ensuring that all data published by the agency are free, in a machine-readable format under the open licence, and constantly available on the agency's website.[138] BiH has also launched a National Summary Data Page[139] for publishing essential macroeconomic data in both human and machine-readable formats, which is hosted by the Central Bank of BiH on its website. In December 2019, the RS government adopted the Strategy for the Development

of e-Government 2020-2022, which also includes objectives on data accessibility and the obligation of public sector institutions to exchange data or provide their data for re-use and e-service creation. The implementation of this strategy, however, has not begun as financial resources have not yet been allocated. The PAR Co-ordinator's Office conducted an online survey in June 2020, in which 57 state institutions participated. The survey findings showed that the average fulfilment of proactive transparency standards (publishing all data and information of public importance) is 64.04% among participating institutions; 11 institutions met 80% of the standards and only 4 institutions met 100% of the standards (one of which was the Agency for Statistics).

### *Sub-dimension 10.2: Use*

**Digital government** has been developing unevenly across the two entities in Bosnia and Herzegovina. The Policy of the Information Society Development (2017-2021), adopted by the Council of Ministers in 2017, outlines the principles of information society development, but does not specifically address the promotion of digital government and the development of e-services by the public sector. Some aspects of digital government development are included in the SFPAR, which was created by the PAR Co-ordinator's Office and adopted by the Council of Ministers in June 2018. The SFPAR was a condition for Bosnia and Herzegovina's EU membership application and is donor funded through the Public Administration Reform Fund.[140] The FBiH adopted the PAR and its Action Plan on 8 October 2020, while RS adopted it two years later, in June 2020 (European Commission, 2020[39]). The entity government of FBiH instructed the Institute for Public Administration of the Federal Ministry of Justice to engage in follow-up activities with the cantons to harmonise legislation regarding the civil service, and to draft the Rulebook on Internal Organisation. In the meantime, the entity government of RS has been implementing its own policy document for e-government since 2009, and recently adopted the Development Strategy of e-Government for 2019-2022, which is not yet budgeted. Despite the adoption of these policies, the economy-wide implementation of public administration reforms and service digitalisation is hampered by the lack of political ownership and co-ordination among different levels of the government, which also leads to the allocation of insufficient budgetary resources for implementation (European Commission, 2020[39]).

The lack of interoperable information systems across entities and different levels of government in Bosnia and Herzegovina is a major obstacle to developing economy-wide digital government services, which adds considerable burden to citizens and businesses in their domestic and international exchanges. It also hampers interconnection with EU information systems, and thus the EU integration process, as noted in the latest European Commission report evaluating BiH's application for EU membership.[141] The National Interoperability Framework was adopted by the Council of Ministers in June 2018, but is not fully implemented as consensus was not reached among entities. A number of enacted laws at the state and entity levels are affected by the adoption of the interoperability system.[142] The FBiH has adopted the interoperability framework at the entity level and established a co-ordinator for its implementation. The co-ordinator has developed a long-term implementation plan for the Interoperability Framework that contains 12 projects in the field of e-government development and modernisation of FBiH registers; however, without sufficient budget allocation the plan's implementation depends on identifying donor support. The lack of interoperability, and even the development of digital government, is also reflected in the monitoring of relevant indicators, which is weak and insufficiently systematised.

Bosnia and Herzegovina has developed an eConsultation[143] portal, where all regulatory proposals should be uploaded by state-level institutions for public consultation. Some e-services are already available for citizens and businesses in BiH for issuing residence permits, identification documents, passports and drivers' licences; for the registration of business entities in RS; and for the payment of contributions with tax administrations. Particularly for tax related e-services, enhanced co-operation and data exchange between tax administrations of the entities and the Brčko District is required to improve the quality of services offered throughout BiH. One-stop shop services exist only in RS. The one-stop shop business registration system in RS became operational in 2013, alongside a reform package comprising 13 laws

and a series of bylaws.[144] In the FBiH, provisions regarding the delivery of submissions in person are incomplete or outdated, making e-submissions practically impossible.

There are no policy documents that directly promote **private sector ICT adoption** in BiH, and the uneven development of e-business and e-commerce legislation across entities affects the pace of the digital transformation of businesses. At the state level, the Law on Electronic Business and Legal Traffic was adopted in 2007. RS has the most developed e-commerce framework, based on the 2009 Law on Electronic Commerce, which was amended in 2016. The RS government considers that private sector ICT adoption is sufficiently encouraged through the updated e-commerce framework, one-stop shop e-registration of businesses, and the new Development Strategy for e-Government, adopted in 2020. Additionally, the RS Chamber of Commerce has been offering training services[145] (webinars) on e-commerce to companies registered in Republika Srpska. Moreover, during 2019 the RS government adopted the Law on Incentives in the Economy and the Decree on the Procedure for Granting Incentives for Direct Investments to support business growth. This legislation promotes financial support measures aimed at improving business efficiency through the introduction of new technologies, including ICT. Private sector companies can submit investment projects following a public call. The FBiH has not yet adopted an e-commerce framework. However, the Ministry of Trade and Ministry of Transport and Communications are working on a draft Law on e-commerce for FBiH. It has been identified that 50 existing laws across all cantons require amendment to create a one-stop shop e-registration service for businesses. The adoption of the SFPAR and its action plan by the FBiH government is expected to accelerate this process and stimulate private sector ICT adoption. Despite the under-developed framework, e-commerce is rising in Bosnia and Herzegovina. According to the Agency for Statistics of BiH, 19.2% of enterprises received orders for products or services through a website or mobile application (excluding email) during 2019 (Agency for Statistics of Bosnia and Herzegovina, 2020[130]).

### *Sub-dimension 10.3: Jobs*

While all stakeholders declare that **digital skills for students** are of great importance for education and training in Bosnia and Herzegovina, the framework is still under development. The Policy of the Information Society Development (2017-2021) includes a pillar on strengthening digital literacy and skills, but an action plan with specific measures and budget on the development of digital skills for students has not been adopted. Digital skills are also one of the key competencies in the Guidelines for the Implementation of the Common Core Curricula in Bosnia and Herzegovina. The state-level working document, Priorities in Integrating Entrepreneurial and Digital Competence into Education Systems in Bosnia and Herzegovina (2019-2030), aims to bring digital skills development in line with the European Digital Competence Framework, with a short-term goal of integrating digital skills into ISCED levels 1, 2 and 3 (ETF, 2019[131]). This working document is meant to be used as the basis for the development of policy and reference documents at the entity or local administration level to become effective.

The governance of education in Bosnia and Herzegovina is complex, with more than 14 ministerial-level institutions involved at the state and entity level.[146] At the state level, the Agency for Preschool, Primary and Secondary Education supports the development and implementation of IT systems in schools. Internet access and computers for students are not yet available in all schools, and IT curricula are not harmonised or co-ordinated across education levels. Some subjects deal with informatics in the final grades of primary school and as elective subjects in secondary school. Positively, the Framework Law on VET of BiH and legislation at each level of governance include references to digital skills for VET students. In 2019, the RS government launched a reform of education aimed at modernising its VET framework to make it more responsive to labour market needs. The reform includes the digitalisation of teaching and learning materials and the purchase of IT equipment for 500 schools (ETF, 2019[131]). In response to the COVID-19 pandemic, the RS Ministry of Scientific and Technological Development, Higher Education and Information Society implemented the project 1000 for the Future, which distributed 1 000 Raspberry Pi mini computers (fourth generation) to primary school students from 20 under-developed municipalities in RS. During this period, the RS government also installed Microsoft Office 365 tools in schools and trained teachers in using

a variety of modern educational tools, including Google classroom and Moodle, and how to exploit the e-Teaching portal for access to instructions and online lessons. These tools and platforms are planned to be permanently integrated into the teaching process. However, there are still problems with Internet connectivity in primary schools in RS, with only 14% of primary schools in remote areas having access to the Internet, compared to all schools in central, densely populated areas. Positively, all high schools in RS are connected to the Internet. The computer-to-student ratio in RS primary schools is around 1/5, which is quite high for the WB region, while the same ratio for high schools is just over 1/14.

The ICT industry supports the development of digital skills for students in BiH. The Bit Alliance, an IT industry association, organises the CoderDojo programming school at 16 locations in 11 cities across BiH. Over 700 primary and secondary school students have attended the free coding programme so far. At the same time, IT Girls, a United Nations initiative that aims to make girls and women more visible in ICT, organises Arduino workshops (ETF, 2019[131]). Based on research conducted by the Bit Alliance, there is a need for approximately 6 000 new employees in the IT industry, which the current education system cannot produce.

There is no economy-wide framework for **digital skills for adults** in BiH. The Labour and Employment Agency, the Federal Employment Agency and the RS Institute for Adult Education provide adult learning courses through a donor-supported portal,[147] and some of these courses target the development of digital skills. In 2019, 100 individuals with university diplomas who had not found a job in their profession attended the first IT adult training programme organised by the RS Ministry of Science and Technology Development, Higher Education and Information Society, and the Innovation Centre in Banja Luka.

Higher education institutions provide IT study programmes, and some provide digital and online learning solutions to the wider community (e.g. University of Sarajevo, Tuzla University, International University of Sarajevo, Logos Centre Mostar, Vitez University Travnik). Informal education providers also offer various ICT courses and educational programmes, including programming, web design and graphic design. The Bit Alliance maintains a list of these courses on a portal dedicated to the ICT sector and developing ICT careers.[148] Some training centres offer online learning platforms, such as Akademika (online basic and advanced ICT courses), IT Academy (online learning platform and a distance-learning programme) and SmartLab (online and offline training) (Bit Alliance, 2019[132]). The need for highly skilled ICT professionals is clearly identified by market stakeholders. According to the Agency for Statistics of BiH, 15.2% of enterprises employed ICT professionals in 2020. However, a skills mismatch has been identified, with the education system not meeting the demands of the labour market in terms of ICT professionals. According to the European Training Foundation, 67.5% of IT companies in BiH rely on in-house training, and 9% provide various adult training courses (ETF, 2019[131]).

Bosnia and Herzegovina has not adopted a policy framework that targets **ICT sector promotion** at any level of government. The Policy of the Information Society Development (2017-2021) includes a pillar on supporting the software industry as a subsector of the ICT sector, but an action plan with specific measures and budget on ICT sector promotion has not been adopted. There are also no measures providing tax incentives or tax relief to support ICT sector companies. The key actors of the IT industry in BiH are united as the Bit Alliance, which includes 58 companies employing around 80% of IT personnel in the economy. The Bit Alliance undertakes initiatives and implements projects targeting the strategic strengthening of the IT industry in BiH in co-operation with authorities, academia and international donors. According to Bit Alliance research, IT industry income has been growing continuously by approximately 25% annually for the past ten years. The total income of the 382 registered software development companies was over EUR 400 million in 2017 (Bit Alliance, 2019[132]). The Bit Alliance has adopted the IT Manifesto, which is a model for the Strategy for the Development of the IT Industry in BiH. The IT Manifesto defines three pillars as the most significant for the further development of the industry: 1) education; 2) legislation; and 3) economy. These are in line with the EU 2020 Strategy. Among several other strategic objectives, the IT Manifesto proposes the initiation of new legal solutions that support the digitalisation of business and education; reforms in taxation policy that support the IT industry; support for the IT start-up ecosystem by strengthening IT clusters, start-up hubs, technology incubators and similar systems; and support for the

application of IT in the modernisation of business operations in all branches of industry (Bit Alliance, 2019[133]).

### *Sub-dimension 10.4: Society*

Bosnia and Herzegovina has not made notable progress in improving its **digital inclusion framework** since 2018. However, the Policy of the Information Society Development (2017-2021) includes a pillar promoting e-inclusion and a vision to address the digital divide, although this has not been translated into specific budgeted activities. The existing legal framework at the state level includes the 2009 Guidelines on the Construction and Maintenance of Official Websites of Institutions in Bosnia and Herzegovina that aims to promote e-accessibility by ensuring that public bodies are presented online in accordance with international standards. Every public procurement process for products and services at state or entity levels, including the ICT domain, has to be published on the e-procurement portal[149] of the Public Procurement Agency and the Procurement Review Body of Bosnia and Herzegovina, according to the 2014 Public Procurement Law. Measures to ensure the inclusion and participation of the public in the design, implementation and monitoring of strategic plans, public policies and regulations are included in the SFPAR. These obligations are partially implemented (for state-level institutions) through the eConsultation portal. To promote innovation in the public sector, the United Nations Development Program (UNDP) will support the piloting of policy innovation clinics, which will provide the opportunity for policy makers to apply innovative, people-centred and inclusive approaches to policy making related to the digital transformation. The UNDP (BiH) officially launched the Accelerator Lab in BiH in October 2019, as part of the UNDP Accelerator Labs network. Civil society organisations in BiH are also implementing projects, mostly donor funded, to promote digital inclusion for marginalised groups (e.g. women), such as the project by non-governmental organisation (NGO) Amica Educa, Digital inclusion of marginalized women.[150] However, the impact from these programmes is limited by the relatively small number of beneficiaries. Indicators on digital inclusion are not systematically monitored by any institution in BiH.

### *Sub-dimension 10.5: Trust*

The current framework on digital **privacy protections** in Bosnia and Herzegovina is largely outdated. The framework on Personal Data Protection (PDP) is not yet aligned with the EU's General Data Protection Regulation (GDPR) and Police Directive on personal data processing by competent authorities investigating criminal offences. A new Law on PDP was drafted in 2018 but has not been adopted. The framework on PDP includes the 2013 Law on the Protection of People who Report Corruption (whistle-blowers) in the Institutions of Bosnia and Herzegovina, as well as subsequent secondary legislation. The Agency for Personal Data Protection is responsible for the implementation of the PDP framework in BiH. It publishes annual reports on data protection activities, but its resources are insufficient to perform its tasks effectively, especially given the SAA obligation to comply with the GDPR by 2021. The Agency for Personal Data Protection employed only 24 staff members at the end of 2018, although staff have received training on the GDPR through TAIEX, which is positive. The Ministry of Security of BiH in co-operation with other ministries and NGOs, has prepared the Action Plan for Child Protection and Prevention of Violence against Children through ICT (2014-2015), which addressed online privacy protection for children. However, the practical implementation of this action plan has not received due attention, and there have been no updates. The RS government is preparing a law on information security that will also cover digital privacy issues.

Development of the framework on **consumer protection in e-commerce** in Bosnia and Herzegovina is uneven. At the state level, consumer protection in e-commerce is only partially covered by the 2007 Law on Electronic Business and Legal Traffic, which is aligned with the Electronic Commerce Directive. However, this law is not fully operational as the e-signature legislation (adopted in 2006) is outdated and not being implemented (European Commission, 2019[4]). Other regulations concerning consumer protection are under the jurisdiction of the Institution of Ombudsman for Consumer Protection in BiH and the Market Surveillance Agency of Bosnia and Herzegovina, under the Law on Consumer Protection

(adopted in 2006), which does not address consumer protection in e-commerce. The RS Law on Consumer Protection was adopted in 2012 and amended in 2017, and relevant legislation on e-commerce and e-signature have also been recently updated and are under implementation. The FBiH government has not yet adopted a framework for e-commerce and consumer protection in e-commerce. Indicators on consumer protection in e-commerce are not being monitored by any institution in Bosnia and Herzegovina, with the exception of general indicators on Internet use by the Agency for Statistics.

Bosnia and Herzegovina has made limited progress in creating an effective **digital risk management framework** since the CO2018 assessment. It has not yet adopted a strategic framework for information systems security and for combating cybercrime. Cybersecurity and cybercrime related provisions are dispersed across four criminal codes and laws on criminal procedure (one at the state level and three at the entity level). Bosnia and Herzegovina is obligated to adopt legislation and other necessary measures for combating cybercrime to harmonise its framework with the other signatories of the Convention on Cybercrime in terms of felony treatment, data acquisition, processing and storage. The Ministry of Communication and Transport is planning to draft the new law for information security and security of networks and information systems, in line with the EU's Network and Information Security (NIS) Directive, but the adoption timeframe has not been announced. The Ministry of Security of BiH adopted a strategy for the establishment of a computer emergency response team (CERT) in 2011, but this was never implemented, which has left BiH without state-level co-ordination of cybersecurity incident response and management. There is no economy-wide accepted definition of domestic critical information infrastructure (CII) and no formal categorisation of CII assets in BiH. However, the Ministry of Defence has developed its own cyber-defence strategy to establish a secure cyber environment for its information systems. While the FBiH depends on state-level authorities to tackle digital security risk management, the RS government is preparing a Strategy for Information Security and a new Law on Information Security to replace the existing 2011 law. Republika Srpska also established the only operational CERT in 2015, which became an organisational unit of the Ministry of Scientific and Technological Development, Higher Education and Information Society in 2018. Indicators on digital risk management and information security are not regularly monitored by any institution in BiH. It is evident that cybersecurity is not yet instilled in public and private sector mindsets in Bosnia and Herzegovina, and public and private sector stakeholders have an overall low level of awareness of the values, attitudes and practices necessary for a healthy cybersecurity ecosystem (GCSCC, 2019[134]).

The adoption of a new law on electronic identification and trust services for electronic transactions in compliance with the EU *acquis* is still pending. Although state-level e-signature legislation from 2006 has not been practically implemented in Bosnia and Herzegovina, the Ministry of Communication and Transport established the Office for Supervision and Accreditation of Certifiers at the state level to supervise and inspect certifiers' compliance with the Law on Electronic Signature and related regulations, and to maintain the electronic register of accredited certifiers. In October 2019, the Office for the Supervision and Accreditation of Certifiers registered the first trusted service provider to introduce qualified e-signatures in BiH (European Commission, 2020[39]). In Republika Srpska, the updated e-signature framework is under implementation, supervised by the Ministry of Finance, the Ministry of Science and Technology, and the Agency for Information Society. The RS government has also adopted bylaws related to the accreditation and certification of qualified e-signatures and issuers of services, including the unique register of service issuers, the use and protection of e-signatures, means of drafting e-signatures, and the obligatory insurance of service issuers.

### *The way forward for digital society*

Despite some important steps taken to improve the digital society policy framework in Bosnia and Herzegovina, the government should pay more attention to the following aspects:

- **Accelerate the adoption of the broadband strategy and ensure consensus and sufficient budgetary allocation for its implementation. Prioritise network infrastructure development in rural and remote areas**. Develop a budgeted action plan for broadband infrastructure development that will be agreed by all competent institutions at all levels of government. Seek donor financing, following the example of neighbouring WB economies, and secure sufficient funding from loans that will support private sector investment in scarcely populated areas. Improve the broadband infrastructure development framework, align state aid rules with the EU framework, and investigate the practical and financial feasibility of proposed network investment projects.
- **Accelerate the adoption of the new Law on Electronic Communications to complete alignment with the EU regulatory framework, and implement the broadband mapping exercise**. The alignment of the electronic communications regulatory framework with the EU *acquis* is the first step towards the creation of an enabling broadband investment framework that facilitates co-usage and co-deployment and reduced costs for broadband deployments. The broadband mapping exercise is a valuable tool for monitoring network availability and development progress, as well as promoting infrastructure sharing, particularly in under-served areas.
- **Prioritise sufficient budgetary allocations for implementation of the Strategic Framework for Public Administration Reform 2018-2022 (PAR) and implement economy-wide interoperability** for the exchange of data between institutions to deliver effective e-services to citizens. Economy-wide interoperable information technology systems are a prerequisite for joining the EU and exchanging data with other states. Transposing the relevant EU Interoperability Directive into domestic legislation would ensure the compatibility of information systems and processes, and would lead to unified, high-quality services for citizens and businesses across Bosnia and Herzegovina. Reforms across all levels of the government outlined in the SFPAR action plan will need to be accelerated, and practical implementation of the e-signature framework will need to be expedited across the state.
- **Design programmes promoting the digitalisation of businesses in collaboration with chambers of commerce and other industry stakeholders**. Programmes could provide capacity building for e-commerce development, consulting services for assessing digitalisation needs, and support or incentives for buying ICT equipment. International and regional good practices could be considered when designing these programmes, such as Serbia's Digital Transformation Support Programme for micro, small and medium-sized enterprises implemented by the Development Agency of Serbia.[151]
- **Adopt an ICT sector strategy aimed at improving the legal framework, align the education system with ICT industry needs and stimulate ICT innovation**. Research and regional experience show that the ICT sector can become a driver for economic growth if provided with highly skilled ICT professionals, support for innovation and an enabling ICT legal framework. The ICT strategy would need to align with the SFPAR and ensure consensus across all levels of government. This strategic document will need to be a product of collaboration between all competent institutions, the ICT industry and academia. The process could benefit from strategic proposals outlined in the Bit Alliance IT Manifesto.
- **Accelerate the adoption of a new Law on Personal Data Protection to transpose the EU's GDPR and Police Directive into domestic legislation**. The Agency for Personal Data Protection would need to be strengthened with financial and human resources to be able to perform its tasks effectively, particularly regarding implementation of the new law. The agency would need to develop a plan for delivering the necessary training on the new law to data protection officers from the public and private sector.

- **Adopt a strategic framework for information security and cybercrime, and accelerate the establishment of a domestic CERT with sufficient resources**. The state will need to adopt a framework for information and network security, in accordance with the NIS Directive, to fight cybercrime and to align with commitments under the Convention on Cybercrime. BiH will need to establish a domestic CERT tasked with co-ordinating international co-operation for the fight against cybercrime, define CII and the formal categorisation of CII assets in BiH, and promote economy-wide efforts to establish a network of computer security incident response teams (CSIRTs) in the public and private sector.

## Transport policy (Dimension 11)

### *Introduction*

Since the last CO assessment, the main improvements in Bosnia and Herzegovina concern aviation operations and inland waterways (IWW) policy. Moderate development has been observed in the railway sector. There has been stagnation in asset management and slow progress in other fields. Bosnia and Herzegovina's performance in the transport dimension is significantly below the Western Balkan regional average across all sub-dimensions (Table 21.17).

**Table 21.17. Bosnia and Herzegovina's scores for transport policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 1.5 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 1.9 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 0.8 | 1.3 |
| **Bosnia and Herzegovina's overall score** | | **1.3** | **2.0** |

### *State of play and key developments*

#### *Sub-dimension 11.1: Planning*

Regarding **transport vision**, since the last CO assessment Bosnia and Herzegovina has identified a set of measures to improve the transport sector through the Framework Transport Strategy (FTS) (2016-2030) (Ministry of Communication and Transport, 2016[135]), which consists of transport strategies in the two entities and the Brčko District. The FTS takes into consideration various other policy documents at both state and entity levels,[152] but is currently not aligned with the tourism policy and other relevant strategies (e.g. those related to the environment), which shows the lack of a holistic policy-making approach. The level of harmonisation with the EU's Transport Community Treaty (TCT) (EUR-Lex, 2017[136]) in the RS only covers 6% of the legislation prescribed by the TCT, of which only 4% is presented as fully transposed and 2% as partially transposed.[153] Some legislation has been adopted as a result of the FTS (as presented in transport modes below), but the level of adoption is not fully known.

Since the last CO assessment, the monitoring reports for FTS implementation in RS were prepared for 2016-2018; such reporting is not available for the FBiH. The Ministry of Communications and Transport is responsible for the development of the monitoring reports for FTS implementation. The FTS covers all transport modes with very clear overall and specific objectives, but intermodal transport is covered only partially within the railway transport mode.

The priority projects presented in the FTS were adopted after a wide range of consultation processes with the relevant stakeholders (transport ministries, implementing agencies for all transport modes, non-governmental sector, etc.). The strategic actions have been proposed to achieve specific and general objectives of the strategy without the use of any state-of-the art methodologies (transport models) to assess proposed transport infrastructure measures and prioritise them accordingly. Strategic actions are presented through measures and indicators, which must be followed by the Ministry of Communications and Transport as prescribed in the FTS. The implementation timeline is defined in the strategy as short-term (2016-2020), mid-term (2021-2025) and long-term (2026-2030). The budgets to meet the objectives were assessed for each listed project within the FTS. The proposed 15-year implementation timeline is long for there to be no update, and the strategy does not propose any update before it expires. The planning framework and transport vision are set out in the strategy, but some important fields need to be upgraded, such as the development of the transport model, which should be used in the prioritisation process for the measures proposed within the FTS (if the concrete projects are set there) and through the state-level Transport Master Plan and Single Project Pipeline (SPP).[154] Proposed measures and actions

through the transport strategy should be assessed and evaluated through the outputs of the transport model, otherwise the transport model developed as part of the strategy would not be useful.

The methodology applied for **transport project selection** is not presented through the FTS nor through domestic legislation. There is an SPP for Bosnia and Herzegovina, developed in December 2018, that includes the scoring of projects and shows that prioritisation is in place; however, the SPP, including the methodology for scoring, is not publicly available. The Annual Programme of the Government of the RS,[155] which represents an input for the SPP, is in line with the FTS. The SPP should be updated every six months, but it has not been updated since 2018. The Annual Programme of the RS is updated every six months, but currently only for roads and for railways. Responsibility for the project prioritisation process between the state and the FBiH is not clear as the division of responsibility is not clearly defined. There are no cost-benefit analysis (CBA) guidelines for transport projects, including all accompanying survey, analysis and technical instructions. These need to be developed and updated every few years to help prioritise and control funds. A good example of the procedure for the identification of projects, as well as their pre-selection, financing, implementation, monitoring, *ex post* monitoring, and impact assessment, can be seen in other WB economies (e.g. Albania and Serbia) (Box 21.12).

Co-operation with the WB economies to exchange experiences regarding a common approach to transport planning could be improved. Such co-operation has so far been conducted mainly through participation in thematic working groups organised by the transport community and cross-border co-operation programmes,[156] as well as though projects related to transport facilitation at the border crossing points with Croatia, Montenegro and Serbia. Co-operation and exchange of good practice with WB economies needs to be enhanced and intensified and take place regularly. Such regular regional discussion would help pave the way for a single and competitive regional transport market.

The level of harmonisation of the procurement rules applicable to the transport sector with the TCT is not available. Based on the Law on Public Procurement,[157] alternative procurement processes are allowed for some specific groups[158] defined within the law. The roles and responsibilities of the government bodies within the transport sector are defined, but there is no established department within the transport ministry responsible for combined transport. The institutions and implementing agencies carrying out activities related to procurement and implementation procedures do not have sufficient human and financial capacity to carry out their tasks. Projects and grants funded by international financial institutions are subject to the domestic procurement procedure, as per the Law on Public Procurement. There has been no exchange of good practices related to the lessons learned for the **implementation and procurement** of public-private partnership (PPP) projects in the region. National bodies have not been given oversight roles for the procurement and monitoring of PPPs. There is no clear evidence of procurement procedures or project outputs being consistently monitored, and no evidence of *ex post* evaluation of procurement procedures. A good example of a project implementation and monitoring tool can be seen in other WB economies, as stated above.

Bosnia and Herzegovina is in the early stages of developing an **asset management**[159] system in the transport sector, which so far only covers the road and railway sectors. Such a system is not mandatory for every transport mode based on current legislation in force. Some efforts have been made in recent years to establish an asset management system, as presented in the report, Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6 (CONNECTA, 2018[137]). However, these efforts have not been successful. The main obstacles are related to the legal framework, implementation capacities, and funds for frequent and costly updates. Some data on assets are surveyed occasionally, but without regular updates, and the level of development is not co-ordinated throughout BiH and its entities. To follow and implement regional asset management plans (rail and road maintenance plans, performance-based maintenance contracting, road asset management system, railway infrastructure asset management system, etc.), more efforts are needed from the government side (e.g. Albania and Kosovo have adopted railway and road maintenance plans).

The road asset management system needs to be institutionalised so that it can effectively continue with efforts in this field. The key objective of a well-developed asset management system is to provide justification for the maintenance budget and to help direct limited funds to areas with the greatest return on investment. Such a developed system should be considered an integral component of the above-mentioned transport planning, identification, prioritisation, implementation and monitoring processes. A good example recently established in the region is the Albanian financial management system, which includes asset values. Other good examples (road asset database, bridge asset databases, etc.) can be found in North Macedonia and Serbia.

### Box 21.12. Effective tools to manage transport projects in Albania and Serbia

Albania and Serbia are the only two economies with a sound tool for transport project identification, selection, prioritisation and implementation in the WB region.

In 2018, Albania adopted the Decision on the Public Investment Management Procedures. For the purpose of budget planning on investment expenditure, the projects are divided into two groups: 1) capital administrative expenditure on equipment, furniture, computers, IT, etc; and 2) expenditure on investment projects, including capital expenditure on infrastructure such as new constructions, reconstructions, rehabilitation with design costs, expropriation costs, purchase of larger technological equipment, implementation of works and supervision; and capital expenditure for capacity development, including research projects, technical assistance and capacity building.

The following project management cycle is applied:

1. Project identification based on an analysis of the public's needs.
2. Project evaluation and preparation, including an evaluation of the economic and financial justification.
3. Project approval and financing.
4. Project implementation.
5. Monitoring of project implementation, which should ensure that project activities are in line with planned activities.
6. Evaluation and audit, including implementation-related reporting and financial audit through the project performance indicators.

The following steps are applied based on the project cycle presented above:

1. Identify the project idea.
2. Review the draft idea (done by the project management team leader and responsible authorities).
3. Prepare detailed project and evaluation, and a shortlist of alternatives.
4. Submit investment project proposal to the ministry responsible for investment projects.
5. Review the proposal (done by the Council of Ministers).
6. Final approval, after the approval of investment projects within the annual budget.

As per Decision No. 290 of 11 April 2020, a financial management information system has been installed in every spending unit, including in all ministries, and is integrated into various departments to be used for all steps in the project management cycle.

In Serbia, the procedure for project identification, analysis of relevance, pre-selection, funding, implementation and monitoring is clear and publicly available, and co-ordinated through the Ministry of Finance. This procedure was adopted in 2019 though the Rulebook on the Management of Capital Projects.

The prioritisation process, which is applied to all projects, applies a CBA, an environmental and social impact analysis, and a safety assessment, among other things. Once the project is approved for financing there is a special procedure, similar to the one in Albania, that forms the preparation of a plan for project implementation. During project implementation there are specific procedure forms for reporting. One type of report is the interim report for the presentation of the current project status, which covers the activities carried out and the plan to execute the remaining project activities. At the end of the project, a final report needs to be developed.

There are three categories of project: 1) less than EUR 5 million; 2) between EUR 5 and 25 million; and 3) over EUR 25 million. *Ex post* monitoring is conducted for the third category three years after completion, which is a significant advancement on local legislation.

Source:, (Republic of Albania, 2018[138]) - *Decision of the Council of Minster No 185/2018*, http://80.78.70.231/pls/kuv/f?p=201:Vendim%20i%20KM:185:29.03.2018; (QBZ, 2020[139]), *Albania - Decision of the Council of Minster No 209/2020*, https://qbz.gov.al/eli/vendim/2020/04/11/290; (Ministry of Finance, 2019[140]), *Serbia – Rulebook on the management of capital projects*, https://www.mfin.gov.rs/UserFiles/File/podzakonski%20akti/2019/Uredba%20o%20upravljanju%20kapitalnim%20projektima.pdf; (Ministry of Finance, n.d.[141]), *Serbia – Project cycle process – Forms*, https://www.mfin.gov.rs/dokumenti/saobracaj/.

### *Sub-dimension 11.2: Governance and regulation*

Since the last CO assessment, regulatory reforms have continued[160] in the field of **aviation regulation**. Bosnia and Herzegovina's Air Navigation Services Agency (BHANSA) took over responsibility for air traffic control of BiH skies in December 2019 from Croatia, Montenegro and Serbia, which had undertaken air traffic control for BiH since 1992. This means that BiH will have full air control over its territory, and all charges will be now paid directly to Bosnia and Herzegovina. The Single European Sky (SES) I package has been fully transposed into domestic law, while the SES II provisions have been partially transposed (the exact extent of transposition is not available). Bosnia and Herzegovina's Directorate for Civil Aviation (BHDCA) is a member of the Functional Airspace Block Central Europe,[161] which identifies that domestic fragmentation negatively impacts on safety, limits capacity and adds to cost. The mission of the National Supervisory Authority is to ensure the supervision of the air traffic management regulatory framework; however, it does not have adequate staff or capacity to fulfil its obligations.

The Airport Charges Directive has not yet been transposed. The market is not monitored as per Air Service Regulation, which provides the economic framework for air transport in terms of granting and overseeing the operating licences of community air carriers, market access, airport registration and leasing, public service obligations, traffic distribution between airports, and pricing. The Air Traffic Management Plan[162] was developed within the Bosnia and Herzegovina Air Traffic Management Strategy and is monitored regularly through Local Single Sky Implementation Monitoring (EUROCONTROL, 2021[142]). A safety culture programme, including safety risk assessment and safety assurance, has not yet been adopted. The State Safety Programme, designed as an integrated set of regulations and activities aiming to improve safety (e.g. safety risk management, safety assurance), is in progress.

Air traffic is growing in Bosnia and Herzegovina, with the total number of transported passengers from all airports increasing in the period 2016-2018 by approximately 38%, which amounted to 1.7 million passengers annually in 2018. This is an excellent achievement in comparison with the world average, which increased by 14.7% over the same period (Statistica, 2020[143]), and shows how the air transport industry in BiH has grown in importance. Given the significant growth of this transport mode and its projected importance for the economy, Bosnia and Herzegovina must continue regulatory reforms and bring the governance of the aviation sector closer to European standards and international good practices.

In FBiH there has been moderate development in the **railway regulation** sector since the last CO assessment, with rail reforms initiated. In RS, the public enterprise Railways of Republika Srpska is due to complete restructuring at the end of 2021. The FBiH has not yet begun the harmonisation process with the TCT, while the RS has partially aligned its legislation[163] (as explained in Sub-dimension 11.1: Planning). The level of implementation of the regional Rail Action Plan (Transport Community, 2020[144]) is not currently available. Network statements are prepared in BiH but not published. According to an EU directive,[164] such statements should be published to ensure transparency and non-discriminatory access to rail infrastructure, and to services in service facilities. Market access has not yet been approved, which means that foreign companies cannot access the rail infrastructure and service facilities. Infrastructure management has not yet been separated from railway undertakings in both entities. The Railway Accident Investigation Body is operational and issues investigation reports. There is no Rail Freight Corridor Regulation, which is a prerequisite for a high-capacity and competitive modal shift to rail, and no Technical Specifications for Interoperability, which are an important component of the development of international railway transport. Regulations regarding passengers' rights and obligations, which prescribe the framework to safeguard users' rights and to improve the quality and effectiveness of rail passenger services in order to increase the share of rail transport in relation to other modes of transport, have not yet been transposed.

Table 21.18 presents current trends in the railway transport of passengers and goods in Bosnia and Herzegovina, with 77.6% of railway traffic (train*km travelled) taking place in the FBiH and 23.4% in Republika Srpska.

### Table 21.18. Trends in rail transport in Bosnia and Herzegovina (2017-19)

| Rail network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of track) | +87.4 | 0.054 | 1.34 |
| Freight (tonnes*km/km of track) | +12.8 | 1.237 | 56.60 |

Source: Inputs provided by the government as part of the quantitative questionnaire (CO2021); (Eurostat, 2021[145]), *Eurostat database*, https://ec.europa.eu/eurostat; (Agency for Statistics of Bosnia and Herzegovina, n.d.[15]), *Agency for Statistics of Bosnia and Herzegovina homepage*, http://www.bhas.ba/?lang=en.

The rail sector in Bosnia and Herzegovina is not reaching its full potential, even though there has been an increase in railway transport. Examples of activities that would help achieve the numbers necessary for a cost-effective rail network and rail fleet utilisation in BiH, and help reach the EU average level of network utilisation, include the full opening of the market, incentives for shifting transport from road to rail, development of rail freight corridors and development of multimodal facilities.

Limited progress has been made regarding **road market regulation** in BiH since the last CO assessment, with some efforts undertaken to harmonise legislation with the TCT (as explained in Sub-dimension 11.1: Planning). Many other fields require further work to ensure full harmonisation (e.g. tachographs, enforcement of social legislation, intelligent transport systems). BiH continues to participate in the multilateral quota system of the European Conference of Ministers of Transport (ITF, 2014[146]), which enables hauliers to undertake an unlimited number of multilateral freight operations in 43 participating European countries. The regulation complies with the road haulage qualifications standards for companies, managers, and drivers under the Quality Charter for Road Haulage (ITF, 2015[147]). The implementation of market access agreements and EU legislation is not monitored in BiH. Domestic limits on the maximum weights and dimensions for road vehicles have been harmonised with EU requirements.

In 2019, the average age of passenger cars in BiH was 16.5 years, which is almost 60% higher than the EU average (10.6 years) in 2018 (ACEA, 2019[148]).

### Table 21.19. Trends in road transport in Bosnia and Herzegovina (2017-19)

| Road network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of road) | +3.8 | 0.20 | 18.9 |
| Freight (tonnes*km/km of road) | +2.8 | 0.47 | 126.3 |

Source: Input provided by the government as part of the quantitative questionnaire (CO2021); (European Commission, 2019[149]), *Statistical Pocketbook 2019*, https://ec.europa.eu/transport/facts-fundings/statistics/pocketbook-2019_en; (Agency for Statistics of Bosnia and Herzegovina, n.d.[15]), *Agency for Statistics of Bosnia and Herzegovina homepage*, http://www.bhas.ba/?lang=en.

The freight mode share of road transport is higher than that of rail transport with shares of 88.7% and 21.3% respectively. The 2018 EU averages for freight transport are 75.3% carried by road, 18.7% carried by rail and 6% carried by inland waterways (Eurostat, 2021[150]). Such a high road freight share points to negative effects on air pollution and climate change, and the incentives for shifting from road to rail could have a positive impact on reducing air pollution and climate impact. Recent trends show slight increases in road network utilisation (Table 21.19).

The COVID-19 outbreak is affecting the global transport and mobility market, including those in WB economies. Bosnia and Herzegovina introduced measures at border and customs control in the second quarter of 2020 to enable the provision of essential goods and medical equipment. These measures include "green lanes" in the major corridors for the transport of emergency goods, which require that freight vehicles and drivers are treated in a non-discriminatory manner. Passing through these green lane border crossings (including any checks and screenings) should not exceed 15 minutes, and procedures should be minimised and streamlined. The implementation of the above measures could directly impact how border crossings in the region are treated in the future by installing measures that minimise crossing time (Transport Community and CEFTA, 2020[151]; Transport Community, 2020[152]; Government of Serbia, 2019[153]; Estonia Border, n.d.[154]).

**Maritime and inland waterway (IWW) market regulations** are in the early stage of preparation in BiH, and a very little has been done so far. Since the last CO assessment, Republika Srpska adopted the Law on Inland Waterways, which has fully aligned only a part of the prescribed legislation with the TCT. The institutional, legal and regulatory set-up of waterway transport in BiH should be further developed. A framework on market access to port services and the financial transparency of ports, in line with EU regulations, has not yet been transposed. Both IWW and maritime transport are not considered a priority in BIH, and there are no specific incentives prescribed for shifting to the use of IWW and maritime transport. BiH should consider developing a roadmap for institutionalisation and the creation of a policy and operational framework regarding IWW and maritime transport.

Monitoring indicators to assess the performance of all transport modes either do not exist, are not properly established or are not properly updated (missing indicators include average user costs, travel time satisfactory level reliability, value of assets, market research and customer feedback, quality of user information, and audit programmes). Regular data surveys are neither planned soundly (including the purpose, level of data needed and budget allocated) nor conducted regularly. Surveys conducted have only been for the purposes of the specific project and not for general transport infrastructure assessment and planning. Therefore, the basis for assessing the quality of transport network performance is lacking.

#### *Sub-dimension 11.3: Sustainability*

Since the last CO assessment there has been moderate improvement within the field of **road safety** in RS, and stagnation in the FBiH. Bosnia and Herzegovina needs to enhance institutional, administrative and financial capacities to improve road safety. Implementation of the existing road safety framework and related measures remain a concern. The establishment of the Road Safety Council was approved by the Council of Ministers in 2019. There is a Road Traffic Safety Strategy (RTSS) in RS for the period 2013-2022, but it does not provide a budget for measures and actions proposed (TSA, 2013[155]). The FBiH has not yet adopted such a strategy. The monitoring report of RTSS implementation in RS for the period

2015-2018 has been issued, as has the new implementation plan for the period 2019-2020, but it is not clear if the lessons learnt from the previous monitoring report have been implemented. Based on the previous monitoring report of RTSS implementation in RS, approximately over 50% of the RTSS has been implemented. The RTSS is not fully aligned with the TCT and EU *acquis* to ensure harmonisation (outstanding areas include road infrastructure safety management, safe system approach, "forgiving" roads). The Traffic Safety Agency of the RS is a member of the European Council for Transport Safety, which means that it can participate in international co-operation on road accident data and analysis, including the promotion of effective measures to reduce transport crashes and casualties, based on international scientific research and good practices. The draft Road Safety Regional Action Plan, developed by the Transport Community Permanent Secretariat (TCPS) in 2019, has been neglected, and there is no monitoring body to co-ordinate its implementation. The Regional Action Plan (Transport Community, 2020[156]) has been endorsed by the Council of Ministers of the TCPS in October 2020, and Bosnia and Herzegovina needs to align its domestic plans to achieve the goals set within this plan (strengthening road safety management, promoting safe infrastructure, protecting road users, enhancing co-operation and exchange of experience). Data on road safety are collected by the Ministry of the Interior of the RS.

The goal of the EU publication, Policy Orientation on Road Safety for 2011-2020 (European Commission, 2010[157]), was to reduce road fatalities by 50% between 2010 and 2020, as per the Decade of Action for Road Safety 2011-2020 officially proclaimed by the UN General Assembly in March 2010. This goal has been difficult for BiH to achieve, and it has seen approximately only a 2% annual decrease in road fatalities between 2010 and 2019 (Table 21.20). Therefore, significant additional efforts are needed to meet the newly defined goal of the European Vision Zero strategy for 2050 (European Commission, 2019[158]), which also aims for a 50% decrease in road fatalities in the decade 2020-2030. As there is no developed clear framework for road safety at the state level in Bosnia and Herzegovina, and no strategy in RS for the new decade beyond 2022, expectations for the new goal are not high. In addition to Vision Zero, the RTSS in Republika Srpska also aims to decrease the number of fatalities by 50% in the period 2011-2022. This will only be possible if significantly more efforts (road safety campaigns, enforcement of legislation, etc.) are undertaken by the government. However, RS has made a good start, with the annual number of fatalities decreasing by approximately 37% between 2011 and 2019, from 163 in 2011 to 102 in 2019. Innovative practices to promote and incentivise road safety could be taken over from projects being implemented in Montenegro (Box 21.13).

### Table 21.20. Road safety trends in Bosnia and Herzegovina (2010-19)

| | Change over 2010-19 (%) | Change over 2017-19 (%) | 2019 |
|---|---|---|---|
| Number of fatalities (Bosnia and Herzegovina) | -18 | -13.6 | 261 |
| Change in the number of fatalities (EU) | -23 | -2.5 | - |
| Number of fatalities per million inhabitants (Bosnia and Herzegovina) | - | - | 74.6 |
| Number of fatalities per million inhabitants (EU) | - | - | 51 |

Source: (European Commission, 2019[159]), *Press Corner: 2019 Road Safety Statistics: What is behind the figures?,* https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004. (TSA, n.d.[160])Traffic Safety Agency, https://absrs.org/. (Agency for Statistics of Bosnia and Herzegovina, n.d.[15]) *Agency for Statistics of Bosnia and Herzegovina homepage*, http://www.bhas.ba/?lang=en. Information provided by the government for this assessment.

Some of the **environmental sustainability** goals[165] related to the transport sector are addressed in other strategies,[166] and as such are difficult to monitor. It is necessary to integrate a clear chapter dealing with sustainability in all transport modes through state and entity-level transport strategies, or through transport sector strategies for each specific mode. There is no evidence that the governments in BiH are preparing environmental sustainability strategies.

The legal and regulatory framework to support **combined transport**[167] as a transport mode that has the best cost efficiency and that decreases environmental pollution and increases co-operation between freight

forwarding network companies still needs to be developed. There is no combined transport strategy in place or planned, with intermodal transport addressed in the railway chapter in the FTS, which proposes incentive schemes for shifting to intermodal transport and the construction of intermodal terminals throughout BiH. The total amount of transported freight using combined transport is not presented though the official statistics of Bosnia and Herzegovina.

The World Bank's Logistics Performance Index is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation. The Index's most recent scoring (2018) ranked BiH 72 out of 160 with a score of 2.81, which is slightly below the world average (2.85) and far below the EU average (3.52). The best score given to Bosnia and Herzegovina was for the logistics competence indicator[168] (ranked as 65) while the worst score was for infrastructure indicator[169] (ranked as 97) (World Bank, 2020[161]).

Data collection, which is currently weak, needs to be one of the key actions for the assessment of performance in all sustainability areas, and a strategy for data collection needs to be established as a basis for the assessment of the transport sector and to directly influence the prioritisation processes within transport policy in general.

### *The way forward for transport policy*

BiH has taken some important steps in the development of a competitive transport sector, as presented above, but special attention should be paid to the following areas:

- **Update the state-level transport strategy every four years.** An update of the existing strategy is not proposed within the FTS. However, one should be carried out based on the monitoring reports for the implementation of the FTS. The lessons learnt should be applied in the updated strategy and implementation plans.
- **Develop domestic CBA guidelines for all transport modes.** Economies should develop and regularly update their CBA guidelines with accompanying technical instructions. The guidance needs to be updated at least every two years. A good example is the United Kingdom's Transport Analysis Guidance (UK Government, 2019[162]), which provides information on the role of transport modelling and transport project appraisal tailored to the UK market. Develop a benchmark for all technical and economic parameters to ensure consistency in the discount rates used for similar projects in the same economy, including the financial and economic discount rate in the state guidance documents. Apply the benchmark consistently in project appraisal at the state level. Empirical research needs to be conducted at the state level to generate input data for the calculation of externalities.
- **Develop/update a tool for project identification, selection, prioritisation and implementation**. This tool should be applied to all transport projects in BiH. Good examples could be taken from other economies in the region, such as Albania and Serbia (Box 21.12), which have recently introduced well-developed systems that are currently in the initial stage of implementation. These systems comprise all processes, from identification to *ex post* monitoring of implemented projects to the financial management of an information technology system planned to be implemented in all spending departments of governmental institutions and implementing agencies.
- **Continue rail reforms in RS, and begin rail reforms in the FBiH**. Structural and access reforms that started in RS need to be continued, while at the same time parallel reforms should take place in the FBiH. Reforms in the FBiH should cover at least structural reforms to promote competition. Access reforms are key as they enable efficient systems with better performance. Freight corridor management reforms are also key as they are a prerequisite for the next steps to achieving high-quality capacity and a competitive modal shift to rail (which is also related to the lack of a logistics strategy). Reforms regarding passengers' rights and obligations, as well as interoperability reforms, should be undertaken gradually as they take time and funds, but are very important for the development of international railway transport.

- **Develop a study on the institutional, legal and operational framework for maritime and IWW transport to define the roadmap for this transport mode**. Maritime and IWW transport are at the early stage of development in BiH. As a result, a detailed needs assessment should be conducted, accompanied by a roadmap for institutionalisation and a policy and operational framework that includes the responsible institutions and agencies, timelines for implementation and budget allocation.
- **Ensure that transport facilitation remains a priority.** Implement one-stop shops[170] and other measures as per the regional Action Plan for Transport Facilitation (Transport Community, 2020[152]) endorsed in October 2020, which includes an electronic queuing management system, improvement and upgrade of existing ICT infrastructure, construction or modernisation of infrastructure to remove physical and technical barriers and to increase existing capacities, and capacity building to improve performance efficiency. The implementation of these measures will be key for increasing the competitiveness and connectivity of the WB region to help it further integrate into the European market. Good examples could be taken from other economies in the region, such as North Macedonia and Serbia, which have recently introduced a well-developed one-stop shop system and are currently in the initial stage of implementing a pilot project for an electronic queuing management system.
- **Implement asset management principles in the transport sector in line with the domestic inventory system.** Developing sound asset management practices[171] enables economies to collect data (through annual data collection planning and budget allocation) and to manage and analyse conditions across all the transport modes. This information will then be used to optimise transport sector maintenance strategies and justify maintenance budgets by directing funds to areas with the greatest return on investment. Performance-based maintenance contracts, although not extensive, are already implemented in some WB economies such as Albania, BiH and Serbia (CONNECTA, 2018[137]). These are an essential component of the road asset management system and, if well-developed, lead towards predefined good road conditions at relatively low cost.
- **Develop an Integrated Environment and Transport Action plan.** This plan needs to integrate existing indicators and develop additional indicators through the development of a framework for environmental sustainability in the transport sector. Measures and indicators should be applied in the relevant strategies, including the new transport strategy. A good example was developed by the European Environmental Agency in the form of the Transport and Environment Reporting Mechanism, which prescribes indicators for tracking transport and environment in the EU (EEA, 2000[163]).

### Box 21.13. Innovations in road safety: Road safety social impact bonds, Montenegro

In 2018, the United Nations Development Program (UNDP) in Montenegro, in co-operation with the key domestic players in road safety, developed the idea of road safety social impact bonds as an innovative and alternative performance-based public financial instrument that shifts the policy framework from inputs and outputs to outcomes and value-for-money. This innovative idea involves the private sector investing in road safety improvements to strengthen sustainability together with the public sector. The public partner commits to paying the outcome payments to the investor if (and only if) the predefined and measurable social goals are met. This idea has great potential to help other economies in the region (and beyond) replicate and scale-up the model.

Source: (UNDP Montenegro, 2014[164]), *Rethinking Road Safety in Montenegro*, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

## Energy policy (Dimension 12)

### *Introduction*

Bosnia and Herzegovina has made some progress since the last Competitiveness Outlook, with its score rising from 1.4 to 2.1 (Figure 21.1). The most pronounced progress has been in the security of supply sub-dimension, where Bosnia and Herzegovina has shown progress in building a more robust energy market, in part due to seeking to expand supply routes and supply diversification in natural gas. Good progress has also been made in the energy markets sub-dimension, where Bosnia and Herzegovina has made progress regarding unbundling key public monopolies in electricity, and a small amount of progress within the natural gas sector (Table 21.21). Nonetheless, despite progress in the deployment of a Third Energy Package (Box 21.14) compliant legislative framework for the natural gas market in some of BiH's jurisdictions, FBiH's natural gas market continues to not even be compliant with the Second Energy Package. Moreover, bundled monopolies are still present in some jurisdictions, and the natural gas market remains closed to competition.[172]

**Table 21.21. Bosnia and Herzegovina's scores for energy policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Energy policy dimension** | Sub-dimension 12.1: Governance and regulation | 1.7 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 2.6 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 1.8 | 3.0 |
| **Bosnia and Herzegovina's overall score** | | **2.1** | **3.0** |

### *State of play and key developments*

#### *Sub-dimension 12.1: Governance and regulation*

The **energy policy, legal, and institutional framework** reflects the complicated constitutional set up of Bosnia and Herzegovina, with differentiated approaches between the entities. However, not only is there a fundamental difference between state-level BiH, and the FBiH and RS, there are also significant differences across the different energy markets.

Although an energy policy, legal and institutional framework is in place, there is significant room for improvement. The Energy Community Secretariat[173] judges that Bosnia and Herzegovina has transposed 22% of the EU's Third Energy Package (Box 21.14), with a further 47% transposed but requiring adjustment, and 31% not transposed at all (Energy Community, 2020[165]). This is mirrored in terms of implementation, where the Energy Community Secretariat rates average implementation to be around 39%, ranging between 20% and 55% across the different sub-sectors (Energy Community, 2020[165]).

Considering the electricity sector, although there is a legislative and policy framework that works towards some transposition of the Third Energy Package, the state of legislation differs across entities. There is more unison regarding policy, as although there are different policy documents in the different entities, there is also a state policy framework based on the entities' respective policies. However, the policy framework for the electricity sector needs to be refreshed, as such there is ongoing work to jointly draft a National Energy and Climate Plan. Moreover, it should be stressed that there is also ongoing work to adjust the legislative framework to increase compliance. Electricity markets are mostly deregulated, and consumers are free to choose their supplier (see Sub-dimension 12.3: Energy markets).

### Box 21.14. The EU's Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Co-operation of Energy Regulators, ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all of the WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies as members of the Energy Community, whose acquis reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude, the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

The largest difference between entities is within the natural gas sector, where there is no basis for state-level reform and entities have very divergent policies and natural gas markets. RS introduced a legislative package in 2018 that approximates significant elements of the Third Energy Package, while the FBiH continues to follow outdated legislation that is not even compliant with the Second Energy Package.

There are also significant differences in the approach to **energy regulations** between the entities, cantons and state. While stakeholders surveyed for this assessment suggested that all relevant regulatory entities are independent and conform with the European Union's Third Energy Package requirements, the Energy Community Secretariat perceives that Bosnia and Herzegovina's energy regulator is the least compliant regulator within the Western Balkans due to non-compliance of the governing legislative framework and lack of regulatory competences (Energy Community, 2020[165]).

The non-compliance, and thus low score in this sub-dimension, are due to a number of reasons. The regulator is not established as a single regulatory authority with economy-wide competences across natural gas and electricity. Bosnia and Herzegovina's regulatory structure includes three institutions: the State Electricity Regulatory Commission (SERC), the Regulatory Commission for Energy in the FBiH (FERK) and the Regulatory Commission for Energy of the RS (RERS). These three regulatory authorities have different areas of competence and are not equipped with all the competences prescribed in the Third Energy Package. Furthermore, in the past there have been political interventions related to the operation of the regulatory authorities, which brings into question their independence, and so far no actions have been taken to limit such political intervention in the future. The autonomy of the regulatory authorities has been limited in terms of staff management, with salaries limited to general civil servant salary schemes. The energy sector is highly competitive, which means that regulatory agencies could find it difficult to find and retain key staff if they are bound by public salary limitations.

There are significant deficiencies regarding the regulators' governing board, the Board of Commissioners. The appointment of new commissioners is subject to considerable delays, which has resulted in some commissioners overstaying their terms in office without a renewed mandate. The delays are partly due to an overly complicated selection process in which criteria are not limited to standard requirements such as education, experience and neutrality, but also include, for example, strong ethnic requirements. The process is also subject to significant political influence. Regarding the dismissal of commissioners, reasons for dismissal are not limited to cases of criminal offence, non-compliance with independence requirements, illness rendering person incapable to perform the duties, violation of the Code of Ethics or non-performance of duties (failure longer than six weeks to participate in proceedings). Also, all SERC decisions need to be taken in unanimity, which limits the capacity to take timely decisions.

Nonetheless, the Energy Community Secretariat has noted that despite issues, the regulators, particularly SERC, co-operate internationally and try to implement as much as possible of the Third Energy Package within their limited scope. Moreover, information provided by stakeholders states that regulators have sufficient staff and training opportunities. The monitoring of regulatory activities is also in line with international good practices.[174] Furthermore, despite the negative assessment by the Energy Community Secretariat regarding compliance, there is a legislative framework in place, although as stressed above key regulatory competences are missing (Energy Community, 2020[165]).

The **management of energy infrastructure** is guided by a variety of legislation and policy documents. However, this framework needs to be improved, with the Energy Community Secretariat assessing the transposition of the elements of the Third Energy Package pertaining to infrastructure management as not complete, and implementation at just 8% (Energy Community, 2020[165]).

There is therefore significant room for improvement regarding the legislative and policy framework and implementation. One of the most pressing issues is the final transposition and implementation of EU regulation 347/2013 on guidelines for trans-European energy infrastructure. This regulation promotes infrastructure management within an economy and aims to promote a regional co-operative approach. Connected to this is the lack of a Manual of Procedures, which has not been published in BiH. Article 9 of the EU regulation 347/2013 on guidelines for trans-European energy infrastructure also states that all economies need to publish a procedure on the permitting process for projects of common interest. This procedure facilitates cross-border projects and is currently missing in BiH. Some guidelines for investors were published in 2018, but these did not fully comply with the requirements set forth by the aforementioned EU regulation.

Related to the issue of cross-border projects, BiH has not designated a competent authority in line with Article 8 of EU regulation 347/2013 on guidelines for trans-European energy infrastructure. The role of such an authority is to support the granting of regional infrastructure projects, and thus support the management of infrastructure and regional integration. The regulator should publish the methodology or criteria used for the evaluation of investment in infrastructure projects, in particular with reference to impact on tariffs. These methodologies are needed to provide more certainty for investors regarding the projects

they are investing in and the recovery of their investment. It should be highlighted that BiH is aware of these shortcomings and plans to tackle them with the help of a working group established to transpose and implement EU regulations.

Power and natural gas Ten-Year Network Development Plans (TYNDP) for 2018-2027 have been drafted and adopted in BiH. However, some new versions of the TYNDPs are outstanding, with one of the plans for 2021-2030 having been drafted by Elektroprenos BIH, but not yet consulted on or approved, although this is expected to happen soon. While the lack of or non-timely adoption of plans is currently a small issue, it could signal a systemic issue going forward as the lack or non-timely adoption of such plans reduces the sector's guidance in infrastructure development.

One issue regarding infrastructure management connected to the electricity supply framework is network losses. Western Balkan economies, including BiH, are in line with the European average in terms of transmission losses; however, they are lagging behind in terms of distribution losses – although Bosnia and Herzegovina performs better than most of its neighbours (Table 21.22).[175] Urgent action is needed to upgrade infrastructure to avoid wasting energy.

### Table 21.22. Distribution losses as a share of final electricity consumption

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| EU | 10.7% | 8.0% | 7.8% | 7.6% | 6.7% |
| BiH | 10.7% | 10.4% | 10.2% | 9.8% | 9.3% |
| CEEC | 5.9% | 5.8% | 5.5% | 5.3% | 5.2% |

Note: EU and CEEC exclude Bulgaria and Romania.
Source: (CEER, 2020[166]), *2nd CEER Report on power losses*, https://www.ceer.eu/documents/104400/-/-/fd4178b4-ed00-6d06-5f4b-8b87d630b060.

On a positive note, FBiH and RS have an infrastructure project list that includes additional interconnection to Serbia for natural gas. Moreover, the FBiH pursues some form of active monitoring and data collection, and has indicated that it has an asset management system in place that includes the monitoring of the condition of existing infrastructure.

#### *Sub-dimension 12.2: Security of energy supply*

The **natural gas supply framework** is governed by a legislative and policy framework. While the legislation is drawn up by the entities, the policy side encompasses both state policy[176] and entity-level policies.[177] These polices largely reflect EU standards and are defined along five key strategic goals:

1. Efficient use (exploitation) of resources.
2. Safe and affordable energy.
3. Efficient use of energy.
4. Energy transition and environmental responsibility.
5. Development and harmonisation of the regulatory institutional framework.

The policy recognises the importance from a supply security perspective of further enhancing and expanding the natural gas infrastructure (see Table 21.23 below for a list of projects).

## Table 21.23. List of strategic natural gas infrastructure projects

| Level | Gas project | Commercial operation date | | | | Focus |
|---|---|---|---|---|---|---|
| | | By 2020 | By 2025 | By 2030 | By 2035 | |
| FBiH | Southern interconnection (Zagvozd - Imotski – Posušje – Novi Travnik / Travnik with branch towards Mostar) | | ✓ | | | ● |
| | Northern interconnection (Slobodnica – Brod – Zenica) | | ✓ | | | ● |
| | Western interconnection (Rakovica – Tržac – Bosanska Krupa with section towards Bihać & Velika Kladuša as part of phase I.) | | ✓ | ✓ | | ◑ |
| | Western interconnection – extension (B. Krupa – Ključ as part of phase II. and Ključ – B. Petrovac i Pećigrad – Bužim as part of phase III.) | | | ✓ | ✓ | ◔ |
| | LNG supply via Port of Ploče by railway or trucks | | ✓ | | | ◑ |
| | Gasification of Gornje Podrinje | | | ✓ | ✓ | ◔ |
| | Network expansion Travnik – Gornji Vakuf and Jajce | | | ✓ | ✓ | ◔ |
| | Gasification of Orašje | | | ✓ | ✓ | ◔ |
| | Underground gas storage Tetima with connection pipeline Kladanj – Tuzla – Tetima | | | ✓ | ✓ | ◔ |
| RS | Gasification of Bijeljina | ✓ | | | | ● |
| | Interconnection with Serbia in the area of Bijeljina (Novo Selo) | | ✓ | ✓ | | ● |
| | Main gas pipeline (Bijeljina - Banja Luka - further) | | ✓ | ✓ | | ◑ |
| | Gasification of Gornje Podrinje | | | ✓ | | ◔ |
| | Gasification of Trebinje from IAP | | ✓ | ✓ | | ◔ |
| | Connection with Croatia (Gradiška and Brod) | | | ✓ | | ◔ |
| BD BiH | Gasification of Brčko District of Bosnia and Herzegovina | | ✓ | ✓ | ✓ | ◑ |

Source: Information provided by BiH authorities as part of this assessment.

The entities of BiH have undertaken energy security stress tests to test the supply framework,[178] and natural gas security of supply plans are in place.[179] Extensive monitoring and indicator collection is also being undertaken by the different entities.

However, there are some concerns, notably regarding the legislative framework. As mentioned above, each entity has its own framework in place, with no mandate for a state legislative framework or reform. The entities' frameworks have evolved at different speeds. The legislative package adopted in 2018 in RS approximates the Third Energy Package, while the FBiH is governed by a decree from 2007 that is not even compliant with the Second Energy Package and does not transpose key aspects like third party access or market liberalisation.

Also of concern is that natural gas supplies are being priced based on oil indexation, which often leads to supply not being reactive to market signals, especially as natural gas is largely sold as an independent product from oil (both from a supply and demand perspective).[180] Another area of concern is the fact that supply is imported exclusively from Russia via one key route through Ukraine, Hungary and Serbia. This exposes BiH to key supplier and route risks. Although BiH is not the only Western Balkan economy subject to this risk, it is important that it seeks diversification. BiH is working on importing natural gas via alternative routes for Russian supplies (through Turkey and Serbia) and alternative sources (via the Ionian Adriatic Pipeline that uses natural gas sourced from Azerbaijan).

The **electricity supply framework** includes legislative policies drawn from all entities. Broadly speaking, the policies conform with good practices and focus on four goals:

1. Harmonisation with EU directives.
2. Upgrading of regulatory mechanisms to encourage efficiency and quality and relationships with market stakeholders.
3. Reduction of network losses and increased supply quality.
4. Flexible and technologically modern Distribution System Operators as a basis for energy sector modernisation.

Monitoring and data collection relating to electricity is being undertaken based on good practices.

Despite there being some good practices in place in BiH, there are also some concerns. For example, BiH intends to continue its reliance on coal-fired generation within its power mix as it is seeking to build new coal plants to replace older coal-fired power plants. Information provided by the authorities suggests that the lack of a natural gas supply and limited growth in renewable generation is a key driver behind this decision. However, although BiH does have coal resources, unless it invests in additional natural gas infrastructure and renewable generation it will continue to perpetuate the problem of there being insufficient alternatives to coal. Moreover, pursuing the expansion of natural gas and renewable generation would not prohibit the future use of coal, but rather extend the diversification of energy generation, thus increasing the security of supply across different energy types. Accordingly, alternative sources should be pursued aggressively.[181] Although environmental factors were considered in the decision to build new coal plants,[182] it appears that BiH did not factor in the explicit pricing of greenhouse gas emissions. This also reflects the fact that there are no plans in BiH to introduce an emissions market aligned with the EU Emissions Trading Scheme.[183] BiH is a signatory of the Sofia Declaration, which involves signatories committing to "continue alignment with the EU Emissions Trading Scheme, as well as work towards introducing other carbon pricing instruments to promote decarbonisation in the region" (Berlin Process, 2020, p. 2[167]). However, at the state level there is currently no concrete plan or action taken to deploy a carbon tax or other kind of greenhouse emission pricing scheme. Moreover, the legislative and regulatory framework for the monitoring and reporting of greenhouse gas emissions is not complete and will need to be finalised before any pricing of greenhouse gas emissions will be possible.[184]

Bosnia and Herzegovina generated around 35% of its energy from **renewable energy** sources in 2018 (Eurostat, n.d.[168]). Moreover, nearly all renewable energy is generated from hydro generation, with wind and solar accounting for only around 2% of electricity: wind generated 103 gigawatt hours (GWh) and solar generated 21 GWh in 2018 (Eurostat, n.d.[168]), although this share is expected to expand as new projects were connected for the first time in 2018 and 2019. BiH has considerable potential for renewable energy generation, particularly beyond hydro generation. The International Renewable Energy Agency estimates that Bosnia and Herzegovina has a renewable energy potential of 23 gigawatts (GW) of installed capacity, out of which only 2.3 GW is being currently utilized, with 110 megawatts (MW) from non-hydro renewable energy sources (IRENA, 2017[169]; IRENA, 2019[170]; Energy Community, 2020[165]; Eurostat, n.d.[171]). Moreover, out of the 23 GW, only 6.1 GW is hydro and 17.1 GW is other renewable energy sources (IRENA, 2017[169]; IRENA, 2019[170]).

As in the other sub-dimensions, there are multiple legislative and policy frameworks for renewable energy across the state and entities in BiH. The Energy Community Secretariat rates the transposition of the Third Energy Package as not complete due to issues relating to simplified administrative procedures, operational deployment, and the functioning of the system for the issuing, transfer and cancellation of guarantees of origin (Energy Community, 2020[165]). Overall, the Energy Community Secretariat rates the implementation of the Third Energy Package at 49% in BiH (Energy Community, 2020[165]). BiH has a National Renewable Energy Action Plan that guides the sector,[185] and has established a 40% target for the share of renewable energy in gross energy consumption and a 10% target in transport, although the share of renewable energy in transport was only 0.44% in 2019 (Energy Community, 2020[165]). Moreover, BiH has published two out of three progress reports – one in 2017 and one in 2019. BiH is also in the process of drafting the National Energy and Climate Plan, which is expected to be completed by the end of 2021. Legislation grants renewable generators priority dispatch and connection to the distribution network, and there are clear

guidelines for connection to the transmission system to facilitate the speedy connection of renewable energy generators.

There are, however, some challenges regarding renewable energy in BiH. There is currently no competitive assignment of renewable projects, which means that the competitive forces of, for example, an auction are not harnessed to choose and allocate projects that represent best value added. In addition, apart from RS which uses feed-in-premiums, a feed-in tariff scheme is currently being used, which is a subsidisation approach that has fallen out of favour as it creates a disconnect between renewable generator incentives and market signals. However, it should be noted that legislation for the competitive assignment of renewable projects and the use of a feed-in premium (with a feed-in tariff for small-scale renewable energy projects) has been drafted but not yet adopted. Similarly, the concept and importance of small-scale distributed renewable (self-) consumers (prosumers) are recognised in new draft legislation that has not yet been adopted. Although the entities recognise the importance of Guarantee of Origins,[186] there is no system for issuance, transfer and cancelation. Guarantee of Origin is a key channel for further monetising generated renewable energy both within the state subsidisation scheme (where the state can benefit from product differentiation and higher paying margin customers) or for renewable projects outside the state support scheme (where the project owner can increase the income stream). The Energy Community Secretariat has also noted that renewable energy generators within a support scheme have limited imbalance responsibilities, which is a significant market distortion as it encourages generators to deviate from optimal behaviour based on market signals and good practices for forecasting.

BiH has a partial legislative and policy framework in place for **energy efficiency**.[187] However, energy efficiency legislation is still lacking, and further action is necessary to achieve full compliance with international good practice.[188] There has been no progress since 2018 regarding adjusting product labelling regulation, despite a Ministerial Council decision adopted in November 2018 that required adjustments. The Energy Community Secretariat assesses Bosnia and Herzegovina's transposition of energy efficiency legislation related to the Third Energy Package as not complete, measuring it at 48% (Energy Community, 2020[165]).

Energy efficiency strategies in BiH are out of date, with the National Energy Efficiency Action Plan 2019-2021 and a long-term building renovation strategy drafted but not adopted. Furthermore, energy efficiency laws in the FBiH and RS have not transposed the Third Energy Package, and implementation is far from complete. For example there has been no implementation of an energy efficiency obligation scheme nor a comprehensive energy management and information system. Additionally, human resources within public institutions dedicated to the topic of energy efficiency need to be enhanced.

Some monitoring and data collection is in place, but it could be systematically improved. For example, there is no inventory of buildings, which means that it is difficult to assess the extent to which energy performance has been deployed and what remains to be done with regards to BiH building stock.

Positively, both entities have established energy efficiency funds, and the concept of an Energy Service Companies market (ESCO) has been established within the legislative framework, although it is currently not operational due to a variety of issues regarding public procurement and the lack of model ESCO contracts. BiH has been publishing regular progress reports on implementation of the National Energy Efficiency Plan. The fourth progress report was published on 31 August 2020. BiH is also working on drafting the National Energy and Climate Plan. Both entities have implemented an energy efficiency audit and certification scheme for all new buildings and buildings undergoing major renovations.

### *Sub-dimension 12.3: Energy markets*

Regarding energy **market operations**, there is a wide divergence between natural gas and electricity, as well as between the entities of BiH.

The wholesale electricity market is largely deregulated, except within RS, where electricity generation prices remain regulated, although price regulation is being phased out. There is no legislation or target to

establish and deploy a power market and associated day-ahead market[189] (i.e. an organised market). Moreover, BiH does not have the required legislative text that allows for the mutual recognition of trading licences with other economies. However, Transparency (REMIT) Regulation[190] and Connection Network Codes[191] have been transposed and implemented. The balancing market[192] has been operating since 2016 as an efficient market covering the energy needed for balancing the system and the acquisition of reserve capacity.

The electricity retail market is formally deregulated, with only households and small consumers allowed to use the Universal Supplier at a regulated price. Supplier switching is codified but remains low, and as a result so does market liquidity.

The situation is less favourable in the natural gas market where, as mentioned above, the FBiH is not even compliant with EU's Second Energy Package. The wholesale market is dominated by the incumbent BH-Gas, which also has a monopoly in the retail market. There is a more positive situation in RS, which has a wholesale market, although the virtual trading point is not operational, which means that transactions are done on a bilateral basis. Switching rules are in place , and only a small portion of consumers are supplied under regulated public supply conditions. However, the market remains highly centralised, with the incumbent GAS RES which has a market share of more than 85%.

The complexity of the constitutional set up in BiH is also reflected in the successes and failures of **unbundling and third-party access**.

Regarding electricity, Bosnia and Herzegovina's transmission system is operated by the independent system operator NOS BIH, which is involved in the management of the transmission network, the day ahead and intraday markets, the balancing market, security analysis, cross-border mechanisms, development of long-term plans, and the transmission company Elektroprenos BIH, which owns the transmission network and associated facilities and is responsible for electricity transmission. They are owned by the two entities and controlled by the Council of Ministers of BiH. However, the ownership is such that they are part of an ownership structure in which there is also control over the generation and supply of electricity. Accordingly, the transmission network in BiH is not unbundled in the sense of the Third Energy Package. The legal basis for unbundling at the state level is missing, and is unlikely to be resolved anytime soon.

Concerning electricity distribution system unbundling, the legal unbundling requirement according to the Third Energy Package is reflected in the legislation of both entities. Functional unbundling is also covered in legislation, but only in RS. Nonetheless, the distribution system operators in both entities continue to operate as legal and functionally bundled companies. In the FBiH there is no legal requirement for compliance programmes, as there should be in line with international good practice.

Positively, third-party access is enshrined in legislation and, as mentioned, Transparency (REMIT) Regulation and Connection Network Codes are transposed and implemented.

Regarding the natural gas sector, BiH is operating outside of the EU *acquis*, and is not even in line with the Second Energy Package. In the absence of a state-level approach, the entities have implemented divergent regulatory frameworks.

The most promising actions have taken place in the RS, which in 2018 transposed Third Energy Package legislation regarding natural gas. As part of this legislative package, the RS established the basis for unbundling. One of the three natural gas transmission system operators in BiH, Gas Promet Pale a.d. is currently seeking unbundling certification and which was granted by the RS energy regulator, RERS. However, the Energy Community Secretariat has not yet given its positive opinion regarding this certification. Gas Promet Pale a.d. operates as a transmission system under network system rules that do not conform with the EU Capacity Allocation and Congestion Management Regulation. The other two transmission system operators have no legal basis for unbundling and thus have not attempted to be certified as unbundled transmission system operators.

Third-party access is only enshrined in legislation in the RS, and even there third-party access to pipelines is granted under regulated tariffs for only some parts of the network. In the FBiH there is no legal basis for guaranteed non-discriminated third-party access, which is only granted on bilateral negotiated contracts. However, the FBiH is currently working on implementing an Energy Sector Restructuring Programme that would address some of the shortcomings and establish the legal basis to move ahead with unbundling and third-party access. However, so far, this programme has not been adopted.

**Regional integration** is governed at the state level in BiH and is subject to a legal framework.

Regarding natural gas, the sole interconnector with Serbia is governed by an agreement that conforms with EU Regulation 2015/703 on establishing a network code on interoperability and data exchange rules. For electricity, the capacity of the interconnectors is allocated using good practice in the form of the joint auction facilities of the Co-ordinated Auction Office in South East Europe – except for the interconnector with Serbia where bilateral joint auctions are used. Positively, there is balancing co-operation between Bosnia and Herzegovina and its fellow load frequency bloc members, Croatia and Slovenia, as well as with Montenegro and Serbia on bilateral agreement basis.

The Energy Community Secretariat notes that day-ahead market integration and coupling has ceased (Energy Community, 2020[165]). This largely reflects that there is no power exchange, and any progress is conditioned on yet to be adopted state-level laws. BiH does not have the required legislative text that allows for the mutual recognition of a trading licence with other economies, which represents a hurdle for regional integration as it means that any trader from neighbouring economies would needs to seek an additional licence in BiH. Also concerning is the use of congestion income/revenue, with information provided suggesting that income is used as cross-subsidisation to lower network tariffs. While not prohibited by Article 16 Paragraph 6 of EU regulation 714/2009 on conditions for access to the network for cross-border exchanges in electricity, it does encourage the use of income to guarantee the availability of capacity or to maintain or increase interconnection capacity in an attempt to further the interconnection of the economy, rather than to lower transmission costs domestically.

### *Cross-cutting policy area: Energy incentives – direct and indirect subsidies in the energy sector*

In addition to the use of congestion revenues, there are several instances of subsidisation and cross-subsidisation in BiH. Another form of subsidisation appears to take place between households supplied by the Universal Supplier and commercial consumers, where the prices for households supplied by the universal supplier are below the market cost, and compensated by commercial consumers. However, this issue is currently being tackled by the regulator, which aims to reduce and eventually eliminate this form of cross-subsidisation.[193]

BiH is also subsidising coal production, with a cascading effect onto power via the five coal-fired power plants. A study by Miljević (2020[172]) estimates that between 2015 and 2019 BiH provided direct annual subsidisation to coal/lignite electricity producers amounting to EUR 166.6 million, or roughly EUR 33 million per year. Miljević (2020[172]) estimated that this subsidisation amounted to an indirect subsidisation of electricity generated from coal of about EUR 2.1/MWh, meaning that coal-fired generation was around EUR 2.1/MWh cheaper than it would have been without direct subsidisation. This subsidisation has market distorting effects that lead to higher consumption due to cheaper electricity consumption away from market equilibrium and optimal outcome, while also making it harder for renewable energy to compete as it lowers prices. This is especially counterproductive as the public financial support mechanism for renewable energy will have to compensate for lower fossil fuel prices.

Regarding thermal generation, another subsidisation concerns BiH's support in the form of state guarantees for a loan to Elektroprivreda BiH d.d. Sarajevo for the Tuzla 7 project, a thermal power plant. This constitutes state aid and thus the subsidisation of a coal-fired power plant as it mitigates the risk of investment via state funds.[194]

### *The way forward for energy policy*

The following are recommendations for actions to be taken by BiH to improve its energy markets and align with good practices:

- **Harmonise energy policy frameworks across energy sectors and markets, and between the entities**. This would facilitate the internal efficiency of energy markets and cross-entity operations by stakeholders.
- **Undertake wide-ranging reforms to finalise the transposition and implementation of the Third Energy Package (and possibly start on the Clean Energy Package)**, particularly in the areas of natural gas, unbundling and third-party access. Finalisation of the transposition and implementation of the Third Energy Package will move BiH's energy market into a position where international good practices are used to drive a competitive energy market where economic forces such as liquidity and competition are used to achieve the greatest benefit for the people and economy of Bosnia and Herzegovina. This is particularly an issue with natural gas, where bundled natural monopolies and the lack of third-party access means that markets are closed and dominated by monopolies. This largely means that no competitive forces are harnessed, and economic rent is not necessarily fairly distributed.
- **Develop and implement a strategy for the introduction of EU-style organised markets in electricity and natural gas markets** (i.e. power exchanges and associated day-ahead markets). Such markets contribute to the efficient allocation of scarce resources and the distribution of economic rent between producers and consumers. They also minimise transaction costs as market transactions are centralised.
- **Pursue a reinvigorated reform to increase market integration and market coupling**. International trade flows are a useful tool to promote market liquidity and competition, and thus limit the market powers of dominant domestic incumbents.
- **Introduce the competitive assignment of renewable projects in combination with good practice subsidisation schemes (**Box 21.15**) and simplified procedures**. This will support the growth of renewable energy as it reduces costs and minimises risk, while assuring the best value for money for Bosnia and Herzegovina. Competitive renewable energy will also contribute and support the consideration of coal phase out as renewable energy costs are reduced.
- **Consider designing a strategy and deploying a greenhouse gas pricing scheme** (either as a tax, trading scheme, a combination or a sequential introduction). This would support the phasing out of coal and the decarbonisation of the power sector, and shift the entire economy to a more environmentally friendly and sustainable state. A greenhouse gas pricing scheme will support the power sector to decarbonise as it shifts the explicit cost function in favour of renewable energy by introducing the environmental and climate impact of fossil fuels as an explicit cost factor. Moreover, the scheme would offer income flows for the government and companies. The government would benefit through sales of emission certificates, and companies would be rewarded for efficiently reducing emissions. The consideration of the introduction of a scheme becomes more pressing as the EU is considering introducing a carbon border tax.
- **Expand and pursue a policy to advance energy efficiency**. While energy efficiency is a good tool to minimise the cost burden of energy within the economy, it also supports efforts to decarbonise the power sector, and thus support environmental and climate goals.

#### Box 21.15. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated, independent of the electricity market price (Banja et al., 2017[173]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in-tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (European Commission, 2013[174]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (European Commission, 2013[174]), which is a particular problem as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (European Commission, 2013[174]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (European Commission, 2013[174]).

The European Commission (2013[174]) suggests using a feed-in premium scheme in combination with the following good practice recommendations:

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable projects and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

The Council of European Energy Regulators (2018[175]), reports that in 2016/17, some 17 of the 27 EU Member States still used some form of feed-in tariff (although mainly for small projects), while around 16 used feed-in premiums, including to complement feed-in tariffs.

For more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.
Source: (Banja et al., 2017[173]), "Renewables in the EU", doi:10.2760/521847; (CEER, 2018[175]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (European Commission, 2013[174]), *Guidance for the design of renewable support schemes*, https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (EUR-Lex, 2014[176]), *Guidelines on State Aid for Environmental Protection and Energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Environment policy (Dimension 13)

### *Introduction*

With an overall score of 1.7 in the environment policy dimension, Bosnia and Herzegovina is the lowest performing Western Balkan economies (Table 21.24). Nevertheless, several initiatives have been undertaken, and the economy slightly increased its performance since the previous assessment, particularly in the environmental quality of life sub-dimension (Figure 21.1).

**Table 21.24. Bosnia and Herzegovina's scores for environment policy**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 13.1: Resource productivity | 1.7 | 2.0 |
| | Sub-dimension 13.2: Natural asset base | 1.7 | 2.1 |
| | Sub-dimension 13.3: Environmental quality of life | 1.8 | 2.3 |
| **Bosnia and Herzegovina's overall score** | | **1.7** | **2.1** |

## *State of play and key developments*

### *Sub-dimension 13.1: Resource productivity*

Bosnia and Herzegovina has committed to combat climate change by undertaking activities to reduce greenhouse gas emissions and limit global warming to a maximum of 2°C by the end of this century, as a Non-Annex-I signatory to the United Nations Framework Convention on Climate Change (UNFCCC) and its Paris Agreement, and a party to the Kyoto Protocol. However, these efforts have been rather limited so far. The energy production sector remains the main carbon dioxide ($CO_2$) emitter, contributing to around 70% of total $CO_2$ emissions, followed by the transport sector that contributes around 23% (World Bank, 2016[177]).

Major changes have occurred regarding the legislative **framework for climate change** in BiH since the last assessment in terms of adopted amendments in the RS to laws on water and renewable energy sources, and the new Law on Energy Efficiency in the FBiH. BiH is currently developing enhanced nationally determined contributions (NDCs), required under the Paris Agreement, which will state that 1990 emissions should be reduced by 37% by 2030 and by 61% by 2050. It is planned that NDCs will be adopted and submitted by mid-2021. There is a greenhouse gas inventory that is made publicly available, and measures regarding energy efficiency (renovation of public buildings and more energy efficient public lighting) and renewable energy sources (share in total energy mix increased to 38.7% in 2019) have been undertaken to align with the EU *acquis* regarding greenhouse gas emission reductions.

BiH was working on an adaptation plan at the time of drafting that will identify the necessary resources and set timelines for implementing climate change related policies and strategies. The Climate Change Adaptation and Low Emission Development Strategy (CCALEDS) of BiH was also under revision with an aim to be fully harmonised with the NDCs and the overarching Environmental Protection Strategy and Action Plan of BiH by the end of 2021. The CCALEDS will encompass sub-sector strategies for waste and water management, air quality and nature protection. The main energy strategies[195] are aligned with climate change mitigation goals and long-term low-emission development strategies in BiH, but this is still not the case for transport and industry or agriculture policies, although certain changes in this regard are expected once the revision of the CCALEDS is complete. Although no systematic monitoring and evaluation of the strategies is conducted, active policy implementation, as measured by programme inputs and outputs of the approved climate change adaptation and mitigation policy framework, has been recorded.[196]

Competences for environment and climate change rest with the two entities and the Brčko District. In the FBiH, competence is shared between the federation and the ten cantons. At the state level, the Ministry of Foreign Trade and Economic Relations (MoFTER) is responsible for defining policies and basic principles, co-ordinating activities, and consolidating entity plans with those of international institutions in the area of energy, agriculture, protection of environment and use of natural resources, and tourism. Entity-level institutions are responsible for the strategic framework, policy setting, data exchange and reporting.[197]

Administrative capacities and inter-sectoral co-operation need to be significantly improved to systematically address climate change and go beyond the current project-by-project approach to ensure further alignment with and effective implementation of the climate *acquis*. Regarding vertical and horizontal co-ordination, representatives of relevant state- and entity-level institutions participate in working groups and consultative meetings and contribute to the development of strategic/policy documents. However,

institutional capacities are limited, vertical and horizontal co-ordination for planning and implementation are weak (caused by a complex administrative structure and top-down approach), and stakeholder participation in strategic planning is limited. Capacity building is mainly ensured through project-based initiatives and the activities of NGOs. There are also financial constraints and a lack of local financial mechanisms to address climate change adaptation and mitigation issues.

Regarding climate change adaptation, major climate-related risks have been identified as a temperature increase (drought, heat waves) and a change in annual precipitation patterns. As mentioned, adaptation measures have been implemented, in particular those regarding landscape restoration and reforestation actions,[198] more secure facility locations and infrastructure,[199] and early warning systems in connection to water-related disasters.[200]

Bosnia and Herzegovina's municipal waste generation per capita of 356 kg is much lower than the EU average (492 kg per capita in 2018), and among the lowest in the Western Balkans (386 kg per capita on average in 2018) (Eurostat, 2018[178]). A total of 36 municipal landfills have been registered in the RS, 44 in FBiH, and 1 in Brčko District, with few categorised as controlled landfills (Republika Srpska Institute of Statistics, 2019[179]), (EEA, 2018[180]). Households in rural areas with no available waste collection service need to organise their own collection and transport, which means that the majority of collected waste ends up disposed in illegal dumpsites (EEA, 2018[180]). The problem of the unregulated incineration of waste, especially of plastic, waste tyres and agricultural waste, is also present throughout the economy, and no specific sanctions are taken in this regard.

Some steps have been taken in relation to developing a **circular economy framework** and **municipal waste management** in Bosnia and Herzegovina (especially in the RS) since the last assessment, although it remains underdeveloped. The RS Waste Management Strategy (2017-2026) is in force, in accordance with which the RS Waste Management Plan (2019-2029) has been adopted that outlines a comprehensive list of short (2019-2024) and long-term objectives (2024-2029).[201] In the FBiH, with the exception of amendments to the Law on Waste Management in 2017 there have been no changes in the policy framework following the expiration of the FBiH Environmental Strategy 2008-2018 that indirectly covered waste management. The new overarching Environmental Protection Strategy of BiH (to be adopted by the end of 2021) will indirectly cover these aspects.

Although there is no systematic monitoring and evaluation of the environment related policy documents in the two entities, evidence of policy implementation has been recorded in the RS, with the following measures completed since 2017:

- Harmonisation of the legal framework with EU regulations.
- Establishment of a packaging waste management system and introduction of the extended producer responsibility.[202]
- Promotion of environmentally friendly waste management through the introduction of recycling islands,[203] and organised waste collection carried out as part of various awareness-raising activities.[204]
- Improvements in the municipal waste collection system and the rehabilitation and closure of municipal and illegal landfills.[205]
- Establishment of a system of joint landfill sites for the management of remaining municipal and non-hazardous industrial waste.[206]

Activities on waste prevention were also undertaken in RS in 2020 through the introduction of a fee for plastic bags. In addition, food waste has been recognised as an issue in the RS Waste Management Plan, particularly through the measure on "improvement of the data collection system on food waste", which calls for identification of the types and quantities of food waste generated as a first step. The development of a feasibility study for the functioning of a food bank and the development of a guide for food donation is planned, but no concrete timeline had been set at the time of drafting.

In the FBiH, waste separation at source is conducted in certain municipalities, and measures are undertaken regarding resource efficiency along product life cycles (i.e. extended producer responsibility schemes), which has led to an increase in the share of recycled packaging, electronic and electric waste in the total electronic and electric waste.[207] In 2018, the FBiH established the Waste Management Information System (WMIS) within the Environmental Protection Fund of FBiH to serve as an overall waste database. However, it is at the initial operational stage and the waste operators who are supposed to share or upload their information on waste to the WMIS are not properly informed about its existence.

The civil society organisation, Centers for Civic Initiatives, is planning activities for the coming period in co-operation with local governments, competent cantonal and federal ministries, the tax administration, and experts to develop guidelines for implementing regulations to treat illegal landfills[208] and illegal waste disposal. This process has however been slowed due to the COVID-19 pandemic.

Similar to other WB economies, waste collection and treatment infrastructure in BiH is financed through waste collection fees, budget and donor funds, while waste collection and treatment services are funded from waste collection fees. Waste disposal tariffs have not changed since the last CO assessment. Certain investments in new waste treatment facilities have been undertaken in the FBiH, but they were of a small scope due to the overall lack of financial resources. In the RS there is a plan to invest in new waste treatment facilities using government funds and some donor support. Illegal dumping and the unregulated burning of waste have been recognised as challenges in both the FBiH and RS – around 15% of illegal dumpsites have recently been closed – and inspections have been taking place according to the annual plan for inspection visits. However, local stakeholders report poor inspection supervision and the insufficient prosecution of perpetrators in this regard.

### *Sub-dimension 13.2: Natural asset base*

Bosnia is water-rich, with total renewable freshwater of 10 592 $m^3$ per year per capita in 2017. However, there is uneven distribution across the territory and noticeable seasonal amplitudes, sometimes with extreme hydrological phenomena. The major users of water are households (approximately 82%) followed by industry (16%), with the remainder used in agriculture (UNECE, 2018[181]; World Bank, 2017[182]).

Bosnia and Herzegovina has a relatively well established **freshwater management framework**, but lacks investment plans on water management that would include implementing legislation and monitoring. There have been no major changes in the legislative and policy framework regarding freshwater management in BiH since the last CO assessment. The legislative framework in this area is based on EU water framework directives, which apply to all surface and groundwater, the prevention of pollution at source, emissions control, water quality standards, and prevention and protection against flood risks. At the time of drafting, flood hazards and risks were being mapped for the economy through the IPA project, Support to Flood Protection and Flood Risk Management (2016). Planning of hydropower conforms with the relevant EU legislation; however the strategic environmental assessment, environmental impact assessment, nature protection and water-related provisions of the EU *acquis* need to be better enforced to adequately address growing environmental concerns (European Commission, 2020[39]). There is a system for prior regulations and/or specific authorisation for water extraction from groundwater and/or from surface waters, and a river basin management system has been developed. Co-operation with neighbouring economies in this regard has been established, especially with those at the Sava and Danube River Basins.

The main strategic document in RS is the Strategy of Integrated Water Management (2015-2024),[209] but implementation remains limited as no related action plan was adopted, no measures or targets were set, and it is not aligned with sectoral strategies. Key policies in the FBiH are the Water Management Strategy (2010-2022) and the Action Plan for Flood Protection and Water Management (2014-2021).[210] Local stakeholders report that the implementation record of both documents remains modest, although regular monitoring is conducted (once every four years for the Water Management Strategy and annually for the Action Plan for Flood Protection and Water Management).

Numerous institutions regulate freshwater management in BiH,[211] but they all lack the necessary financial and human resources to conduct their roles, and there are no regular capacity building activities. Vertical and horizontal co-ordination are also lacking. Data and projections on water demanded from agriculture, industry (including energy) and households are only partially available, and thus not guiding decisions about handling competing uses now and in the future. No data on water risk management are collected, and activities to raise awareness of water-related risks are lacking.

In terms of **biodiversity,** Bosnia and Herzegovina is one of the richest economies in Europe due to its specific environmental, climatic and geomorphological conditions. The large variety of land, freshwater, marine and underground habitats has resulted in an abundance of species and subspecies, including endemic species. However, its ecosystem is threatened by the unsustainable use of land and forests, habitat conversion, vegetation succession and invasive alien species, overexploitation of natural resources, waste mismanagement, inadequate fire protection, illegal hunting and fishing, and climate change as well as inappropriate integration of land, water and biodiversity concerns into development planning (UNECE, 2018[181]). **Forests** make up a large share of the total land area of Bosnia and Herzegovina (around 43% in 2016), which is around the WB average of 42% (World Bank, 2016[183]).

There have been no major changes in the legislative or policy framework since the last CO assessment. The Strategy on Nature Protection of the RS (2011-2017) expired and was not updated. In the FBiH, the Environmental Protection Strategy, which contained the Federal Nature Protection Strategy, expired in 2018 (the new strategy should be adopted by the end of 2021). The draft state-level Environmental Protection Strategy covers biodiversity aspects and outlines the following objectives: protection of biological, pedological and geodiversity of the economy through establishing and strengthening an institutional framework for the realisation of efficient measures for nature protection; sustainable use of natural resources; equal distribution of revenue from use of natural resources; reduction of pressure on biological and geodiversity in the economy; and establishment of financial mechanisms for the sustainable management of biological and geodiversity.

Although no reports were produced regarding the implementation of the RS Strategy on Nature Protection, certain activities in this field have been conducted. In particular, the government order on strictly protected and protected wild species was adopted in 2020, and an information system for nature protection was established in 2018 within the Institute for Protection of Natural and Cultural Heritage of the RS. In the FBiH, major activities relate to the adoption of a list of invasive species in 2019, the proclamation of five additional nature protected areas, and the establishment of an information system of nature protection in 2018. Aichi Biodiversity Targets[212] have not been achieved, although certain progress has been made towards objectives 11 and 12, and at some level on Target 1. No biodiversity monitoring system is in place to provide quality data on the status of biodiversity in the economy as there is no institution tasked with monitoring the state of biodiversity. The entities lack the capacity to establish the monitoring systems stipulated in their respective laws on nature protection.

Although several bodies regulate biodiversity in BiH,[213] human and financial resources (mostly government funded) are not adequate to execute their main responsibilities. Vertical and horizontal co-ordination appears non-existent, and capacity building activities are not being conducted.

In the framework document of the Strategic Plan for Rural Development of Bosnia and Herzegovina (2018-2021), the forestry sector is listed only through general data on the area and structure of forests in total and in each entity, without specific measures and plans for the development of forests and their important role in rural development.

The Forestry Strategy for RS (2011-2021) is in line with the entity's forest management plans and includes preventive and reactive measures for forest fires; fire protection is included in the forest management plans and specific plans for fire protection. According to the Information on Forest Management in the FBiH in 2019 and forest management plans for 2020, and considering that there is no Law on Forests or related regulatory instruments, the current legislation in the FBiH relates, among other things, to fire protection.[214] A forest inventory system for Bosnia and Herzegovina has been compiled but not officially published. The

Research and Development Project Centre in Banja Luka compiles annual reports on the health of forests. The Forest and Hunting Inspection of the RS oversees the monitoring and enforcement framework to combat illegal logging, and carries out control measures for both public and privately owned forests based on forest management plans. In the FBiH, the Inspection Service and forestry offices at the cantonal level are responsible for monitoring and combating illegal logging. The FBiH Forestry Inspection (FFI) performs all inspection services regarding the implementation of activities related to the Law on Inspection. Local stakeholders report the relatively small number of FFI staff in Sarajevo and the lack of co-ordination with the Cantonal Forestry Inspection.

There are no data on the range of penalties for illegal activities in the timber trade in both entities, and the levels of detection, reporting and sanctioning for illegal logging are reported to be low (European Commission and UNEP-WCMC, 2020[184]).

**The land-use legal and policy framework** has remained almost unchanged since the last CO assessment in the RS, with the exception of the adoption of the Amendment of Law on Agricultural Land in 2019, which introduced and defined the term “soil and land degradation“ and outlined the methods of soil protection. Four municipalities in the RS are in process of drafting local strategic document for land use planning.

On the policy side, the Council of Ministers adopted an Action Programme to Combat Land Degradation and Mitigate the Effects of Drought in BiH (APCLDMED) in 2017. During the land degradation neutrality (LDN) target setting process (2016-2018), the main land degradation drivers were identified in the RS, and LDN targets with associated measures were created until 2030. Although no implementation reports have been produced, some evidence of effective policy implementation has been recorded under the APCLDMED. These mostly relate to the development and adoption of an LDN report for the RS in 2019, the preparation of the Drought Management Plan for the RS at the time of drafting, the implementation of measures to protect the land and remediate degraded land (the hot spot regions of Bijeljina, Gradiška, Trebinje), as well as awareness-raising activities and enhancing the role of education in combating land degradation and the effects of drought.

Institutions responsible for land-use management in the RS include the Ministry of Agriculture, Forestry and Water Management, the Ministry of Spatial Planning, Civil Engineering and Ecology, and the Republic Administration for Geodetic and Property-Legal Affairs. In the FBiH, the leading institution in this area is the Ministry of Agriculture, Water Management and Forestry. All of these institutions in RS and the FBiH have qualified staff, but financial resources are lacking. So far, horizontal and vertical co-ordination have had an ad hoc and case-by-case nature. There has been limited capacity building and training activities for the responsible bodies. Regarding land-use indicators, very little data are collected in BiH, and when collected are mostly ad hoc on a project basis.

### *Sub-dimension 13.3: Environmental quality of life*

Poor **air quality** is one of the major concerns regarding environmental quality of life in BiH. This becomes an even greater issue in the context of the COVID-19 pandemic given that exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to the virus (OECD, 2020[185]). BiH has one of the highest concentrations of air pollution in Europe, with mean annual exposure to particulate matter ($PM_{2.5}$) of 30 µg/m$^3$, which is triple the World Health Organization recommended highest levels (10 µg/m$^3$), and higher than the averages in the EU (13.1 µg/m$^3$), the OECD (12.5 µg/m$^3$) and the WB region (25.77 µg/m3) (OECD, 2020[186]), (World Bank, 2020[187]). Power generation, heating, industry and transport are the main sources of air pollution in BiH (UNECE, 2018[181]).

The air quality framework remains underdeveloped in the FBiH. In RS, air quality management is regulated by the Law on Air Protection and relevant by-laws, and is almost fully aligned with EU directives.[215] Although there has been little change in the legislative framework since the last assessment, the policy

framework has been modified. In particular, the Swedish Environmental Protection Agency's IMPAQ Programme[216] (2017-2021) is being conducted to build capacities of the key government institutions in BiH to manage air quality, improve air quality data collection, and consequently enhance air quality throughout the economy. The project is run by a steering committee that includes relevant institutions in BiH, with MoFTER as the co-ordinating ministry. Monitoring of the IMPAQ programme is set to be conducted at the state level twice a year through steering committee meetings.

The entities are exclusively responsible for the adoption and implementation of regulations in the field of air protection. Several institutions at the entity and cantonal level are responsible for air quality management, but the lack of financial resources and institutional capacity impedes effective management in this area, although training courses have been conducted to build capacity. Horizontal co-ordination is ensured through the inter-entity body and the main vertical co-ordination tool is the Environment Partnership Programme for Accession (EPPA) Air Quality Working Group.[217]

Air pollution monitoring in Bosnia and Herzegovina is operated at the entity level, the cantonal level, by public health institutes and by companies. In the FBiH and RS, hydrometeorological institutes are responsible for the verification of air quality data and reporting. Although the air monitoring system has improved over the last ten years, it is still insufficient for a well-functioning economy-wide air monitoring regime. Monitoring is not co-ordinated and is undertaken according to different methodologies in both entities,[218] which results in a lack of air quality data available for the entire economy. This is aggravated by the low number of monitored locations (ten), which mainly cover urban areas (UNECE, 2018[181]).

When limit values and the alarm threshold are exceeded in RS, the competent authority informs the public and takes the necessary ad hoc measures. Immediate action is also undertaken in the FBiH. As stipulated in cantonal intervention plans, cantonal authorities conduct ad hoc measures depending on the type of air pollutant exceeded – PM, SOx, nitrogen oxide (NOx), etc. Information on air quality is promptly made available via the websites of the hydrometeorological institutes of FBiH and RS, and distributed via radio and television.

Around 88% of the BiH population has access to a piped **water supply**, and around of one-third of the population in each entity is covered by **the sewerage system** (33% in the FBiH and 36% in RS in 2015) (UNECE, 2018[181]). The main issues regarding water supply and sanitation relate to outdated infrastructure that causes significant water losses (usually more than 50% or even 70% in exceptional cases), infrastructure made up of hazardous material such as asbestos, which requires specific attention in rehabilitation works, and the overall lack of wastewater treatment plants (WWTPs) (in 2015 only 3% of the population in the FBiH and 5% in RS were connected to a WWTP, with no WWTP in the Brčko District) (Eurostat, 2018[188]).

No major changes have been recorded regarding legislative and policy frameworks in this area since the last CO assessment, and it remains relatively undeveloped.

The main sources of investment in infrastructure are the state budget in the RS. Current water service fees do not seem sufficient to cover operational and maintenance costs and necessary investments to renew and enhance the water supply assets. Prices set by local government units and applied by the Public Utilities Cooperation (PUC) are based on social criteria, with little opportunity for the PUC to ensure the reimbursement of service costs through its operating revenue, and thus the viability of the business. The state does not have defined criteria for determining investments, which means that investments in water supply infrastructure are generally ad hoc. In the FBiH, water supply and sanitation infrastructure is funded by local budgets, cantonal budgets, donations, loans by international financial institutions, etc. The water supply and sanitation service is funded by water tariffs and local budgets.

Regarding investments in the updated water infrastructure, the Water and Sanitation Infrastructure Project (WATSAN) has been implemented in the FBiH and the RS. Overall objectives of the WATSAN project (to be finalised by the end of 2021) relate to improving the current living conditions of the population, securing adequate hygienic conditions in the area of water supply and sanitation, and implementation of

environmental protection measures in line with the obligations of EU accession and harmonisation with EU legislation, particularly the Water Framework Directive, the Drinking Water Directive and the Urban Waste Water Directive. Very little has been done to decrease water losses in the system, although this issue has been recognised by the government. Some additional investments in wastewater treatment plants were planned at the time of drafting, but did not consider contaminants of emerging concern (e.g. micro plastics).

**Industrial waste management legislative and policy frameworks** have not changed since the last assessment – the same policies apply to municipal and industrial waste management in RS (Waste Management Strategy 2017-2026 and a Waste Management Plan 2019-2029). There are no similar strategies in the FBiH (as mentioned the draft Environmental Protection Strategy 2020-2030 should cover these aspects).

In the FBiH, the Ministry of Environment and Tourism and the Environment Protection Fund regulate waste management, but they both lack the financial resources to effectively conduct their role. In RS, several institutions regulate this area.[219] Co-ordination and capacity building activities are largely lacking in both entities, although some indirect activities in this regard have been recorded as part of the EU's EPPA programme.

In RS there is a system of prior regulations and/or specific authorisation for the storage and handling of substances endangering or potentially endangering waters, in accordance with the Law on Chemicals and the Law on Biocides. There is also an official register of chemicals on the market – all imported chemicals need to be registered in accordance with the laws and regulations related to the management of chemicals. There are classification, packaging and labelling rules for chemicals (for both substances and mixtures), and the Ministry of Health and Social Welfare of the RS keeps the register of chemicals where all "new" chemical substances are identified and noted.

The Pollutant Release and Transfer Register (PRTR) system has been established in both the FBiH and RS but is still not fully operational. In particular, the obligation to report to the economy-wide PRTR, enabling public access to and integration of collected data, and the transmission of data to EU institutions are still lacking. Regarding managing and controlling industrial risks and accidents, BiH is not aligned with the EU directive on the control of major-accident hazards involving dangerous substances (Seveso III) (European Commission, 2020[39]). There are no hazardous waste disposal facilities and hazardous waste is exported for final treatment.

Regarding soil protection and provisions for the identification and management of contaminated sites, there is no policy and legislative basis for soil protection in RS and the FBiH, and no soil monitoring system in BiH.

### *The way forward for environment policy*

Although there have been some improvements since the last assessment cycle, further efforts are needed in several areas, mostly regarding implementation. The priorities are as follows:

- **Improve the wastewater system** by:
  - Replacing the outdated water and sanitation infrastructure, especially those made from toxic materials such as asbestos. Although there have been some advances in this regard, such as through the WATSAN project, efforts need to be stepped up as BiH is one of the WB economies facing the greatest level of water losses (up to 70%).
  - Increase the number of wastewater treatment plants. Despite some newly constructed WWTPs, most wastewater in BiH ends up in the rivers untreated, resulting in high pollution levels. In particular, a very small number of the population are connected to WWTPs as there are so few in BiH. New investment in WWTPs is therefore needed, preferably financed from the domestic budget and water tariffs and complemented by donor funds.

- Apply the water-user and polluter-pays principles for all water users and dischargers, paying attention to the vulnerable social groups in the economy, and ensure regular maintenance of the existing water supply and sanitation network.

- **Enhance air quality by reducing emissions from the transport sector, industry and domestic heating.** As highlighted above, these three sectors represent the main sources of air pollution in Bosnia and Herzegovina. The per capita mortality rate in BiH attributed to household and ambient air pollution is 79.8 per 100 000 inhabitants, which is one of the highest rates in Europe (World Bank, 2016[189]). More effort is therefore needed, such as the following:
  - Investment in the reconstruction and insulation of residential buildings and private houses to improve their energy efficiency. Effective financial mechanisms, for example through subsidised loans from the banking system to improve domestic heating systems (moving from the use of firewood or coal, which is currently much cheaper than other sources) and overall energy efficiency. Seeking financial support from the international donor community is recommended.
  - Measures to prevent air emissions from industry, such as those described in the EU Best Available Technique Reference Documents (BREFs) (Box 21.16) need to be more regularly included in the environmental permits for industrial facilities in Bosnia and Herzegovina.
  - Introduction of economic incentives to promote a shift to cleaner and newer vehicles, such as the "feebate" system for new cars introduced in France in 2008, which imposes a tax on the buyer if the $CO_2$ emissions of the vehicle exceed a certain threshold and allocates bonuses if they are below a certain level. Supporting local governments in improving their public transport system, in particular by promoting the use of clean and energy efficient transport modes. Encouraging the use of other transportation means, such as bicycles for shorter distances, followed by the construction of an appropriate cycling infrastructure (Manea et al., 2019[190]).

### Box 21.16. EU Best Available Technique Reference Documents (BREFs)

The BREFs are a series of reference documents covering, as far as practicable, the industrial activities listed in Annex 1 of the EU's integrated pollution prevention and control (IPPC) directive. The BREFs provide descriptions of a range of industrial processes and, for example, their respective operating conditions and emission rates. Member States are required to consider these documents when determining the best available techniques for industrial activities generally or in specific cases. They also serve as a good basis for potential candidates.

The BREFs were developed to exchange information between industrial sectors and NGOs in different Member States and the European Integrated Pollution Prevention and Control Bureau.

The documents cover:

- Common Waste Gas Treatment in the Chemical Sector
- Emissions from Storage
- Ferrous Metals Processing Industry
- Industrial Cooling Systems
- Large Combustion Plants
- Refining of Mineral Oil and Gas
- Waste Incineration and Treatment

Source: (EEA, n.d.[191]), *EU Best Available Techniques reference documents (BREFs)*, https://www.eea.europa.eu/themes/air/links/guidance-and-tools/eu-best-available-technology-reference.

## Agriculture policy (Dimension 14)

### *Introduction*

Bosnia and Herzegovina's performance has been stable in the area of agriculture between 2018 and 2020 (Figure 21.1), with the economy achieving a score of 2.0 for the latest CO assessment. Some progress has been made; however, Bosnia and Herzegovina still scores low compared to other WB6 economies, falling below the WB6 region averages in all sub-dimensions, particularly the sub-dimension on agro-food system capacity (Table 21.25).

The rural infrastructure policy in Bosnia and Herzegovina has recently been updated, but budget allocations and utilisation remain limited. BiH's new Rural Development Strategy for 2018-2021 prioritises irrigation infrastructure, and the World Bank project supporting irrigation development has significantly increased the capacity of irrigation infrastructure.

However, BiH has made little progress in harmonising regulations on agricultural registers, the parcel identification system, the common market organisation and the accreditation of a payment agency, in line with the EU's Common Agricultural Policy (CAP) and other policies.

Finally, while BiH has made progress in harmonising its sanitary and phytosanitary (SPS) procedures with EU regulations, implementation of legislation on SPS measures is limited and varies between economic sectors.

**Table 21.25. Bosnia and Herzegovina's scores for agriculture policy**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 1.5 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 2.3 | 2.9 |
| | Sub-dimension 14.3: Agriculture support system | 2.1 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 2.0 | 2.6 |
| **Bosnia and Herzegovina's overall score** | | **2.0** | **2.7** |

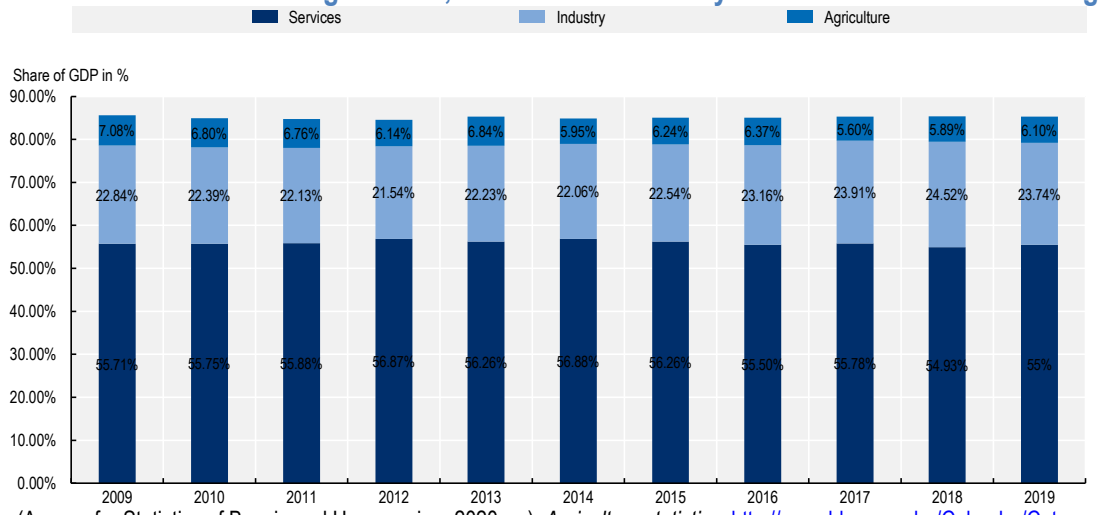
### *State of play and key developments*

The territory of Bosnia and Herzegovina measures 51 209 km$^2$ (5 120 900 hectares, ha), 50.4% of which is agriculture land and 48.3% forest land. Total arable land is 2.2 million ha, (MoFTER, 2018[192]) or 62% of all agricultural land and 30.95% of total land. Although the largest part of agricultural land, in particular arable land, is privately owned, its distribution among around 350 000 rural households makes the land highly fragmented, which negatively impacts agricultural productivity.

The structure of sowing areas has remained unchanged for years, dominated by cereals with a share of 58%, fodder crops at 26%, vegetables at 14% and industrial crops at 2%. Fruit production in BiH is represented by the production of plums, apples and pears, with a strong expansion in the production of raspberries and strawberries in recent years. Bosnia and Herzegovina's dominant portion of meadows and pastures allows for high cattle breeding, which is currently at a moderate level but with a solid basis for further development.

More than half of the total population (3.5 million) live rurally. In 2018, 15.4% of households listed agriculture and fishery as their main field of activity (Figure 21.16). Agriculture is an important pillar of the economy of Bosnia and Herzegovina, both in terms of its contribution to GDP and overall employment. While the contribution of agriculture to GDP in 2020 was 6.1%, 18% of BiH's workforce were employed in this sector, making it the third-most important employment sector, after services and industry.

## Figure 21.16. Contribution of agriculture, services and industry to GDP in Bosnia and Herzegovina




Source: (Agency for Statistics of Bosnia and Herzegovina, 2020[193]), *Agriculture statistics*, http://www.bhas.gov.ba/Calendar/Category/23.

As displayed in Table 21.26, Agriculture represents 2% of total exports and 3.8% of imports in BiH. However, agriculture exports have been decreasing over the last four years, and agricultural imports have begun to decrease more recently due to increased substitution with domestic production.

## Table 21.26. Value of exports and imports of the agriculture, forestry and fisheries sector (2016-19)

| | Exports | | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| | **2016** | **2017** | **2018** | **2019** | **2016** | **2017** | **2018** | **2019** |
| Total (million EUR) | 4.815 | 5.652 | 6.084 | 5.876 | 8.262 | 9.298 | 9.854 | 9.969 |
| Agriculture, forestry and fisheries (million EUR) | 1.42 | 1.46 | 1.29 | 1.18 | 3.89 | 4.21 | 3.82 | 3.85 |
| Percentage share of agriculture, forestry and fisheries | 2.96% | 2.59% | 2.13% | 2.02% | 4.72% | 4.53% | 3.88% | 3.86% |

Source: (Agency for Statistics of Bosnia and Herzegovina, 2020[193]), *Agriculture statistics*, http://www.bhas.gov.ba/Calendar/Category/23.

The potential of agricultural production in BiH is reflected in favourable agro-climatic conditions, preserved agricultural land and a large number of autochthonous varieties. However, agricultural production in BiH still faces low productivity, unfavourable structure and farm sizes, insufficient and poor technological equipment, and high dependence on imports of agriculture inputs, equipment and agricultural mechanisation.

### *Sub-dimension 14.1: Agro-food system capacity*

**Rural infrastructure policy** and strategies in Bosnia and Herzegovina have been updated since the last CO assessment and provide comprehensive priorities; however, implementation is uneven across the entities. MoFTER is responsible for the co-ordination of agricultural policy creation at the state level. Its jurisdiction is to define the framework of policies in co-operation with the competent institutions of the entities and the Brčko District. The ministries of the entities and the Brčko District are responsible for the management and implementation of policies, programmes and measures in their respective territories.

Rural infrastructure policy in BiH is primarily based on the Strategic Plan for Rural Development of Bosnia and Herzegovina (2018-2021), (MoFTER, 2018[192]) which was prepared by MoFTER in close co-operation with relevant ministries from the entities in a participatory process that involved all relevant stakeholders. The strategic plan was drafted and then widely discussed in several public debates and through the online platform for consultations (e-consultation.gov.ba). A total of 133 representatives from the public administration, businesses and the civil sector participated in the public debates. In 2019,

MoFTER, in collaboration with relevant institutions at the entity level, began activities for implementation monitoring.

The strategic plan envisages support for road infrastructure, field roads, anti-hail protection, water supply, Internet, radio and television signal, electricity supply, and infrastructure for waste management.[220] There is a provisional budget for the objectives at the state level, but implementation mechanisms are decided at the entity level.[221]

The total amount dedicated to rural infrastructure was less than EUR 2 million, out of which EUR 1.28 million is allocated to RS. RS has supported the installation of an anti-hail security system, a priority measure of the strategy, at a cost of EUR 31 000, while the Brčko District spent EUR 63 000 on the same measure and an additional EUR 72 500 on the construction and repair of field roads. The Ministry of Agriculture of the FBiH has made no expenditure on rural infrastructure during this period.[222]

Since 2013, the network of roads in BiH has increased by 18.7% to 10 758 km in 2018, local roads have increased by 1 008 km to 4 787 km, and regional roads have increased 444 km to 5 173. Motorways account for 198 km of the road network. In 2019, 76.9% of households in urban areas had an Internet connection, while 68.3% of households in rural areas maintained a connection, a 4% increase from 2018 and a 7% increase from 2017 (Agency for Statistics of Bosnia and Herzegovina, 2019[194]).

The potential of **irrigation infrastructure** in BiH is high, but the current system is limited, covering around 3 600 ha in FBiH and around 10 000 ha in RS. There are no monitoring and evaluation systems. Most investment in new irrigation systems and the rehabilitation of existing systems have been part of the Irrigation Development Project in Bosnia and Herzegovina 2013-2020 and funded by a World Bank loan of USD 40 million. The project supported new irrigation infrastructure investment, including the preparation of technical documentation and construction of an irrigation system in around 4 784 ha of land, as well as the preparation of technical documentation (preliminary or main designs) for new irrigation systems in around 20 000 ha of land. Support for the construction of irrigation and drainage infrastructure was also identified as a priority for development in the Strategic Plan for Rural Development.

According to a 2018 report on the Strategic Plan for Rural Development, the Ministry of Agriculture, Forestry and Water Economy of RS financed the procurement of 483 pumps, typhoons and pool tanks totalling around EUR 46 250. In the same period, the Brčko District's agriculture authority approved and provided small incentives for five applications. The FBiH Ministry of Agriculture, Water Economy and Forestry has not approved any applications regarding irrigation. Entities and the Brčko District should report to the BiH parliament annually as part of the framework report of the strategic plan, but there are currently no mechanisms for monitoring established at any entity level.

**Agricultural education policies** have been updated and enhanced, but the number of students enrolled in agriculture programmes has been slightly decreasing. The Constitution of BiH states that the education sector is regulated by entities, cantons and districts. RS has the Ministry of Education and Culture within its centralised government, but the FBiH has a decentralised government consisting of 10 cantons, each with its own ministry of education. The Brčko District has a centralised government with a single Department of Education. There is a Ministry of Education at the state level, but it primarily plays a co-ordination role over the 12 institutions responsible for education in BiH.

The agriculture education framework in BiH is based on the Strategy of Development of Science in BiH 2017-2020[223] and the Strategic Plan for Rural Development.[224] The actions foreseen by the plan are implemented in a very heterogeneous way in the different entities. As part of Measure 3 of the plan, which involves support for vocational training, knowledge development, and providing advice and information, the Ministry of Agriculture in RS approved five project applications for a total of EUR 260 000 in 2018, while FBiH and the Brčko District recorded no activity on the implementation of agriculture education that year.

Secondary education is represented by both general and vocational secondary education schools in BiH, with only vocational secondary education providing agriculture curricula. In FBiH, the number of students enrolled in the first year of agricultural secondary education slightly decreased from 973 (1.4% of the total

number of students) in 2018/19 to 951 (1.3% of the total number of students) in 2019/20. The number of students who completed education in the field of agriculture and livestock breeding also slightly decreased, from 403 students in 2018 to 368 students in 2019 (Bureau of Statistics FBiH, 2020[195]). In RS, the numbers are higher but have also slightly decreased. The number of enrolled students in the field of agriculture, forestry and veterinary in secondary education decreased from 2 158 (5.6% of the total number of students) in 2018/19 to 1 948 (5.2% of the total number of students) in 2019/20 (Bureau of Statistics Republika Srpska, 2020[196]).

Differences between the entities are less pronounced at the university level. Public university education in the area of agriculture is represented by eight faculties throughout the economy.[225] In RS, 2 371 students enrolled in a first year course in the field of agriculture, forestry, fishery and veterinary at the university level in 2019/20 (Bureau of Statistics Republika Srpska, 2020[196]). Meanwhile, 1 830 students enrolled in a course in the field of agriculture, forestry and fishery at the university level in FBiH in 2019/20, or 3.6% of the total number of enrolled students (Bureau of Statistics FBiH, 2020[195]).

### *Sub-Dimension 14.2: Agro-food system regulation*

Several **regulations on natural resources** in RS have been updated in the last two years, but land consolidation remains weak for all entities in Bosnia and Herzegovina. As the regulation of natural resources is the responsibility of the entities in BiH, both RS and the FBiH have specific laws in the area of natural resources management. The Law on Waters in RS was last amended in 2012 and regulates the protection, use and management of water, while the Law on Water in FBiH was adopted in 2006. Regulations in RS improved with amendments to the Law on Agriculture Land in 2019 regarding soil and land degradation and additional measures for soil protection. The Law on Agriculture Land in FBiH was adopted in June 2009. To reform agricultural policy in the FBiH, a mid-term strategy for development of the agricultural sector in the FBiH (2015-2019) was developed, and the FBiH government adopted one decree in 2019 (no. 1389/2019) and one in 2021 (no. 267/2021) to extend the implementation period of the strategy until the end of 2020 and 2021, respectively.

The Strategic Plan for Rural Development[226] provides an in-depth interpretation of the state of land, climate and water in BiH. Regarding agro-ecology it identifies land degradation, waste management, agro-ecological policy, and protection of the biodiversity of animal and plant genetic resources as priorities for improvement. Water management in the FBiH is based on the FBiH Water Management Strategy 2010-2022, which defines the objectives for sustainable water management and the necessary activities to be implemented as part of the action plan. In 2020, RS improved its co-operation and co-ordination between the water management and agriculture departments and irrigation users through the establishment of a new irrigation department within the public agency, Vode Srpske.

While both entities have defined the land consolidation process and provided a legal framework for its implementation, land consolidation remains an unresolved issue in BIH. There has been little progress in this area, and capacity and budget support are limited. There is also a lack of knowledge and awareness among farmers.

**Regulations on products** in Bosnia and Herzegovina are generally in line with international standards, and the economy made progress in updating laws in 2019. Regulations on products fall under the auspices of the BiH Administration for Plant Health Protection (PHPO), a department of MoFTER. The PHPO is the central authority for plant health protection in BiH and for the exchange of information with official international authorities. The PHPO performs administrative and related technical tasks in line with the Law on Plant Health Protection and other substantive regulations that make up the legal framework. The PHPO co-operates, informs and exchanges information with official international plant protection authorities and organisations. Based on substantive regulations, phytosanitary competences are shared between the PHPO and the entities. The PHPO, in collaboration with competent inspection bodies of the entities, works on a co-ordinated multi-annual control programme to ensure compliance with maximum

residue levels of pesticides, and to assess consumer exposure to pesticide residue in and on food of plant and animal origin.

Regulations on products are based on the Law on Plant Health Protection, which was harmonised with the International Plant Protection Convention in 2015. Also relevant are the Law on Agricultural Seeds and Propagating Material, the Law on Protection of New Plant Varieties, the Law on Mineral Fertilisers, and the Law on Phyto-pharmaceutical Products. Regulations on pesticides are defined by Rulebook on the Maximum Level of Pesticides Residues in and on Food and Feed of Plant and Animal, last updated in 2019. The rulebook determines the maximum residue level of pesticides in and on food and feed for animals of plant and animal origin for insurance purposes, in accordance with general principles prescribed by the Law on Food and regulations at the entity level that refer to pesticide residue.

The Law on Mineral Fertilisers regulates conditions for the composition, quality and marking of mineral fertilisers placed in the market; their use; and supervision of the implementation of this law and by-laws adopted based on this law, and other regulations adopted for the application of this law. The list of active substances permitted for use in plant protection products is updated continuously.

### *Sub-dimension 14.3: Agricultural support system*

**The agriculture policy framework** has been updated recently at all entity levels; however, BiH has still not implemented mechanisms that would ensure its eligibility for EU Instrument for Pre-accession Assistance for Rural Development (IPARD) funding. The legislative framework for measures to support agriculture and rural development at the state level consist of the Law on Agriculture and the Law on Food and Rural Development of BiH. In RS, the framework is made up of the Law on Agriculture and the Law on the Provision and Directing of Funds for the Promotion of Agriculture and Rural Development, and in FBiH it is the Law on Agriculture and the Law on Financial Support in Agriculture and Rural Development.

The agriculture policy framework of Bosnia and Herzegovina at the state level is based on the Strategic Plan for Rural Development.[227] At the entity level, the framework consists of the Mid-term Development Strategy of the Agricultural Sector in the FBiH (2015-2019) and the Strategic Plan for Development of Agriculture and Rural Areas in RS (2016-2020).

Harmonisation with the EU's CAP is a priority for all strategies related to agriculture policy at all levels in BiH. The Office for Harmonisation and Co-ordination of Payment Systems in Agriculture within MoFTER is in charge of the harmonisation of payment systems in agriculture and rural development in BiH, as well as the gradual harmonisation of the payment system with the EU system. The office is also responsible for developing a legal framework to establish and develop institutional structures for the implementation of EU funds.

Budgetary support for agriculture in BiH is implemented at the level of entities and cantons. In FBiH, support is implemented based on the adopted programme of funds expenditure with allocation criteria for incentives for agriculture. In RS, financial support for agriculture is carried out in accordance with the adopted plan allocation of resources to support agriculture, all of which are adopted annually. Funding for agricultural policy is provided by state and entity budgets, as well as through EU and international projects. Bosnia and Herzegovina is not yet eligible for IPARD funding as the mechanisms for implementation are still not ready. According to MoFTER data, in 2019 approximately 70 000 producers were supported by available measures at the state level.

**Domestic producer support instruments** in Bosnia and Herzegovina are well structured as part of rural development strategies in both entities; however, there are no monitoring and evaluation mechanisms. Domestic producer support instruments are implemented at the entity level. In RS, support responsibilities fall under the Ministry of Agriculture, Forestry and Water Management, which adopts the Rulebook on Conditions for Incentives for the Development of Agriculture and Rural Areas annually. Domestic support instruments are laid out in the Strategic Plan of the Development of Agriculture and Rural Areas of RS (2016-2020), which includes support for current production,[228] capital investments,[229] rural development

and systemic support.[230] The agriculture support budget for 2020 was EUR 37.5 million, implemented by the Agricultural Payment Agency of RS.

The legislative framework for domestic support measures in agriculture and rural development in the FBiH are regulated and implemented through the Law on Agriculture and the Law on Subsidies in Agriculture and Rural Development. Cantonal sectoral ministries also provide support. In the FBiH, agricultural support measures are based on the principles of the Mid-Term Strategy for the Development of the Agricultural Sector (2015-2019). In 2019, the cantons supported agriculture with more than BAM 22 million (EUR 11.09 million), an increase of 10% from 2018. Cantonal support accounts for 24.9% of the total FBIH budget for agriculture. Compared to 2018, the share of cantonal support in agriculture support measures has increased by 2.7%.

The 2020 budget of the FBiH for the support of agriculture was EUR 43.5 million. The FBiH government, as part of the Public Investment Programme (2020-2022), runs the Rural Development Programme worth EUR 104.5 million. Farmers are also eligible for International Fund for Agricultural Development grant funds and EU funds of over EUR 10 million. Part of the funds are directed towards investments to increase the competitiveness of agricultural products and reduce the large trade deficits in the sector. The implementation of agriculture support programmes is relatively high in both entities; however, there are no consistent data within annual monitoring reports on the outcomes of the programmes, and impact assessments are not conducted regularly at either the entity or state level.

**Agricultural trade policy** of Bosnia and Herzegovina is aligned with EU customs tariff nomenclature, and tariff rates benefit from regular reports and analyses on agriculture trade development. Trade policy in BiH remains under the auspices of the Council of Ministers, which annually adopts a decision on the Determination of the Customs Tariff in accordance with the Law on Customs Tariffs. BiH is a member of CEFTA and has ratified the Stabilisation and Association Agreement (SAA) and the European Free Trade Agreement (EFTA). BiH also maintains a free trade agreement with the Republic of Turkey . Bosnia and Herzegovina does not have export subsidies, export credit support, export duties or export prohibitions for agricultural commodities (crops and livestock). The customs tariff nomenclature of goods is aligned with the harmonised system and the combined nomenclature used by the EU.

Goods imported into Bosnia and Herzegovina and placed in free circulation are subject to payment of VAT at the rate of 17%. There are import quotas for agriculture products under the trade agreement between the EU and BiH, notably for cattle, swine, sheep, live animals and meat. Customs duties on all commodities imported into BiH are paid according to the value at rates of 0%, 5%, 10% and 15%. These rates apply to commodities originating from economies that have concluded an agreement with a “most favoured nation” clause with BiH, or from economies that apply the same clause on commodities originating in BiH. Upon accession of BiH to the WTO, most-favoured nation status will be granted to all WTO members, some alterations to tariff protection for agricultural products in BiH will then be expected, subject to negotiations.

Regulations on customs tariffs are adopted based on an analysis of the previous situation to make implementation as enforceable as possible. Although there is no exact assessment, transparency is guaranteed based on publicly available regulations and procedures, which are published on the MoFTER website. Annual reports are prepared, including the level of implementation of strategies, action plans and legislation. No impact assessments are conducted in the agriculture sector specifically, but various documents are regularly prepared that provide analysis, such as annual reports in the field of agriculture, food and rural development; analysis of the foreign trade of agricultural and food products of BiH; and analysis of the milk and dairy product market in BIH.

**Agricultural tax policy** in Bosnia and Herzegovina is relatively standardised across the entities; however, only a small number of agricultural products benefit from VAT exemptions. Tax policy falls under the remit of the Tax Authority of FBiH, the Tax Authority of RS and the Indirect Taxation Authority of BiH. Tax policy, including agricultural tax policy, is based on the Law on Value Added Tax, the Law on Tax Procedure and Tax Administration of RS, and the Law on Income Tax of FBiH, which is currently undergoing parliamentary approval.

Personal income tax in Bosnia and Herzegovina is 10%, with no exclusions for agriculture at the state or entity level. Social contributions depend on the entity.

Standard VAT in Bosnia and Herzegovina is 17%, but there is no VAT on the export of goods for agriculture in general. The exclusion of VAT for certain agricultural products depends on the entity and mostly cover machinery and the provision of agricultural inputs such as seeds and seedlings. Both entities can defer, which is done on annual basis by the governments of the respective entities based on analysis of the ministries of finance and agriculture.

The **sanitary and phytosanitary system** in Bosnia and Herzegovina is well organised with a clear division of responsibilities and strong alignment with EU regulations. The SPS system and measures are governed by the Law on Food and fall under the auspices of MoFTER and the Food Safety Agency of BiH (FSA), an independent administrative organisation established by the Decision on the Establishment of the Food Safety Agency of Bosnia and Herzegovina. The FSA provides scientific advice and scientific and technical assistance regarding the legislation and policies of BiH in all areas that have a direct or indirect impact on food and feed safety. It provides independent information on all issues within these areas and transmits risk information. The FSA collaborates with competent authorities to improve the effective connection between risk assessment, risk management and risk disclosure functions.

The FSA does not have its own inspection body, but inspections are carried out through the Veterinary Border Inspection and Inspections of the Veterinary Office of Bosnia and Herzegovina. The Veterinary Office is under the direct jurisdiction of MoFTER and works in accordance with the operative activities of entity veterinary services.

The FSA, in collaboration with competent inspection bodies, prepares a co-ordinated multi-annual control programme, funded by the state budget, to assess consumer exposure to pesticide residue in and on food of plant and animal origin. Food control laboratories in BiH are authorised by the entities to undertake their work, in accordance with EU regulation. The FSA, in co-operation with the competent bodies of the entities and the Brčko District, has initiated, prepared and proposed over 100 regulations adopted by the Council of Ministers of BiH since 2006.

The Plant Health Administration of Bosnia and Herzegovina is an administrative organisation within MoFTER responsible for phytosanitary measures. It was established by the Decision on Establishment of the Administration of Bosnia and Herzegovina for Plant Health Protection in 2014.

There is a strict division between legislative and executive authorities at all levels of governments, and no duplications of inspections. The system is well organised, and each institution in the system has designated contact points and officials responsible for the flow of information and the efficient handling of notices consistent with the assessed risks. The FSA generally proposes regulations in line with relevant EU legislation, prepares amendments according to EU legislation and aligns regulations through co-operation with the BiH Directorate for European Integration.

### *Sub-dimension 14.4: Agricultural innovation system*

Bosnia and Herzegovina has enhanced its **agriculture research and innovation** legislation to some extent, but research and development remains limited. The government has increased its efforts to upgrade research and innovation policies and related activities through the preparation and adoption of the Strategy for the Development of Science and related action plan in 2010 for a five-year period. The strategy sets the basis for the future development of research in all areas. The programme was later extended to 2019 and its implementation is still under way. The government has also increased its use of funds under the EU Horizon 2020 Programme.

The Strategic Plan for Rural Development of Bosnia and Herzegovina (2018-2021) emphasises the need to increase institutional co-operation and improve partnerships between scientific research advisors and producers. The strategy calls for further support for the improvement of experimental educational and

development centres, the introduction of technological innovations in agriculture, the improvement of laboratories, and the preservation of indigenous breeds and strains of domestic animals.

The number of research projects and applications has increased in recent years in RS. In FBiH, there are limited data regarding research projects and applications, with two new laws regarding the funding of agro-innovation apparently in the preparation phase. These laws should define the use of funds in the field of innovation, scientific research and development.

Agriculture research and development remains an important area for further planning, support and organisation to provide expected results and improve the performance of the agriculture sector.

**Agricultural extension services** in BiH continue to lack administrative capacities and funding to improve advisory services, and impact assessments are still not conducted. Extension services in agriculture at the state level fall under the auspices of MoFTER, which is responsible for the co-ordination and guarantee of the quality of private and public rural development and agricultural advisory services. It is part of the support of the implementation of rural development and agricultural policies and programmes throughout BiH. Advisory services at the entity level are organised and implemented by all entities, benefitting predominantly small agricultural producers. The legislative framework for agricultural extension services is based on the Law on Agriculture and the Law on Agricultural Extension Services of FBiH. Both laws regulate the goals and approaches of agricultural extension activity, who can perform an extension activity, and how to organise extension services.

The Strategy for Rural Development of BiH emphasises the role and importance of improving the system for providing extension services in terms of strengthening human, material and technical capacities; improving the planning, programming and provision of advisory services; and improving breeding and selection work in animal husbandry.

Advisory services in BiH are free and mainly deal with agriculture production, processing and marketing (i.e. vegetables and fruit growing, animal husbandry, processing and quality of agro-food products, agro-economy). The BiH public agricultural extension service is strongly focused on production techniques, while farm management, markets and marketing, regional rural development and the promotion of producer organisations are only partially served.

Agricultural extension services in BiH are severely impacted by a lack of human resources, limited funding, a lack information sharing between advisory services and other stakeholders, and a lack of specialised research institutions. Private extension services are present on a small scale and only operate on a commercial basis by charging farmers for their services. Monitoring of implemented activities is undertaken through annual reports, but impact assessments for policies and programmes are not conducted. Currently, activities within the extension service are planned according to the needs of farmers, and the training of farmers is determined by the annual working plan of the extension service.

### *The way forward for agriculture policy*

- **Increase investment and improve the implementation of rural infrastructure policy**. There is a continuous need to improve rural infrastructure and boost the use of current programmes and support schemes, especially in the FBiH.
- **Harmonise rural development programmes across the economy**. BiH needs to effectively implement the Strategic Plan for Rural Development (2018-2021) at all levels. The harmonisation of rural development programmes and support measures throughout the economy should be enhanced and the new strategic plan for 2021 should reflect the harmonised measures and approach to implementation.
- **Implement a common market organisation regulatory framework**. The finalisation of the registers of farms and agriculture cadastres needs to be implemented. Furthermore, statistics need to be more reliable and harmonised across entities.

- **Set up the institutional framework for IPARD funding**. BiH needs to make further efforts in the process of an integrated administration and control system as a prerequisite for IPARD funding, the land parcel identification system and the farm accountancy data network. Furthermore, strengthening administrative capacity at all levels of government, as well as the full functionality of the payment agency, should be a priority for further harmonisation with the CAP and the use of EU funds.
- **Speed up the process of the preparedness of domestic reference laboratories**. Further efforts to increase the accreditation of laboratory methods used in hygiene, veterinary and phytosanitary controls are needed. State reference laboratories would improve food and safety policy, thus increasing the competitiveness of the agriculture sector overall.

## Tourism policy (Dimension 15)

### *Introduction*

Table 21.27 shows Bosnia and Herzegovina's scores for the five sub-dimensions and compares them to the WB6 average. Bosnia and Herzegovina has a very complex tourism policy framework and responsibilities are highly fragmented between different administrative levels. In all five sub-dimensions, Bosnia and Herzegovina scores below the WB6 average, with the lowest scores in the region in the sub-dimensions of governance and co-operation, destination accessibility and tourism infrastructure (along with Kosovo), and tourism branding and marketing. Although limited, some progress has been made in the tourism policy framework since the 2018 CO assessment (Figure 21.1), mainly regarding the availability of a qualified workforce sub-dimension, driven solely by improvements in the VET framework for tourism. Moderate progress has been made in the destination accessibility and tourism infrastructure sub-dimension, driven by improvements regarding accommodation capacity and the quality of the tourism offer with the adoption of mandatory accommodation categorisation standards and the development of quality standards for other tourist products and destinations in Republika Srpska. Progress in all other sub-dimensions is relatively low.

**Table 21.27. Bosnia and Herzegovina's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Governance and co-operation | 1.3 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 1.5 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 1.3 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 1.3 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 0.5 | 1.6 |
| **Bosnia and Herzegovina's overall score** | | **1.2** | **2.0** |

### *State of play and key developments*

The tourism industry in Bosnia and Herzegovina has been growing significantly over the last ten years, and BiH has the highest average annual growth of international tourist arrivals (14%) in the Western Balkan region. In 2019, the number of tourist arrivals reached 1.6 million (25.6% growth since 2017), and the number of tourist overnight stays was 3.4 million (25.9% growth since 2017). This is the result of increased foreign tourist visits (increase of nearly 30%) and foreign tourist overnight stays (increase of 26%) (Agency for Statistics of Bosnia and Herzegovina, 2020[95]). In 2019, the direct and indirect contribution of tourism to GDP was 9.3% (USD 1.8 million), which is 6.85% higher than in 2017. Bosnia and Herzegovina reached the highest average receipt per arrival (USD 950) in the WB region in 2019. Tourism contributes 13% to total exports and directly creates 25 700 jobs (3.2% of total employment), contributing 9.6% to total employment (79 100 jobs) (WEF, 2019[197]). Tourism is consequently becoming one of the most important sectors in the economy.

Although the tourism industry has significantly increased in recent years, BiH's share of international arrivals among the WB region was only 3.3% in 2019. According to the World Economic Forum's (WEF) Travel and Tourism Competitiveness Index 2019 (WEF, 2019[197]), BiH has increased its ranking by eight places since 2017; however, it is the least competitive economy in the region, ranking 105$^{th}$ out of 140 economies in 2019. This indicates that the tourism policy framework in BiH is not competitive enough compared to its regional peers, and that the tourism sector faces several challenges that need to be addressed.

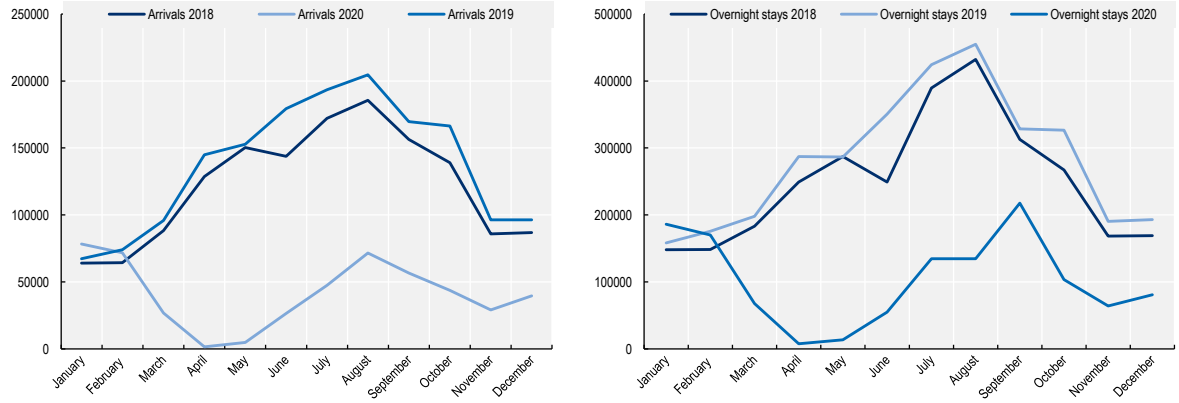
The main challenges in the tourism industry are the low visibility of BiH as a tourist destination internationally and the low quality of tourist products, services and infrastructure. Moreover, finding qualified workers is pressured by high seasonality (BiH ranks 105$^{th}$ on the WEF Index for the indicator

"ease of finding skilled workforce"), which affects the quality of tourist products and services (WEF, 2019[197]). Nevertheless, BiH's rich cultural and natural heritage is an opportunity to develop unique and authentic touristic products, thus increasing its competitiveness in the global market and bringing economic and social benefits to local populations. To lower seasonality one solution would be to disperse the tourist offer to rural areas and less known tourist destinations and prolong tourist stays in the destinations. In the short term, this will also help the tourism sector recover from the COVID-19 pandemic, adapt to new circumstances and attract visitors to BiH.

The COVID-19 pandemic stalled the development of the tourism industry in 2020 with the implementation of measures to limit the spread of the virus (Figure 21.17). Tourist arrival numbers were promising at the beginning of 2020 but started to drastically decrease from March in BiH and globally. The easing of restrictions and the lifting of lockdown led to slow signs of recovery in June 2020 that lasted until September 2020 when the second wave of the pandemic occurred. Accordingly, the consequences of the pandemic have been significant.

## Figure 21.17. Tourist arrivals and overnight stays Bosnia and Herzegovina (2018-20)

Monthly




Source: (Agency for Statistics of Bosnia and Herzegovina, 2020[95]), *Tourism statistics*, http://www.bhas.ba/Calendar/Category/19.

StatLink https://doi.org/10.1787/888934255627

The share of foreign tourists decreased from 75% in 2019 to 44% in 2020 due to the pandemic. According to the Directorate of Civil Aviation of BiH, airports in BiH recorded a decline in passenger traffic of 71% between January and September 2020 (400 000 passengers compared to 1.3 million in the same period in 2019). Sarajevo Airport had 78% fewer passengers than the previous year, Mostar Airport had a 96% decrease, Banja Luka Airport had a 62% decrease and Tuzla Airport had a 59% decrease.

Bosnia and Herzegovina followed instructions from the UN World Tourism Organization (UNWTO) and entity governments took measures to support the tourism sector. Notably, in RS a compensation fund was established to pay minimum wages, taxes and contributions for workers in sectors affected by the pandemic. A plan to issue 50 000 tourist vouchers to stimulate domestic tourist consumption was also established. In the FBiH, a similar compensation fund was established, along with a specific allocation of BAM 2.5 million (~EUR 1.25 million) for the tourism sector.

In October 2020, guidelines and protocols for health care regarding COVID-19 in tourism in BiH were issued, and BiH received the "safe travel country" label from the World Tourism and Travel Council (Ministry of Environment and Tourism FBiH, 2020[198]). The guidelines set out the principles to be followed in carrying out tourism activities during the COVID-19 pandemic, as well as protocols for tourism and hospitality businesses. The purpose of the guidelines is to protect tourists and the workforce, while respecting health regulations and measures to limit physical contact (Ministry of Environment and Tourism FBiH, 2020[198]), and to reinforce the trust of tourists to travel to BiH.

In November 2020, the FBiH government allocated BAM 6 million (~EUR 3 million) to Sarajevo, Tuzla, Mostar and Bihać airports to support their liquidity and maintain the employment of airport workers following reduced activity as a consequence of the pandemic. In December 2020, the FBiH government allocated a BAM 30 million (~EUR 15 million) fund to organisations in the tourism and hospitality sectors. The assistance for businesses was intended for salaries and business expenses from 1 July to 31 December 2020 (Ministry of Environment and Tourism FBiH, 2020[199]).

### *Sub-dimension 15.1: Governance and co-operation*

In Bosnia and Herzegovina, the multi-layered constitutional and political system demands a specific **tourism governance structure and institutional set up**. At the state level, the Tourism Department within MoFTER is in charge of co-ordinating activities and harmonising plans with the entities' authorities and international institutions in charge of tourism. At the entity level, the FBiH Ministry of Environment and Tourism, the Ministry of Trade and Tourism of RS and the Brčko District's Department of Economic Development, Sports and Culture are responsible for the legislative framework, the adoption of tourism strategies and the development of tourism in general. In the FBiH, a draft Tourism Strategy for 2008-2018 was prepared but never adopted, and in RS a new Tourism Strategy is being prepared after the strategy adopted for the period 2010-2020 expired. The entities have adopted their own governance structure and institutional set up, which is different in each entity. The tourism governance framework in RS is similar to most commonly established governance frameworks in other economies,[231] whereas the governance structure and institutional set up in the FBiH is more complex, with tourism development management divided between the Ministry of Environment and Tourism and cantons' ministries responsible for tourism. Cantons have also adopted their own legislation and regulations as the FBiH Law on Tourism was cancelled in 2014 and a new one has not yet been adopted. The key challenge for the FBiH is to establish a legislative and regulatory framework at the entity level to improve the governance framework and harmonise tourism development at the local level.

In 2007, the Tourism Working Group was established by MoFTER to co-ordinate tourism activities among the entities and the Brčko District. Its main activities are to regulate the tourism sector in BiH in accordance with EU directives and standards, to improve the organisation and regulations in order to harmonise activities and establish a single economic space in BiH, and to establish an effective regulatory framework in the tourism sector by strengthening the competencies of existing institutions and identifying the competencies of tourism associations. Members of the working group are representatives of the ministries responsible for tourism in both entities and the Brčko District, and of the Foreign Trade Chamber of BiH. The complex governance structure and institutional set up require considerably more human and financial resources in comparison with other economies in the region.

Due to the complex governance structure, **partnership with stakeholders** at the state level is relatively weak. Except for the Foreign Trade Chamber of BiH, no other private stakeholders are involved in the established Tourism Working Group. The private sector is involved in different working groups in both entities and meetings are organised with the ministries; however, private sector stakeholders report that more active co-operation and dialogue is still needed, especially when preparing new legislation and regulations as no consultations with the private sector are currently required. There has been no monitoring or evaluation to assess the level of actual public-private co-operation at the destination level. However, recently implemented donor projects[232] have contributed to the improvement of public-private co-operation at the destination level by providing support for the development of tourism clusters. The experiences of these clusters are a good basis for building public private co-operation in the other main tourist destinations in the economy.

**The vertical co-operation and co-ordination framework** from the state to the local/destination level is relatively weak. Although the ministries of both entities co-operate with their sub-entities (the cantons in the FBiH and local tourist organisations in RS), there is no formal co-operation body. The tourism governance structure at the local level still needs to be improved, particularly as many municipalities lack

the financial resources and qualified staff to manage tourism development. Moreover, local stakeholders report that the private sector's readiness to co-operate at the local level and its understanding of the benefits of co-operation at the destination level are weak, which hinders the successful implementation of tourism policy measures.

BiH has established a **tourism data collection system** as a baseline for statistics on tourism. The Agency for Statistics of Bosnia and Herzegovina is responsible for the production and development of statistics on tourism in accordance with the Law on Statistics.[233] Currently, the Agency for Statistics is producing data on accommodation statistics, and in 2019 it introduced a new survey on demand-side tourism. RS and the FBiH also have entity statistical institutions, namely the RS Institute of Statistics and the FBiH Institute for Statistics. However, since 2017 progress on improving tourism data collection has been limited. The key challenge is the lack of electronic data collection methods (e-questionnaires, web surveys) that would contribute to the higher reliability of collected tourism data. Positively, the development of Tourism Satellite Accounts (TSA) is planned as part of the IPA 2019 programme (European Commission, 2020[200])and will serve as a good start for the overall improvement of the tourism data collection system.

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

Since 2017, BIH has not improved its **connectivity framework** as no further reductions of visa requirements nor any other measures to ease border crossings have been introduced.

There are **accommodation capacity and quality assurance frameworks** at both entity levels that foster availability and quality improvements of all types of accommodation, and certain policy measures have been implemented. These frameworks, which are in line with international standards, have facilitated investments in high-quality tourism accommodation facilities by ensuring the consistent quality of accommodation. The categorisation of accommodation is now mandatory for all types of accommodation, registers of accommodation facilities have been established in both entities and monitoring is conducted regularly. RS has quality standards for tourist destinations and municipalities in addition to accommodation quality standards. In 2019, in co-operation with Serbia and Montenegro, bike friendly standards for accommodation facilities and other tourist service providers were also developed. Despite this progress, the regular monitoring and evaluation of policy measures is still lacking, and would facilitate further investment in accommodation facilities.

In BiH, **the tourist information system** is established at the entity level. In both entities, information is provided via websites and mobile applications, road signage and in tourist information centres. Information is mainly available in English and local languages and is regularly updated. No major progress has been reported since 2017 in this field. RS has a well-established tourism information system, managed and co-ordinated by the Tourist Organisation of Republika Srpska and implemented by local tourist organisations. In the FBiH, tourist information is provided by the tourist boards of destinations and is not co-ordinated at the entity level. The absence of a tourist organisation at the FBiH level results in a lack of management and co-ordination of the tourism information system. Moreover, the absence of a tourist organisation at the state level hinders the creation of a comprehensive tourism information system and the visibility of BiH as a tourist destination in the global market.

### *Sub-dimension 15.3: Availability of a qualified workforce*

BiH has a complex education system, with competences split at the entity level. In the FBiH, education is under the jurisdiction of the cantons. According to information provided by the authorities, no progress has been made since 2017 in the development of the **skills supply framework** nor in **the tourism VET and higher education framework**. Moreover, BiH worsened its position in the 2019 WEF Competitiveness Index: it went down six places in the "human resources and labour market" category (ranking 106$^{th}$ out of 140), with its worst rankings in the categories of "labour market" (134$^{th}$), "ease of hiring foreign labour" (132$^{nd}$), "ease of finding skilled employees" (130$^{th}$), and "extent of staff training" (133$^{rd}$) (WEF, 2019[201]).

Improving the human resources development framework thus remains one of the main challenges for the development of tourism in the economy.

In 2020, there were 22 secondary/vocational schools in RS and 13 in FBiH with tourism and hospitality courses. Secondary/vocational schools (three- or four-year programmes) have been educating students in recent decades in the following professions: waiter, chef, hospitality technicians, culinary technicians and tourism technicians. All programmes involve mandatory practical training, which is organised in co-operation with the private sector. In 2018, curricula were updated with the development of new occupational qualification standards using donor support. However, private stakeholders reported that they are not actively involved in the modernisation of curricula, especially regarding subjects increasingly relevant to the tourism industry (such as ICT, digital marketing, foreign languages). Moreover, curricula are reported to be outdated and too general, which leads to the insufficient practical skills of secondary school graduates. Private stakeholders also noted that vocational schools are not perceived as prestigious and therefore do not attract the best students. This is evident in the decreasing number of students in VET programmes in RS (from 2 887 in 2016 to 2 537 in 2019). The lack of adequate equipment in VET schools also hinders the quality of the teaching process.

Bosnia and Herzegovina does not have a specific two-year long **higher education framework** dedicated to tourism. However, the study of tourism is included in higher education programmes at universities. At the university level, ten high schools or universities (eight in the FBiH and two in RS) provide tourism studies, hotel management, catering and tourism marketing courses. Nevertheless, Bosnia and Herzegovina should also consider establishing a two-year long higher education framework in tourism that is focused on training middle management staff in the tourism industry. These programmes should be more practice-oriented than programmes at universities, and include obligatory practical training.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

Although BiH is making efforts to include its rich cultural and natural heritage when developing tourism, **a natural and cultural heritage enhancement framework in tourism** is still in the early stage of development. Natural and cultural heritage is included in several strategic documents at the state and entity level, such as in the Strategy of Cultural Policy in Bosnia and Herzegovina (adopted in 2008), the Biodiversity Strategy and Action Plan for the period 2015-2020 (adopted in 2016) and the Tourism Development Strategy of RS 2011-2020. The Environmental Protection Strategy 2020-2030 of Bosnia and Herzegovina is currently being developed that will provide a long-term planning framework and allow for coherent environmental practices and actions across the economy. The enhancement of natural and cultural heritage in tourism should be included in the new tourism development strategies planned to be developed in the coming years.

There is no policy framework that includes clear measures for the **promotion of sustainable tourism and operations**. Although sustainable development in BiH has become an important objective that is strongly supported by the World Bank and the EU, the integration of the concept of sustainability in tourism strategies and policies is still absent. Consequently, sustainability assessment and monitoring have not yet been established. Given the lack of a strategic framework for sustainable development and assessment, sustainability in tourism arises from individual business initiatives, destinations and NGOs. Thus, the main pillars of sustainable tourism development in BiH are linkages between private, public and non-governmental actors in the tourism sector and their co-operation in implementing projects, particularly transnational projects. Nevertheless, both entities plan to include the promotion of sustainable tourism development in their new tourism development strategies, which are in preparation. There are also several donor projects that focus on the development of sustainable tourism development frameworks in BiH. For example the “Tailor-made model for a BiH ‘Green Scheme’” will support the sustainable development of tourism in the economy using the best practice example of Slovenia.[234] The findings of this and other projects implemented in this field should be included in the new tourism development strategies, along with clear policy measures to facilitate the sustainable operations of public and private tourism actors.

BiH is developing a comprehensive **tourism investment and innovation policy framework**. Investments in tourism are included in the annual action plan for the promotion of FDI, managed by the Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA). The promotion of tourism investment will also be included in the new FDI strategy. Both entities are implementing policy measures to facilitate investment in public and private tourist infrastructure, with EUR 1.25 million per year in FBiH and EUR 1.5 million in RS allocated as grants for tourism projects and investments. However, in both entities monitoring is implemented only at the level of supported projects, and the evaluation of implemented policy measures has not yet been carried out. Moreover, private sector stakeholders report a lack of transparency regarding local development strategies, local spatial plans and investment policy, and the lack of a clear strategy for investment in transport infrastructure to reach the destinations.

*Sub-dimension 15.5: Tourism branding and marketing*

Due to the current legislative arrangement of tourism, BiH does not have a **tourism branding and marketing strategy** at the economy level, which lessens the visibility of BiH as a tourist destination in the global market. In 2019, BiH went down four places in the WEF Competitiveness Index regarding "effectiveness of marketing and branding to attract tourists", ranking 118th (WEF, 2019[201]).

The development of tourism branding and marketing differs among the entities. In RS, the Tourist Organisation of Republika Srpska is responsible for tourism branding and marketing. There is a marketing strategy adopted and implemented in RS, and public-private co-operation is well established. The monitoring of the marketing strategy is implemented regularly and the strategy is adapted according to new circumstances in the market. The main challenge in RS is the introduction of an evaluation process of implemented marketing activities. In FBiH, there is no tourism organisation established at the entity level, with tourism marketing activities implemented by the tourist boards of the main tourist destinations. As there is no monitoring and evaluation of implemented marketing activities in place, a more detailed assessment is not possible.

The **digital tourism marketing framework** is in the early phase of development. In RS, digital marketing is included in the marketing strategy, and in FBiH digital marketing tools are used in the marketing activities of tourist destinations. The main weaknesses are the lack of a common approach to the development of a digital tourism marketing framework at the state level, the lack of financial resources, and the lack of capacity for using digital marketing tools among public officials and private tourism companies.

## *The way forward for tourism policy*

To ensure the further successful development of tourism, policy makers should:

- **Ensure that new tourism development strategies clearly define a governance structure and institutional set up at the entity level**. Such strategies should include policy measures to strengthen public-private co-operation at the entity and tourist destination level, and define a timeframe and clear budget allocation for implementation. A monitoring and evaluation model should also be included (Box 21.17). When drafting new tourism development strategies, Bosnia and Herzegovina should aim to move away from further developing mass tourism and start developing new, high-quality and personalised tourist experiences around natural and cultural sites. Bookings should be available at short notice.
- **Further develop destination management, using best practice examples from the economy** (such as the tourism clusters of Unasana and Herzegovina). Focus on awareness raising and training private and public stakeholders on the benefits of co-operation at the destination level, as this has been recognised as a challenge for the successful development of destination management.
- **Develop a human resources development strategy in tourism,** or include human resources in the Tourism Strategy. The strategy should include a skills gap assessment, a programme for

strengthening the tourism educational system in close co-operation with tourism industry representatives, and policy actions to promote jobs and careers in tourism.

### Box 21.17. Harnessing potential synergies through a national platform for tourism in Switzerland

In Switzerland, numerous political bodies at both national and regional levels, as well as various industry organisations, influence the delivery of tourism policy. Federal tourism policy and its levers are subsidiary to the work of the cantons, local authorities and tourism-related industries. Maintaining dialogue within the federal administration, between the cantons and with tourist actors and associations is fundamental to the development of the industry. Tourism Forum Switzerland (TFS) was established to provide a platform for dialogue and co-ordination and to allow co-operation across the sector. Broadly diversified and often temporary working groups consisting of representatives of the private sector, cantons, communes and the federal administration meet regularly to discuss current challenges and potential improvements.

At the forum's main event in November 2020, the results of the working groups were gathered and presented, and the priorities for the following year were discussed. Since 2012, the State Secretariat for Economic Affairs (SECO), which is responsible for the development and implementation of Switzerland's tourism policy, has organised one forum event each year. The topics have included "Re-positioning Switzerland in summer tourism", "Structural change as the key to success in Swiss Tourism" and "Tourism product development: basis for successful marketing".

Presentations from renowned national and international experts are combined with smaller group discussions. The integration of international know-how is essential for the success of the TFS. The findings and feedback generated by the TFS are evaluated and published and serve as an important basis for the continual development and improvement of Switzerland's tourism policy.

Source: (OECD, 2020[202]), *OECD Tourism Trends and Policies 2020*, https://doi.org/10.1787/6b47b985-en.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 21.28 shows Bosnia and Herzegovina's scores for the anti-corruption policy dimension and compares them to the Western Balkans average. All scores of Bosnia and Herzegovina are below the WB6 average, but the scores for corruption risk assessment and anti-corruption public awareness and education reflect the strongest relative progress. Bosnia and Herzegovina has several elements of a legal framework for the prevention of corruption and has strengthened awareness-raising and education activities since the last assessment. However, the investigation and prosecution of high-level corruption remains limited, and there is evidence of insufficient capacity and independence of prosecutorial institutions.

### Table 21.28. Bosnia and Herzegovina's scores for anti-corruption policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 1.5 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 3.0 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 2.0 | 2.8 |
| **Bosnia and Herzegovina's overall score** | | **2.0** | **2.5** |

Note: For comparability with the previous assessment, the two new sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

Since the previous assessment, Bosnia and Herzegovina has undertaken noteworthy initiatives in the fight against corruption (Box 21.18).

### Box 21.18. Recent initiatives in the fight against corruption in Bosnia and Herzegovina

- **An Action Plan for the Prevention of Corruption in the Institutions in BIH during the COVID-19 pandemic,** developed by the Agency for the Prevention of Corruption and Coordination of the Fight against Corruption (APIK) in 2020. It contains five main measures, namely:
  - supervision and control of securing financial and material donations, incentives and assistance
  - supervision and control of the employment process in BIH institutions
  - monitoring and control of the public procurement process
  - reporting corruption and protecting whistle-blowers during the COVID-19 pandemic
  - coordination of anti-corruption activities during the COVID-19 pandemic.
- **The Council of Ministers** unanimously approved a draft proposal amending the **Law on Public Procurement** in February 2021, harmonising it with the EU *acquis*. The proposed law enables the publication of procurement plans, and of contractual implementation terms within the Public Procurement Portal, which makes public procurement more transparent and easier to monitor.
- APIK issues **awards during the international anti-corruption day** every year for the best artistic and literary work on anti-corruption topics prepared by primary and secondary school students in BIH. The topic of 2021 is "I am worth more than money."

Source: (OECD, 2021[203]), *The OECD and South East Europe: Fair Market Conditions for Competitiveness in the Adriatic Region*, https://www.oecd.org/south-east-europe/programme/fair-market-conditions-adriatic.htm; (APIK, 2021[204]), *Agency for the Prevention of Corruption and Coordination of the Fight against Corruption*, http://apik.ba/kontakt/default.aspx?id=51&langTag=en-US.

*Sub-dimension 16.1: Anti-corruption policy framework*

Due to its complex constitutional structure, Bosnia and Herzegovina has several anti-corruption **policy planning documents**. At the state level, the expired Anti-Corruption Strategy for 2015-2019 and related action plan envisaged the highest strategic measures and set a broad framework for the harmonisation of strategies and action plans at other levels of government. The new strategy and action plan had been prepared but not adopted at the time of writing (APIK, 2020[205]).

There are 13 strategies and 14 action plans at the levels of the state, entity, Brčko District and FBiH cantons. The anti-corruption policies of the state, the FBiH and RS do not have dedicated budgets. The state-level strategy assumes that for most activities additional funds are not required. According to the government, the Agency for Prevention of Corruption and Co-ordination of the Fight against Corruption (APC) has requested the approval of dedicated budget funding for anti-corruption policy in the new planning period 2020-2024.

The APC ensures the overall **co-ordination of anti-corruption policy**, provides explanations regarding the implementation of certain measures and opinions on whether measures planned by authorities are in line with the strategy and the principles of law, and proposes new activities or changes to implementation. It carries out annual reviews of implementation of the state-level strategy and action plan. Three monitoring reports have been published by the APC, with the fourth report prepared but not publicly available, according to the government. At the entity level there are no established bodies but instead co-ordination arrangements: the Anti-Corruption Team in the FBiH and the Commission for Implementation of the Anti-Corruption Strategy in RS.

The APC has encountered difficulties in enforcing the requirement for institutions to report on progress regarding **implementation** of the Anti-corruption Strategy (OECD, 2018[47]). The third monitoring report (published in October 2018) notes continuing challenges of non-compliance with deadlines for submitting

information, discrepancies in data, and uneven quality of information. However, the APC also claims that it has been able to overcome these flaws with an adequate methodological and systematic approach (APIK, 2018[206]). According to the government, 48% of action plan measures have been implemented, 43% have been partially implemented and 9% have not been implemented.

According to information provided by the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption, in 2019 an external consultant (hired by the Organization for Security and Co-operation in Europe, OSCE) analysed progress made in the fight against corruption in Bosnia and Herzegovina to inform the drafting of a new anti-corruption strategy The participatory engagement of non-governmental stakeholders took place in the preparation of the Anti-Corruption Strategy and Action Plan 2020-2024 of BiH and the Anti-Corruption Strategy and Action Plan 2018-2022 of RS. At the state level, an interdepartmental working group was set up to prepare these documents, with 27 public institutions of different levels involved, as well as the non-governmental sector and academia. However, published documents do not reflect how the proposals by stakeholders were handled, i.e., what was accepted, what was rejected and why. The Anti-Corruption Strategy and Action Plan 2020-2024 had also not been published on the website of the APC at the time of writing.

In April 2020, the APC disseminated a framework action plan for the prevention of corruption during the COVID-19 pandemic to governments and anti-corruption bodies at all levels and called upon all competent institutions to engage teams in developing individual action plans for anti-corruption action. In terms of implementation, according to the APC most institutions have focused on publishing information online, especially regarding the supervision and control of recruitment processes and public procurement.

Bosnia and Herzegovina has no legislation on **corruption risk assessment**. The law stipulates the responsibility of the APC to prescribe a uniform methodology and guidelines for making integrity plans and help all public institutions with their implementation, but institutions are not legally obliged to carry out the assessment. Anti-corruption action plans envisage the creation of a legal basis for the preparation and adoption of integrity plans, which have not been implemented. Several guiding documents envisage corruption risk assessment as one of the stages in the preparation of integrity plans, for example the handbook Rules for the Elaboration and Implementation of Integrity Plans in the Institutions of Bosnia and Herzegovina (APIK, 2018[207]), guidance on integrity plans in judiciary institutions (VSTV BiH, 2016[208]), and rules on the elaboration and implementation of integrity plans in RS (2015).

Evidence regarding the adoption of integrity plans is fragmented, and no comprehensive and up-to-date data are available regarding the extent and quality of the practice. As of mid-2018, 73 public institutions at the state level had adopted integrity plans (APIK, 2018[206]). According to the 2019 report of the FBiH Anti-corruption Team, 78 institutions had adopted integrity plans, which is 91% of the targeted number (FBiH Anti-Corruption Team, 2020[209]). According to the government, several institutions in RS have conducted ad hoc risk assessments, with one performed for the preparation of the Anti-Corruption Strategy 2018-2022.

**Corruption proofing of legislation** is not mandatory according to law. The Unified Rules for Legislative Drafting in the Institutions of Bosnia and Herzegovina prescribe the methodology for assessing the impact of regulations (including on corruption and conflict of interest). The rules are mandatory for state-level institutions and recommendatory for other levels of authority. They designate the APC as one of the control bodies whose opinion must be obtained for impact assessments. The methodology for assessing corruption risks in regulations has been published, sponsored by the Austrian Development Co-operation (Hoppe, 2017[210]). According to the government, in 2019 the APC examined and gave opinions on seven regulations, but no information is available about any modifications based on the opinions. There is no evidence of the corruption proofing of legislation at the entity level.

*Sub-dimension 16.2: Prevention of corruption*

The APC has been Bosnia and Herzegovina's main **corruption prevention body** since 2013, when it was introduced as part of the law of the APC However, it has limited direct powers. Its mandate includes developing the anti-corruption strategy and action plan and monitoring implementation, designing methodologies, co-ordinating the work of public institutions, monitoring the implementation of anti-corruption legislation and instances of conflict of interests, taking action upon receiving information on corruption-related acts, and developing educational programmes. The FBiH and RS do not have established prevention bodies; however, Sarajevo canton has a prevention body, the Office for Combatting Corruption and Quality Management.

In law, the APC has certain independence and accountability provisions. It reports to the Parliamentary Assembly (PA) of Bosnia and Herzegovina, which appoints the director of the APC and two deputies upon proposal of the Selection and Monitoring Committee of the Agency, following open competition. The director's term is five years with a possibility of another reappointment. The committee can submit a proposal to dismiss the director if there are grounds as stated in the law. The committee comprises nine members (three from each of the chambers of the PA, two from the academic community and one from civil society). The committee may not interfere in the daily work of the APC nor request information on individual cases. Meetings of the committee should be open to public.

In practice, the mandate of the committee expired in 2018, and no evidence is available regarding its renewed activity, except for information from September 2020 about the appointment to the committee of someone included in the US sanctions list for corruption (Transparency International BiH, 2020[211]). According to the law, the committee should review reports on APC operations at least twice a year; however, the annual reports for 2018 and 2019 have not yet been considered and approved for publication. The director of the APC submits a budget proposal, but the APC does not have any guarantees of a certain level of funding. With 30 employees, the APC is one of the smallest prevention agencies in the region.[235] Given that many prevention tasks are carried out at the entity level, the institutionalisation of prevention of corruption and safeguards against undue interference in the fulfilment of this function are limited in Bosnia and Herzegovina overall.

At the state level, the Law on Conflict of Interest in Governmental Institutions of Bosnia and Herzegovina has been the central act governing matters of **conflict of interest**. There are also equivalent laws in the FBiH (not implemented since 2013) and RS. The state-level law applies to elected officials, holders of executive functions and advisors, which is similar to the scope of the entity-level laws. In other respects, the laws differ and lead to a diversity of approaches. For example, the RS law defines a conflict of interest in terms of an actual or apparent conflict, while the state-level law does not cover an apparent conflict. Laws on civil service at the state and entity levels regulate conflicts of interest of civil servants. In January 2021, the House of Representatives (the lower house of the PA) adopted a new law on conflicts of interest, which has not been assessed in this analysis.

The law stipulates that the oversight institution at the state level is the Commission for Deciding on Conflicts of Interest (CDCI), which comprises three members from each of the chambers of the PA as well as the director and two deputy directors of the APC. The Republican Commission for Determining Conflicts of Interest in Public Bodies of RS is the oversight body in RS. The membership rules of the two commissions differ regarding political neutrality. At the state level, members of the PA sit on the commission, whereas in RS members may not engage in party political activities. However, in neither case safeguards for political independence appear particularly strong. Bosnia and Herzegovina has not implemented the Group of States Against Corruption (GRECO) recommendations to, among other things, harmonise "the legislation on conflicts of interest throughout the national territory" and ensure the independence and timeliness of the advisory, supervisory and enforcement regime regarding conflicts of interest (GRECO, 2018[212]).

According to the law, the CDCI may initiate proceedings based on a credible, well-founded and non-anonymous application, or by virtue of the office held in cases where an individual has information on

a possible conflict of interest. In terms of sanctions, the CDCI may suspend payment of part of the net monthly salary, propose a dismissal from office and call for resignation. According to the government, the CDCI has imposed 10 sanctions (9 monetary). Sessions of the CDCI should be open to the public and decisions published on its website.[236] The mandate of the CDCI expired in 2018 and it resumed activity only in mid-2020. Civil service agencies at the state level and in the FBiH have organised training on conflict of interest, but effective and stable oversight in this area is yet to be developed.

Regarding **asset and interest disclosure**, elected officials, executive office holders and advisors are required to submit financial reports to the CDCI within 30 days of the assumption of office, followed by annually and then within 30 days of the expiration of six months after the termination of duty. The CDCI decides the form and content of the financial report, which covers the personal data of officials and close relatives, information on public functions, current revenue and sources of income, assets, liabilities and data on other positions, and the positions of their close relatives but not of their assets and income. The CDCI checks but does not publish the accuracy of the content of the statements. In RS, officials submit financial reports to the Republican Commission for Determining Conflicts of Interest. In the FBiH, no general functional system of disclosure is in place, although the Sarajevo canton maintains an online public register of data on the property of public officials. Notwithstanding some good practice at the sub-entity level, there is generally little evidence of effective implementation of asset and interest disclosure.

The Election Law of Bosnia and Herzegovina obliges all candidates elected at all levels of authority to submit a signed asset declaration form to the Central Election Commission (CEC). Elected persons must also submit declarations after the termination of their tenure. The CEC makes the statements available to the public, with restrictions concerning personal information. The CEC is not legally competent to verify the accuracy of the data, and hence the system is conducive to failures in fully disclosing assets (CIN, 2020[213]).

Bosnia and Herzegovina is yet to establish a comprehensive and fully functional framework of asset and interest disclosure in line with, among other things, the recommendations of GRECO regarding the publication and control of disclosure reports (GRECO, 2018[212]).

At the state level, the Law on Whistle-blower Protection in the Institutions of Bosnia and Herzegovina (adopted in 2013) provides **protection for whistle-blowers**. The law applies only to the public sector at the state level. Whistle-blower reports and identities constitute an official secret. If the APC establishes that a detrimental action has been taken against the whistle-blower in relation to the reported case of corruption, it can issue an instruction to the director of the institution to remove the consequences of the detrimental action. If the director claims that the action would have been taken even without whistleblowing having taken place, they must prove this is the case. The law envisages internal reporting as the default option, with external reporting to investigation/prosecution authorities, the APC or the public subject to conditions, such as when the whistle-blower has reasons to believe that the recipient of the internal report is associated with the act of corruption. The law is short of providing many elements set out in EU Directive 2019/1937 on the protection of persons who report breaches of Union law, for example it is not applicable to the private sector; does not cover several categories of reporting persons who are not current employees of the institution, as well as persons connected with whistle-blowers; it imposes specific mandatory preconditions for external reporting; and it envisages a narrower set of forms of retaliation. The law does not envisage provisional protection before the decision on granting whistle-blower status and free legal assistance (according to the government, civil society organisations provide such assistance).

The Law on Protection of Persons Reporting Corruption of the Republika Srpska (adopted in 2017) is in several important ways more comprehensive than the state-level law. For example, it protects reporting persons in both the public and private sectors, envisages protection to persons connected with the whistle-blower, does not set mandatory preconditions for external reporting, envisages a broad set of forms of retaliation, and provides the right to free legal assistance. There is no whistle-blower protection law in the FBiH.

The APC and the Ministry of Justice are the oversight bodies for the implementation of the law at the state level. The APC has supported implementation by, among other things, developing unified regulations on internal reporting and whistle-blower protection, supervising and co-ordinating the adoption of the respective internal acts in public institutions, preparing an instruction for the implementation of the law, establishing a toll-free number for reporting persons, preparing promotional materials, and conducting training and lectures.

The government provided no up-to-date statistics on whistle-blower activity for this assessment, and it is therefore impossible to understand the effectiveness of implementation of the laws. According to the APC, there have been instances of denied whistle-blower status due to reporting persons not being employees of state institutions covered by the law, not having acted in good faith, or failing to have concrete evidence for the allegations. Anecdotal evidence suggests that a whistle-blower may be subject to sanctions in practice despite having received whistle-blower status (Rovcanin, 2020[214]), but the overall extent of the challenges is uncertain.

The APC and certain other public bodies have actively engaged in **public awareness raising and education**. The APC gives awards for the art and literary works of school students on anti-corruption topics through an annual campaign. The best works have been included in a promotional film and printed in the APC's calendars. The authorities have also produced easily accessible information materials, with both the APC and the RS Ministry of Interior having published leaflets on reporting corruption.

The Civil Service Agency of Bosnia and Herzegovina (CSA) regularly organises training for civil servants on anti-corruption topics (funded from the CSA's own budget and other institutions and donors), and the RS Ministry of Justice has been organising training for public sector institutions. The APC has made online training available on its website. It has also analysed training and, based on the data and the needs of institutions, developed harmonised programmes for all public institutions in co-operation with state-level civil service agencies, the FBiH and RS. The APC has been co-ordinating a major programme of ethics and integrity in the education system across Bosnia and Herzegovina, and its website contains a collection of education materials.[237] According to the FBiH, its authorities have not engaged in other anti-corruption campaigns or educational activities.

### *Sub-dimension 16.3: Independence of the judiciary*

The judicial authority at all levels is governed in a partially centralised manner. The High Judicial and Prosecutorial Council appoints judges for life and relieves judges from duties based on grounds set out in the law on the HJPC. The appointment of judges is based on a competitive procedure. The Law on the HJPC (adopted in 2004) sets basic qualification requirements and criteria for determining the competences required for judicial office. According to rules of the HJPC, the competition procedure includes entrance exams and written tests, candidate interviews, the ranking of candidates, and proposals for appointment. Selection procedures differ for candidates whose appointment represents entry into the judiciary and for those already in the judiciary, for whom qualification is determined based on performance results for the past three years and interviews. The HJPC announces judicial vacancies in the Official Gazette and online as public calls, and posts appointment decisions. It also elects court presidents based on a public competition among judges appointed to the respective court. Appointment proceedings are reportedly fraught with flaws such as deviations from the rankings of candidates, insufficient transparency, insufficient motivation of appointment decisions, excessive weight of ethnic criteria, and the annulment by court of the criteria on performance appraisal for judges and prosecutors in May 2020 (European Commission, 2020[39]).

Out of 15 members of the HJPC, 10 are judges and prosecutors elected by their colleagues. The House of Representatives of the PA, the Council of Ministers, the Judicial Commission of the Brčko District and bar chambers of the two entities each elect one member. The HJPC publishes detailed minutes of its meetings. The legal and institutional framework of judges' careers through the Law on the HJPC provides certain guarantees of judicial independence. However, the system is affected by the lack of an explicit

constitutional status of the HJPC, incompatibility of RS legislation, which envisages an entity-level HJPC, and certain other deficiencies of the Law on the HJPC. In 2018, the HJPC submitted an initiative to amend the law comprehensively with a view to implementing European Commission recommendations to improve appointment, performance appraisal, integrity, and disciplinary and other procedures (European Commission, 2019[4]). The initiative has been discussed within the Ministry of Justice. According to information provided by authority representatives during consultations in September 2020, certain parts of the draft may be selected for speedier adoption, such as the introduction of a strengthened mechanism for the verification of financial reports of judges and prosecutors. Reforms of the HJPC are also needed regarding the recommendations of GRECO to, among other things, provide for separate judicial and prosecutorial sub-councils, avoid an over-concentration of powers, ensure that decisions of the HJPC are subject to appeal before a court, and develop an effective system for reviewing annual financial statements (GRECO, 2018[212]).

The HJPC conducts disciplinary proceedings, imposes disciplinary measures on judges and publishes the decisions in an anonymised format. Procedural guarantees of due process for a judge in disciplinary proceedings include the right to be duly notified of the allegations and evidence and to respond, the right to a fair and public hearing, the right of defence with legal counsel of choice, and the right to appeal adverse decisions (although the right to judicial review applies only in cases of dismissals). Concerns have been raised regarding the excessive dominance of HJPC members in disciplinary commissions; obstacles to the disciplinary liability of members of the HJPC themselves and the perceived unwillingness to hold the former chairperson of the HJPC to account for alleged corruption in 2019; alleged inconsistencies in decisions, which reject disciplinary action or impose disciplinary measures; excessive discretion of the HJPC and the disciplinary commissions; lenient sanctioning policy made even less effective by the anonymisation of published decisions; and bias due to the fact that the HJPC has full access to records of the Office of the Disciplinary Prosecutor, which is also placed within the HJPC (Delegation of the European Union to Bosnia and Herzegovina and EUSR, 2019[215]; Omerović, 2020[216]; Transparency International BiH, 2020[217]). Despite these concerns, by default the media and representatives of the public may be present at disciplinary hearings, which represents a high standard of transparency. The distribution of cases among judges is random and automatic in accordance with predefined parameters in all courts, although the possibility of reassignment without a specific justification exists at least in small courts (European Commission, 2020[39]). There is no universal practice of publishing court decisions, but the HJPC publishes decisions selected either by the highest courts or in accordance with general criteria (war crime, corruption, organised crime cases, etc.). Some decisions are available at the websites of individual courts. Overall, it appears that the judiciary in Bosnia and Herzegovina adheres to at least certain minimum standards of transparency.

### *Sub-dimension 16.4: Business integrity and corporate liability*

Bosnia and Herzegovina does not have a distinct policy for promoting **business integrity**. Company laws in the FBiH and RS do not explicitly envisage the responsibilities of boards of directors to include overseeing the management of corruption risks, apart from general fiduciary duties. The APC held several training courses on ethics and integrity in companies for private sector representatives in 2019, in co-operation with the Foreign Trade Chamber of Bosnia and Herzegovina.

According to the government, information on beneficial owners of legal entities in FBiH is not disclosed in a central register. The Law on Registration of Business Entities in RS requires the submission of data on beneficial owners to the court register of business entities. The definition of a beneficial owner (founder with a 20% or more share) is narrower than envisaged in EU anti-money laundering directives. Data from the Register of Business Entities are available to all interested parties without proving a legal interest, in accordance with regulations governing personal data protection. Moreover, identification of the beneficial owner (in accordance with a significantly broader definition) is one of the elements of customer due diligence under the Law on Prevention of Money Laundering and Financing of Terrorist Activities that should be carried out by both financial institutions and designated non-financial businesses and

professions. The government provided no evidence regarding the level of compliance with these requirements.

No designated institution such as a business ombudsman is responsible for receiving complaints from companies about corruption-related matters.

Bosnia and Herzegovina, the FBiH and RS each have a Criminal Code and Law on Criminal Procedure,[238] which means that provisions regarding the **liability of legal persons** are multiple but generally similar. According to the Criminal Code of Bosnia and Herzegovina, for a criminal offence perpetrated in the name of, for account of or for the benefit of the legal person, the legal person shall be liable: 1) when the purpose of the criminal offence is arising from the conclusion, order or permission of its managerial or supervisory bodies; 2) when its managerial or supervisory bodies have influenced the perpetrator or enabled them to perpetrate the criminal offence; 3) when a legal person disposes of illegally obtained property gain or uses objects acquired in the criminal offence; or 4) when its managerial or supervisory bodies failed to carry out due supervision over the legality of work of the employees. Thus, for a legal person to be liable, apart from the case of illegally gained property/objects, managerial or supervisory bodies must be involved or must have failed to act.

The liability of legal persons is general (liability possible for any criminal offence) and autonomous (the legal person shall be liable for a criminal offence even when the physical person is not guilty of the perpetrated criminal offence). However, the physical perpetrator apparently has to be identified. Sanctions include fines, confiscation of property and dissolution of the legal person. Security measures include forfeiture, publication of judgement and a ban on performing a certain activity. Legal consequences following the conviction of a legal person include the prohibition of work based on a permit, authorisation or concession. The law does not allow due diligence (compliance) defence to exempt legal persons from liability or mitigate sanctions, nor does it allow the court to defer the application of sanctions on legal persons if they comply with organisational measures to prevent corruption as determined by the court.

The legal framework for corporate liability would benefit from guidance on anti-corruption compliance that managerial and supervisory bodies of legal persons should ensure. The effectiveness of the corporate liability framework for combatting corruption could not be assessed due to the absence of relevant statistics.

### *Sub-dimension 16.5: Investigation and prosecution*

Little data are available on the **investigation and prosecution of high-level corruption**. In 2018, the HJPC adopted the definition of high-level corruption. According to the European Commission, the track record of convictions for high-level corruption is extremely limited in Bosnia and Herzegovina (final conviction of two persons in 2017 and no final conviction in 2018) (European Commission, 2019[4]). According to data provided by the HJPC, a notable example in 2019 was the conviction of the former Minister of Agriculture, Water Management and Forestry of the FBiH who was sentenced to a prison term and subject to confiscation of illicit gain in the amount of EUR 333 000. In January to June 2020, prosecutors filed indictments in four cases of high-profile corruption, while courts reached verdicts in three cases (two convictions and one acquittal). Reportedly, only a minority of corruption investigations initiated by the State Investigation and Protection Agency (SIPA) in 2019 were finalised (European Commission, 2020[39]).

Monitoring by the OSCE found that in 2017-18 two out of six defendants in high-level corruption cases were convicted, i.e., the conviction rate was 33%, and the sentences were imprisonment converted into fines (OSCE Mission to BiH, 2019[218]). It is common to employ plea bargain agreements, and sanctions tend to be lenient. Moreover, it is reportedly technically impossible to retrieve statistical data on final convictions (European Commission, 2020[39]). To strengthen the recovery of corruption proceeds, since 2018 the HJPC has imposed mandatory financial investigation in all corruption cases, but no data are available on the recovered amounts.

Among **specialised anti-corruption investigative bodies**, SIPA, which is within the Ministry of Security, is the only institutionally separate body tasked with combating several categories of serious crime, including corruption. Within SIPA's Criminal Investigation Department, there is the Section for Prevention and Detection of Financial Crime and Corruption. Investigators responsible for the prevention and detection of financial crime and corruption work within SIPA's regional offices. SIPA's Internal Control Department is responsible for, among other things, internal investigations into allegations of misconduct by SIPA employees and investigations of actions involving the use of force, corruption, and abuse of authority by police officials.

SIPA is the only specialised enforcement body that has certain special guarantees of independence. The law defines SIPA as an operationally independent administrative organisation. The Council of Ministers appoints the director and deputy director, upon proposal of the Minister of Security who selects the candidate from a list submitted by an independent board. The tenure of the director is four years, with the possibility of a second consecutive term. The Council of Ministers dismisses the director and deputy director under conditions and through procedures implemented by the independent board. For the appointment and dismissal of heads of internal units, the general procedures of the police apply. The director adopts the Rulebook of SIPA with the consent of the Council of Ministers. SIPA's budget is adopted in a standard procedure, and it does not have specific guarantees of a certain level of funding. The general rules of the police determine the salaries of SIPA staff. The director submits reports on the work of SIPA and the situation in the areas of competence to the Minister of Security of Bosnia and Herzegovina. Upon request, the director also submits reports to the PA, the Council of Ministers and the Presidency of Bosnia and Herzegovina.

In RS, several organisational units of the Ministry of Interior, such as the Department for Economic Crime and Corruption, are responsible for investigating corruption. The FBiH has not established specialised anti-corruption investigation units.

Bosnia and Herzegovina has no organisationally independent **specialised anti-corruption prosecutorial and judicial bodies**. Anti-corruption specialisation is ensured through internal sections and departments of the prosecutor's offices at the state level, in the FBiH (envisaged in law but not established in practice) and in RS. At the state level, corruption cases are assigned to prosecutors in the Section for Corruption within the Special Department for Organised Crime, Economic Crime and Corruption of the Public Prosecutor's Office. The Chief Prosecutor selects and appoints the head of the section, who has no fixed term in office. The Section for Corruption has four prosecutors and four legal associates (two legal advisors on financial investigation). In the FBiH and RS, laws on the suppression of corruption and organised crime define key elements of the specialised departments. The Special Department of the Prosecutor's Office of RS is competent for 36 categories of crime, including corruption-related offences, but in practice most corruption cases are low level (OSCE Mission to BiH, 2019[218]).

In 2019, the European Commission reiterated the need to substantially enhance the capacity to investigate economic, financial and public procurement-related crime in terms of staff numbers, equipment, autonomy, specialisation and co-operation (European Commission, 2019[4]). Data available for this analysis are too limited for a full assessment of the capacities. An independent assessment carried out in 2018 and 2019 found that indictments in corruption cases frequently contained no or unclear identification of one or more of the elements of the offence; the poor quality of indictments resulted in a low rate of convictions in corruption cases. There are also reportedly flaws concerning the process of gathering and presenting evidence (OSCE Mission to BiH, 2019[218]).

### *The way forward for anti-corruption policy*

To strengthen the anti-corruption policy framework and implementation, policy makers should:

- **Ensure effective and impartial implementation of rules and oversight in the areas of conflict of interest and asset disclosure.** According to the Western Balkan Recommendation on

Disclosure of Finances and Interests by Public Officials, declarations need to be subject to control by an oversight mechanism, which includes compliance with declaration obligations, the accuracy of submitted information, and the possibility of conflicts of interest or undeclared cash-flows (EIN, 2014[219]). At the time of writing, Bosnia and Herzegovina remained largely non-compliant with this standard.

- **Develop and adopt new whistle-blower protection laws at the state level and in the FBiH in line with international standards**. BiH should take measures to encourage and support the sustained practice of whistle-blowing. The relevant EU directive envisages the protection of whistle-blowers in both public and private sectors and applies protection measures to whistle-blowers, facilitators of whistle-blowing, and physical and legal persons connected with the whistle-blowers. In line with the directive, state and entity levels in Bosnia and Herzegovina should provide the following support for whistle-blowers: comprehensive and independent information and advice that is easily accessible to the public and free of charge on procedures and remedies available, on protection against retaliation, and on the rights of the person concerned; effective assistance from competent authorities before any relevant authority involved in their protection against retaliation; legal aid, counselling or other legal assistance; and financial assistance and support measures, including psychological support, for reporting persons in the framework of legal proceedings. Bosnia and Herzegovina has made certain efforts in this area, but the degree of progress is highly uneven at the state level and in the entities.
- **Ensure the registration and disclosure of the beneficial ownership of legal entities in line with international standards.** This applies in both the FBiH and RS, where the authorities do not ensure disclosure in a central register. A register does exist in RS, but certain elements, such as the definition of a beneficial owner, are not fully in line with international standards. The EU Anti Money Laundering Directives envisages that beneficial ownership information is held in a central register and is accessible in all cases to competent authorities and financial intelligence units without any restriction, to obliged entities within the framework of customer due diligence, and to any member of the general public. It is also required that the information held in the central register of beneficial ownership information is adequate, accurate and current, and that states put in place mechanisms to this effect. Box 21.19 shows a good-practice example of collecting beneficial-ownership information from different sources.

### Box 21.19. Databases containing information on beneficial ownership in Spain

A combination of different sources can ensure the comprehensiveness and enhanced reliability of data on beneficial ownership. Spain has three databases that hold information on beneficial ownership of companies, each based on information collected by different obliged entities (notaries, registrars and credit institutions). All are accessible on line to law enforcement agencies. The network of overlapping mechanisms secures the availability of beneficial ownership information of all commercial entities operating in Spain:

- The Single Notarial Computerised Index contains beneficial ownership information obtained by notaries through their customer due diligence.
- The Business Registry collects information on beneficial ownership as reported by the authorised representatives of companies. All companies, except those publicly listed, must annually submit a form that identifies their beneficial owners to the Business Registry.
- The Spanish financial intelligence unit, Sepblac, holds the Financial Ownership File. Credit institutions submit monthly reports about their opened or held accounts to Sepblac, which identifies the beneficial owners of the account holders.

Source: Abridged from (FATF, 2019[220]), *Best Practices on Beneficial Ownership for Legal Persons*, https://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf.

- **Continue efforts towards amending the Law on the HJPC and other legislative acts to bring the judiciary in line with EU standards**. Judicial independence is a fundamental principle enshrined in international standards such as the European Convention on Human Rights, according to which "everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law" (European Court of Human Rights, n.d.[221]). In 2020, the European Commission emphasised the adoption of the new Law on the HJPC as a key priority to strengthen the HJPC as a guarantor of the independence of the judiciary (including changes regarding the composition of the HJPC; the election and disciplinary responsibility of its members; the appointment, promotion, performance appraisal, disciplinary responsibility, conflict of interests and integrity of judicial office holders; and a judicial remedy against all final decisions of the HJPC).
- **Strengthen capacity to investigate and prosecute high-level corruption** and consider setting up independent specialised anti-corruption prosecutorial bodies that focus on serious offences and are adequately protected from outside interference. The United Nations Convention against Corruption sets the standard that a body or bodies or persons specialised in combating corruption through law enforcement shall be granted the necessary independence, in accordance with the fundamental principles of the legal system of the State Party, to be able to carry out their functions effectively and without any undue influence (Article 36) (UN, 2004[222]). This CO assessment did not evaluate in-depth the work of SIPA, the specialised organisational units of the Ministry of Interior of the RS, and internal sections and departments of the prosecutor's offices, and therefore does not argue whether any undue influence on their activities has taken place. However, Bosnia and Herzegovina should consider introducing additional means to safeguard the independence of the institutions as appropriate to their status through the more public and competitive selection of management, strengthened protection against arbitrary dismissal, and guarantees of dedicated budget funding. The FBiH should set up the specialised bodies envisaged in law.

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## Notes

[1] Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses different scoring model (See the Scoring approach section for information on the assessment methodology).

[2] Staff from the Agency for Statistics of Bosnia and Herzegovina and entity statistical offices who co-ordinate the statistical data collection.

[3] A person from the Ministry of Foreign Trade and Economic Relations who co-ordinates the state-level assessment in Bosnia and Herzegovina and from the Ministry of European Integration and International Co-operation of the Republika Srpska and Prime Minister's Office of the Federation of Bosnia and Herzegovina who each co-ordinate the assessment in their respective entities.

[4] World Bank classification.

[5] The Foreign Investment Law of the Federation of Bosnia and Herzegovina states that: "Foreign investment will not be nationalized, expropriated or subjected to similar measures consequences except in the public interest and in accordance with applicable laws and other regulations. Foreign investors are entitled to adequate, prompt and appropriate compensation, which they are free to use dispose of any damage resulting from nationalization, expropriation or other measures that have similar consequences." (Government of Bosnia and Herzegovina, n.d.[293])

[6]Law on Expropriation (Official Gazette of the FBiH, Nos. 70/07, 36/10 and 25/12); Law on Expropriation (Official Gazette of the Republika Srpska, Nos. 112/06, 37/07, 66/08, 110/08 and 79/15); Law on Expropriation (Official Gazette of the Brcko District of BiH, Nos. 26/04, 19/07, 2/08, 19/10 and 15/11).

[7]Currently, the most active clusters in the Republika Srpska are the wood industry and auto services, as well as a cluster dedicated to research and technological development in the field of medicine and health sciences.

[8] With the exception of passenger vehicles, and slot and gambling machines.

[9] According to the Law on Administration of BiH (Official Gazette of BiH, No. 32/02, 102/09 and 72/17) and the Law on Ministries and Other Administrative Bodies in BiH (Official Gazette of BiH, No. 32/02).

[10] Customs policy, technical regulations and standards, market surveillance, competition, state aid, intellectual property, agriculture, and energy and environmental protection.

[11] Mainly the obligations arising from the Agreement on Trade Facilitation of the World Trade Organization (WTO) and CEFTA's Additional Protocol 5.

[12] Rules of Procedure of the Government of Republika Srpska (Official Gazette of RS, no 123/18); Guideline for the Republic Administrative Bodies Conduct Regarding the Participation of the Public and Consultations in Developing the Law (Official Gazette of RS, no 123/08 and 73/12).

[13] Those consultations include the active participation of stakeholders (private companies and civil society) in all phases during the enactment of law and bylaw acts and strategic documents related to trade policy.

[14] Regulations on Consultations in Legislative Drafting (Official Gazette of BiH, no. 5/17).

[15] According to the 2019 Annual Report on Public Consultations, the eConsultation website was used by 63 institutions, compared to 56 institutions in 2018. Moreover, in 2019, the institutions of BiH conducted a total of 539 consultations in the drafting of legal regulations and published 445 reports on the conducted consultations, which is also a significant increase in the ratio of 2018 when there were 281 total consultations conducted and 234 published reports on consultations http://www.mpr.gov.ba/web_dokumenti/default.aspx?id=10631&langTag=bs-BA.

[16] Guidelines for the Republic administrative bodies regarding the participation of the public and consultations in developing the law (Official Gazette of RS, no 123/08 and 73/12)

[17] According to the 2019 Annual Report on Public Consultations, 17 institutions were surveyed regarding the acceptance rate of comments during consultation processes. Two institutions stated that they accepted more than 80% of proposals and comments, one institution stated that it accepted 50-80% of proposals and comments, seven institutions accepted 20-50% of proposals and comments, and four institutions accepted below 20% of comments and suggestions.

[18] Article 2 of the Regulations on Consultations in Legislative Drafting (Official Gazette of BiH, no. 5/17).

[19] According to the 2019 Annual Report on Public Consultations, the response of users in the consultation process and the number of submitted proposals and comments were still small: 47 out of 56 surveyed institutions reported that the response rate in the consultation process was poor or unsatisfactory, and 10 institutions reported that the response was better in live consultations. Most institutions stated that they did not receive any suggestions or comments during the consultation processes.

[20] Since 2019, the FBiH parliament has adopted the majority of its laws under emergency procedure (89%). In the Republika Srpska, the National Assembly has adopted about a third (36%) of its laws under a fast-track procedure since the last reporting cycle. These procedures, in principle reserved for exceptional cases, have been taken without any form of public consultation.

[21] The regulatory databases set up for the partial OECD STRI for the WB6 were created thanks to co-operation with the WTO and CEFTA, which is gratefully acknowledged. They are based on the WTO/World Bank I-TIP Services regulatory databases, updated in November 2020 and to which the OECD STRI methodology has been applied. For more information on the methodology see the Methodology and assessment process chapter.

[22] OECD member states and partner economies: Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

[23] The full set of OECD STRI indices and comparison tools, as well as policy simulators for OECD member and partner states that have undertaken the OECD STRI, are available on the dedicated website https://www.oecd.org/trade/topics/services-trade.

[24] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[25] In order to facilitate comparison with OECD member states that have undergone the Services Trade Restrictiveness Index exercise, the paragraphs below have been drafted in accordance with the

methodology of the STRI project publications. The OECD members' country notes and sector notes are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/.

[26] Official Gazette of RS, no 14/2.

[27] EU Directive (2000/31/EC).

[28] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks' risk management.

[29] The term haircut is used to reference the percentage difference between an asset's market value and the amount that can be used as collateral for a loan.

[30] IFRS 9 is published by the International Accounting Standards Board's (IASB) in response to the financial crisis. It aims to improve the accounting and reporting of financial assets and liabilities. It contains three main topics: classification and measurement of financial instruments, impairment of financial assets, and hedge accounting.

[31] Zenica- Doboj Canton (2019-21), 67 projects with an estimated value of BAM 381 million (~EUR190 million) (Federation of Bosnia and Herzegovina, n.d.[296]); Tuzla Canton (2018-20), 44 projects with an estimated value of BAM 339 million (~EUR170 million) (Federation of Bosnia and Herzegovina, 2018[294]); and Central Bosnia Canton (2018-20), 30 projects with an estimated value of BAM 95 million (~EUR 47 million) (Government of Central Bosnia Canton, 2018[295]).

[32] Some of the projects financed under the non-concession PPP model are the EFT Stanari Coal Plant and the Doboj to Vukosavlje motorway in 2012, Corridor 5c between Karuše and Poprikuše in 2013, the Haemodialysis Project in 2014 and the District Heating System project in Sokolac in 2016

[33] Applicable rates are either 5% for dividend income or 10% for other types of income (interest, royalties, etc). However, no withholding tax is levied on dividends paid to foreign entities holding more than 10% of a domestic entity's share.

[34] For a minimum of BAM 20 million (EUR 10.2 million) invested over five years.

[35] Provided the employment contract is granted on a full-time basis for a minimum of 12 months and the employee has not been already employed by the corporation or a related entity in the last 5 years.

[36] List of activities of public interest: public postal services, medical and health care services, social security services, education, services performed by registered religious organisations, services in the field of culture, and services of public radio and television bodies

[37] The current Annual Audit Plan uses 19 criteria.

[38] Four types of audit are carried out: comprehensive field audits, desk control, control of non-registered entities and special controls.

[39] This programme is organised around four pillars: entry in the taxpayer registry, tax return submission, accurate registration and payment obligation.

[40] This project is supported by the Dutch Ministry of Finance, the Centre of Excellence in Finance (CEF), the International Monetary Fund (IMF) and the Assistance Technique France (Adetef). The overall objective of the project is to contribute to the strengthening of beneficiary institutions' capacity in accordance with EU recommendations.

[41] The OECD Database on General Competition Statistics (OECD CompStats) is a database with general statistics about competition agencies, including data on enforcement and information on advocacy initiatives. In 2020, it included data from competition agencies in 56 jurisdictions, including 37 OECD economies (36 OECD economies and the European Union): Argentina, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas); Australia, Brazil, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other) (OECD, 2020[297]).

[42] The 27 SOEs under the purview of the RS Share Fund does not include enterprises undergoing bankruptcy or liquidation. It also excludes companies that "have not registered in accordance with the legislation", which refers to SOEs that have not been transformed into limited liability companies or joint-stock companies, as required by applicable legislation. According to RS authorities, 42 SOEs are undergoing bankruptcy or liquidation and 34 are not fully incorporated as companies. The authorities report that most enterprises in the latter category have not been conducting business activities for a number of years and should be liquidated in accordance with the Law on Registration of Business Entities.

[43] The central levels of government in Bosnia and Herzegovina (FBiH and RS) do not maintain centralised data on SOEs held by the subnational levels of government (cantons and municipalities). The figure of 128 SOEs held by subnational levels of government in FBiH is based on data gathered by the authorities for the purpose of the current assessment. Separately, an IMF team conducted an independent study of SOEs at all levels of government in Bosnia and Herzegovina, based on 2017 data, which concluded that approximately 550 enterprises are in state ownership at all levels of government (Parodi and Cegar, 2019[78]).

[44] The figures presented in IMF (Parodi and Cegar, 2019[78]) concern SOEs at all levels of government (FBiH, RS, 10 cantons and 145 municipalities). The 414 enterprises were those for which financial statements were publicly available.

[45] The sectoral classification used in the referenced IMF study has been modified to align with the sectoral classification used in the OECD's recurrent SOE data collection exercise (OECD, 2017[79]). The "Electricity and gas sector" includes steam and air conditioning supply enterprises.

[46] Information on SOE board composition in RS is as reported by the authorities in the context of this assessment.

[47] This is based on information provided by the authorities in the context of this assessment. Separately, of the 181 SOEs held by all levels of government in FBiH, 19% (34 companies) have non-state minority shareholders.

[48] The FBiH Government is a minority shareholder in the following companies: Aluminij, Sarajevo Osiguranje, Energopetrol and ArcelorMittal Zenica.

[49] The World Bank is providing technical support in the context of the "BEST-SOE project" that focuses on "Support for Better, Effective, Sustainable and Transparent Public Enterprises in Bosnia and Herzegovina",

http://documents1.worldbank.org/curated/en/223291604413419904/Concept-Project-Information-Document-PID-Bosnia-and-Herzegovina-Forest-Economy-Development-Project-BiH-FEDEP-P171513.docx

[50] Figures on the number of privatisations in FBiH are based on data provided by FBiH authorities for assessment. The identification of the two SOEs privatised in 2016 is based on (US Department of State, 2019[80]).

[51] The OECD SOE Guidelines recommend that public procurement procedures applicable to general government are applied to SOE activities intended to fulfil a governmental purpose (OECD, 2015[84]).

[52] Prior to PISA 2018, the last time BiH had comparable results on student learning was in 2007 when its participated in the Trends In International Mathematics And Science Study (TIMSS).

[53] Internationally reported data for BiH is only available for 2019, while regional averages are only available for 2019.

[54] In 2018, the gross enrolment ratio in pre-primary education was on average around 53% in the Western Balkans and 98% in the EU (UIS, 2021[88]).

[55] For the purpose of this profile, the instruction system refers to teaching and learning processes that take place in school education. It generally consists of curriculum, standards for schools and student learning, assessment and evaluation frameworks, and other elements that support instruction.

[56] The Strategy of Education Development for Pre-university Education 2016-2021.

[57] The PISA 2018 reading assessment in Bosnia and Herzegovina revealed that general/modular programmes had an average of 19% low performers, while vocational programmes had 61% (OECD, 2018[87]).

[58] For five economies that could serve as peers for Bosnia and Herzegovina (Bulgaria, Croatia, Hungary, Romania and Slovenia) the average activity rate was 71.2%.

[59] Note that data for the entities do not specify the age group.

[60] Around EUR 27.5 million is dedicated to cover minimal salary, contributions and taxes for around 70 000 employees directly affected by COVID-19 in April, and possibly May (OECD, 2020[298]).

[61] Official Gazette of the Federation of Bosnia and Herzegovina, No. 26/16 and 89/18.

[62] The Labour Law has been harmonised with the following: Directive 2003/88/EC of the European Parliament and of the Council of 4 November 2003 on certain forms of organisation of working time; Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encouraging the improvement of safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding (tenth individual Directive within the meaning of Article 16 (1) of Directive 89/391/EEC); and Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the protection of employees' rights in respect of transfers of undertakings, establishments or parts of undertakings or establishments.

[63] Official Gazette of SRBiH, No. 22/90. The new law came into force on 8 November 2020.

[64] Direct-executable Council Directive 89/391/EEC of 12 June 1989 on the introduction of measures to encourage improvements in the safety and health of workers at work.

[65] It will consist of BiH government representatives, representatives of employers' associations, trade unions and prominent experts in occupational safety and health.

[66] Official Gazette Republika Srpska 01/16 and 66/18.

[67] Official Gazette Republika Srpska 1/08 and 13/10.

[68] Responses of government to OECD questionnaire.

[69] As laid down in the Law on Inspections in the Federation of Bosnia and Herzegovina (Official Gazette of the Federation of BiH, No. 73/14).

[70] Authorised healthcare institutions have the authority to conduct specific health care for workers and occupational medicine. Authorised organisations for performing professional work in the field of occupational safety have the authority to draft an act on risk assessment, conduct periodic inspections and tests in the field of occupational safety (means of work, harmfulness and microclimate in the work environment), and train workers for safe and healthy work. The worker, trade union, employer or employee council may submit a request to the labour inspector to conduct an inspection.

[71] Official Gazette Republika Srpska 18/20.

[72] In March 2021, the total number of employees within the RS administration for the inspection of jobs was 398, among whom 258 were inspectors and 32 labour inspectors.

[73] Information provided by BiH-RS. In 2019, labour inspectors executed 5 369 inspection controls (4 140 were regular planned controls and 1 229 were as part of an extraordinary process). There is no indication about the share of companies visited and controlled.

[74] Information provided by BiH-RS.

[75] Information provided by BiH-RS.

[76] The Ministry for Labour, War Veterans and Disabled persons protection, Economic and Social Council and other ministries have periodic meetings within working groups related to creation strategies, annual action plans for implementation strategies and draft laws

[77] The Law on Employee Councils (Official Gazette of the Federation of BiH, No. 38/04) provides for the possibility of forming an employee council at company level. The employer has the obligations to inform, consult and obtain prior consent when it comes to making certain decisions important for workers' rights. In case there is no employee council, the trade union undertakes its tasks. According to Article 22, the employer must inform the employee council at least every six months about issues that affect their interests in workplace relations, particularly those regarding the condition and results of operations, development plans and their impact on the economic and social position of employees, movements and changes in salaries, safety at work and measures to improve working conditions, and other issues important for the rights and interests of employees. Article 23 determines consultation rights on issues such as the adoption of work regulations; the intention of the employer to terminate the employment contract by more than 10% for economic, technical or organisational reasons; employment plan, relocation and dismissal; measures related to health and safety at work; significant changes or introduction of new technology; vacation plan; working hours; night work; fees for inventions and technical improvements; other decisions for which the collective agreement provides for consultation; employee councils in their adoption. See http://www.advokat-prnjavorac.com.

[78] The provision of Article 158 of the Law on Labour stipulates that it should be consulted in order to promote and harmonise economic and social policy, and encourage the conclusion and application of collective agreements. Each delegation (trade unions, employers and the federation) has seven members.

[79] Representative Trade Unions of Republika Srpska include the Alliance of Trade Unions of Republika Srpska and the Confederation of Trade Unions of Republika Srpska. The Union of Association of employers of Republika Srpska is the only employers' association.

[80] In addition to wage levels and principles of wage development, collective agreements fix issues such the organisation of working time, shift and night work, overtime, annual leave, years of work, reimbursements of costs for hot meal, anniversary award, working conditions at the work place, and rights and obligations of trade union representatives. The latter are usually fixed by law in EU economies.

[81] Official Gazette of RS, no 26/01.

[82] One third of employees, as well as trade unions (representing at least 20% of the workforce), have to agree.

[83] Official Gazette of RS, no. 110/10 and 91/17.

[84] Through participation in working groups the council provides its opinion on work and employment, the economic reforms of Republika Srpska, and on law proposals and the budget.

[85] Wave 3 of the Skills Toward Employment and Productivity (STEP) survey (World Bank, 2018[299]).

[86] Note: "Non-routine" jobs refer to managers, professionals and higher-level technicians whose job descriptions usually contain non-routine cognitive and socio-emotional tasks. This corresponds to Type A occupations in STEP methodology. "Routine jobs" refer to all other occupations, which are Type B occupations in STEP methodology. This methodology was slightly adapted.

[87] Information, Counselling and Training Centres (CISO) were established in 2011 within seven branch offices of Employment Institute of Republika Srpska (EIRS). These centres provide professional information services for pupils. During the 2018/19 school year, professional information and orientation services were provided for 2 813 pupils in 141 high school graduation classes. Data were taken from the reports of schools that carried out this activity. In 2018/19 this measure was provided for 8 129 pupils in primary and secondary schools (information provided by BiH-RS).

[88] Information provided by BiH-RS.

[89] The main strategic objectives are: 1) improving adult education legislation in the context of lifelong learning and harmonising with the EU reference framework; 2) establishing effective ways of participating with relevant social partners in the adult learning process in the context of lifelong learning; 3) developing programmes and institutional capacity and improving the accessibility of adult education in the context of lifelong learning; and 4) ensuring and improving the quality of adult education in the context of lifelong learning (Official Gazette of BiH, No. 96/14).

[90] Information provided by BiH.

[91] Official Gazette of BiH, No. 39/14.

[92] Official Gazette of BiH, No. 96/14.

[93] It was expected that the government would provide its comments by the end of June 2020. At the time of writing there has been no advancements.

[94] Official Gazette of RS, 59/09 and 1/12.

[95] Including craft occupations for shoe production, agricultural occupations, care occupations, mining occupations and hospitality sector occupations.

[96] In line with the EU-agreed definition, a person (15-64) is at risk of in-work poverty if they are in employment and live in a household that is at risk of poverty. A household is at risk of in-work poverty if its equivalised disposable income is below 60% of the national median. However, the authors of this study counted as employed all individuals aged 18-64 who had declared themselves to be working, rather than those who had worked more than half of the income reference year as required by the EU methodology.

[97] According to the law, the government of the FBiH at the proposal of the Federal Ministry of Finance in co-operation with the Federal Institute for Development Programming, and with prior consultation with the Economic and Social Council, should fix the level of the minimum wage. At the time of writing, the above-mentioned FBiH act had not yet been adopted.

[98] Ministry of Human Rights and Refugees of Bosnia and Herzegovina, Gender Equality Agency of Bosnia and Herzegovina, Gender Action Plan of Bosnia and Herzegovina (GAP) (Agency for Gender Equality of Bosnia and Herzegovina, 2018[326]). It includes the following planned measures:

- Identification of priority laws, strategies, action plans and programmes with the aim of introducing international and domestic standards for gender equality.
- Conducting gender analyses of strategies, policies, programmes and projects in the field of labour market, employment and access to economic resources to identify shortcomings, strengths, real needs and opportunities regarding gender equality.
- Regular collection, analysis and publication of gender-disaggregated data on women's and men's participation in the labour market and economic life, including participation in decision-making positions, career advancement, income, wages, indefinite/fixed-term work, business contract terms and access to credit.
- Development and implementation of programmes of measures and activities to eliminate gender discrimination in the field of labour, employment and access to economic resources, including strengthening institutional capacity to apply international and domestic standards in this area, introduction of gender responsive budgets, and establishment of appropriate institutional mechanisms for gender equality to co-ordinate the implementation of these measures.
- Support for research and programmes to increase women's participation in the labour force and reduce unemployment, the development of women's entrepreneurship, as well as representation in agricultural production and the informal sector, and the economic and social empowerment of women.
- Support for research and programmes aimed at improving social protection that address the specific position of women in the labour market and in social and economic life, for example: casual work, career breaks and lower average wages.
- Support for research and programmes related to the advancement of women in the field of rural development, as well as the integration of gender issues into programmes related to sustainable development and environmental protection.
- Organising training programmes for women to help them seek, select and obtain adequate employment, including retraining and self-employment, and starting and developing entrepreneurship.
- Improving measures to reconcile business and private life, including maternity and paternity protection, improving the provisions on paid maternity leave, paid parental leave for both parents, as well as special measures that make it easier for employees to reconcile professional and family obligations.
- Conducting promotional activities, information campaigns and campaigns to raise public awareness of the right of women and men to have equal access to employment, the labour market and economic resources in the field of environmental protection and sustainable development.

- Monitoring progress and reporting on the representation of women and men in the field of labour, employment and access to economic resources, as well as in the field of women's entrepreneurship.

Responsibility holders for the implementation of these measures are legislative and executive institutions and bodies at the state and entity level, cantonal bodies and bodies of local self-government units, in accordance with the sectorial competencies prescribed by applicable legal regulations. Corresponding budgets are adopted budgets of responsible institutions at all levels of authority, with the possibility to combine it with the use of IPA and other donors' funds.

[99] 325 women participate in this programme. Information provided by FBiH.

[100] In families with small children, women perform on average 33.89 hours a week more housework than men (almost another full-time job).

[101] Horizontal co-ordination for the implementation of Gender Action Plan of BiH 2018-2022 in RS is provided through Co-ordination Committee, appointed by the Government of Republika Srpska. The Co-ordination Board of Republika Srpska (CBRS) is led by the Gender Centre and its members are appointed representatives of all ministries in the government. The CBRS has a rulebook and regular meetings (every quarter), proposes annual operational plan for gender equality and annual reports in Republika Srpska within the implementation of GAP BiH 2018-2022, and follows implementation. One of the priority areas is labour, employment and access to economic resources.

Vertical institutional co-ordination is provided through the Management Board: Agency for Gender Equality of BiH, Gender Centre of Federation BiH and Gender Centre of Republika Srpska. The Management Board meets periodically and follows the implementation of the GAP BiH, proposes strategic activities, proposes annual plans and reports, and develops co-operation with international organisations interested in supporting the implementation of GAP BiH.

[102] Conclusion No. 04/1-012-2-2716/16.

[103] The Gender Centre celebrates International Girls in ICT Day in Republika Srpska every April to stimulate the interest, visibility and participation of girls and women in education and professional careers involving innovation, technical, technological and ICT. Various promotional campaigns and events are organised across a week. On the initiative of Gender Centre, primary and secondary schools in RS organise school children and youth education institutions, institutions, companies, faculties and research centres. The Gender Centre has also developed a close partnership with the ICT company LANACO Banja Luka, which every year helps celebrate this day by offering different courses for girls. These courses are certified at the global level and give students the opportunity to enter the labour market in a job related to ICT. This type of co-operation enables the economic empowerment of women, as well as further training in one of the highest paid professions. This model of co-operation has proved to be useful and significant not only in the form of promotional activities, but also in terms of concrete actions for the direct involvement of women in the labour market. The Gender Centre's campaign is recognised internationally by the International Telecommunication Union (ITU), with the Gender Centre and Republika Srpska included in the calendar and map of all economies in the world that organise activities to celebrate the day. A 2016 government report foresees implementing programmes to stimulate young women and girls to choose education in technical and mathematical areas that provide better employment and contribute to development (Gender Centre, 2019[300]).

[104] Information provided by BiH-RS.

[105] The main objective is to strengthen the competitiveness of business entities led by women entrepreneurs and improve the accessibility and attractiveness of entrepreneurship and business for women. Financial resources for the realisation of activities from the Action Plan 2018-2022 amount to BAM 4.5 million, most

of which relates to loan support from the Investment and Development Bank of Republika Srpska, while the remaining funds are from the government and local budgets, as well as international projects and programmes. The Investment and Development Bank of Republika Srpska will work to further reduce the basic interest rate to encourage women's entrepreneurship and help women improve their businesses and to become stronger economically.

[106] Based on the recommendations from the implementation of the first Action Plan for Improving the Position of Rural Women in Republika Srpska, the RS government adopted the second Action Plan for 2019-2020. For the initial action plan, measures developed were special temporary measures for rural women within the framework of the Strategic Plan for Rural Development 2009-2015. The action plan was a targeted public policy based on field indicators. It encompassed various measures in the field of economic empowerment, education, training, improvement of quality of life and access to basic services, protection from violence, social strengthening of the role of rural women, and women's participation in decision making

[107] EIRS has allocated BAM 1.73 million (around 9.5% of the 2019 ALMP budget) for employment and self-employment of these target groups within the project Supporting Employment and Self-employment of target categories in the Economy of Republika Srpska in 2018. Some 396 women from rural areas participated in the programme, and most of the budget was spent (more than 80%). Female victims of war torture were also included as a target group for ALMPs (Information provided by BiH-RS).

[108] Official Gazette of the Federation of BiH, No. 55/00, 41/01, 22/05 and 9/08.

[109] Official Gazette of the Federation of BiH, No. 74/18.

[110] Federal Employment Agency responsibilities:

a) monitor and propose measures to improve the employment and social security of unemployed persons; b) monitor and ensure the implementation of the established policy and measures in the field of labour and employment on the territory of the FBiH and inform the competent bodies thereof; c) manage funds for ensuring material security during unemployment, in accordance with this law; d) monitor and co-ordinate the work of employment services in the implementation of established policies and measures in the field of employment and social security of unemployed persons within the competence of the Federation; e) monitor and propose measures to improve the employment of disabled persons and their professional rehabilitation, and ensure the fulfilment of conditions for their employment in co-operation with employment services; f) provide assistance in the implementation of vocational guidance, training and retraining programmes for the unemployed and their re-employment in appropriate jobs; g) consolidate and keep summary records in the field of labour and employment of interest to the FBiH and propose measures and necessary resources for the development and functioning of a single information system in this field; h) monitor the implementation of international agreements and agreements in the field of labour and employment related to the FBiH; i) represent employment services in relations with bodies and services of Bosnia and Herzegovina, the FBiH and RS; j) approve the employment of foreign citizens and stateless persons at the proposal of the Employment Service, in accordance with the Law on Employment of Foreigners (Official Gazette of the Federation of BiH, No. 8/99); k) monitor and take measures to create conditions for the return of citizens of the FBiH from temporary work abroad and their employment; l) perform other tasks determined by the law, the statute and acts of the Federal Bureau and the ILO Conventions and Recommendations related to the field of labour, employment and social policy; m) submit to the Parliament of the Federation of Bosnia and Herzegovina an annual report on its work and n) submit the consolidated annual financial plans of the Federal Bureau and Employment Services to the federal ministry responsible for labour affairs, in accordance with the Law on Budgets of the Federation of Bosnia and Herzegovina;

Cantonal employment services responsibilities:

a) employment mediation; b) collecting and submitting data on unemployed persons to the Federal Bureau; c) information on employment opportunities; d) co-operation with educational institutions in order to harmonise educational programmes with the staffing needs of employers; e) implementation of programmes of professional orientation, training and retraining of unemployed persons and their re-employment in appropriate jobs; f) determining the rights of persons in case of unemployment; g) issuing work permits to foreign citizens and stateless persons; h) adoption and implementation of programmes of measures for faster employment of certain categories of unemployed persons whose employment is difficult; i) other activities determined by this and other laws.

Information provided by FbiH.

[111] Information on the vocational profile, employment status within the 60 days before registering, social and health characteristics, and motivation for work is collected. Those unemployed are classified into three groups, according to their degree of employability: 1) easily or directly employable persons (employable within the next 9 months according to counsellor's judgement); 2) medium or conditionally employable persons (assessed to be employable within the next 18 months); 3) hard-to-employ persons (assessed to be not employable within the next 18 months, have skills which are not in demand, have health problems and have a low job-search motivation).

[112] Information provided by FBiH.

[113] According to administrative data provided by FBiH. The budget spent for ALMPs amounted to roughly BAM 27.6 million in 2019.

[114] The percentage is in fact lower, as the number of participants are cumulated over the year. In Q2 2019, 76% of unemployed were long-term unemployed.

[115] Official Gazette of RS, No. 90/16.

[116] The legal framework is formed by the Law on Mediation in Employment and Unemployment benefits (RS Official Gazette, No. 30/10, 102/12) and the Law on changes and amendments to the Law on Mediation in Employment and Unemployment benefits (RS Official Gazette, No. 94/19); regulations on conditions, criteria, and manner of implementation of active employment policy measures (RS Official Gazette, No. 94/19); and regulations on active job search (RS Official Gazette, No. 94/19). The EIRS consists of 1 central office, 7 branch offices and 59 bureaus. It employs 334 employees, of whom 83 are counsellors serving 87 000 registered unemployed and 3 485 registered vacancies.

[117] Information provided by RS.

[118] In France and Germany for example, the caseload of for hard-to-place jobseekers is around 70 jobseekers per employment counsellor. The caseload may vary in these economies between 100 and 350, depending on how much jobseekers need individual guidance and how autonomous they are to use self-help guidance tools (OECD, 2015[301]; Manoudi et al., 2014[302]; Pôle emploi, n.d.[303]).

[119] Easily or directly employable, conditionally employable and difficult-to-employ persons.

[120] Information provided by BiH-RS.

[121] Labour market analysis was undertaken by the bureaus located in the local communities. Local councils proposed a plan for secondary school enrolment in accordance with the needs of the economy at the local level. Representatives of employment bureaus took active participation in these activities. In January 2019, the ILO project ended, leaving 9 local partnerships in 15 local communities in RS still running. The objective is to continue co-operation with the key labour market actors through conferences, meetings and advisory bodies in local communities.

[122] In 2019, the EIRS participated in the EU4Business Entrepreneurship Development project, implemented

by the ILO. The aim of the project was to promote the establishment and development of micro, small, medium and newly registered companies by designing mechanisms to provide financial and non-financial (technical/professional) assistance to end users (new and existing entrepreneurs from the target categories of unemployed) and further entrepreneurship development. Within the EU4Business project, training was organised for project partners from PES on the topic "How to start and improve business".

[123] During 2019, significant co-operation regarding improving the work of the bureaus through the implementation of the reform package was achieved with the "Youth Employment Project - YEP" (Phase III) supported by the Swiss Embassy and implemented by the German company GOPA. The emphasis was on the implementation and development of the methodology for monitoring and evaluating individual employment plans, increasing customer satisfaction with services, expanding the network of job search clubs, creating a basis for developing social entrepreneurship, and strengthening partnerships in the labour market.

[124] Answers of the government to the OECD questionnaire.

[125] The Law on Amendments to the Law on Mediation in Employment and Rights During Unemployment. Official Gazette of RS, No. 94/19.

[126] Information provided by BiH-RS.

[127] Official Gazette of the Federation of BiH, No. 26/16 and 89/18.

[128] Official Gazette of the Federation of BiH, No. 92/16.

[129] Official Gazette of RS No. 60/15 and 5/16, amendments refer to Article 10.

[130] Official Gazette of the RS, No. 52/2019. The law entered into force on July 1, 2019.

[131] In Slovenia, in 2018 the most requested occupations were welders, masons and cooks. The public call for the employment of healthcare workers in Germany is permanently open, and in 2018 the necessary activities were undertaken in BiH in accordance with the announced call. The employment office received 94 applications from medical workers during 2018. In the same year, 149 healthcare professionals from RS received work permits as carers in Germany, according to the procedure for employment with known employer. In 2019 the number was 57.

[132] See European Commission, Peer review on “Employer service delivery”, 26-28 October 2020 (online), The Peer Review was hosted by the Dutch PES (UWV WERKbedrijf) and focused on PES employer services design and delivery regarding employment of disabled jobseekers. Report available at: https://ec.europa.eu/social/main.jsp?catId=1070&langId=en&newsId=9528&furtherNews=yes.

[133] Horizon 2020 is the biggest EU framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020).

[134] European Cooperation in Science and Technology (COST) is an EU-funded, intergovernmental framework that currently gathers 38 Members and 1 Cooperating Member. It is a funding organisation for the creation of research networks (COST Actions), which offer an open space for collaboration among scientists across economies. COST funding is intended for collaboration activities and complements national research funds (https://www.cost.eu/who-we-are/about-cost/).

[135] Eureka is the largest intergovernmental network for co-operation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and

innovation or offers advice through various programmes (such as EUREKA Clusters, Globalstars, InvestHorizon) (https://www.eurekanetwork.org/).

[136] EURAXESS – Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated economies. It supports researcher mobility and career development and enhances scientific collaboration (https://euraxess.ec.europa.eu/).

[137] EU distinction between competitive areas ("black" areas) where no state aid is necessary, and unprofitable or under-served areas ("white" and "grey" areas) where state aid may be justified if certain conditions are met. This distinction is then adapted to the situation of next generation access (NGA) networks (whose deployment is still at an early stage) by requiring EU Member States to take into account not only existing NGA infrastructures, but also concrete investment plans by telecom operators to deploy such networks in the near future (European Commission, 2013[304]).

[138] BiH Agency for Statistics (http://www.bhas.gov.ba).

[139] National Summary Data Page (https://cbbh.ba/Content/Read/1133).

[140] The extension of Annex VI. Memorandum for the establishment of the Public Administration Reform Fund is not yet approved as the government of RS has not adopted the document, in contrast to the Council of Ministers of BiH, the Government of the FBiH and the Government of the Brčko District. Given the possible closure of the fund, donors (Sweden and Denmark) have requested the return of their funds (approx. BAM 5.2 million) due to the perceived lack of commitment in the PAR demonstrated by BiH authorities (Public Administration Reform Coordinator's Office, 2020[305]).

[141] The importance of interoperability is also underlined in the European Interoperability Framework (EIF) network, which was adopted by the European Commission in 2017. The EIF makes 47 concrete recommendations for how public administrations can improve their interoperability activities, establish cross-organisational relationships, streamline processes supporting end-to-end digital services, and ensure that both existing and new legislation do not compromise interoperability efforts (European Commission, 2017[306]).

[142] Law on Electronic Signature of BiH, Official Gazette of BiH, 91/06; Law on Amendments to the Law on Identity Card of BiH Citizens, Official Gazette of BiH, 18/12; Decision on the basics of the use of electronic signatures and the provision of verification services, Official Gazette of BiH, no. 21/09; Decision on electronic commerce and e-government in the Council of Ministers of BiH, Official Gazette of BiH, no. 7/10; Law on Electronic Business and Legal Traffic, Official Gazette of BiH, no. 88/07; Law on Electronic Document, Official Gazette of BiH, no. 58/14; Law on Protection of Personal Data, Official Gazette of BiH, no. 49/06, 76/11 and 89/11; Law on Electronic Document of FBiH, Official Gazette FBiH, 15/13; Law on Electronic Signature of the Republika Srpska, Official Gazette of RS, no. 106/15; Law on Electronic Commerce of the Republika Srpska, Official Gazette of the Republika Srpska, no. 59/09, 33/16; Law on Electronic Document of the Republika Srpska, Official Gazette of the Republika Srpska, no. 106/15; Law on Information Security, Official Gazette of the Republika Srpska, no. 70/11.

[143] The eConsultations portal was created by the Ministry of Justice with support from the project "Capacity Building of Government Institutions for Participation in Dialogue with Civil Society" (CBGI), funded by the European Union. Some 64 state-level institutions are registered in the portal and have started to publish their draft legal acts for public consultation (https://ekonsultacije.gov.ba/).

[144] The Law on Registration of Business Entities in RS defines that the process of a one-stop shop system for the registration of business entities from 1 December 2013 is performed at the counters of the RS Agency for IT and Financial Services and at 11 locations of business units.

[145] RS Chamber of Commerce webinars: Electronic sales (e-commerce), IT tools for remote work, electronic books of incoming and outgoing invoices (KUF and KIF), and the impact of social networks on business (https://komorars.ba/).

[146] In accordance with the BiH Constitution there are 12 responsible institutions for education in BiH (the Ministry of Education and Culture of RS, ten cantonal ministries of education in FBiH and the Department for Education of the Brčko District). The Federal Ministry of Education and Science has only a co-ordination role. At the state level, the Ministry of Civil Affairs co-ordinates activities within all education institutions, performing harmonisation of plans of entity bodies and defining strategies at the international level, including for education. At the state level, the Agency for Development of Higher Education and Quality Assurance, the Centre for Information and Recognition of Qualifications in Higher Education, and the Agency for Preschool, Primary and Secondary Education have been established.

[147] Under the auspices of the Adult Education Project (2010-2016), the German GIZ, the Swiss Development Cooperation and the USAID-Sida FIRMA Project, in collaboration with the Federal Employment Agency, the Labour and Employment Agency, the RS Institute for Adult Education and the SPEKTAR Agency, created a registry of adult education providers (http://www.obuke.ba/).

[148] ITkarijera.ba is a portal that offers comprehensive information on the IT sector of BiH to help young people become part of one of the most promising sectors in BiH (https://itkarijera.ba/).

[149] Public procurement portal, managed by the Public Procurement Agency of BiH (http://www.ejn.gov.ba).

[150] The Digital inclusion of marginalised women project by Amica Educa focuses on reducing existing gender inequalities in BiH society by involving women in the process of lifelong learning and active participation in the highly computerized society. Some 48 women were involved in the activities of the project (https://www.amicaeduca.com/digital-inclusion-of-marginalized-women.php).

[151] Digital Transformation Support Programme for MSMEs. Programme implemented by the Development Agency of Serbia in co-operation with the Centre for Digital Transformation and co-funded by the GIZ (https://ras.gov.rs/javni-poziv-za-ucesce-u-programu-podrske-digitalnoj-transformaciji-mmsp).

[152] The FTS considered the following: the Development Strategy for Railways in the RS (2009-2015); the Road Traffic Safety Strategy in RS, including implementation plan (2014-2018) (the new implementation plan for 2019-2022 has been developed but the FTS has not been updated so far); the three-year plans of FBIH ministries and institutions; a study on the market and transport demand for river navigation; and various studies for intermodal transport in Bosnia and Herzegovina, including legislation and spatial plans in force and other available sectorial studies and reports.

[153] Railway transport: interoperability, market access, passengers' rights and obligations. Road transport: road charging infrastructure, annual vehicle taxes.

[154] A single project pipeline (SPP) is a list of projects developed based on a strategic tool for project planning that aims to avoid an ad hoc approach to planning preparation and implementation of investment projects. The SPP helps to prioritise projects, enables the systematic and timely planning of resources, provides a reliable basis for defining the proper sequencing of the priority axis and actions per sectors, and helps link investment planning and programme budgeting.

[155] Annual Programme of the Government of the RS, http://vladars.net/sr-SP-Cyrl/Vlada/Premijer/Documents/Ekspoze_171218.pdf.

[156] European Commission, Instrument for Pre-Accession Assistance, IPA Cross-border Co-operation Programmes, https://ec.europa.eu/regional_policy/en/funding/ipa/cross-border/.

[157] The Law on Public Procurement, https://www.paragraf.ba/propisi/bih/zakon-o-javnim-nabavkama.html.

[158] Projects of state importance, state secrets, projects funded by international financial institutions or donor institution/country, etc.

[159] An appropriate definition of "asset management" for the roads sector was proposed by the OECD in 2001: "A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organized and flexible approach to making the decisions necessary to achieve the public's expectations" (OECD, 2001[307]).

[160] The rulebook laying down framework for the creation of the Single European Sky was adopted in 2020 (Official Gazette No 40/20); Rulebook on Search and Rescue services in the event of an aircraft accident in Bosnia and Herzegovina (Official Gazette of BiH, No 52/19); Rulebook on air traffic flow management (Official Gazette of BiH, No 20/19); Rulebook on approval of exemptions and derogations from the application of by-laws enacted by the Bosnia and Herzegovina Directorate of Civil Aviation (Official Gazette of BiH, No 88/18); Rulebook on the procedure for avoidance of mid-flight collision (Official Gazette of BiH, No 79/18); Rulebook on harmonisation of Bosnia and Herzegovina with International Civil Aviation Organization requirements (Official Gazette of BiH, No 65/18); Rulebook on flight approval (Official Gazette of BiH, No 53/18); Rulebook on NOTAM office of Bosnia and Herzegovina (NOF) (Official Gazette of BiH No 9/18); Rulebook on oversight in civil aviation (Official Gazette of BiH, No 22/16, 55/18 and 5/19)

[161] The Functional Airspace Block Central Europe is a joint initiative of seven states and air navigation service providers from Central Europe: Austria, Bosnia and Herzegovina, Croatia, Czech Republic, Hungary, Slovakia and Slovenia (https://www.fab-ce.eu/).

[162] An air traffic management plan must define the operational air traffic management concept, strategic airspace management, tactical airspace management, air traffic service, ait traffic flow management, flight operation, functional integration, crisis management, search and rescue, and regional air navigation plans and supplementary procedures.

[163] Law on railways of Republika Srpska (Official Gazette of RS, 19/17, 28/17, 100/17); Regulation (EC) No 1371/2007 of the European Parliament and of the Council of 23 October 2007 on rail passengers' rights and obligations (OJ EU L 315, 3.12.2007, p. 14).

[164] Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area (Text with EEA relevance): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012L0034.

[165] Modal shift from road, standards for energy efficiency, standards for noise emission, reduction of greenhouse gas emissions, vehicle labelling for emissions and fuel efficiency, introduction of carbon footprint calculators, eco-driving and speed limits, intelligent transportation system applications, co-modality in transport, urban mobility solutions, etc.

[166] Modal shift though FTS, measures related to the reduction of emissions to stimulate new and more ecologic vehicles through FTS, improvement of transport infrastructure and promotion of bio-fuels and other renewable fuels though the Strategy for Environmental Protection of the FBiH, etc.

[167] As per the Combined Transport Directive 92/106EC, amended by the Directive 2013/22/EU: "combined transport" means the transport of goods between Member States where the lorry, trailer, semi-trailer, with or without tractor unit, swap body or container of 20 feet or more uses the road on the initial or final leg of the journey and, on the other leg, rail or inland waterway or maritime services where this section exceeds 100 km as the crow flies and make the initial or final road transport leg of the journey" (EUR-Lex, 1992[350]).

[168] Competence and quality of logistic services (e.g. transport, operations, customs, brokers).

[169] Quality of trade and transport related infrastructure (e.g. ports, railways, road, information technologies).

[170] A one-stop shop is a business or office where multiple services are offered; i.e. customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one location, instead of having to "drive all over town" to attain related services at different stores. One-stop shop is a way of facilitating trade.

[171] Periodical and regular measurements to monitor infrastructure asset conditions, assessment of the value of assets and costs for non-maintained assets, adoption of asset management strategies, consistent approach in the identification of the mix and timing of asset operation and construction strategies, etc.

[172] For more information on the Second Energy Package and the different Energy Packages within the EU, please see https://www.europarl.europa.eu/factsheets/en/sheet/45/internal-energy-market, in particular Section A. Liberalisation of gas and electricity markets.

[173] The Energy Community is an international organisation that works to integrate the European Union and neighbouring energy markets into a pan-national energy market. For more information please see https://www.energy-community.org/aboutus/whoweare.html.

[174] More precisely, the monitoring of the regulatory authorities is performed by an independent auditor based on international good practices and standards. The reports are released for public consumption. The latest report for SERC can be viewed at: https://www.derk.ba/DocumentsPDFs/Skraceni-revidirani-fin-izvj-DERK-a-za-2019.pdf.

[175] For a more detailed exposition of the issue of losses in the transmission and distribution of electricity please see (CEER, 2020[166]).

[176] Framework Energy Strategy of Bosnia and Herzegovina until 2035.

[177] Republika Srpska: Energy Development Strategy of Republika Srpska until 2035, adopted in 2018. Federation of Bosnia and Herzegovina: Framework Energy Strategy of the Federation of BiH until the year 2035.

[178] Document named STRESS TEST has been made in case of the possible scenario of the interruption of natural gas supply. (Official gazette of FBiH, No. 25/20). Government of FBiH adopted the report on Stress Test for possible disruption of natural gas supply in the FBiH and based on the adopted a finding (Official gazette of FBiH, No. 69/14).

[179] Regulation on security of supply and delivery of natural gas ('Official Gazette of RS', No. 17/11), complied with the guidelines of EU Directive 67/2004/EC.

[180] Oil indexation was once the dominant pricing format for natural gas in Europe. This largely reflected the fact that natural gas spot markets were not liquid enough at the time to provide good price signals. Moreover, when natural gas was competing with oil for power generation and heating, oil indexation was a good approach to ensure that natural gas was competitive with the main alternative fuel. Oil indexation is often also justified by natural gas being produced as a by-product from oil exploration or because natural gas competes with oil for capital investment. However, in the current market situation, oil indexation means that price of natural gas price does not reflect the supply and demand realities, which are largely now disconnected from oil, both in terms of alternative demand and production. Furthermore, Europe has a variety of liquid natural gas spot markets that offer good pricing and indexation points, especially considering the interconnected natural gas markets, including those based on the European natural gas pipeline network. Extensive literature discusses the benefit and drawbacks of the oil indexation of natural gas pricing, examples include (Dubreuil, Gergely Molnar and Jeon, 2020[351]), (European Commission, 2015[352])—with regard to legality of oil indexation, (Melling, A.J. (2010), Natural gas pricing and its future-Europe as the battleground, 2010[353]) (IEA, 2020[355]) --for the current split in pricing approach in Europe, see (Stern, 2007[354])

[181] It should be noted that deficiencies such as the lack of a harmonised legislative framework for natural gas limits its potential.

[182] Although there is an active Energy Community *acquis* infringement case, which stipulates that environmental impact assessments for the construction of a thermal power plant did not conform with *acquis* requirements. See https://www.energy-community.org/legal/cases/2015/case0115BH.html.

[183] The EU Emission Trading Scheme is a construct for the internalisation of externalities relating to the emission of greenhouse gasses of certain economic activities. For further information please see https://ec.europa.eu/clima/policies/ets_en.

[184] For more information on greenhouse gas pricing in Bosnia and Herzegovina and the Western Balkan economies please see (Energy Community, 2021[308]).

[185] The National Renewable Energy Action plan (NREAP) was adopted at the 50th session of the Council of Ministers of Bosnia and Herzegovina held on 30 March 2016. It is based on the adopted Action plans of the Federation of BiH and Republika Srpska.

[186] Guarantee of Origin (GO) is a tracking instrument defined in Article 15 of the European Directive 2009/28/EC on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC. GO are certificates used to identify and certify that specific consumed electricity was sourced from renewable energy. A certificate is issued per MWh generated from renewable energy to the generator and then transferred to and cancelled by a consumer or supplier who would like to certify that their consumed energy comes from renewable energy. For more information on GO and their use and implementation, see (Association of Issuing Bodies, 2020[356]) or (Umweltbundesamt, 2021[357]).

[187] There is no energy efficiency law at the state level, but there are laws in the two entities and the Brcko District.

[188] In particular Directive 2012/27/EU on Energy Efficiency; Directive 2010/31/EU on the Energy Performance of Buildings; Directive 2010/30/EU on Indication by Labelling and Standard Product Information of the Consumption of Energy and Other Resources by Energy Related Products; and Regulation 2017/1369/EU Setting a Framework for Energy Labelling and Repealing Directive 2010/30/EU.

[189] A day-ahead market is an organised market space in which interested parties can buy and/or sell energy for the next day in the form of putting in bids/offers that are algorithmically matched.

[190] The Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) aims to establish a fair and transparent playing field for all stakeholders involved in the trading of energy through establishing a common transparency requirement. As such, REMIT prohibits insider trading and market manipulation. For more information please see https://acer.europa.eu/en/remit.

[191] Network Codes were established under Article 6 of EU Regulation 714/2009 and are secondary acts, in many cases of a technical nature, that aim to overcome legislative gaps and barriers to a non-discriminated, open internal EU energy market by establishing uniform regulation. In essence they overcome barriers and friction in order to promote competition. In some sense, they represent lessons learned over time that aim to perfect the legislative framework for the EU internal energy market and represent EU best practices and standards.

[192] Balancing markets are an integral part of any energy market. Most markets are settled in advance of physical delivery, as in an organised market forecasted supply is matched with forecasted demand (i.e. the market is cleared). However, to maintain the actual system stability at the moment of delivery, it is essential that the same amount of actual energy is fed into the system as is taken out. To this end, the balancing market is used in as close to real time as possible to correct for any mismatch between what is actually generated and fed into the system and what is taken out of the system for consumption. It is essential that all generators, including renewable energy generators, are “imbalance responsible” as this means that they are liable for any mismatch between their forecasted and generated/delivered electricity. If they were not imbalance responsible, other entities or the consumer would need to cover the cost arising from the imbalance caused by the generator, which would also disincentive the generator to be precise with their forecast. For more detailed explanations of balancing market and design options please see (Van der Veen and Hakvort, 2016[360]), (Pinson, 2020[361]), (Bundesnetzagentur, 2020[362]), and (50hertz, 2020[363])and (ACER, 2020a[364]) for an overview of the relevant EU legislation for electricity balancing.

[193] According to information presented by the government: “In electricity tariffs for universal service there is cross subsiding between households and commercial customers in favour of households. Regulators seek to correct tariff values for universal service in order to eliminate cross subsiding. Cross subsidies are being reduced.”

[194] This support is currently central to an ongoing case at the Energy Community (Energy Community Case ECS-10/18: Bosnia Herzegovina/State aid). For more information, please see https://www.energy-community.org/legal/cases/2018/case1018BH.html.

[195] The Energy Strategy of Bosnia and Herzegovina until 2035 was approved in 2018 and the Energy Development Strategy of RS until 2035 was adopted in 2018.

[196] Main measures implemented relate to climate change adaptation measures, especially as regards early warning systems and flood risk management, awareness-raising activities and capacity building for state- and entity-level authorities responsible for various aspects of climate change policies.

[197] Ministry of Spatial Planning, Construction and Ecology RS; Ministry of Agriculture, Forestry and Water Management RS; Ministry of Agriculture, Water Management and Forestry FBiH; Ministry of Environment and Tourism FBiH; Department of Agriculture, Forestry and Water Management; Department for Spatial Planning, Proprietary and Legal Affairs Brčko District.

[198] Such an adapted agroforestry scheme for flood risk management was designed and piloted in the Srbac

municipality. Trees were planted along a 5 400 metre stretch of riparian area, with the total area covered being approximately 1 325 hectares of agricultural land.

[199] In particular, 20 non-structural measures were realised in 11 municipalities in the Vrbas River Basin from August 2017 to November 2019. Interventions included regulation of torrential streams, cleaning of riverbeds, strengthening of embankments, bolstering riverbank protection with stone embankments and gabion systems, constructing stormwater drainage systems and reinforcing riverbanks with vegetation, including under an agroforestry management system. The total value of implemented projects is estimated at more than USD 2 million. In addition to the transfer of modern technologies in flood risk management and improvements in legislative and institutional framework, the project contributed to better preparedness to floods and increased awareness of over 200 000 citizens in 11 municipalities in the Vrbas River Basin.

[200] A Flood Forecasting Early Warning System established for the Vrbas River Basin and a signed protocol on warning information exchange between key institutions is expected to have significant effects on the advancement of flood risk management in the RS and BiH, which could ultimately lead to the reduction of losses and damage for more than 200 000 citizens situated in the Vrbas River Basin. This system might be extended to the entire BiH; however, no concrete steps were planned at the time of drafting.

[201] **Short-term objectives (2019-2024)**: increase the percentage of separately collected waste for recycling from municipal waste through primary selection to reach 10% of the total amount of collected municipal waste, i.e. 25% of paper and cardboard, plastic, glass and metal from the total amount of collected waste; achieve a share of 2% of treated municipal waste by 2024 by increasing the coverage of organised waste collection services and building infrastructure for the separate collection of municipal waste components. **Long-term objectives (2024-2029):** increase the coverage of the population with organised waste collection and disposal services on an annual basis (the goal of 100% by 2029 is set); complete the construction of all regional landfills, transfer stations, and extra facilities for treatment or recycling of special and hazardous types of waste; continue the separate collection of recycling waste from municipal waste (paper and cardboard packaging, plastic and glass packaging, and metal packaging) to achieve the goal of 15% of the total amount of collected municipal waste, or about 37% of paper and cardboard, plastic, glass and metals from the total amount of waste material produced and collected; rehabilitate the remaining areas of contaminated land ("black spots") in accordance with the prepared remediation plans and create the space for treatment or disposal of hazardous waste by amending the Spatial Plan of the RS.

[202] According to the Law on Amendments of the Law on Waste Management (Official Gazette of RS 70/20), the system of management of special waste streams (e.g. waste tyres, batteries and accumulators, vehicles, waste electric and electronic products, oils and lubricants) has been established and the key principles of extended producer responsibility have been legally introduced.

[203] The operator of the packaging waste management system has set up "green islands" in the following municipalities: Prijedor, Trebinje, Laktasi, Kozarska Dubica, Mrkonjic Grad, Ribnik, Prnjavor, Banja Luka and in the area of Olympic Center "Jahorina". Through these activities, containers for the separate collection of waste for recycling through green islands in public areas have been installed. However, separate collection remains in its infancy, and most packaging waste comes from companies in the system, rather than citizens.

[204] Educational promotional videos, education through primary and secondary school activities, distribution of advertising material, sending info-material with utility bills, and similar.

[205] This measure relates to the preparation of the necessary study documentation for the remediation and closure of municipal landfills in the municipalities of Pelagićevo, Čelinac, Srbac, Kotor Varoš, Bratunac, Šekovići, Vlasenica, Doboj and Trebinje.

[206] This measure consists of the preparation of the necessary study and project documentation for the construction of a joint landfill in the municipality of Prijedor (regional landfill) covering local governments: Kozarska Dubica, Kostajnica, Krupa na Uni, Novi Grad, Ostra Luka and Prijedor.

[207] Since the introduction of the Extended Producer Responsibility scheme in 2012, 35% of total packaging waste and 35% of total electric and electronic waste had been recycled in the FBiH, and the set targets have been reached.

[208] The Centers for Civic Initiatives conducted a campaign "Mapping of illegal landfills – Contribution to soil remediation". According to the results of this campaign, which were presented in mid-2019, about 1 300 illegal landfills were recorded throughout the FBiH.

[209] In addition to this strategy there is the Sava River Basin Management Plan of the RS (2018-2021) and the Trebišnjica River Basin Management Plan of the RS (2018-2021).

[210] The River Basin Management Plans (RBMPs) for the Sava River Basin and the Watershed of Adriatic Sea in the FBiH (2016-2021) complement the aforementioned strategic documents.

[211] The Ministry of Agriculture, Forestry and Water Management of the RS and the public institution Waters of Srpska are responsible for water management in the RS. At the state level MoFTER is in charge of international co-operation, co-ordination of entity level institutions, harmonisation of River Basin Management Plans and harmonisation of Flood Risk Management Plans. The Food Safety Agency of Bosnia and Herzegovina defines conditions to ensure the health protection of people from the negative effects of drinking polluted water. In the FBiH there is the Federal Ministry of Agriculture, Water Management and Forestry; the Federal Ministry of Environment and Tourism; Sava River Watershed Agency Sarajevo; the Agency for Watershed of the Adriatic Sea Mostar; the Federal Hydro Meteorological Institute; federal water inspection; cantonal ministries for water management; cantonal ministries of environment; cantonal inspections and local authorities (cities and municipalities).

[212] At the tenth meeting of the Conference of the Parties to Convention on Biological Diversity, held in October 2010, in Nagoya, Aichi Prefecture, Japan, a revised and updated Strategic Plan for Biodiversity was adopted, including the Aichi Biodiversity Targets, for the 2011-2020 period. This Plan provided an overarching framework on biodiversity, not only for the biodiversity-related conventions, but for the entire United Nations system and all other partners engaged in biodiversity management and policy development. Parties agreed to translate this overarching international framework into revised and updated biodiversity strategies and action plans within two years, which are intended to define the current status of biodiversity, the threats leading to its degradation, and the strategies and priority actions to ensure its conservation and sustainable use within the framework of the socio-economic development of the economy. There are 20 Aichi biodiversity targets grouped around 5 strategic goals: 1) address the underlying causes of biodiversity loss by mainstreaming biodiversity across government and society; 2) reduce the direct pressures on biodiversity and promote sustainable use; 3) improve the status of biodiversity by safeguarding ecosystems, species and genetic diversity; 4) enhance the benefits to all from biodiversity and ecosystem services; and 5) enhance implementation through participatory planning, knowledge management and capacity building (Convention on Biological Diversity, 2020[283]).

Aichi Target 11 states: "By 2020, at least 17% of terrestrial and inland water, and 10% of coastal and marine areas, especially areas of particular importance for biodiversity and ecosystem services, are conserved through effectively and equitably managed, ecologically representative and well-connected systems of protected areas and other effective area-based conservation measures, and integrated into the wider landscapes and seascapes." (Convention on Biological Diversity, 2020[283]).

[213] In the RS, the Ministry for Spatial Planning, Construction and Ecology is responsible for activities in the area of nature protection. Activities in the area of nature protection within the competence of local self-government units are performed by bodies of local self-government units and by departments responsible for protection of the environment of local self-government unit. Expert activities in the area of protection of nature and natural resources are performed by Institute for Protection of Cultural, Historical and Natural Heritage of the RS. In the FBiH, the Federal Ministry of Environment and Tourism, Federal Ministry of Agriculture, Water Management and Forestry, Federal Forest Administration and all ministries at the cantonal level dealing with environment are responsible bodies. The Institute for Nature Protection has not been established yet, and there is no professional institution that assists and directs the processes of nature protection.

[214] Relevant documents are the Law on Protection and Rescue of People and Material Goods from Natural or other Disasters (Official Gazette of the FBiH, No. 39/03 and 22/06); Assessment of the Vulnerability of the FBiH to Natural or Other Disasters (Official Gazette of the FBiH, No. 41/05); Plan for Protection and Rescue of the Federation of BiH from Natural or Other Disasters (Official Gazette of the FBiH, No. 40/08); Law on Fire Protection and Firefighting (Official Gazette of the FBiH, No. 64/09).

[215] Air protection and air quality management in the RS is regulated by the Law on Air Protection (Official Gazette of RS No. 124/11 and 46/17) and subordinate legislation. Regulations in the field of air protection in the RS are almost fully harmonised (about 94%) with two EU directives: 2008/50/EC and 2004/107/EC. Alignment with the requirements of the directives relating to emissions from large combustion plants was carried out during 2017 in accordance with Annex II of the Energy Community Treaty.

[216] Improving Air Quality and Air Quality Management in Bosnia and Herzegovina (IMPAQ). The following targets have been set as part of the IMPAQ programme: 1) data hosting infrastructure and capacity; 2) reference laboratory infrastructure and capacity; 3) source apportionment study in six major cities (three in each entity); 4) cost-effective and scalable air quality improvement activities; 5) information campaigns regarding air quality and public health; and 6) implementation of legislation via inspectors.

[217] Main tasks of this working group are: 1) strengthening of capacities for the improvement of air quality monitoring, air quality management and reporting, air quality assessment methodologies and development of air quality improvement plans according to the Air Quality Directive; 2) assistance on capacity building related to emissions inventories, projections, reporting, and reduction strategies according to the National Emission Ceilings Directive (NEC), and facilitation of the ratification of the Gothenburg Protocol; 3) strengthening of capacities for monitoring sulphur emissions in maritime transport and enforcing EU and International Maritime Organisation (IMO) requirements on sulphur; and 4) assistance on capacity building related to managing permits in accordance with BAT and BAT conclusions developed under the Industrial Emissions Directive (IED), setting emission limit values for pollutant emissions and monitoring requirements in accordance with the principles and provisions of the IED.

[218] the Hydrometeorological Institute of the Federation of Bosnia and Herzegovina uses the CORINAIR methodology, while the Hydrometeorological Institute of Republika Srpska uses the IPCC methodology

[219] These are the same bodies that are in charge of municipal waste management: Ministry of Physical Planning, Civil Engineering and Ecology, which is a focal point for the UNFCCC and the ministry responsible for environmental protection/in charge of the overall waste management; Ministry of Health and Social Welfare, which is in charge of addressing medical waste and ionised radiation; Environmental Fund of the RS, which is in charge of collecting data on waste; RS Statistical Service, which is in charge of waste data collection and processing; local governments and utility companies in charge of waste shipment; regional sanitary landfills in charge of communal waste management; and local system operators of packaging waste.

[220] Measure 4: Support for rural infrastructure development and the improvement of availability of services to the rural population was enacted to improve the availability of rural services and the general living conditions in rural areas. The increasing levels of migration of the rural population towards urban areas and abroad in search of new employment opportunities are recognised as indirect consequences of underdeveloped physical rural infrastructure and limited availability of public services in rural areas.

[221] Funding is provided to support infrastructure investment needed for the development of rural areas, including facilities for agriculture related activities (e.g. green markets in the communities, buy-out centres, venues for exhibition and fairs); local roads important for local economic development; access to agricultural and forest land; electrical energy supply, waste and water management; local access to IT; venues for educational, sport and other activities of the local population; and rural services of common interest for groups of villages (IT centres, training centre, fire protection units).

[222] Report for the implementation of the Strategic Plan for Rural Development of Bosnia and Herzegovina (2018-2021). The Ministry of Agriculture of the FBiH managed to include the Rural Development Programme of the FBiH in the Public Investment Programme of the FBiH 2018-2020, which created the preconditions for securing credit funds for financing projects under rural development measures in the FBiH. The Federal Ministry of Finance should initiate the procedure of external borrowing with the government of the FBiH, after which the loan agreement could be accepted by the FBiH parliament.

[223] The Strategy of Development of Science defines the priorities in the development of agriculture sciences as including: 1) biorational use, fertility increase, remediation and soil protection; 2) raising the productivity of agricultural production and processing, ensuring the quality and safety of food; 3) creation of new high-yielding and quality varieties/hybrids/breeds; 4) development of new technologies in agricultural and forestry production; and 5) research that supports rural development, which supports innovation in agriculture and the creation of additional income on farms and rural communities (use of agricultural waste – renewable energy, new insulation materials, compost, etc.).

[224] Measure 3: Support for vocational training, knowledge development and providing advice and information to help farmers, forest holders and SME's to improve the sustainable management, economic and environmental performance of their holdings and/or businesses.

[225] Faculty of Agriculture and Food Sciences at the University of Sarajevo; Faculty of Biotechnology at the University of Tuzla; Faculty of Agriculture at the University of Banja Luka; Faculty of Agriculture in East Sarajevo; Faculty of Agriculture and Food Technology in East Sarajevo; Faculty of Agriculture and Food Technology at the University of Mostar; Agro-Mediterranean Faculty at the University of "Džemal Bijedić" of Mostar; Faculty of Biotechnology at the University of Bihac.

[226] The strategy foresees: 1) promotion and strengthening of good agricultural practices; 2) equalisation of business conditions in areas with natural constraints and preservation of valuable landscapes; 3) strengthening the water management system in agriculture; 4) strengthening awareness of climate change, its consequences and methods for mitigating or protecting the sector from such changes; 5) promoting the use of renewable energy sources and using waste from agriculture; 6) revitalisation and preservation of pasture areas; 7) establishing and strengthening the mechanisms of sustainable land management.

[227] The plan defines seven main strategic goals for the development of agriculture and rural areas in BiH for 2018-2021, including: 1) ensuring income stability and harmonising business conditions with the region; 2) strengthening competitiveness of agriculture, forestry and rural areas; 3) increasing the level of investment and improving the transfer of knowledge and promotion of innovation; 4) improving the marketability of agri-food products by increasing value-added activities, improving quality and safety standards and strengthening linkages within value chains; 5) sustainable management of natural resources and climate change adaptation; 6) improving quality of life in rural areas through new income generating sources and the improvement of physical infrastructure, social inclusion and accessibility of public services; and 7) improving institutional systems and capacities and harmonisation of the legal framework in agriculture and rural development at all governmental levels with the aim of gradual approximation to the EU CAP.

[228] Support for current production encourages primary livestock and crop production through the allocation

of incentives for produced/sold fruits, vegetables, herbs, seeds and planting material; for organic production and sowing and planting; and through encouraging plant health programmes.

[229] Long-term development measures and incentive funds for capital investments include support for capital investments, procurement of agricultural machinery, investments in livestock and crop production, irrigation and support for processing capacities. These measures include agricultural and non-agricultural activities in rural areas, enabling increased employment opportunities for the rural population, improved access of the rural population to the market and public services, reduction of population outflow, preservation of cultural and historical heritage, sustainable use of natural resources, and preservation of the environment and biodiversity.

[230] Systemic support measures include market intervention measures, emergency assistance related to repairing damage from natural disasters, the purchase of market surpluses, and market regulation through purchasers or processors of food products.

[231] The ministry responsible for tourism manages overall tourism development, and the tourist organisation is responsible for the promotion of tourism and marketing in the global market.

[232] The tourist cluster of Unasava seems to be a good practice case of public-private co-operation at the destination level. The cluster was developed with the support of the Swedish International Development and Co-operation Agency, or Sida and implemented by the World Wide Fund for Nature. More information available at: https://www.unasana.ba/en/turisticki-klaster-una/. The tourist cluster of Herzegovina, which is also established as a public-private organisation for the promotion of tourism, is another example of good practice. More information available at: http://www.tkh.ba/?lang=en.

[233] Official Gazette of Bosnia and Herzegovina, No. 26/04 and 42/04.

[234] The project is a part of the EU4Business initiative under IPA 2016 Support in the Sector of Competitiveness and Innovation. It is co-financed by the EU and the German Federal Ministry for Economic Cooperation and Development (BMZ) and implemented by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) as the lead organisation. The UNDP and ILO are co-delegates under the Co-Delegation Agreement with the EU.

[235] For comparison see (SELDI, 2019[286]).

[236] Website of the Commission for Deciding on Conflicts of Interest: https://www.coi.ba/.

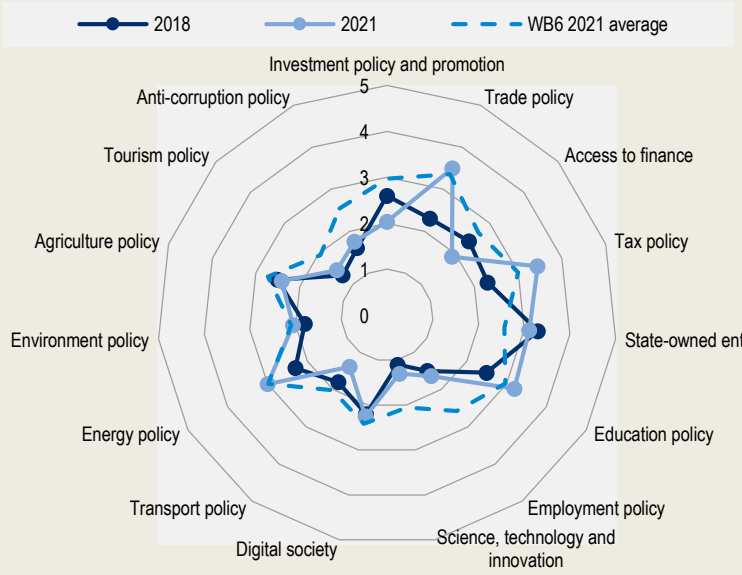
[237] Website of the Agency for Prevention of Corruption and Co-ordination of the Fight against Corruption: http://www.apik.ba/obuka/materijal-za-ucenje/Default.aspx?langTag=bs-BA.

[238] The Brčko District also has own Criminal Code and Law on Criminal Procedure

# 22 Kosovo profile

# Key findings

## Figure 22.1. Scores for Kosovo (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Dimension scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicator. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Scoring approach section for information on the assessment methodology. Scores for Dimension 5 Competition Policy are not included in the figure due to different scoring methodology. See the Scoring approach for more information.

Kosovo has improved its performance since the publication of the Competitiveness Outlook 2018 report in 9 of the 15 policy dimensions[1] covered in the assessment (Figure 22.1). Although this clearly indicates progress in the setting up of polices to enhance its competitiveness – at least in about half of the dimensions covered in this assessment – if they are to have a lasting impact then their effective and continuous implementation, monitoring and upgrading should remain a key priority. Kosovo achieved its highest average scores in the trade, tax, education and energy policy dimensions, with scores all over 3.0 and all above the WB6 average. Kosovo's main achievements since the last assessment are as follows:

- **The trade policy framework includes better public consultations, fewer restrictions in trade in services and an e-commerce policy reform is underway.** Public consultations for trade-related regulatory policies have been strengthened through new legislation, a centralised consultation platform and regular monitoring by a single and independent public institution. Not only is Kosovo the least restrictive economy in the WB6 for trade in services – it also one of the most attractive in comparison to OECD members states and key partners. The signing of the Additional Protocol 6 to the Central European Free Trade Agreement (CEFTA) on trade in services in December 2019 has prompted reforms to remove restrictions on the movement, recognition of qualifications and activities of CEFTA service providers. Kosovo is also working to make its markets more attractive to foreign investors, notably through sectoral reforms based on EU regulations, such as in the courier sector. Finally, Kosovo is continuing its efforts to adapt its trade framework to the new challenges of e-commerce.
- **The tax administration is increasingly efficient.** The Tax Administration of Kosovo (TAK) continues to unify tax collection and all core tax administration functions. It now carries out all the main tax administration functions, including tax fraud investigations (generally carried out by

special police departments in other WB economies). TAK also oversees tax compliance assessment and risk management using a risk-based analysis which identifies taxpayers with certain abnormalities against a predetermined set of risk criteria. In terms of independence and transparency, TAK has full operational autonomy within the Ministry of Finance. Most taxes can be filed and paid electronically or manually, and information can be accessed on line or through regional services. TAK is regularly assessed by several domestic and international institutions.

- **Early childhood education (ECE) framework is more strategic and early school leaving is falling.** Kosovo's strategic ECE framework has clear objectives to increase inclusion and participation at this level of education, and is backed by an implementation timeline and budget. Kosovo has made progress in implementing new early learning and development standards for children aged 0-6, and is developing infrastructure to better monitor and respond to early school leaving. Policies have contributed to a decline in the early school leaving rate from more than 18.4% in 2013 to 9.6% in 2018, thus achieving the EU's 2020 target of less than 10%.
- **Energy markets reform is progressing, and energy efficiency and security are increasing.** The unbundling of network monopolies and third-party access in the energy sector are almost fully aligned with international good practice, notably the EU's Third Energy Package. Kosovo has made significant progress in unbundling the ownership of the transmission system operator (TSO), and fully unbundling the distribution system operator (DSO). Both are unbundled and separate from generation and supply activity, in line with EU directives. Compliance programmes and officers are in place and non-discriminatory third-party access is established and guaranteed by legislation. Kosovo has also made progress in energy efficiency, adopting a new Law on Energy Efficiency in 2018 as well as the relevant policy documents. In 2018 it simplified the administrative procedure for renewable energy projects and regulations to create a one-stop shop for renewable energy sources. These measures should help strengthen Kosovo's energy security by increasing domestic generation capacity and reducing losses from inefficient energy consumption.

### Priority areas

Despite these significant achievements, there are a number of areas in which Kosovo still needs to step up its efforts. These include the dimensions on employment; investment policy and promotion; science, technology and innovation; transport; agriculture; and environment, where Kosovo scores the lowest and below the WB6 average (Figure 22.1). The priority actions for these six areas are as follows:

- **Reduce youth unemployment and skills mismatches and introduce employment support policies.** Youth unemployment is extremely high, indicating severe problems with the school-to-work transition. Deficiencies in the education system and mismatches between the labour market and field of study mean Kosovo suffers skills shortages despite high unemployment rates for people of all skill levels. Kosovo should use its whole education and training infrastructure, including vocational education and training (VET), to provide adults with remedial education and improve their vocational skills. In order to build on the working population's existing skills and knowledge, and given high levels of informality, the authorities should develop a framework that can combine the recognition of prior learning with upskilling activities. Kosovo currently has no unemployment benefit system, although benefits were exceptionally allocated during the COVID-19 pandemic. Reforms to the social protection system are planned and will introduce unemployment benefits – they should introduce both an unemployment benefit scheme and a general healthcare scheme, and should ensure the social assistance scheme better targets the poor.
- **Further improve investment promotion and facilitation**. Kosovo lacks a comprehensive strategy framework for attracting foreign direct investment (FDI), or solid inter-agency or inter-ministerial co-ordination mechanisms, and council meetings are irregular. The Kosovo Investment

and Enterprise Support Agency (KIESA) lacks the capacity and resources to execute its very wide and extended mandate. This limits its ability to foster linkages between the FDI it is striving to attract and the small and medium-sized enterprises it is supporting. A clear strategy to attract FDI and proactively target investors would enable KIESA to focus its resources more efficiently.

- **Establish an overarching strategic vision for science, technology and innovation (STI).** Kosovo's performance is constrained by a lack of system-level STI priorities, limited implementation of relevant policy initiatives, and a lack of monitoring and evaluation activities. In order to develop and prioritise targeted policy measures, it should start by identifying and mapping the research and development infrastructure to gather economy-wide data on labs and researchers, increase investment in public sector research, and encourage research excellence.
- **Improve transport project selection tools and the governance of road and rail transport.** Kosovo still uses inefficient and suboptimal processes for selecting important transport infrastructure projects, with no progress since the last assessment. Although there has been progress in opening the railway market and unbundling rail monopolies, no positive improvements to road market regulation have been achieved and substantial additional efforts are needed to align local road market legislation with the EU and Transport Community *acquis*. Moreover, the high share of freight carried by road, around 88.4%, has clear negative effects on air pollution and climate change. Incentives to shift freight from road to rail could speed up harmonisation with the EU *acquis* and have a positive impact on the environment. Enhancing the human and financial capacities of the regulatory authorities should be one of the first priorities. In addition, interoperability activities are very important for the development of international railway transport and should be continued, but gradually, as interoperability takes time and funds.
- **Boost agricultural productivity by improving irrigation water management**. Although Kosovo has implemented several plans to improve irrigation infrastructure since the last assessment, it remains underdeveloped and inefficient. Only 32 237 hectares are irrigated (17.3% of Kosovo's arable land), while water network losses and lack of water storage facilities hinder efficiency. The productivity of agriculture in the economy largely depends on irrigation, as well as a functional water management system. Kosovo should increase investment in maintaining the existing irrigation network while bringing new areas under irrigation. Kosovo also needs to reduce illegal irrigation systems, improve monitoring and control, and increase the payments for irrigation services.
- **Advance environmental policies, in particular air quality and waste management.** Kosovo has one of the highest concentrations of air pollution in Europe with an annual mean exposure to particulate matter ($PM_{2.5}$) of 27 micrograms per cubic metre ($\mu g/m^3$). This is almost three times the World Health Organization recommended highest levels (10 $\mu g/m^3$). Kosovo can improve air quality by reducing its energy dependence on fossil fuels (particularly coal and lignite), improving household heating systems and reducing emissions from transport. Although some actions on waste management and the circular economy have already been planned in the former Waste Management Strategy, implementation has been limited, with most actions simply rolled over to the new strategy. Kosovo should focus on offering incentives at the municipal level for the separation of municipal waste at source, i.e. before it is collected and recycled or converted to energy, (e.g. rewarding households for sorting waste, decreasing utility bills) together with regular awareness-raising activities on waste prevention and recycling (brochures and information campaigns).

1: Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses different scoring model Scoring approach.

## Economic context

### *Key economic features*

Kosovo is a small open economy with a limited but growing productive base. Services account for the largest share of the Kosovar economy, making up 47.5% of gross domestic product (GDP) and 65% of employment (World Bank, 2021[1]; Kosovo Agency of Statistics, 2021[2]). Wholesale and retail trade, real estate, transportation and storage, and financial services are the largest service sectors in the economy (Kosovo Agency of Statistics, 2021[3]). Industry accounts for 26.4% of GDP, with the highest contribution coming from the manufacturing and the construction sectors (11.7% and 8.5% of GDP, respectively) (Kosovo Agency of Statistics, 2021[3]). The contribution of agriculture, forestry and fishing to Kosovo's GDP has declined considerably over the past decade, from 15% in 2008 to 6.9% in 2019, although it still accounts for a significant share of employment – 5.5% of formal employment and an estimated 35% of informal employment (World Bank, 2021[1]; Cojocaru, 2017[4]).

Over the past decade, the growth of Kosovo's economy has been relatively strong, on the back of consumption growth supported by high inflows of remittances (over 18% of GDP), as well as credit from the expanding financial sector. However, given the economy's limited production base, the consumption-driven growth model has relied strongly on imports, which accounted for 56.1% of GDP in 2019. In combination with the relatively weak export base – 29.1% of GDP – this has resulted in the build-up of significant external imbalances, including high trade and current account deficits, which in 2019 reached 43.8% and 5.6% of GDP, respectively (European Commission, 2021[5]) (World Bank, 2021[1]).

Investment in Kosovo has been high; however, most of this investment, including foreign direct investment (FDI), has not supported the growth of the domestic production base or the tradable sector. Over the past decade, investment has mainly gone into the wholesale and retail trade, construction, transport, and financial service sectors. These sectors support domestic consumption and, with the exception of financial intermediation, have limited impact on the growth of domestic productive capacities or on productivity enhancing spillovers. Similarly, FDI has been mainly market-seeking, with the largest share allocated to the real estate and construction sectors (nearly 60% over the past decade) (Kosovo Agency of Statistics, 2021[3]). Thus, unlike in many peer economies in the Western Balkan region or aspirational Central and Eastern European peers, FDI in Kosovo has not been a significant driver of structural transformation, particularly towards more export-oriented growth.

Kosovo's economy is also characterised by relatively weak productivity, with growth slowing down considerably over the past five years. Across all sectors, labour productivity – measured as output per worker – is less than a quarter of the European Union (EU) average (World Bank, 2021[1]). The limited reallocation of labour from less to more productive sectors has resulted in lower productivity gains. Growth within sector productivity has declined over the past decade. In the context of strong investment growth this points to weaknesses in investment allocation, as outlined above, as well as significant frictions in the market preventing the reallocation of capital and other inputs to the most productive sectors and firms (World Bank, 2017[6]). These frictions stem from numerous structural challenges, including inadequate access to finance, significant infrastructure gaps, inadequate competition (including from the large informal sector) and high levels of corruption (see Structural economic challenges section below).

## Table 22.1. Kosovo: Main macroeconomic indicators (2015-20)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 4.1 | 4.1 | 4.2 | 3.8 | 4.9 | -3.9 |
| GDP per capita[2] | Current international $ | 9 576 | 10 062 | 10 530 | 11 157 | 11 972 | 11 368 |
| Domestic GDP[2] | USD billion | 6.4 | 6.7 | 7.2 | 7.9 | 7.9 | 7.6 |
| Inflation[1] | Consumer price index, annual % change | -0.5 | 0.3 | 1.5 | 1.1 | 2.7 | 0.2 |
| Current account balance[1] | % of GDP | -8.6 | -7.9 | -5.4 | -7.6 | -5.6 | -7.1 |
| Exports of goods and services[1] | % of GDP | 21.9 | 23.7 | 27.1 | 28.8 | 29.1 | 21.6 |
| Imports of goods and services[1] | % of GDP | 50.4 | 50.9 | 52.6 | 56.8 | 56.1 | 53.7 |
| Net FDI[1] | % of GDP | 4.7 | 2.9 | 3.3 | 3.4 | 2.7 | 4.2 |
| Public and publicly guaranteed debt[3] | % of GDP | 12.8 | 14.4 | 16.3 | 16.9 | 17.5 | 22.8* |
| External debt[4] | % of GDP | 33.3 | 33.2 | 32.6 | 30.3 | 31 | ... |
| Unemployment[1**] | % of total labour force | 32.9 | 27.5 | 30.5 | 29.6 | 25.7 | ... |
| Youth unemployment[2***] | % of total labour forces ages 15-24 | 57.7 | 52.4 | 52.8 | 55.4 | 49.5 | ... |
| International reserves[1] | in months of imports of G&S | 4.3 | 3.5 | 3.3 | 2.9 | 2.8 | 3.2 |
| Exchange rate[1] (if applicable local currency/euro) | Value | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Remittance inflows[2] | % of GDP | 15.1 | 14.7 | 15.3 | 15.6 | 15.7 | 18.9 |
| Lending interest rate[5] | % annual average | 8.32 | 7.45 | 6.83 | 6.65 | … | .. |
| Stock markets (if applicable) [1] | Average index | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

Note: Data as of July 2019. n.a.=not applicable; G&S = Goods and services; *estimates for 2020; **2019 data due to unavailability of 2020 data; ***National estimate due to unavailability of modeled ILO estimate.
1. (European Commission, 2021[7]), *EU Candidate Countries' and Potential Candidates' Economic Quarterly Q1 2021,* https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf.
2. (World Bank, 2021[1]), *World Development Indicators*, https://databank.worldbank.org/source/world-development-indicators.
3. (World Bank, 2021[8]), World Bank Western Balkans Regular Economic Report https://openknowledge.worldbank.org/bitstream/handle/10986/35509/Subdued-Recovery.pdf?sequence=1&isAllowed=y.
4. (EBRD, 2020[9]),*Transition Report 2020-21*, https://2020.tr-ebrd.com/countries.
5. (IMF, 2020[10]), *International Financial Statistics database*, https://data.imf.org/regular.aspx?key=61545855.

In the context of weak productivity growth, a strong increase in wages has weakened labour cost competitiveness. Over the past decade, Kosovo has seen a significant increase in the average wage, driven primarily by the growth in public sector wages, which have more than tripled since 2008 (Kosovo Agency of Statistics, 2021[3]). In conjunction with high remittance income, this has contributed to higher reservation wages and growing wage-to-productivity ratios in the private sector. This has significant policy implications. In light of the limits on monetary and exchange rate policy imposed by the unilateral adoption of the euro, competitiveness gains will need to be achieved internally through contained wage growth and higher productivity.

Labour market performance has been improving in Kosovo, but the outcomes are still weak relative to OECD and EU benchmarks. At 30.1%, the employment rate in Kosovo is among the lowest in the world, and the unemployment rate remains high at 24.6% (as of Q3 2020), despite a significant decline over the past decade (European Commission, 2021[7]). Furthermore, 60% of the working age population are inactive, with the activity rate among women especially low at roughly 21%. Meanwhile, the share of youth not in employment, education or training (NEET) is 37.7% (Kosovo Agency of Statistics, 2021[2]). Given its relatively young population, Kosovo's weak job growth and high youth inactivity limits the prospects of a demographic-dividend driven boost in growth and development. The high pace of emigration is further undermining growth prospects, even if it temporary relieves labour market pressures from the growing labour force. On the flip side, however, diaspora remittances support poverty reduction and thus remain an important source of income for the economy (Table 22.1).

Looking ahead to the next decade, Kosovo will need to strengthen its business and institutional environment, reduce infrastructure gaps, and strengthen the skills of its population in order to lay the foundations for sustained and job-creating economic growth. Nurturing and strengthening the linkages with the diaspora can help in this process as they have been an important driver of FDI investment and a significant source of remittances. Fostering the competitiveness and growth of the domestic private sector will also require limiting the growth of wages, particularly in the public sector, in order to help better align worker compensation with productivity across the economy, and make private sector employment more attractive and competitive.

### *Sustainable development*

Kosovo has committed to implementing the 2030 Agenda for Sustainable Development, which includes 17 Sustainable Development Goals (SDGs) and 169 targets, many of which were reflected in Kosovo's National Development Strategy (NDS) 2016-2021. However, considerable progress is still needed to meet the 2030 targets and ensure that Kosovo's development path is sustainable and inclusive. Better aligning SDG goals with all strategic documents would help in this process, as would better data collection to monitor progress on the goals: a 2019 study found that out of 231 SDG-related indicators applicable to Kosovo, only 33 indicators were readily available from official sources (Institute for Development Policy, 2019[11]).

Regarding well-being (SDG3), considerable progress is needed to improve outcomes across several dimensions. Extreme poverty has not yet been eradicated in Kosovo: about 5% of the population is estimated to be living on less than USD 1.90 per day. While the overall poverty rate has declined, faster progress is needed to reach the 2030 targets. More progress is also needed to create economic opportunities. As noted earlier, Kosovo's economy is characterised by very low employment and labour force participation. There are also significant inequalities between men and women, as well as young people – see Employment policy (Dimension 8). Significant disparities in various aspects of well-being are also noted across regions and ethnic groups (see discussion on inclusive growth below).

Vast progress is particularly needed in the area of health (SDG3), with Kosovo lagging behind not only the EU average, but also the averages of all its regional peers in many critical health indicators, such as infant mortality (Eurostat, 2021[12]). The sector is strongly impacted by a lack of financing for infrastructure, equipment, medications, etc. (see discussion on health below).

Significant progress is also needed on the environment. Kosovo's energy consumption is highly dependent on fossil fuels, and renewable energy contributes only 6% to the total energy mix. If the planned construction of a new coal-fired power plant is approved, Kosovo's reliance on the highly polluting lignite coal will remain a major obstacle to achieving SDG13, and may even lead to a regression in the goal of reducing emissions and developing a low-carbon economy. However, some progress has been made in the area of waste collection (Institute for Development Policy, 2019[11]) – see Environment policy (Dimension 13).

Regarding peace and institutions (SDG16), Kosovo needs to make considerable progress in tackling corruption and improving the efficiency and effectiveness of public institutions at the central and local level.

### *Structural economic challenges*

Kosovo faces a number of key structural challenges that undermine its competitiveness and attractiveness, as well as its integration into global value chains (GVCs).

*Weak human capital reduces the scope for profiting from the demographic dividend*

As the youngest economy in Europe, with nearly 40% of the population aged 19 or younger, Kosovo could reap significant growth and development benefits if it put its growing labour force to work in high productivity jobs. However, weaknesses in the quality and relevance of education undermine these prospects:

- **Education quality**: The shortcomings in education quality are exemplified in student performance on international assessments such as the Programme for International Student Assessment (PISA), where Kosovo is the third-lowest performer of all participating economies. Less than a quarter of students attained the minimum level of proficiency across the three testing subjects (21% for reading, 23% for mathematics and 23% for science), which is well below the OECD average of over 75% for all three subjects (OECD, 2018[13]). The outcomes are especially worrying in the context of Kosovo's relatively high spending on education compared to regional peers: at 4.4% of GDP, education spending is on par with the OECD average. This points to the inefficient allocation of spending, with a high share going on teacher salaries but without translating into high-quality teaching. This in turn reflects limited resources for, and implementation of, evaluation and other quality assurance processes across all levels of the education system. It also highlights the poor implementation of competency-based curricula, reflecting in part weak teacher training and outdated textbooks.
- **Mismatches between education with labour market needs:** The challenges in the education system also reduce its alignment with labour market needs. In the latest Business Environment and Enterprise Performance Survey (BEEPS), 44% of firms identified an inadequately educated workforce as a major constraint (BEEPS, 2018[14]). This reflects significant challenges in the vocational education and training (VET) system and tertiary education. Kosovo's VET system is organised by specialised profiles; however, these do not align with labour market needs, which is particularly concerning as enrolment in the VET system has increased significantly in recent years, and is considerably higher than in the OECD and other Western Balkan (WB) economies – see Education policy (Dimension 7). Although other significant reforms have been introduced, including new curricula frameworks that include work-based learning, career guidance in higher education institutions and a National Qualification Framework, the lack of effective implementation, monitoring and evaluation negatively impacts educational outcomes. Various agencies collect data on labour market and education; however, initiatives to link and analyse the data in order to inform policy making have been delayed by a lack of funding and insufficient stakeholder engagement – see Education policy (Dimension 7).
- **Poor labour market participation and employment outcomes for youth and women**: Kosovo's employment rate is one of the lowest in the world, at 30.1%. Young people are particularly strongly affected by the lack of job prospects, with the unemployment rate of those aged 15-24 at 46.9%. Given Kosovo's relatively young population, weak job creation, especially in the private sector, creates significant labour market pressures, provides high incentives for youth emigration and weakens long-term growth prospects. Such prospects are also weakened by the underutilisation of women's productivity potential. The participation of women in the labour force is very low: about 20% of women are active in the labour market compared to about 60% of men. The weak participation of women is constrained by economic considerations, limited childcare options and cultural norms (Kosovo Agency of Statistics, 2021[2]).

*A poor business environment hampers private sector development and investment*

Over the past decade, Kosovo has made progress in reducing the regulatory and administrative burden on businesses, especially for starting a business, and has improved the overall business environment. As a result it is currently ranked 57 out of 191 economies globally on the World Bank's Doing Business index

(World Bank, 2020[15]). Nevertheless, many outstanding challenges in this area undermine the competitiveness, investment and growth of enterprises:

- **Obtaining licences and permits takes much longer and is considerably costlier than in peer economies**. For example, obtaining a construction permit in Kosovo takes on average 273 days (compared to an OECD average of 152 days), requires 18 procedures (OECD average of 13) and costs 5.2% of the warehouse value (OECD average of 1.5%).
- **Contract enforcement is slow, costly and unreliable**. Contract enforcement takes on average 330 days, which is considerably faster than the OECD average (590 days), but much longer than the global leaders in the Doing Business Index (120 days). The process is slowed down by the overburdened court system, which has a significant backlog of cases (World Bank, 2017[6]). Contract enforcement is also quite costly: at 34.4% of the claim value it is well above the OECD average of 21.5%. Perhaps most significantly, confidence is lacking in the judicial system's fair and impartial decision making, which elevates uncertainty in contract enforcement. In the latest Regional Cooperation Council barometer survey, 50% of respondents stated that they do not trust the court system, 54% stated that they do not believe that the judiciary is independent of political influence, and 60% stated that they do not believe that the law is applied equally to everyone (Regional Cooperation Council, 2019[16]). In the latest BEEPS, 43% of firms identified the courts as a major constraint to doing business (World Bank, 2020[17]).
- **Unfair competition, particularly from the informal sector, represents a significant constraint for businesses in Kosovo**. In the latest BEEPS, 63.4% of firms stated that competition from informal enterprises represents a notable obstacle for their business. The high and persistent levels of informality are mainly due to weak enforcement rather than the prohibitive costs of doing business in the formal sector, as tax rates in Kosovo are relatively low compared to regional peers and EU and OECD averages (World Bank, 2021[1]). High tax evasion is instead linked to corruption among politicians and the tax and customs administrations (World Bank, 2017[6]).

### *Infrastructure deficiencies undermine investment, trade and GVC integration*

- **Unreliable electricity supply:** The reliability of the electricity supply is a significant obstacle for doing business in Kosovo. In the latest BEEPS, 63% of all firms, and 78% of manufacturing firms, identified electricity as a major issue. Firms in Kosovo report more frequent and more costly outages than firms in peer economies (World Bank, 2020[17]). Challenges in the electricity sector reflect a combination of factors, including insufficient and unreliable supply from the old and outdated coal-fired power plants, inefficient energy consumption, limited scope for importing electricity, and underdeveloped alternative sources of domestic electricity generation or energy supply (e.g. natural gas) (World Bank, 2017[6]).
- **Transport infrastructure**: Deficiencies in transport infrastructure connectivity harms the attractiveness of Kosovo as an investment destination. In terms of network size, Kosovo lags behind peer economies across all modes of transport. In road transport, the length of motorways is lower than peers of comparable size, as is the length of the overall road network (Eurostat, 2018[18]). In the rail sector, Kosovo lags behind peers in terms of the size of the network and the freight transported, particularly compared to economies with similar sized manufacturing sectors (as share of GDP), such as North Macedonia and Serbia (Eurostat, 2018[19]). Limitations in transport policy and a lack of investment in transport infrastructure development and maintenance mainly account for these gaps.
- **Limited access to finance**: This remains a significant obstacle to the investment, innovation and internationalisation of small and medium-sized enterprises (SMEs) in Kosovo. Although credit growth has been strong over the past decade, supported by the expansion of the mainly foreign-owned banking sector, declining interest rates, and low and declining non-performing loans,

enterprises still face constraints in accessing credit from the banking system. This is particularly the case for micro and small enterprises, which cannot meet banks' stringent loan requirements. For example, over 90% of loans in Kosovo require collateral, the value of which is well above regional and global peers, at 267% of the loan amount (World Bank, 2020[17]). Meanwhile, with the exception of leasing, which has grown considerably in recent years, financing alternatives to bank lending are very limited or non-existent.

*Cross-cutting and sector-specific constraints undermine the growth of key sectors*

- **Agriculture**: Agriculture is an important sector in Kosovo, accounting for 6.9% of GDP. The share of agriculture in formal employment is 14%, and the sector also accounts for a significant share of informal employment (World Bank, 2021[1]; Kosovo Agency of Statistics, 2021[3]). Given that 60% of the population live in rural areas and depend directly or indirectly on agriculture, this sector also plays an important role in poverty reduction. However, it is characterised by low productivity and limited internationalisation, which are hampered by high fragmentation, low access to finance and technology, and limited market links (World Bank, 2017[6]).
- **Manufacturing**: Upgrading and diversifying the manufacturing sector could play a key role in boosting exports and global value chain integration. Analyses of the capabilities embodied in the current export basket reveal considerable long-term potential for growth in the automotive industry (vehicle and engine parts), as well as in various other machinery and metal products. In the short to medium term there is growth potential in boosting exports of car seats, chemical products, metals and metal-based products, wood-based products, and agro-processing products (OECD, 2019[20]). The growth of this sector is constrained by factors such as gaps in infrastructure, customs and logistics, lack of skills, and weaknesses in the business environment. The attraction of FDI to this sector is also constrained by the limited capacities of Kosovo's investment promotion agency, the Kosovo Investment and Enterprise Support Agency (KIESA) – see EU accession process.
- **Information and communication technology (ICT) services**: This sector has contributed notably to service exports in recent years and has strong potential for further growth. The sector is constrained by factors such as the limited size of the domestic market, insufficient supply of skilled workers, weak collaboration between the sector and relevant educational institutions, and lack of access to finance, particularly for start-ups and high-risk venture capital (World Bank, 2017[6]).

*Poor public finance management undermines long-term development*

Despite Kosovo's success in keeping fiscal deficits and the public debt at relatively low levels over the past decade, fiscal performance has been relatively weak in terms of impact on the sustainable growth of the economy. High informality and tax evasion has had a significant negative impact on revenue collection. In addition, high and rising current expenditure, notably highly generous and poorly targeted social transfers, have increased non-discretionary fiscal spending. This has crowded out public investment in infrastructure and spending on critical sectors such as health and education (IMF, 2018[21]).

*Environmental degradation could affect the well-being of current and future generations*

- **Air pollution has become a critical challenge** in all major cities in Kosovo, as in the rest of the Western Balkan region. Air pollution is particularly acute in the winter months, when heating from burning solid fuels compounds the polluting effects from other sources. In Kosovo, annual exposure to most air pollutants – particulate matter (PM), carbon monoxide (CO), carbon dioxide ($CO_2$), nitric oxide (NO) and nitrogen dioxide ($NO_2$) – exceeds OECD and EU averages, and in many cases by a significant margin. For example, the annual exposure to $PM_{2.5}$ is 27 micrograms per cubic metre (μg/m$^3$) in Kosovo, which is slightly above the WB6 average (25.77 μg/m$^3$), but more than double the EU and OECD averages of 13.1 μg/m$^3$ and 12.5 μg/m$^3$, respectively. It is

nearly triple the World Health Organization (WHO) recommended maximum annual exposure level of 10 μg/m$^3$ (EEA, 2020[22]).

- **Kosovo is vulnerable to the impacts of climate change**, but the transition to low carbon growth is slow. The energy sector is highly dependent on fossil fuels, including for power and heat generation and transport. The efficiency of energy consumption also remains low: the energy consumed per unit of GDP is nearly double the EU average (IEA Statistics, 2018[23]). Climate adaptation is a priority. For example, Kosovo has more limited water resources than other WB economies; however, due to increasing economic, environmental, climatic and demographic pressures, all river basins in Kosovo are expected to be water stressed in 20 years (World Bank, 2018[24]). More sustainable water management will therefore be critical to strengthen Kosovo's resilience to the impacts of climate change and to secure its long-term development.

### *Regional inequalities are undermining inclusive growth and well-being*

Although living standards have improved considerably in Kosovo over the past decade, the prosperity gains have not been shared evenly by all citizens. Inequality, as measured by the Gini coefficient, has increased since 2016. Regional disparities are also quite striking, with many rural areas lacking connections to piped water, sewage systems and reliable power supply. These gaps are even more pronounced in some regions – for example, in Mitrovica, only about 42% of villages are connected to piped water, compared to over 85% in Pristina (European Commission, 2018[25]). Considerable disparities also exist among ethnic minorities: Roma, Ashkali and Egyptian communities have considerably lower education, health, poverty and employment outcomes compared to the rest of the population (UNICEF, 2014[26]).

### *COVID-19 has exacerbated structural challenges*

Kosovo's economy has been strongly affected by the COVID-19 pandemic. In the first nine months of 2020, real GDP declined by 5.9% year on year (y-o-y), driven largely by a sharp decline in service exports (-63% y-o-y in quarter 2 and -60% y-o-y in Q3 of 2020), which were mainly tourism services to the diaspora, and a decrease in investment (-41% y-o-y in Q2 and -10.2% y-o-y in Q3 of 2020). The contraction was moderated by the decline in imports and increased government spending. Private consumption also bounced back in Q3 of 2020 following the removal of lockdown restrictions. The sectors most critically affected by the pandemic included construction, wholesale and retail trade, and accommodation services. Meanwhile, the growth in industry and ICT sectors moderated the decline in economic activity (European Commission, 2020[27]; 2019[28]).

The impact of COVID-19 on the labour market in Kosovo was mitigated by government support measures. The brunt of the fallout from the crisis was borne in Q2 of 2020, but some recovery has taken place since, and as of Q3 2020, labour market indicators have mostly been in line with their values in the previous year. Unemployment remained roughly the same at 24.6% (after increasing to 27.2% in Q2 of 2020), while the labour force participation rate declined from 42.9% in Q3 to 40% y-o-y (after declining to 33.2% in Q2). The impact on youth has been mixed. Youth unemployment decreased from 48.9% to 46.9% y-o-y in Q3, but the share of NEET youth increased from 36.3% to 37.6% over the same period (Kosovo Agency of Statistics, 2021[2]; European Commission, 2020[27]; 2019[28]).

Government support has helped to mitigate the impact of COVID-19 on household income and poverty. The main support measure was to allow citizens to withdraw 10% from their pension fund savings over a period of four months from August 2020. Citizens were also relieved from the repayment of loan instalments for a period of three months from April to June 2020. The government provided additional funding to support those who had the most difficulty in finding employment (OECD, 2020[29]).

Many of the abovementioned structural challenges have played a role in either amplifying the impact of COVID-19 or limiting the scope of the policy responses to lessen its impact. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** The fiscal response has been critical in preventing a significant economic fallout from COVID-19, especially on labour market outcomes, but has resulted in a significant narrowing of the fiscal space. In the context of weaker prospective revenues in the wake of the crisis, particularly if recovery is slow, improving the efficiency of public spending will be critical in the coming months, as well as the prioritisation of expenditure that can support recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This includes increasing public investment, which has suffered significantly due to high and rising current expenditure. The crisis has also highlighted the importance of rebuilding fiscal buffers in the post-crisis period. In addition to better management of expenditure, this goal will require tackling some of the structural constraints that undermine revenue performance.
- **Innovation and technology adoption:** The COVID-19 crisis has starkly demonstrated the importance of the ability of firms to adapt to meet new challenges and changing circumstances. It has also revealed the advantages that firms which have embraced digitalisation and modern practices have over others. The resilience of the post-COVID recovery will therefore depend on the extent to which the structural issues limiting firm innovation and technology adoption are addressed (see Structural economic challenges), and to what extent digitalisation and digital skills become mainstreamed.
- **Access to finance:** COVID-19 has highlighted the significance of a well-developed and diversified financial sector that can respond to the financing needs of enterprises in times of crisis and during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis were in the form of subsidised lending or lending guarantees. However, a robust financial sector comprised of diversified financial institutions that can provide financing for riskier and innovative ventures, not just for established enterprises, will be essential during the recovery phase and going forward.
- **Informality:** The large size of the informal sector, as well as significant informal employment within the formal sector, have limited the scope of measures aimed at protecting the income and employment of people in the most affected sectors. As informality is widespread in the sectors most affected by the crisis, including retail trade and tourism, they have not been able to benefit from measures such as government subsidies, favourable loan terms or loan guarantees. Developing a more resilient economy also depends on the extent to which incentives for formalisation can be enhanced, and how much the oversight and sanctioning of non-compliance can be improved.
- **Health sector:** The health sector in Kosovo faces many challenges linked to insufficient funding. Healthcare expenditure is 1.6% of GDP (as of 2016), which is the lowest in the region. This represents only about 40% of the annual requirements for public health care, and translates into a lack of basic resources, including beds, equipment and medication. As a result, many people must seek quality health care in private institutions. In the absence of publicly available health insurance, citizens' out-of-pocket healthcare expenses are an estimated 40% of total healthcare costs. This is considerably higher than the OECD average of 13% (Kosovo Women's Network, 2016[30]).

### *EU accession process*

Kosovo has been a potential candidate for EU accession since 2008. The Stabilisation and Association Agreement (SAA) with Kosovo was initiated in July 2014 and came into force in April 2016. In November 2016, Kosovo also adopted the European Reform Agenda, which set out priorities until the end of 2017. The agenda's primary objective was to prioritise specific areas under the SAA such as good

governance and rule of law to boost the implementation of activities that fulfilled these areas. In 2018, the European Commission (EC) confirmed that Kosovo had fulfilled all outstanding criteria for the visa liberalisation regime and proposed lifting visa requirements for its citizens. The decision on this proposal is still pending with the European Parliament and the European Council (European Commission, 2020[31]).

The importance of making progress on the socio-economic reform agenda remains a critical priority for Kosovo's path to EU membership. As Kosovo negotiates its accession to the EU, the findings in this Competitiveness Outlook 2021 offer monitoring relevant to a number of critical chapters of the *acquis*, while its recommendations provide the guidance needed to meet the accession requirements. The Competitiveness Outlook also provides a good basis for assessing the critical challenges that the economy faces as a starting point for the development of Economic Reform Programmes (Box 22.1).

### Box 22.1. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU

Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[32]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[33]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

*EU financial and development support*

The EU represents the largest source of external financial assistance in Kosovo. Since 2007, the EU has provided EUR 1.21 billion in assistance aimed at strengthening democracy, the rule of law, competitiveness, innovation, education, climate action and other critical priorities for Kosovo's sustainable and inclusive development. A further EUR 229 million has been provided since 1999 through lending from the European Investment Bank (EIB). The Western Balkans Investment Framework (WBIF) has provided EUR 148.4 million in grants that have leveraged investments of an estimated EUR 1.3 billion (European Commission, 2021[34]).

The EU also provides guarantees that support public and private investment by reducing the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade (European Commission, 2020[35]).

The latest package of the Connectivity Agenda, which was set up under the WBIF, seeks to support investments in sustainable transport and clean energy. This package was presented at the Western Balkans Summit in Sofia on 10 November 2020 and completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment for better connectivity in the WB region. It also represents the first step in the implementation of the flagship projects under the Economic and Investment Plan for the region. Kosovo is expected to receive up to EUR 204.7 million between 2021 and 2024 under this programme (European Commission, 2021[36]).

The EU has been instrumental in supporting Kosovo's response to the COVID-19 pandemic. EUR 68 million in bilateral assistance from the Instrument for Pre-Accession Assistance (IPA) 2014-2020 was provided to Kosovo to cover the urgent needs of the health sector and to support the economic and social recovery following the crisis.[1] A further EUR 100 million was provided in macro-financial assistance to support the economic recovery. Kosovo and other Western Balkan economies have also been recipients of the EU's regional economic reactivation package of EUR 455 million, as well as EUR 7 million of EC/WHO joint assistance to support vaccination readiness and health sector resilience. The EIB has provided a further EUR 1.7 billion in financing to the region (European Commission, 2021[34]).

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced Kosovo's Competitiveness Outlook public authority[2] and Statistical Office Co-ordinators[3] to the new digitalised assessment frameworks (see

Methodology chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, Kosovo Investment and Entreprise Support Agency (KIESA) disseminated the materials among all 16 Policy Dimension Co-ordinators and Statistical Office contact points in Kosovo. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All 16 Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from KIESA, Policy Dimension Co-ordinators and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders that included chambers of commerce, academia and non-governmental organisations (NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook public authority Co-ordinator, Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 17 December. The draft Competitiveness Outlook economy profile of Kosovo was made available to Kosovo's public authorities for their review and feedback from mid-January to mid-February 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 22.2).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Methodology chapter.

**Table 22.2. Competitiveness Outlook scoring system**

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

*Exceptions*

Unlike the other 15 policy dimensions, competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time, are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

Kosovo's performance in the investment dimension has slightly worsened since the last Competitiveness Outlook (OECD, 2018[37]), decreasing from 2.6 in the 2018 assessment to 2.0 in the 2021 assessment (Figure 22.1). Progress has been made on investment policy, but there has been declining development in investment promotion and facilitation. Table 22.3 shows Kosovo's scores for the investment policy and promotion sub-dimensions for the 2021 assessment.

### Table 22.3. Kosovo's scores for investment policy and promotion

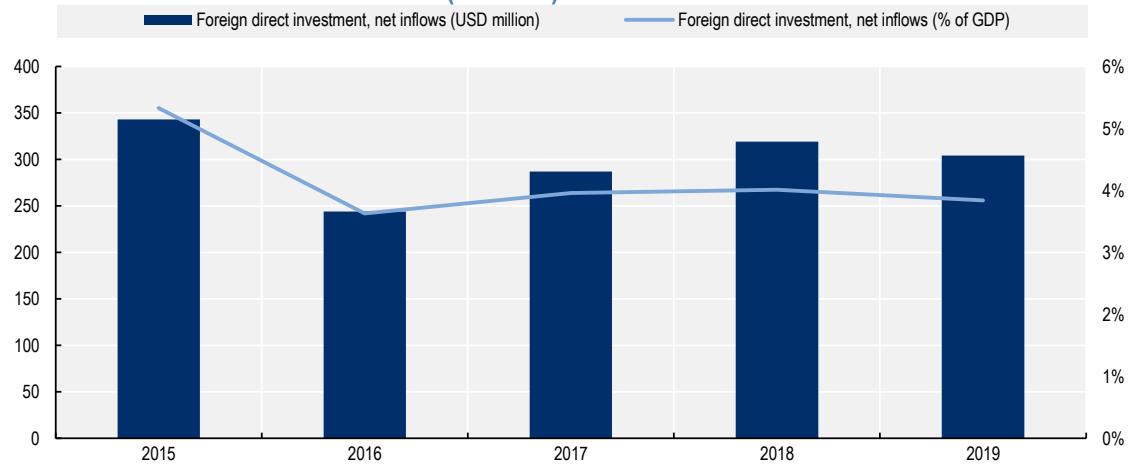
| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1: Investment policy framework | 2.4 | 3.2 |
| | Sub-dimension 1.2: Investment promotion and facilitation | 2.4 | 3.0 |
| | Sub-dimension 1.3: Investment for green growth | 0.0 | 2.0 |
| **Kosovo's overall score** | | **2.0** | **3.0** |

Note: No information was provided or available regarding green investment practices in Kosovo, thus, the economy received a score of zero for sub-dimension 1.3.

### *State of play and key developments*

In 2019, Kosovo attracted USD 304 million in net FDI inflows, which represented 3.8% of its GDP (Figure 22.2) (Kosovo Agency of Statistics, 2019[38]). This performance is well below the best performers of the WB6, where FDI inflows represent 8.4% of GDP for Montenegro, 8.3% for Serbia and 7.9% for Albania. However, it is similar to North Macedonia (3.8%) and higher than Bosnia and Herzegovina and "upper middle-income countries",[4] which average 1.6% of GDP. However, it should be noted that FDI has been mostly market seeking, with a significant share going to real estate, and mostly from the diaspora. The stock of portfolio investment in 2019 totalled USD 2.05 billion. Real estate and leasing activities are the largest beneficiaries of FDI, followed by financial services and energy. Food, ICT, infrastructure and energy are growing sectors. Most FDI came from the diaspora located in Albania, Germany, Switzerland, Turkey and the United Kingdom.

### Figure 22.2. Net FDI inflows to Kosovo (2015-19)




Note: BoP refers to balance of payments in million current USD.
Source: (World Bank, 2021[1]), *World Development Indicators*, https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934255646

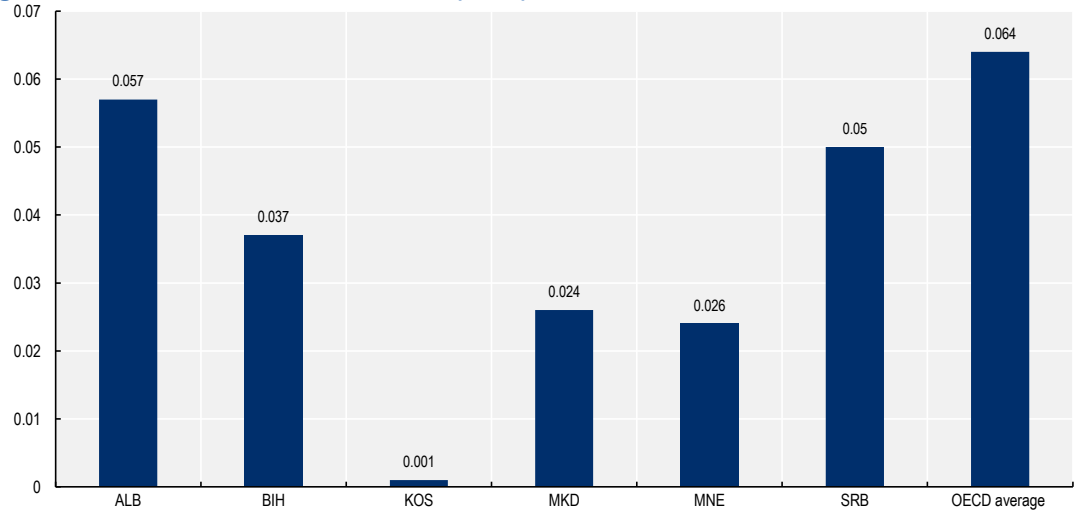
*Sub-dimension 1.1: Investment policy framework*

Kosovo has a clear and comprehensive **legal framework for investment activities** and for conducting business; however, it does not have a stand-alone investment law. The main laws[5] governing investment are the 2014 Law on Foreign Direct Investment, the 2017 Law on Strategic Investments[6] and the 2018 Law on Business Organisations. The Law on Foreign Direct Investment gives equal and fair treatment, offers protection for foreign investors and provides a clear definition of foreign investors. The Law on Strategic Investments describes investment activities and the conditions under which investors can receive the status "strategic investor". The Law on Business Organisations covers the registration and closure of a company, and the rights and obligations of shareholders. All investment legislation is available in English on the official Kosovo Gazette website.[7]

Public consultations are organised according to the 2016 regulation, the Minimum Standards for Public Consultation Process. Kosovo has set up an online platform for public consultations, and draft laws are published on the Kosovo Assembly's website. In 2017, the government adopted the 2017-2021 Better Regulation Strategy 2.0,[8] which aims to improve the design of policies and legislation by ensuring that they are based on evidence (data and statistics), encouraging consultations with stakeholders and contributing to inclusive growth. However, the minimum standards for public consultations are not being applied consistently (European Commission, 2020[39]).

Kosovo's market is open, and **exceptions to national treatment** are very limited**.** Kosovo had the lowest score (0.001) of the WB6 economies in the 2019 OECD FDI Regulatory Restrictiveness Index, which assesses and benchmarks market access and exceptions to national treatment, scoring well below the OECD average (0.064) (Figure 22.3) (OECD, 2019[40]). This low score indicates that Kosovo has very limited restrictions to foreign investment, and that foreign firms operating in Kosovo are not subject to screening mechanisms and are granted the same privileges as local businesses. In other words, foreign investment rules do not constitute impediments to FDI. However, Kosovo does not have a negative list that delimits the sectors where foreign investment is prohibited or conditioned, and which outlines which discriminatory conditions apply.

## Figure 22.3. FDI Restrictiveness Index (2019)




Note: Restrictions are evaluated on a scale which goes from 0 (no restrictions) to 1 (maximum restrictions).
Source: (OECD, 2019[40]), *FDI Regulatory Restrictiveness Index*, https://data.oecd.org/fdi/fdi-restrictiveness.htm.

**Investor protection against expropriation** without fair compensation is guaranteed by Articles 7 and 8 of the Law on Foreign Investment. Article 7 clearly stipulates that direct or indirect expropriation measures

are taken only in a non-discriminatory manner, for a public purpose, under due process of law, and against "immediate, adequate and effective compensation". Article 8 indicates the compensation modalities and the timely compensation payment based on fair market prices. Additional protection and modalities are provided by the Law on Expropriation, which covers judicial and administrative appeal mechanisms for reviewing or contesting decisions on expropriation, as well as the amount of compensation. Kosovo also has a network of bilateral investment treaties that constitute an additional layer of protection for foreign investors.

Foreign investors have the same rights and remedies as domestic investors. However, the functioning of the judiciary remains a key weakness in Kosovo. While the laws and regulations are consistent with international benchmarks for supporting and protecting investment, their implementation suffers from high levels of interference from the executive, as well as limited resources and capacity. Kosovo introduced constitutional amendments in 2016 to improve the independence of the judiciary and align it with EU standards. The government has also implemented reforms which have improved court efficiency and reduced the case backlog. However, the administration of justice is deemed slow and inefficient (European Commission, 2020[39]). In addition, the judiciary lacks the capacity to deal with complex commercial and economic cases, as Kosovo does not yet have dedicated commercial courts,[9] and cases are examined by a designated department for commercial matters within the Pristina Basic Court.

Regarding **dispute settlement**, Kosovo is stepping up its efforts to offer alternative dispute resolution mechanisms. Its courts recognise international arbitration awards, as Kosovo has ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). It has a pro-arbitration stance and hosts private arbitration centres in the Kosovo Chamber of Commerce and the American Chamber of Commerce in Kosovo.

Kosovo is striving to improve its mediation mechanisms in order to reduce the backlog of cases. In 2018 it adopted a new mediation law, which is being completed with secondary legislation, and organised awareness-raising events and training courses on mediation. Positive first steps towards online mediation were taken in early 2020. In 2019, the courts referred 2 846 cases to mediation, and prosecution offices referred 2 244 cases, a significant increase on 2018 figures (European Commission, 2020[39]). However, public awareness and familiarity with alternative dispute resolution tools remain low.

Kosovo has a sound **intellectual property rights (IPR) legal framework**,[10] which is partly harmonised with EU legislation[11] and contain minimum requirements of the Trade-Related Aspects of Intellectual Property (TRIPS) agreement. Kosovo is not party to international treaties related to IPR or organisations such as the World Intellectual Property Organization (WIPO), but abides by the multilateral conventions on intellectual, industrial and commercial property rights.[12]

**IPR enforcement** and implementation in Kosovo have improved overall, but remain challenging. The Agency for Industrial Property (AIP), a central administrative body of the Ministry of Trade and Industry, is responsible for the legal protection of intellectual property rights. It offers IPR registration conforming to regional and international practices[13] using efficient WIPO software. It has made good progress in reducing the backlog of applications for patents, trademarks and industrial designs. In 2020, the agency recruited 3 new staff members, bringing the total to 21 (European Commission, 2020[39]). On the enforcement side, the State Intellectual Property Council and the Task Force against Piracy and Counterfeiting are the main bodies responsible for co-ordination. However, their actions are restricted by limited institutional co-operation and capacity, a lack of resources within enforcement agencies, a lack of specialised prosecutors and judges, and poor public awareness.

Kosovo has also reinforced **IPR awareness raising and access to information**. The AIP, the Copyright Office under the Ministry of Culture, Youth and Sport, and the Kosovo Council on Intellectual Property Rights continuously organise awareness-raising activities, albeit on a low scale due to lack of resources.

It is noteworthy that the AIP publishes a monthly bulletin on IP applications and maintains a regularly updated online trademark and patent database.

### *Sub-dimension 1.2: Investment promotion and facilitation*

Kosovo has a clearly defined **investment promotion agency structure and strategy**, however, the Kosovo Investment and Enterprise Support Agency (KIESA) lacks the capacity and resources to execute an extended mandate. KIESA continues to have a large mandate that includes investment and export promotion, as well as support to SMEs and managing special economic zones. Under the economy's National Development Strategy 2016-2021, its staffing increased from 21 staff in 2016 to 28 in 2020, while its budget expanded from EUR 510 000 in 2016 to EUR 3.1 million in 2020. However, despite this expansion, its staff and resources are still insufficient to execute its very large mandate (European Commission, 2020[39]).

KIESA reports directly to the National Council for Economic Development (NCED).[14] The NCED is chaired by the Prime Minister of Kosovo and is composed of ministries with an economic orientation, and economic business associations. It organises and co-ordinates the activities of state institutions and aims to eliminate barriers and address the challenges of doing business in Kosovo, thus having an impact on improving the environment of business and investment in the economy. Nevertheless, Kosovo does not seem to have a comprehensive strategy framework for attracting FDI, or solid inter-agency or inter-ministerial co-ordination mechanisms, and council meetings are irregular. KIESA's budgetary and capacity limitations also limit its ability to foster linkages between the FDI it is striving to attract and the SMEs it is supporting.

Regarding IPA mapping indicators, KIESA does not have a clear **investor targeting** strategy or actions. The Law on Strategic Investments provides a list of priority sectors, namely: energy with infrastructure and mining, transport and telecommunication, tourism, processing industry, agriculture and food industry, health, industrial and technological parks, and wastewater and waste management. While KIESA provides dedicated information on key sectors[15] on its website, it does not have a clear strategy targeting these sectors. The agency promotes Kosovo as an investment destination through participation in international fairs, the organisation of FDI conferences abroad, and information sessions[16] targeting the diaspora. It also promotes the emergence of industrial clusters in the special economic zones.

Unlike the rest of the WB6 economies, Kosovo does not offer **investor incentives** to attract investments. It does, however, provide an attractive taxation regime and support measures for strategic projects. Kosovo has a flat corporate tax rate of 10%, and grants firms VAT (value-added tax) advantages including deferments and exemptions, such as for imports of raw materials and machinery. The Law on Strategic Investments provides additional advantages to businesses, including the provision of state-owned immovable property and supported access to basic infrastructure. The government can also issue guarantees or jointly finance FDI projects. KIESA supports investment in the special economic zones according to the Law on Economic Zones.[17]

Kosovo has improved its **investment facilitation services and activities**. This is illustrated by its ranking of 12 out of 190 economies in the starting business dimension of the Doing Business Index (World Bank, 2020[41]). Registering a business in Kosovo is simple, with minimal fees involved. The Ministry of Trade and Industry's Business Registration Agency offers 29 one-stop shops for registration at the municipal level. KIESA provides the necessary information during the pre-investment phase and facilitates interactions with other government agencies/departments in the process of obtaining all the necessary licences and permits. It also provides assistance dealing with the one-stop shop services.

However, it is worth noting that the overall ranking of Kosovo in the Doing Business Index regressed from 44 in 2019 to 57 in 2020. This regression is due to problems regarding electricity, protecting minority investors and obtaining construction permits (World Bank, 2020[41]). The quality of the business environment is also hampered by the size of the informal sector, which is estimated to be 31% of Kosovo's GDP (European Commission, 2020[39]).

KIESA provides **aftercare services** aimed at keeping investors satisfied and collecting their feedback. The function is included in the agency's official mandate, which requires maintaining a foreign investor registry and conducting regular visits to foreign investors. KIESA organises regional conferences with the private sector in different municipalities to ensure public-private dialogue. It also visits 300 to 350 foreign investors each year to understand their perception of the investment climate and business in Kosovo, and submits a report to the Kosovo Economic National Council so they can take required measures.

### *The way forward for investment policy and promotion*

Kosovo has a very open economy and a clear pro-investment stance. However, improving its attractiveness as an FDI destination requires policy adjustments and reforms in the following areas:

- **Adopt and develop a clear strategy to attract FDI and proactively target investors**. Although Kosovo participates in events aimed at attracting foreign investors, a clear strategy for target sectors would enable KIESA to focus its resources more efficiently.
- **Reinforce the independence, resources and capacity of the court system, notably for commercial disputes**. As commercial cases are currently redirected to a small division of the basic court system, Kosovo should focus on establishing a dedicated commercial court to handle business disputes effectively.
- **Increase public awareness and implementation of the recently adopted mediation mechanisms**. Although some awareness-raising campaigns are in place, Kosovo should focus on increasing businesses access to information on alternative dispute resolution to ease the court system's burdensome caseload.
- **Reinforce the co-ordination between IPR implementation and enforcement bodies, increase IPR agency capacity and resources, and step up IPR awareness-raising efforts**. IPR bodies currently only have the capacity to conduct low-level awareness-raising campaigns, and lack the capacity to train and allocate specialised judges and prosecutors to handle IPR disputes.
- **Reinforce KIESA's investment facilitation role, notably through better co-ordination with other government bodies and agencies**. As KIESA has a large mandate, a clear division of responsibility between departments and agencies, as well as greater inter-institutional co-ordination, should be enforced to avoid repetitive and overlapping objectives.
- **Ensure adequate capacity and resources for KIESA to allow it to fully implement its comprehensive mandate**. As KIESA's authority extends to several sectors and divisions, it is crucial that it receives more resources to promote linkages effectively between SMEs and multinational enterprises, as well as to establish an aftercare unit to boost aftercare services.
- **Integrate green growth priorities into the National Development Strategy**. Kosovo's NDS already includes a base for the promotion of FDI and promoting competitive industries which could be expanded on to include green growth objectives such as renewable energy and energy efficiency projects as a priority sector to develop. Additionally, the economy may include the green sectors in the Law on Strategic Investments, elaborating on the existing energy with infrastructure sector.

## Trade policy (Dimension 2)

### *Introduction*

Kosovo has made significant progress in all sub-dimensions since the last assessment, and has increased its score for trade policy from 2.3 in 2018 to 3.5 in 2021 (Figure 22.1; Table 22.4).

Kosovo has particularly strengthened its regulatory transparency by improving public consultations and increasing their number. The inter-institutional co-ordination mechanism in Kosovo has proven effective, and progress has been made in the implementation of public consultation standards through new legislation and a dedicated platform where all documents are published. The new communication channels, which are made available on the website of the Ministry of Trade and Industry (MTI), have increased the number of consultations with institutions and stakeholders on trade-related issues. The consultation mechanism is regularly evaluated and annual reports are prepared according to a specific methodology for the implementation of the standards, which is relatively rare in the Western Balkans and justifies Kosovo's high score of 3.8 for the sub-dimension on trade policy framework.

Regarding trade in services, significant progress has been made in lifting restrictions hindering trade in Kosovo with the conclusion of Additional Protocol 6 to the Central European Free Trade Agreement (CEFTA) in December 2019. Kosovo continues to make great strides in increasing the attractiveness of its economy through the modification and adoption of sound policies on trade in services. Significant steps have been taken to open markets in some services sectors, such as the courier sector, which has seen the most significant decrease in the degree of restriction since 2018. Further efforts could be directed towards improving business regulation and changing cumbersome procedures for obtaining business visas. Kosovo is the most open economy for trade in services in the WB6 region. Compared to OECD economies, it is also one of the most attractive in terms of lack of restrictiviness towards service providers .

Regarding e-commerce and digitally enabled services, Kosovo has a strong policy framework for e-commerce that is in line with the EU *acquis*. In September 2020 it launched a draft Law on Electronic Identification on Trusted Services in Electronic Transactions to stimulate e-commerce. This initiative could bolster the existing fragile e-commerce flows and justifies the rating of 3.0 for this sub-dimension.

### Table 22.4. Kosovo's scores for trade policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 3.8 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 3.0 | 3.1 |
| **Kosovo's overall score** | | **3.5** | **3.4** |

### *State of play and key developments*

Trade represents 82% of Kosovo's GDP. Its trade with CEFTA parties represented 43% of total exports in 2019 (a drop from 47.2% in 2018), and its trade with the EU represented 36% (against 30.2% in 2018).

In 2019, the EU supplied 50% of Kosovo's total imports (against 47.2% the previous year). Imports from CEFTA fell to 14.3% (from 25.5% in 2018) as a direct result of the 100% import tariffs imposed by Kosovo on goods originating from Serbia and Bosnia and Herzegovina. In April 2020, the 100% tariffs were lifted and replaced by gradual trade reciprocity measures, which were finally abolished in June 2020.

Kosovo has a small domestic market and limited industrial production, and consequently a relatively high trade deficit. According to the Kosovo Agency of Statistics, Kosovo's trade deficit was EUR 2.97 billion in 2018, up from EUR 2.5 billion in 2017, with imports rising to EUR 3.34 billion from EUR 3.05 billion.

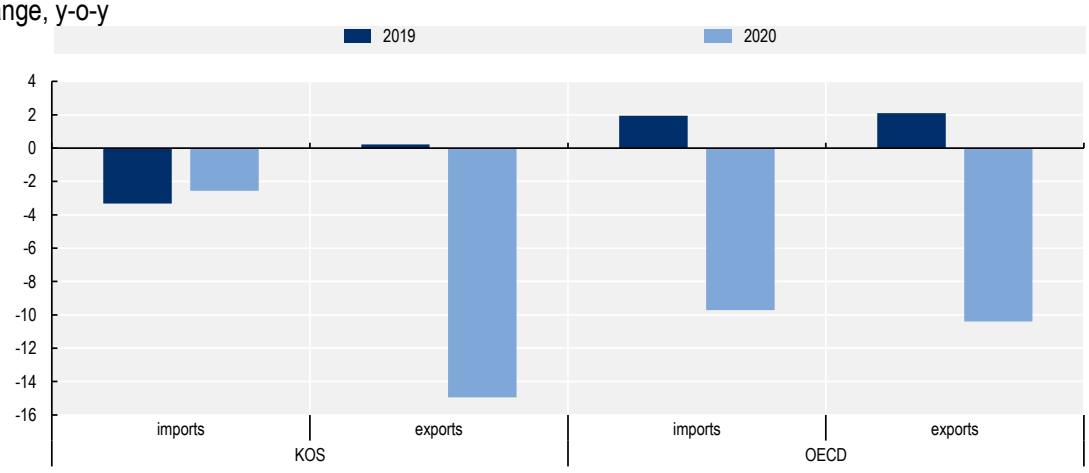
Exports fell to EUR 367 million in 2018 from EUR 596 million in 2017. According to the World Bank, Kosovo's overall trade deficit, which includes trade in both goods and commercial services, was an estimated 29.1% of GDP in 2018.

In terms of percentage share of GDP, in 2019, exports of goods and services represented 29.2%, and imports of goods and services represented 56.25%.

Like all economies, Kosovo has been heavily affected by the COVID-19 pandemic. The relatively low level of new import and export orders prior to the COVID-19 crisis, combined with pandemic-related export bans, restrictions on the movement of people, and closures of shops and services, led to a significant decline in imports and exports in Q2-Q3 2020. Although Kosovo was not the most severely affected economy in the region, it faced a decline of -2% in imports and -14% in exports (Figure 22.4).

## Figure 22.4. Impact of COVID-19 on trade, Kosovo versus the OECD (2019-20)

% change, y-o-y




Source: (IMF, 2020[10]), *World Economic Outlook*, https://www.imf.org/en/Publications/WEO/weo-database/2020/October; (OECD, 2020[42]), *OECD Economic Outlook, Volume 2020 Issue 1*, https://dx.doi.org/10.1787/0d1d1e2e-en.

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Kosovo is mostly dependent on trade in services, which contributes to trade openness more than trade in goods. In 2020, all WB6 economies, except Kosovo, were foreseen to experience a decline of FDI inflows. Before the outbreak of the pandemic, significant investments were made in energy and mining, which makes Kosovo the only economy likely to see an increase in FDI.

Overall, economies with a high dependency on trade in services, such as Kosovo, have suffered great losses due to the restrictions on movement of people implemented in response to the pandemic. Kosovo's current account deficit was projected to increase from 5.5% of GDP in 2019 to about 5.7% in 2020 and 2021 (World Bank, 2020[41]; World Bank, 2021[43]). Tourism, which is a key economic driver of the economy, was expected to contract by 8.8% in 2020 and lead to a severe recession. However, this sector might recover faster in Kosovo than in the other WB6 economies as 80% of travel services exports concern the diaspora.

The closure of EU borders to non-EU citizens, as well as other regulatory responses in the Western Balkans, have particularly affected freight transport services. The Western Balkan economies set up a CEFTA co-ordinating body to exchange information on trade in goods at the beginning of the pandemic. They also set up priority "green lanes" with the EU and "green corridors" within the WB6 to facilitate the free movement of essential goods through priority "green" border/customs crossings (within the WB6 and with the EU). At the peak of the crisis (April to May 2020), most road transport in WB6 economies passed through these green lanes and corridors, and they have helped to maintain a certain degree of international trade in goods in the region. Only about 20% of the goods that benefited

from the green corridor regime (i.e. within the WB6) were basic necessities, with the rest regular trade. Such inclusive regional co-operation has proven very efficient in mitigating the consequences of the COVID-19 pandemic and is helping economies to recover.

### *Sub-dimension 2.1: Trade policy framework*

The importance of transparent legislative procedures has increased in priority for governments in recent years. A fundamental aspect of regulatory transparency is that the legislative process is open to all relevant stakeholders through formal and informal public-private consultation (PPC) channels, before and after the adoption of new regulations (OECD, 2019[44]). These consultation mechanisms increase the efficiency of economic activities and the degree of market openness as they can improve the quality and enforceability of regulations (OECD, 2012[45]). Governments in many economies are also adopting cross-cutting policies and/or guidelines to further improve the consultation process. The first sub-dimension of the trade policy dimension assesses the government's effectiveness in formulating, evaluating and implementing trade policy through two separate but complementary indicators: institutional co-ordination on trade policy formulation, and public-private consultation and transparency.

Kosovo has a functioning **inter-institutional co-ordination mechanism** for trade policy formulation. The MTI is responsible for trade policy development and works alongside the National Council for Economic Development (NCED), which acts as the main advisory and decision-making platform for economic policy making and reforms, including trade policy. The MTI established a co-ordinating body in 2016, the National Trade Facilitation Committee (NTFC), to handle and co-ordinate trade activity between different ministries, the private sector and civil society. The NTFC is also in charge of CEFTA harmonisation and standardisation of procedures, and the implementation of international agreements. NTFC meetings are organised at least twice a year and related reports are made public. The MTI has also established three sectorial working groups on agriculture, industry and services. Kosovo has made efforts to adapt its co-ordination framework to relevant issues, with the National Committee for Trade in Services recently established as an advisory body with the purpose of proposing trade policies in services.[18] It is common practice that the MTI's Secretary General establishes new trade policy working groups and creates channels of communication with the private sector and civil society whenever new laws are drafted. Currently, the trade department of the MTI is drafting its new work programme for the period 2020-2023. (Government of Kosovo, 2019[46]).

Targeted sectoral co-ordination and transparency initiatives are being put in place in Kosovo, and at the end of 2020 the Contact Point on Services (CPS) platform was launched. The CPS is a database to facilitate stakeholder access to the regulatory framework that governs service activities in Kosovo, helping those already in the market and entrepreneurs who want to start providing services.[19]

Inter-ministerial co-ordination and stakeholder consultation processes are conducted in a complementary manner during all stages of policy making (initiation, formulation, implementation, evaluation and monitoring). The private sector, including the different chambers of commerce, are included in all stages of policy making through working groups, the NTFC and the NCED. Chambers of commerce and civil society also participate in public consultations. NGOs, academia, EU offices and other institutions are also regularly involved in trade-related consultations.

Clear progress has been made in implementing **public consultation** standards. Since the Minimum Standards for Public Consultation Process regulation, entered into force in 2017, the fulfilment of these standards has increasingly become part of the MTI's work, and it has been consulting with more institutions and stakeholders. The MTI's website has been set up to enable free access to draft and final trade measures, and allows the private sector to comment on draft laws in a transparent manner.[20] All materials and documents (draft laws, calls for consultations) are made available on the website, and there has been an increase in the number of participants consulting these documents. According to the 2020 report (Government of Kosovo, 2018[47]; Government of Kosovo, 2020[48]), between 2018 and 2019, MTI's

website saw an 18% increase in the number of consultations of published draft regulations. In 2019, 100% of published drafts were consulted; however, the number of consultations per draft was not disclosed. The regulation allows any citizen concerned or potentially affected by a regulation to provide comments before a measure is adopted. The public consultation system was extended to all municipalities in 2018.

Monitoring the quality and shortcomings of PPCs is not yet conducted systematically in the WB6 economies, and there exist few public bodies that supervise the implementation of consultations and monitor their quality. However, Kosovo is somewhat of an exception, and has the most developed consultation evaluation mechanisms among WB6 economies. PPCs, promotion tools and timelines of consultations are evaluated annually by the Office on Good Governance to determine whether an open, transparent and non-discriminatory form of PPC was used throughout the legislative process. Moreover, the Office on Good Governance annually reports and monitors public consultation implementation based on defined goals of effectiveness and inclusiveness.

The Office of Good Governance is tasked with preparing an annual report on the public consultation process, and checks whether draft proposals comply with public consultation requirements before the proposals are submitted to the government. Kosovo's annual reports on the PPC process have so far presented results for 2017 and 2019. (Government of Kosovo, 2018[47]; Government of Kosovo, 2020[48])

The Office for Good Governance established co-ordination structures in 2017 that introduced public consultation co-ordinators in each ministry. It also carried out capacity building activities, such as two rounds of on-the-job training on PPCs, training on using the electronic PPC platform and numerous information workshops. Introducing the electronic public consultation platform was one of the most important steps the government has taken to facilitate PPCs.

The reports produced by the Office for Good Governance show that 274 documents were drafted by all ministries in 2019, with 100% of the acts approved by government open to public-private consultation (compared to 90% in 2017). These documents were made up of 5 concept documents, 31 draft laws, 77 draft regulations, 129 draft administrative directives, 6 strategies, 5 programmes, 7 action plans and 14 "other". Some 272 documents were consulted via the platform, with 2 consulted on by other tools including e-mail communication, stakeholder workshops and public meetings.

The total number of participants in the consultation process was 3 577 in 2019, representing an increase of 143% from 2018, when there were 1 469 participants (there were 2 104 in the first report of 2017). A total of 1 339 comments were received, among which 688 (51%) were accepted and implemented by the drafting institutions, 97 (7.2%) were partially accepted and 543 (40%) were rejected. There is no information for 6 comments.

The minimum standards provided for in the regulations were met by 67% of documents submitted to PPC (compared to 52% in 2017), while 33% did not meet all the minimum standards (compared to 48% in 2017). All documents submitted by the MTI met the minimum standards in 2019. (Government of Kosovo, 2018[47]; Government of Kosovo, 2020[48]).

In terms of **bilateral and multilateral free trade agreements**, Kosovo joined CEFTA in 2007 and signed the Stabilisation and Association Agreement (SAA) with the EU in 2016. Kosovo also signed a Joint Declaration on Cooperation with the economies of the European Free Trade Agreement (EFTA) in 2018, and the first virtual meeting of the joint committee between Kosovo and EFTA was held in November 2020. Kosovo is at an early stage in its application for observer status at the World Trade Organization. In this context a memorandum on the foreign trade regime has been prepared, but not yet implemented.

In June 2019, Kosovo ratified its free trade agreement with Turkey (signed in 2013), which provides for the progressive elimination of customs duties on a list of products within a decade. The agreement also sets out a commitment to negotiate provisions on the facilitation of trade in services. In July 2019, Kosovo signed an Economic Cooperation Agreement with the Czech Republic, and in December 2019 it was the

first economy to sign a Partnership, Trade and Cooperation Agreement with the United Kingdom (in anticipation of the United Kingdom's withdrawal from the EU-Kosovo SAA).

### *Sub-dimension 2.2: Services trade restrictiveness*

Services contribute almost two-thirds of GDP in WB6 economies on average, which illustrates how strongly economic growth, innovation and labour markets depend on effective policies that promote open and competitive service markets. In 2019, services accounted for 74% of GDP in Kosovo, which represents a 6.22 percentage point increase from 2009. Services accounted for 85.2% of employment in 2019 and 83.4% of new businesses registered. Services exports have seen an annual average growth rate of 12.9%, while services imports have seen an annual average growth rate of 8.1%, resulting in a growing surplus. Enhancing the openness of trade in services can improve the efficiency and productivity of domestic firms. Trade in services allows countries to specialise according to their comparative advantages in services and skills (OECD, 2021[49]). The potential gains from lifting stringent restrictions on services trade are significant, as increased domestic and foreign competition complemented by effective regulation can enhance performance (OECD, 2018[37]). Moreover, unbalanced regulatory restrictions on services significantly affect trade by raising the costs for firms to operate in the host economy (Box 22.2).

#### Box 22.2. The costs of regulatory barriers to trade in services

OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[50]). Trade costs arise both from policies that explicitly target foreign suppliers and from domestic regulation that falls short of best practice in the area of competition and rule-making. The costs resulting from barriers to trade in services are much higher than those of trade in manufactured goods.

Trading services is costly. Studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services, 54% for business services, 60% for transport services, 103% for insurance services and 255% for financial services. Even exporting to the most liberal countries still requires compliance with regulations at a cost that corresponds to around 30% of the export value in most sectors, and nearly 90% in financial services. Within the European Single Market, however, services trade costs are significantly lower: policy-induced costs of cross-border services trade are around 10% in most sectors and around 32% in financial services.

Source: (Benz and Jaax, 2020[51]), *The costs of regulatory barriers to trade in services: New estimates of ad valorem tariff equivalents*, https://dx.doi.org/10.1787/bae97f98-en; (Rouzet and Spinelli, 2016[50]), *Services Trade Restrictiveness, Mark-Ups and Competition*, https://dx.doi.org/10.1787/5jln7dlm3931-en.

The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse Kosovo's policies and barriers to trade for 12 services sectors**. The OECD STRI project is a unique, evidence-based diagnostic tool that inventories trade restrictions in 48 economies,[21] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts. For this CO assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

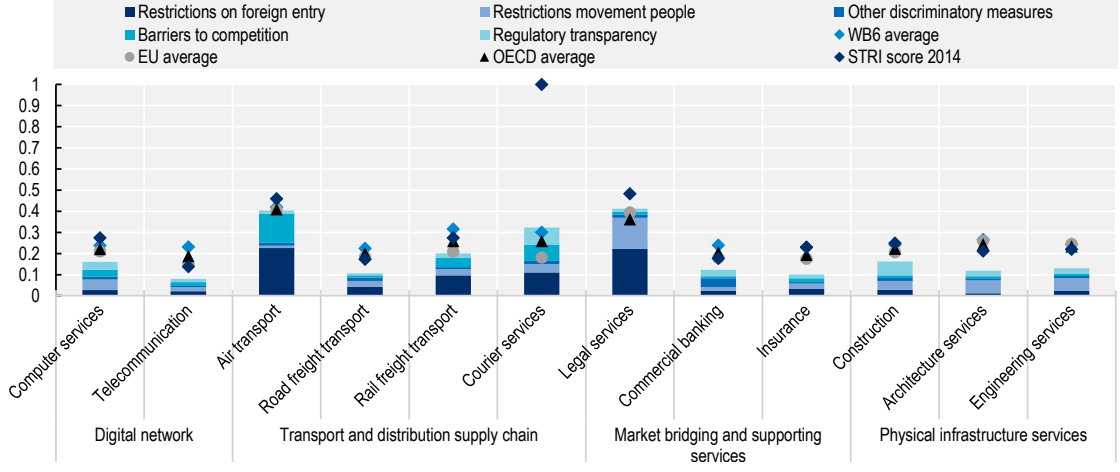
Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices quantify restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory

measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[22]

Each policy area is composed of a series of measures. These measures are called “horizontal” if they are present in all sectors, or “sector specific” if they only affect a particular sector.[23] The STRI measures the “most-favoured-nation” restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso, 2015[52]).

Figure 22.5 shows the STRI indices for each of the sectors, as well as the average scores for the WB6, EU and OECD. Compared to the OECD and key partners’ average STRI indices (represented by a "+"), Kosovo is in the low range in terms of the degree of restrictiveness of its service sectors. Overall, it also has the least restrictive regulatory environment in the region. This makes it a preferred candidate for foreign service providers. The four sectors with the lowest score relative to the WB6 average are telecommunication services, road freight transport, insurance and architecture services. The three sectors with the highest score relative to the WB6 average are courier services, legal services and air transport.

## Figure 22.5. Services Trade Restrictiveness Index for Kosovo (2020)



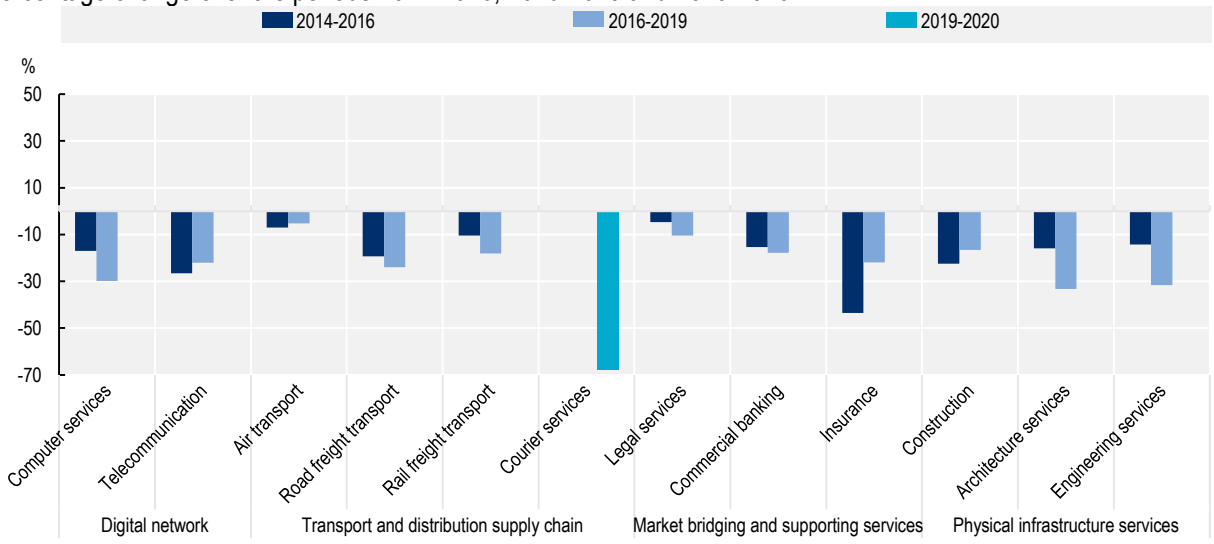

Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People’s Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[53]) *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

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Kosovo shows a continued regulatory willingness to lower restrictions affecting trade in services, as shown in Figure 22.6. The economy has maintained a steady flow of reforms in the period 2014-2020, with a notable highlight being the opening of its courier market in 2019. The slowdown in reforms to open services markets in the period 2020-2021 is explained by regulatory efforts around the world to solely mitigate the negative effects of the COVID-19 pandemic. Nevertheless, the absence of an increase in the degree of restrictiveness in all WB6 economies for the period 2019-2020 is important, and contrasts with the marked overall increase observed in OECD economies for the same period (OECD, 2021[49]).

## Figure 22.6. Evolution of STRI scores by sector in Kosovo (2014-20)

Percentage change over the periods 2014-2016, 2016-2019 and 2019-2020




Note: Negative values indicate a reduction in restrictiveness of the economy's trade regulatory environment.
Source: (OECD, 2020[53]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255703

The following analysis starts with the horizontal measures that are included in all sectors and that typically hamper services trade in the economy as a whole. In particular, in the area of general business regulations, restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. It then reviews each of the 12 sectors analysed, displaying the STRI scores, explaining what drives the results, and providing a brief description of the most common restrictions and good practices.

*General business regulations and barriers to the movement of people* affect the ability of firms to operate in Kosovo. The requirement of minimum capital in the form of a deposit that must be placed in a bank or notary's office to register a limited liability company affects foreign companies,[24] and cumbersome procedures for obtaining business visas limit the search for investment opportunities. However, significant progress has been made in easing conditions for the movement of people between CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA Agreement, although there are still some restrictive requirements for those from economies outside CEFTA or the EU.

A common practice in STRI participant economies is to apply labour market tests (LMTs) to determine whether suitably qualified local workers are available (or could easily be trained to do the work). LMTs typically involve seeking advice from industry representatives and government agencies to determine current skill shortages. In Kosovo, the update of the Law on Foreigners in 2017 lifted LMTs for work permits issued to third economy nationals, and no quotas are applied on the same categories of workers. This greatly improved the attractiveness of the economy compared to other WB6 economies. However, the initial authorised length of stay of foreign services providers (12 months) falls short of international best practice (36 months), and therefore mitigates the positive effects of the 2017 policy change (OECD, 2021[49]).

There is also a low degree of restrictiveness of applied *standards for the cross-border transfer of personal data* in Kosovo. These standards are set at the EU level. Transfers to non-EEA (European Economic Area) economies may take place when standards ensure an adequate level of data protection or, failing that, where appropriate safeguards (e.g. binding corporate rules or standard data protection clauses) are in place.

Kosovo's *legal framework for public procurement* is largely aligned with the 2004 EU Directive. The Public Procurement Act explicitly refers to the principles of transparency, equal treatment and non-discrimination, although there is no explicit mention of non-discrimination towards third country nationals. Kosovo has also prepared implementing legislation that includes rules and guidelines to assist contracting authorities in managing *public procurement* and the award of contracts. Kosovo has a strategy (covering the period 2017-2021) and an action plan (2017-2019) to improve the public procurement system, but does not yet assess its implementation. The 2020-2021 action plan is currently under preparation.

The lack of burdensome *screening of foreign investment* eases such investment. In this regard, Kosovo is very attractive for foreign service providers. Laws and regulations in Kosovo do not mandate that economic interests should be considered in the review of foreign investments, although such consideration is not explicitly ruled out. Kosovo does not set a threshold above which a foreign investment project is subject to screening.

Beyond the regulatory measures that affect Kosovo's trade in services horizontally, there are a number of sector-specific restrictions in the 12 STRI sectors analysed, discussed in turn below.[25]

**Air transport services** are defined as passenger and freight air transport carried domestically or internationally (code 51 under the International Standard Industrial Classification – ISIC). The STRI for this sector only covers commercial establishments. Given the range of air transport subsectors, the approach of the STRI project is to focus on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant where regulations affect the ability of foreign carriers to transport passengers and goods between points. The other aviation services are covered more fully in the STRI for logistics services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601. With a score of 0.404, Kosovo is the third-most restrictive WB6 economy, and scores lower than the WB6 (0.421), EU (0.406) and OECD (0.409) averages.

The air transport sector is the archetype of a service industry where the legal environment is regulated through international agreements. The WB6 region tends to harmonise its regulations with standards in force in the EU, which has several consequences. On the one hand, the sector has very little variation in scores between WB6 economies and the EU. On the other hand, the EU legal influence means that the sector is one of the most restrictive compared to other STRI sectors, which is justified by its nature as it combines legal and safety issues. In absolute terms, Kosovo's air transport regulations are open and highly harmonised with the EU. However, given that there is very little or no exchange of freight by air, as most imports from Kosovo are by land, some measures that raise the economy's STRI score may appear to be disproportionately restrictive compared to the actual size and structure of the market in Kosovo.

*Restrictions on foreign entry* figure prominently in the results of Kosovo's STRI for air services. Like 40 other OECD and STRI key partners (OECD, 2020[54]), the economy limits to 49% the share of capital that foreign natural or legal persons can hold in an air transport service company in Kosovo. This restriction is dictated and justified under EU regulations, but in absolute terms it affects Kosovo's STRI score compared to the limited size of the economy's air transport sector. The leasing of foreign aircraft is allowed, subject to prior authorisation, but only for dry leases (without a crew). The leasing of foreign aircraft with crew (wet leasing) is prohibited.

The other major category that influences the degree of restriction concerns *barriers to competition*. As in several OECD, STRI key partner and WB6 economies, Kosovo maintains public ownership in the aviation sector through two domestic airlines, Kosovo Airlines and Air Prishtina. The maintenance of state-owned enterprises (SOEs) in the sector is generally regarded as a restriction to trade in services, as traditional domestic airlines usually enjoy a competitive advantage over foreign companies. However, none of the airlines in Kosovo have a fleet of aircraft. The domestic airlines continue to work with other airlines serving Pristina and to sell excursion trips. This situation is relatively rare and negatively affects the STRI score in

this sector, even though the impact of Kosovo's domestic carriers on competition is limited due to their size and corporate structure.

The regulation of slots allocated at airports in different economies often has a strong influence on the degree of openness of the sector. In Kosovo, slots are allocated in a fair, non-discriminatory and transparent manner, according to the principle of equal opportunities for all airlines. However, there are some elements that have a negative impact on the STRI score in this area. The general principle in Kosovo concerning slot allocation is that an air carrier that has operated at least 80% of its slots during the summer/winter scheduling period is entitled to the same slots for the equivalent scheduling period of the following year (so-called grandfather rights). To mitigate the anti-competitive nature of this technique, slots not sufficiently used by air carriers are reallocated (the so-called "use it or lose it" rule). However, Kosovo prohibits the commercial exchange of slots, which limits trade in this area.

**Road freight transport** (ISIC Revision 4 code 4293). The STRI for this sector only covers commercial establishment. Cross-border trade is governed by a system of bilateral and plurilateral agreements that involve permits, quotas and other regulations.

The 2020 scores for all OECD member states in this sector range between 0.105 and 0.624. With a score of 0.106, Kosovo is one of the least restrictive economies among all STRI participants, and therefore the least restrictive economy in this sector within the WB6. It scores considerably lower than EU (0.184), OECD (0.201) and WB6 (0.225) averages.

This is of utmost importance for Kosovo, as the road freight sector largely dominates the other transport sectors in the economy. Kosovo does not impose any sector specific regulations that would restrict the sector. Unlike in most STRI participant economies, there is no restriction on foreign entry in the form of limitations on acquisition and use of land and real estate by foreigners. The movement of people is also very unrestrictive, as there is no imposition of quotas or LMTs. There is no firm in the sector that would be controlled by the government. Registering a company is significantly less lengthy, costly and burdensome in comparison to the other WB6 economies.

**Rail transport** (ISIC code 4912) is provided over a dedicated network where the market structure may take different forms, the two most common being: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between infrastructure management and operations. Regardless of market structure, there are well-established best practice regulations that also consider competition from other modes of transport, particularly road transport.

The 2020 scores for all OECD member states in this sector range between 0.129 and 1. With a score of 0.202, Kosovo is the least restrictive economy among WB6 economies in the rail transport sector. It scores lower than EU (0.210), OECD (0.260) and WB6 (0.317) averages.

In terms of *foreign entry restrictions*, the sector is negatively affected by limits to the proportion of shares that can be acquired by foreign investors in publicly controlled firms. According to the Law on Publicly Owned Enterprises, a private person can only own up to 50% of the SOE shares. Existing railway operations in Kosovo are organised and managed by the publicly owned Trainkos. The legal framework also lacks in transit rights for international rail transport, which limits the sector.

Kosovo shares borders with four economies, but is only connected by railroad with Serbia and North Macedonia. There is no bilateral agreement with Serbia, and the bilateral agreement with North Macedonia is only applicable for the railroad sector from the border to the station located nearest to the border in both economies. Railway services can only be supplied if there is commercial presence in Kosovo. A licence is required to enter the rail freight transport market, which also has a negative effect on the STRI score.

Regarding *restrictions on the movement of people*, certain professions in the sector, such as train drivers, need a licence to practise. Only train driver licences granted in an EU member state are considered valid in Kosovo. Licences issued by the authorities of third economies are only recognised through mutual recognition agreements established bilaterally. Although better than a complete lack of recognition procedures, mutual-based recognitions still involve legal uncertainty for foreign service providers.

*Barriers to competition* are an important contributor to Kosovo's STRI performance in rail transport services. Access to railway infrastructure is mandated at a domestic level. The Ministry of Transport establishes the method for calculating the access costs that the infrastructure manager should charge for railway operators seeking access to the network. The transfer and trading of infrastructure capacity are both prohibited. Railway infrastructure is solely managed by a public company, Infrakos.

The **courier services sector** (ISIC Rev 4 code 53) includes postal and courier activities. While courier services have traditionally been important means of communicating, the rise of modern ICT has contributed to the less frequent use of letters between individuals for communication.

The 2020 scores for all OECD member states in this sector range between 0.106 and 0.88. With a score of 0.323, Kosovo is the third-least restrictive WB6 economy. It scores higher than the EU (0.182) and OECD (0.259) averages, but lower than the WB6 average (0.301). Compared to the previous assessment cycle, the courier services sector has undergone a substantial transformation in terms of reducing its restrictiveness. However, the score is still mainly affected by two sector-specific measures: 1) the universal service provider is the state-owned Post of Kosovo JSC; and 2) the designated postal operator (DPO) who performs the universal postal services obtains preferential tax or subsidy treatment.

A 2019 reform has opened the market to foreign service providers and has lowered the economy's restrictiveness index by more than 70%. The main regulatory reason for this change lies in the abolition of monopolies on delivery. In terms of restrictions to the movement of people, authorisations provided by the Regulatory Authority of Electronic and Postal Communications (ARKEP) are required for all courier services practising in Kosovo. As the courier profession is regulated, the fact that there are no laws or regulations establishing a process for recognising qualifications gained abroad contributes negatively to the economy's STRI score in this area.

*Foreign entry restrictions*, such as licence requirements to enter the market, play a significant role in many economies' STRI performance, including Kosovo. ARKEP is the only institution able to authorise the provision of postal services. Prior to 2018, Kosovo, like many other economies, had a monopoly in two reserved areas – letters and parcels. In the 2018 law, the public postal operator was entitled to offer reserved services including acceptance, transport and delivery of local and international shipments with a weight up to 100 grams in order to meet the universal postal service request. Since 2019, reserved services have been provided by the company that receives the status of DPO and bears the responsibility of providing universal postal services. Reserved postal services include the receipt, transportation and delivery of simple shipments weighing up to 100 grams. The public postal service provider can nevertheless continue to exercise its entitlement to provide reserved services until the end of 2021.

Regarding *barriers to competition*, in 2020 the Post of Kosovo JSC was designated as a universal postal service provider for a period of five years. The Post of Kosovo JSC is the only public postal operator in the economy. With the new 2019 Postal Services Law, the universal postal service provider can be compensated by the government if universal services provision incurs additional net costs that may constitute an unreasonable burden, and if the provider cannot cover these costs from other postal or business services. ARKEP determines the level of compensation on a net cost basis.

**Legal services** (ISIC Rev. 4 code 691) cover advisory and representation services in domestic and international law. Measures are entered separately into the STRI database for each, when relevant. International law includes advisory services in domestic law, third-economy law and international law, as

well as a right to appear in international commercial arbitration. Domestic law involves advising and representing clients before a court or judicial body in the law of the host economy.

The 2020 scores for all OECD member states and OECD partners in this sector range between 0.141 and 1. Kosovo is the third-least restrictive WB6 economy with a score of 0.412, higher than the EU (0.394), OECD (0.362) and WB6 (0.391) averages. In comparison to 2014, Kosovo became less restrictive in the legal services sector. The score is mostly a result of restrictions on the entry of foreigners and restrictions on the movement of people, such as the requirement for a licensed foreign lawyer to act as a co-lawyer with a local and licensed lawyer, and other restrictions described in detail below.

Unlike a number of OECD, STRI key partners and WB6 economies, Kosovo does not restrict the temporary movement of natural persons by imposing quotas or LMTs. Restrictions, however, are present in the form of a licence required to provide legal services in the economy. All licences for foreign lawyers are granted by the Kosovo Bar Association (KBA), and all foreign lawyers must be registered by the KBA in the register for foreign lawyers. Two types of licence are possible: a temporary licence for matters of international law, and a permanent license that enables foreign lawyers to practice domestic law. A foreign lawyer can only obtain a licence to practise domestic law if they enter into a contractual relationship with a local lawyer as a co-lawyer, a restriction which negatively affects the STRI score. However, the presence of the temporary licence greatly limits the degree of restrictiveness of this sector, and places Kosovo in the lower bracket of restrictiveness in the WB6 region, as well as compared to OECD member states. Finally, locally licensed lawyers are obliged to declare an address for correspondence within a defined geographical area of their local bar association.

Regarding *restrictions on foreign entry* in Kosovo, partners and shareholders of law firms have to be licenced and registered professionals in order to practice domestic law. Practice or cross-border legal advice on international law is not subject to an equity restriction. Commercial association is only possible between lawyers and other licensed professionals, other law firms, joint law offices, or local and foreign bar associations. Restrictions on the board of directors has a negative effect on the STRI score. In both domestic and international law, all founding partners and shareholders of law firms must be licensed and registered lawyers.

In the area of *barriers to competition*, freely set fees by legal professionals are considered to promote better competition in legal services. In this respect, the STRI considers the imposition of fees as a barrier to trade. Kosovo's laws require the KBA to regulate state lawyers' fees for cases related to domestic law. There is no distinction made between foreign and local lawyers. All fees are mandatory and listed in the regulations for lawyers.

**Commercial banking** (ISIC Rev 4 divisions 64-66) is defined as deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of dynamic economies as they provide financing for investment and trade across productive activities and underlie all value chains.

The 2020 scores for all OECD member states and key partners in this sector range between 0.131 and 0.517. With a score of 0.123, Kosovo is the least restrictive WB6 economy in the commercial banking sector, and scores lower than the EU (0.180), OECD (0.205) and WB6 (0.239) averages. Kosovo is also less restrictive than the Czech Republic, which is the best CEEC[26] performer with a score of 0.127. In comparison to 2014, Kosovo became less restrictive in the commercial banking services sector. The STRI score in this sector is especially affected by restrictions on extending loans or taking deposits in foreign currency, as well as Kosovo's deviation from international risk weighting standards (Basel standards).

The results are mainly due to three policy areas: restrictions on foreign entry, barriers to competition and regulatory transparency. These results reflect the particular characteristics of the sector, as well as the policy environment in which it operates. As the banking sector plays a key role in each economy, but can

pose risks to financial stability, restrictions on entry and competition have sometimes been used as a means for authorities to maintain control over operations in the absence of effective prudential regulation.

*Restrictions on foreign entry* are often identified as the main source of restrictiveness in the commercial banking sector; however, Kosovo remains relatively open in this regard. It does not limit the share of foreign equity capital in local banks, nor does it restrict the establishment of branches of foreign banks. The licensing of foreign-owned banks is not restricted and is undertaken according to objective and transparent principles applied in an undifferentiated manner to domestic banks. Kosovo does not restrict cross-border bank mergers and acquisitions. Foreign banks do not have to be established locally in order to provide services to residents. No restrictions are imposed on the members of the board of directors of a commercial bank.

Although *barriers to competition* generally contribute substantially to economy scores, Kosovo is positioned in the liberal third of the WB6 economies. Its scores are positively influenced by the adequate regulation of financial products, and the full operational, managerial and fiscal independence from the government of its supervisory authority. None of the largest commercial banks is state owned.

Regarding *regulatory transparency* in the licensing process, the authorities are obliged to provide reasons for the rejection of an applicant within a maximum of 15 days, in line with OECD good practice. However, the burdensome length and cost related to resolving a debtor's insolvency contributes negatively to the indices in Kosovo.

In terms of *other discriminatory measures*, Kosovo's adherence to International Financial Reporting Standards (IFRS) has helped its STRI score. However, the compliance of its regulations with international standards differs to some extent, in particular the application of Basel standards (Sub-dimension 1.1: Investment policy framework). Kosovo also applies certain forms of restrictions on foreign banks for raising capital domestically.

**Insurance services** (ISIC Rev. 4 codes 651 and 652) comprise life insurance, property and casualty insurance, reinsurance, and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.1 and 0.565. With a score of 0.101, Kosovo is the least restrictive WB6 economy in the insurance services sector. It scores lower than the EU (0.175), OECD (0.193) and WB6 (0.231) averages. This sector is mostly affected by the requirement that managers must be resident in Kosovo for providing life and non-life insurance, and reinsurance services.

The STRI results of Kosovo’s insurance sector are mainly due to three policy areas: restrictions on foreign entry, restrictions on the movement of people and regulatory transparency. These results reflect the particular characteristics of the sector and the policy environment in which it operates. The insurance sector follows the general logic of the financial sector in Kosovo in its non-restrictive character. Kosovo underwent a redesign of insurance regulations in 2015, lifting most of the restrictions in its insurance legal framework. The sector is now among the three least restrictive services sectors in the economy.

There are, however, some elements that influence the score in this sector. There are still *restrictions on the movement of people* in the form of licence requirements. Licence to practise, which is delivered by the Central Bank of Kosovo (CBK), is required for both insurance and reinsurance intermediaries, and all actuaries need to be appointed by the CBK. For foreign insurer applicants, a statement must be provided by the home economy supervisory authority that there is no objection to the start of proposed activities in Kosovo. One of the criteria for licensing agents as insurance intermediaries is that they must be a resident of Kosovo. Residence is also required for managers of insurance companies in order to exercise their activity. The same limitation applies to brokerage services.

Regarding *barriers to competition*, the insurer, which has a licence to conduct certain classes of insurance and can request the exercise of activities in other classes of insurance, must obtain a licence for activity expansion. The CBK has exclusive responsibility for the licensing, supervision and regulation of insurers. Approval by the regulatory authority is required for new rates or fees and for new products or services.

**Construction services** (ISIC Rev 4 codes 41 and 42) covers the construction of buildings (residential and non-residential) and construction work for civil engineering. Construction services play an important role in the functioning of economies by providing the infrastructure for other industries. These services account for a significant share of GDP and employment in most economies. Public works, such as roads and public buildings, account for about half of the market for construction services. The STRI for construction services therefore covers detailed information on public procurement procedures.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464. With a score of 0.162, Kosovo is the least restrictive WB6 economy. It scores lower than the EU (0.207), OECD (0.223) and WB6 (0.242) averages. The scoring for this sector is mostly affected by the lack of public procurement regulation to explicitly prohibit the discrimination of foreign suppliers.

There are *restrictions on the movement of people* through Kosovo's imposition of licensing requirements to provide engineering services. Furthermore, at least one engineer must be licensed for the issuance of construction permits. To apply for a construction permit, copies of the professional licences of the project designers who prepared the construction documentation are required. However, the law specifies that this requirement is mandatory only when the licences are available through relevant legal acts; until then, applicants must ensure that project designers are qualified with the relevant diploma.

**Architecture services** (ISIC Rev 4 code 711) cover architectural services and related technical consultancy. These services constitute the backbone of the construction sector, with key roles in building design and urban planning. An important feature is the regulatory complementarity between architecture, engineering and construction services, with all three sectors having very similar STRI scores. Architectural and engineering activities are often combined into projects offered by one company, and are sometimes subsumed in the building and construction sector.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.113 and 0.684. With a score of 0.119, Kosovo is the least restrictive WB6 economy. It scores lower than the EU (0.261), OECD (0.244) and WB6 (0.266) averages. The sector's score is mostly affected by licensing requirements and the lack of a temporary licensing system.

*Restrictions on the movement of people* are caused by the fact that a licence or authorisation is required to practice, and there is no temporary licensing system, which means that foreign architects do not have the option to be temporarily authorised to carry out a specific project or to advise in some areas of architecture services but must go through the whole process of being licensed in Kosovo.

**Engineering services** (ISIC Rev 4 code 711) covers several related activities, such as engineering and integrated engineering services, and engineering related scientific and technical consulting services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.118 and 0.575. With a score of 0.130, Kosovo is the least restrictive WB6 economy. It scores lower than the EU (0.246), OECD (0.234) and WB6 (0.244) averages. As in the architecture services sector, the engineering sector's score is mostly affected by licensing requirements and the lack of a temporary licensing system.

Engineering services are the backbone of construction and supply. Engineers are involved in the construction of key infrastructure, such as buildings and roads, and play an important role in the development of production processes and the adoption of new technologies.

In engineering services, the results are mainly affected by *restrictions on the movement of people*. A licence or permit is required to practice and there is no temporary licensing system, which means that

foreign engineers cannot enter Kosovo temporarily to carry out a specific project or to provide advice in certain fields. However, Kosovo does have a procedure for recognising foreign qualifications. An applicant with a qualifying licence in their home economy must take the general part of the professional exam and fulfil the conditions prescribed in the law. Candidates willing to take the professional examination to carry out tasks in construction must present a variety of documents, including a certificate from the Ministry of Education, Science and Technology (MEST) if academic qualification is achieved abroad. Moreover, those applying for registration on the list of architects and engineers in Kosovo can submit, among other documents, a nostrified (i.e. recognised) diploma by the ministry if they graduated outside the economy.

**Computer services** (ISIC Rev 4 codes 62 and 63) include computer programming, consultancy and related activities, and information service activities.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.448. With a score of 0.160, Kosovo is the least restrictive WB6 economy in the computer services sector. It scores lower than the EU (0.211), OECD (0.222) and WB6 (0.239) averages. The scoring is heavily affected by horizontal limitations on duration of stay for contractual and independent services suppliers, as well as intra-corporate transferees.

This sector is very rarely regulated by sectoral legislation, but is still subject to general laws that apply to the economy as a whole. Restrictions on the movement of people therefore account for one-third of the total score in computer services. The skilled labour intensity of the sector, together with the complementarity between cross-border trade and the movement of natural persons, explains why restrictions on the movement of people feature prominently in this sector in Kosovo. It also explains why this sector is the most open compared to similar sectors in the other WB6 economies. Kosovo has the most attractive horizontally applicable regime for foreign service providers, and therefore its computer services sector is the most liberal.

**The telecommunication sector** (ISIC Rev 4 codes 611 and 612) comprises wired and wireless telecommunications activities. These services are at the core of the information society, providing the network over which other services such as computer services, audio-visual services and professional services are traded.

The 2020 scores for all OECD member states and STRI partners in telecommunications services range between 0.108 and 0.682. With a score of 0.079, Kosovo is not only the least restrictive WB6 economy in the telecommunications sector, but also the least restrictive economy among all STRI participants for this sector. Therefore it scores lower than the EU (0.151), OECD (0.188) and WB6 (0.232) averages.

The results for the telecommunications sector are affected by two policy areas: restrictions on the entry of foreigners and barriers to competition. On average in all STRI participating economies, barriers to competition account for 30% of the total STRI scores in the telecommunications sector. This reflects the fact that it is a capital-intensive network industry, and its strategic importance has led many economies to restrict foreign investment and activity in the sector. This is not the case in Kosovo, however, where EU support has benefitted the sector through a rigorous review of its regulatory regime. The immediate consequence is that the regulation of the telecom sector is aligned with EU regulations and good practice.

In order to ensure fair competition in the telecommunications market, Kosovo has an independent telecommunications regulator, ARKEP, which is separate from stakeholders and the government and operates without state intervention. ARKEP has sufficient regulatory powers to effectively regulate the sector through *ex ante* regulation applied in accordance with EU principles, but only in the case of an operator with significant market power, which is not the case in all telecoms markets. *Ex ante* regulations are applied based on regular market analysis, and are readily available on the ARKEP website. Kosovo applies a "use-it-or-lose-it" policy to frequency bands, which is an important measure that prevents incumbent operators from over-holding valuable frequency licences and free tradable spectrum and

telecom services. The fact that Kosovo also maintains the presence of an SOE[27] negatively affects its STRI score, but is widely observed in this sector.

In absolute terms, the regulatory framework of the telecommunications sector in Kosovo is competitive and constrained only by horizontal measures that apply to the economy as a whole, mainly the movement of people. Although telecommunications lend themselves easily to cross-border trade from a technical point of view, restrictions on the movement of persons account for a modest share of the total STRI score in this sector.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring about significant gains for businesses and is positively related to firms' process innovation. It enlarges businesses' market scope, reduces operational costs at various stages of business activities and lowers barriers to entry, thus intensifying competition (OECD, 2013[55]). E-commerce also benefits consumers by providing information on goods and services, helping identify sellers, and comparing prices, while also offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[55]).

Digital trade is therefore becoming an increasingly interlaced platform for the exchange in digital services integrated into trade of goods. These implications of the digital transformation underline the importance of adopting a more holistic approach to policies, as well as more international co-operation (Ferencz, 2019[56]).

An e-commerce law ideally ensures the proper functioning of the digital market by facilitating the establishment of digital services and their free movement within the region, if co-ordinated. Its aim should be to provide legal certainty for business and consumers by establishing harmonised rules on issues such as transparency and information requirements for online service providers, commercial communications, electronic contracts, and the liability limitations of intermediary service providers. Examples of what the EU Directive on Electronic Commerce[28] covers include shopping, newspapers, databases, financial services, professional services (such as lawyers, doctors, accountants, real estate agents), entertainment services, direct marketing, advertising and internet intermediary services (such as hosting and search engines). Modern e-commerce regulations should focus on, among other things, electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property regulations, and intermediary liability. An attractive regulatory environment should refrain from maintaining disproportionately restrictive policies such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows. This sub-dimension analyses the content and implementation of existing legislation in the WB region. It then uses the OECD Digital STRI to quantify the performance of the WB6 economies in trade in digital services by identifying the restrictive elements that hamper digital trade.

Kosovo has a solid **e-commerce policy framework** within the Law on Information Society Services, adopted in 2012. This law transposes the EU e-commerce directive[29] and includes chapters on electronic signatures, electronic contracts and electronic payments. The purpose of this law is to establish convenient possibilities for the development of electronic trade and the use of electronic transactions, and to reduce potential problems and abuse during electronic transactions. The Law on Electronic Identification on Trusted Services in Electronic Transactions (transposing the EU regulation on electronic identification and trust services for electronic transactions in the internal market – the eIDAS regulation) has been approved and is now in the final stages of adoption by parliament. This law will supplement the Law on Information Society Services and will create an enabling legal environment for e-commerce and other electronic services.[30] All public, private, NGO and academic stakeholders were consulted during the drafting process.

Regulations on e-commerce fall under the competence of several institutions. The Ministry of Economy and Environment (MEE) is responsible for e-commerce legislative and policy development, while the MTI

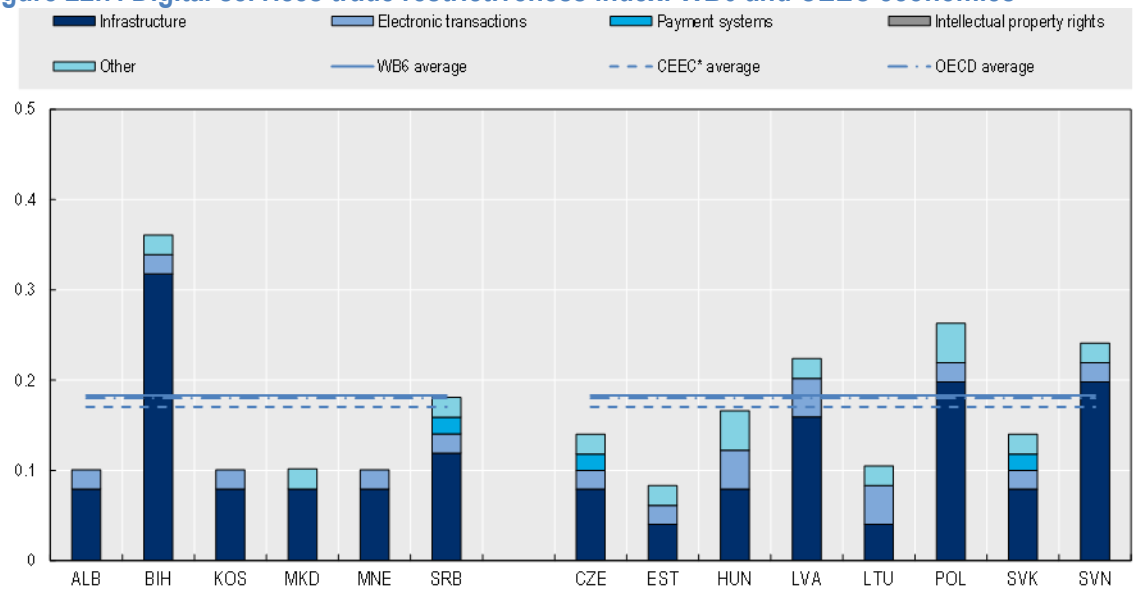
and ARKEP are responsible for implementing the law. The MTI is supported in its role by the European Commission through the Instrument for Pre-Accession Funds (EUR 4 million). A working group has been established to steer the e-commerce regulations and funds and consists of representatives of the government, the banking and financial sector, the private sector, NGOs and academia. The new law will repeal Chapter XIII of the Law on Information Society Services on the use of signatures. According to the draft law, the MTI will have the main roles and responsibilities in addressing e-commerce, and will co-operate with the Agency for Personal Data Protection, the Ministry of International Affairs, the CBK, the Kosovo Banking Association, and others. Co-ordination tools are regulated by the draft law.

The Working Group's work started in September 2020 with the aim to significantly boost e-commerce in Kosovo. It comes in a context of clear evidence of a booming e-commerce sector. The number of online purchases is increasing inside and outside of the economy, and there has been a significant increase in the companies and platforms providing e-commerce in Kosovo. Among the enterprises surveyed by the Kosovo Agency of Statistics in 2018, 11.4% made sales through a website or other computer application; this number rose to 22.7% in 2019. Moreover, based on a consultation with the Kosovo Association of Information and Communication Technology (STIKK), there is evidence that during the COVID-19 pandemic there has been a significant increase in the use of e-commerce solutions by all STIKK member companies as a means of development. This is revealed by the sharp increase in demand for e-commerce solutions addressed to STIKK member companies by customers from different sectors and markets during 2020. COVID-19 has favoured the digitalisation of many companies in Kosovo.

Despite improvements in the legal framework, e-commerce is still very limited, and some regulatory aspects are not yet fully operational. Kosovo lacks an online shopping culture and the related legal environment (63.6% of the population have never ordered or purchased products online, according to 2018 data) (Kosovo Agency of Statistics, 2018[57]). E-commerce suffers from the regulatory shortcomings of the electronic payment system and the lack of consumer confidence in e-commerce: Banks in Kosovo mostly do not support online payment processes, and if they do, the fees per transaction are very high. As a result, the use of e-commerce is difficult. Businesses have had to adapt to this in different ways, the most common solution being "cash payment" upon delivery of goods/services. Unfortunately, there are no reports estimating the size of the e-commerce market in Kosovo.

The OECD digital STRI captures **the restrictiveness of digitally enabled services** by identifying cross-cutting barriers that inhibit or completely prohibit firms' ability to supply services using electronic networks, irrespective of the sector in which they operate. The regulatory data underlying the digital STRI were extracted from the existing OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. The rating takes into account the specific regulatory and market characteristics as well as the links and hierarchies between regulatory measures affecting digitally enabled services (Ferencz, 2019[56]). Figure 22.7 shows Kosovo's score on the digital STRI index.

## Figure 22.7. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[53]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255722

The 2020 Digital STRI scores for all OECD member states in this sector range from 0.043 to 0.488. The WB6 average is 0.183. Kosovo is in the lower bracket in terms of the restrictiveness of its telecommunications sector with a score of 0.101, which places it among the four least restrictive WB6 economies. Since 2014, Kosovo has become less restrictive in the digital services sector.

Results in most Digital STRI economies are regularly driven by infrastructure and connectivity measures. This is due to the lack of effective interconnection regulation, which is not the case in Kosovo where regulation is relatively well-aligned with international good practice. Similarly, although Kosovo has stricter rules than the OECD guidelines in this area (OECD, 2013[58]), it does not impose excessive conditions on cross-border data flows beyond those put in place to ensure the protection and security of personal data. No specific licences or authorisations for e-commerce activities, in addition to ordinary commercial licences, are required.

International standards for electronic contracts and key electronic authentication measures, such as the recognition of electronic signatures, are generally in place.

Policy areas relating to intellectual property rights and payment systems account for a smaller share of the scores of Digital STRI participating economies. Kosovo is relatively open in this category from a regulatory point of view as it follows the principles of European regulations. Regulations are therefore in place that provide for the treatment of foreigners that is no less favourable than that accorded to nationals in terms of intellectual property protection. All necessary regulations related to the payments systems are in place, although their use is limited in practice (as mentioned above).

### *The way forward for trade policy*

Kosovo has taken important steps to improve its trade policy framework, especially in the areas of public consultations on new legislation and evaluation mechanisms. Nevertheless, the government of Kosovo could improve its trade policy framework by considering the following:

- **Strengthen public consultation mechanisms and make them more transparent.** The authorities responsible for public consultation mechanisms should be mandated to publish consultation summaries on the dedicated website. Kosovo should also consider increasing the number of stakeholder comments in the consultation process, for example through the use of methods for public consultation other than electronic platforms (such as informal meetings).
- **Broaden trade in services efforts beyond regional trade agreements**. Significant improvements have been made among WB6 economies to open services trade through the conclusion of CEFTA Additional Protocol 6 in December 2019. Nonetheless, the STRI analysis in this section has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness:
  - **Ease conditions on the temporary movement of natural persons** beyond regional trade agreements to further encourage innovation and knowledge transfer and contribute to economic growth. A starting point could be to amend the limitation on the length of stay of foreign services providers as it falls short of international best practice; OECD good practice recommends a minimum initial length of stay of foreign service providers of 36 months.
  - **Reduce the remaining barriers to market entry and competition in courier services, legal services and air transport sectors**. Further efforts could be made to increase competitiveness. There are improvements to be made in the courier sector, such as amending the preferential subsidy treatment available to the designated postal provider. In the air transport services sector, Kosovo could consider lifting the interdiction of the lease of foreign aircraft with crews. It could also depart from the slot allocation process that gives priority to historic slots, which has a negative effect on competition. The regulation in the legal services sector that requires foreign lawyers obtaining a licence to act as co-lawyer with a local and licensed lawyer could also be reconsidered, and potentially abolished.
  - **Continue to monitor and promote services**. Maintain the momentum of initiatives such as the services database and dedicated website, but also develop additional means to estimate the potential of the economy's services sector. A start could be to systematise statistics collection on services activities by generating more disaggregated data at the sectoral level. Regarding trade in services there is a need to begin generating more detailed data on the different services categories and on foreign affiliate trade statistics (FATS).
- **Strengthen the regulatory regime for e-commerce**. Kosovo should bring into force as soon as possible the new Law on Electronic Identification on Trusted Services in Electronic Transactions that will replace the existing Law on Information Society Service to make up for the current regulatory shortcomings, particularly in the area of payment systems. For this, Kosovo can rely on the recommendations of the OECD's Policy Guidance on Mobile and Online Payments (Box 22.3).

### Box 22.3. OECD policy guidance on mobile and online payments

A key component of a solid e-commerce regulatory policy is the establishment of sound measures for electronic payments and settlements. The main roles of a payment system are to provide a means of transferring value between different parts of the economy and to facilitate transactions at minimum cost. Its design will be optimal if it is organised in such a way as to allow rapid and efficient value transfers, while imposing minimum additional costs and risks. High costs for the payment process can seriously affect economic activity, making transactions too costly. Conversely, the lower costs of efficient payment systems can have a positive effect on economic growth.

Policy makers can help to encourage economic activity by promoting a framework for electronic settlements and payments. The OECD's Policy Guidance on Mobile and Online Payments (OECD,

2014[59]) provides an informative framework on policy measures to establish a regulatory environment for e-commerce that can be adapted to WB6 economies.

The framework is oriented around a number of pillars:

- **Information on conditions and transaction costs**. These principles focus on the accessibility and readability of payment information, the complexity of payment conditions, and the clarity and transparency of billing statements.
- **The privacy implications of mobile and online payment**. These guidelines focus on the collection and use of payment data.
- **Security implications of mobile and online payment transactions**. These guidelines focus on protecting the security of consumer payments.
- **Confirmation process**. These guidelines focus on issues that impede e-commerce transactions, such as the uncertainty of transactions.
- **Children**. This includes issues such as the costs incurred by children in accessing goods and services.
- **Different levels of protection among providers and payment methods**. This includes information on consumer protection and levels of payment protection.
- **Fraudulent, misleading, deceptive and other unfair commercial practices**. These guidelines focus on how to regulate inconsistent payment information, renewable contracts, renewable subscriptions and repeat purchases, unexpected charges and consumer confidence.
- **Dispute resolution and redress**. These include issues such as the roles and responsibilities of the parties and the cost of redress.

Source: (OECD, 2014[59]), *Consumer Policy Guidance on Mobile and Online Payments*, https://dx.doi.org/10.1787/5jz432cl1ns7-en.

## Access to finance (Dimension 3)

### *Introduction*

Kosovo has made progress in certain indicators that facilitate access to finance (Figure 22.1). With an overall score of 2.1, Kosovo is performing below the WB6 average (Table 22.5). However, it should be noted that this is mainly linked to the absence of a stock market in the economy, which negatively impacts the score for the mobilisation of long-term financing and lowers the overall score. Kosovo has made progress regarding access to alternative financing sources since the previous assessment, increasing its score from 1.4 to 1.8.

**Table 22.5. Kosovo's scores for access to finance**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Access to finance** | Sub-dimension 3.1: Access to bank finance | 3.4 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 1.8 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 0.5 | 2.8 |
| **Kosovo's overall score** | | **2.1** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

Kosovo's financial sector is bank-dominated. Banks account for around 66% of overall financial sector assets, which is a lower share than other Western Balkan economies. As of August 2020, ten commercial banks were operating in the economy, eight of which were foreign owned, accounting for 86.7% of total banking assets (CBK, 2020[60]). As of 2019, no bank had ceased its activity and no bank has been sold since 2010. Of the ten operating banks, the cumulative share of the top three banks has constantly decreased from 77.8% in 2010 to 56.9% in 2019, showing an increase of competition in the banking sector. This could also be associated with the parallel decrease of effective interest rates from 14.4% in 2010 to 6.5% in 2019.[31] However, the level of competition should also be carefully monitored, as too much competition in the banking sector increases the possibility of excessive risk taking by banks, potentially leading to failures (Thorsten Beck, 2003[61]; World Bank, 2018[62]).

Kosovo has moderately developed its regulation for the **banking industry**. Some progress has been made since the previous assessment in implementing legislation on banking supervision that aims to strengthen corporate governance and the management of credit risk. This legislation was adopted in March 2019 by the Central Bank of Kosovo (CBK). Some progress has also been made on aligning with the Basel III recommendations,[32] with the CBK implementing the definition of capital and the leverage ratio, as well as the Internal Capital Adequacy Assessment Process for banks as a Pillar 2 requirement[33]. However, in order to be compliant with Basel II requirements[34] from January 2020, Kosovo needs to revise its regulations on credit risk, market risk and operational risk. The CBK is drafting new regulation on liquidity requirements, but no further information on this could be identified during the assessment period.

No major changes have occurred to the **register** since the previous assessment. A cadastre is available online, with all records fully digitalised; however, only authorised intermediaries such as lawyers can obtain information on land ownership. In addition, there is no independent mechanism for filing complaints related to immovable property registration. In 2020, the Kosovo Cadastral Agency launched the testing phase of an online module for mortgage registration and communication with banks and credit non-bank financial institutions. The results are expected to be analysed in the next assessment period.

In February 2020, the CBK approved new instructions on credit registry and established the Credit Registry of Kosovo. It is mandatory for loan providers to use the system and to be monitored by the CBK. The

instructions establish the procedure for reporting the collection and distribution of positive and negative information regarding active loans and the credit history of natural and legal persons. The aim is to improve the credit rating process of credit clients and the performance of CBK's supervisory function. The registration system for security rights over movable assets is also online and publicly accessible. However, it requires a personalised login, after which users can also register pledges through the system. The pledge registry of movable assets covers the entire economy and is open to all interested natural and legal persons. The information is regularly updated and covers the entire economy.

The registration of fixed assets is mandatory and needs to go through the cadastre office. Only fixed assets can be used to secure loans, which potentially limits the options for borrowing money. There is no unique threshold under which **collateral requirements** are flexible for small businesses, this depends on banks' internal policy, however the regulations specify which type of collateral could be used. Although domestic credit lending to the private sector is increasing, banks are increasingly risk averse, which means that they impose high collateral requirements (close to 270% of the loan value and relying on fixed assets), making it difficult for many SMEs to qualify for loans (World Bank, 2019[63]).

Kosovo is one of the few economies in the Western Balkans region that established a **credit guarantee** fund prior to COVID-19 (AECM, 2020[64]). The Kosovo Credit Guarantee Fund (KCGF) is fully operational and covers up to 50% of the risks of principal loans for micro, small and medium-sized enterprises (MSMEs) operating in the industrial sector, up to a maximum guarantee of EUR 250 000. For businesses operating in the agricultural sector the maximum guarantee is fixed at EUR 100 000. The total amount of the loan in both sectors cannot exceed EUR 1 million. The loan maturity under the guarantee is fixed at 84 months. There is also a guarantee fund under the EU's Competitiveness of Enterprises and Small and Medium-sized Enterprises Programme (COSME), through which the KCGF has transferred benefits to the financial sector to support MSMEs operating in the field. The maximum loan amount is fixed at EUR 150 000, and 50% is covered under the guarantee. The minimum loan maturity is fixed at 12 months while the maximum is 120 months. Up to December 2019, approximately 3 500 businesses had benefitted from both programmes, representing a guarantee value of EUR 75 million.

At the end of 2020, the KCGF signed a subsidiary agreement with the Ministry of Finance for around EUR 22 million. This agreement, the result of a financing agreement between Kosovo and the World Bank under the Financial Sector Strengthening Project, aims to increase the capital of the KCGF to further support the private sector's need for short-term liquidity. It will also promote investment by creating guarantees for certain market segments such as women in business, young entrepreneurs, and the manufacturing and agriculture sectors. The KCGF, through support from the Millennium Foundation Kosovo, also foresees supporting the acceleration of project finance investments from private investors in renewable energy and energy efficiency projects.

### *Sub-dimension 3.2: Access to alternative financing sources*

There are limited alternatives to banks as a source of finance in Kosovo; however, **leasing** has become a growing financing resource for businesses, increasing from EUR 20.8 million in 2012 to EUR 52.7 million in 2019. Leasing has been regulated since August 2009 under the supervision of the CBK. The leasing law includes clear definitions and ownership rights, as well as information on how the process should be instigated, the steps to follow and guidance on any required involvement of third parties.

The law on **factoring,** drafted in co-operation with the European Bank for Reconstruction and Development (EBRD) and the CBK, entered into force in October 2018. The regulation establishes the general legal and regulatory requirements for the exercise of factoring by entities licensed/registered by the CBK. It defines and governs types of factoring, factoring contracts, the rights and obligations of the parties to a factoring transaction, as well as the reporting and supervision of licenced/registered entities. However, as of January 2020 no factoring activity had been reported.

There are no government supported **private equity** or **venture capital** activities in Kosovo. The Enterprise Innovation Fund (ENIF), which is a stand-alone venture capital fund covering the Western Balkans region under the Western Balkans Enterprise Development and Innovation Facility (WBEDIF), invested EUR 200 000. In addition, EUR 1 million in equity finance was invested in one company under the Enterprise Expansion Fund (ENEF), which is the second investment fund under the WBEDIF's equity instrument pillar (WB EDIF, 2019[65]).

**Business angel networks** are relatively active in Kosovo and involve smaller investments. One active network saw 15 separate investments in 2018 with a cumulative amount of EUR 250 000; however, the invested amount had decreased by around 50% compared to 2016 (EBAN, 2018[66]).

No activity has been reported on **crowdfunding** or **initial coin offering** during the assessment period. At the time of drafting, the EBRD is assessing the possibility of developing a crowdfunding donation/reward-based system with a financial institution that supports start-ups. The platform is planned to be launched in 2021.

#### *Sub-dimension 3.3: Mobilisation of long-term financing*

The Law on Public Private Partnership is the main legislative act that sets out the policies, procedures and institutional framework for **public-private partnerships** (PPP) in Kosovo. The PPP law clearly defines the rights of all parties involved, including investors. It refers to the Law on Public Procurement for tendering procedures. Dispute mechanisms are regulated by the law and the standard PPP agreement, which foresees: 1) amicable resolution; 2) mediation by an independent expert; and 3) arbitration. Several PPP projects have been approved by the PPP Committee, and contracting authorities have awarded six contracts[35] since 2016 following competitive tendering procedures.

Savings rates are generally low in Kosovo (39%) compared to the euro area (67%). Despite a constant increase, from 5% in 2011 to 9% in 2017, household savings within financial institutions are even lower (49% in the euro area in 2017) (World Bank, 2018[62]). Savings generally reflect households' disposable income, general economic conditions and the rate of poverty. Savings in financial institutions reflect the income of households plus the level of trust in these institutions. The lower the rate, the lower the potential liquidity that could be used by **institutional investors or asset management firms** for potential local investments. Therefore, the low level of savings could also explain the lack of such operators in the economy.

Although there is still no **stock market** operating in Kosovo, the primary government **bonds market** is open to banks. However, non-financial institutions are not allowed to access the market, which limits the number of potential investors and financial resources that could be raised by the government.

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finances, policy makers should:

- **Support crowdfunding by adopting dedicated legal frameworks**. Targeting the large diaspora may be more successful than attracting venture capital, given the lack of such investment thus far. Such initiatives would increase the number of potential financing sources, especially for smaller companies, as well as expand the sources of private financing and boost foreign direct investment. Lithuania offers a good example (Box 22.4).
- **Make use of the new factoring legislation by introducing new factoring services as an additional source of finance from financial institutions**. Since the law entered into force in 2018 no factoring activity has been recorded. A review of the market could help to identify the needs of the private sector and further stimulate the use of factoring services.

- **Consider a review of the business angel network**. A comprehensive assessment of existing business angel investments could help the government to better capture the requirements of business angel networks. Based on the results, which would hopefully clarify the fall in investments in the last four years, the government could consider developing a strategic plan for the development of business angel networks. Additional policy tools, including tax incentives, could be deployed to promote further interest.
- **Diversify equity financing by supporting foreign stock listing**. As there is no operational stock market in Kosovo, and given the relatively small size of the market, foreign stock listing could increase access to finance for large and medium-sized enterprises. Although a listing on a foreign stock exchange might increase reporting and disclosure requirements, which could add additional pressure on executives, the government could increase corporate governance standards by targeting qualified enterprises and facilitate the transition of firms to the new jurisdictions. This could also help businesses attract investors who would otherwise be reluctant to invest. Such government actions might help enterprises overcome liquidity problems following the COVID-19 crisis.

### Box 22.4. Lithuania's crowdfunding legislation

While Lithuania's crowdfunding market is smaller than other European fintech hubs, the economy is only one of 11 EU Member States with dedicated domestic legislation for crowdfunding platforms and boasts a mature and comprehensive regulatory framework for crowdfunding. Although its crowdfunding is in its infancy, Lithuania currently has 15 registered crowdfunding platforms. There has been a positive increase in the total value of crowdfunding platform loan portfolios, from EUR 6.6 million in 2019 to EUR 9.13 million in the first half of 2020 (Bank of Lithuania, 2020[67]).

Lithuania adopted its Law on Crowdfunding in 2016 with the aim of providing a hospitable, clear and transparent setting for cross-border crowdfunding platforms. The law adopted all aspects of the European Commission's Regulation for European Crowdfunding Service Providers, allowing for a seamless transition once the EU Directive comes into force (European Commission, 2018[68]). It was established through a multiple stakeholder consultation process and provides better protection and guarantees for investors through information disclosure obligations, governance rules, risk management and a coherent supervision mechanism. The law covers equity, real-estate and debt-based crowdfunding models, while donation and rewards models continue to fall under the Civil Code of the Republic of Lithuania.

Transparency regulations for crowdfunding platforms help mitigate misinformation and legal risk to better protect investors. Platforms must be included on the Public List of Crowdfunding Platform Operators and subject to an efficient reliability assessment conducted by the Bank of Lithuania's supervisory authority within 30 days. Platform operators, board members and significant stakeholders also undergo a criminal record check, while platforms must instate measures to avoid, identify and address any conflicts of interest that would prejudicially benefit the funder or project owner.

In addition to the EUR 40 000 minimum capital requirement, platform owners are required to put up 10% of starting capital themselves. In the case of offerings between EUR 100 000 and EUR 5 million, platform operators are obligated to publish a light prospectus, while offerings over EUR 5 million require a full prospectus detailing the project and project owner characteristics, proportion of own funds used, details of the offering, security measures, and the existence of secondary markets.

In all cases, Lithuania's crowdfunding regulations require platforms to publish wide-ranging information on their websites for investors, including data on the company, risks associated with investment, project selection criteria, conditions and procedures for repayment of funds, disclaimers on tax and insurance information, and monthly and yearly progress reports.

Lithuania is continuously improving its innovative business environment to give financial institutions and crowdfunding platforms more investment opportunities. In 2016, the economy began allowing the use of remote identity verification via qualified electronic signatures and video streaming/transmission, and is harmonising itself with the EU Regulation on electronic identification. Lithuania has also recently amended its Law on the Legal Status of Aliens to include an e-residency programme that allows foreigners to set up companies, open bank accounts and declare taxes through digital identification. This will further financing opportunities for its fintech platforms.

Source: (European Commission, 2018[68]), *Impact Assessment: European Crowdfunding Service Providers (ECSP) for Business*, https://op.europa.eu/fr/publication-detail/-/publication/2eb8abc0-22cb-11e8-ac73-01aa75ed71a1; (European Commission, 2017[69]), *Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU*, https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf; (Bank of Lithuania, 2019[70]), *Consumer Credit Market Review*, https://www.lb.lt/lt/leidiniai/vartojimo-kredito-rinkos-apzvalga-2019-m; (Bank of Lithuania, 2020[67]), *List of Crowdfunding Platform Operators*, https://www.lb.lt/lt/finansu-rinku-dalyviai?list=36.

## Tax policy (Dimension 4)

### *Introduction*

Table 22.6 compares scores for Kosovo with the Western Balkan average for two tax policy dimensions: tax policy framework and tax administration. Kosovo scores above the WB6 average for both dimensions. Scores for both dimensions are driven by slightly above-average performance in most indicators.

**Table 22.6. Kosovo's scores for tax policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 2.8 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 4.0 | 3.3 |
| | Sub-dimension 4.3: International tax co-operation | n.a. | n.a. |
| **Kosovo's overall score** | | **3.4** | **3.0** |

Note: For comparability with the previous assessment, the new sub-dimension (4.3) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

**Tax revenue** as a share of the economy is relatively low in Kosovo. As for most WB6 economies, Kosovo's tax-to-GDP ratio has increased in recent years, from 21.8% in 2015 to 23.4% in 2019 (Table 22.7). However, this ratio remains below both the OECD (33.8% in 2019) and WB6 (30.6% in 2019) averages. Kosovo's tax mix is highly concentrated on taxes on goods and services, which accounted for 74.2% of total tax revenue in 2019. This share is considerably higher than the OECD average of 32.7% in 2018 and the WB6 average of 51.9% in 2019. Consequently, other taxes play a smaller role in Kosovo. In OECD countries, personal income tax (PIT) and corporate income tax (CIT) combined account for a third of total revenue, on average (33.5% in 2018). In Kosovo, these taxes only account for 14.1% of total tax revenue, in alignment with regional trends (14.9% WB6 average in 2019). The high level of VAT concentration is likely to leave Kosovo exposed to a potential decline in VAT revenue, which largely comes from VAT levied on imports. Kosovo could rebalance the tax mix by strengthening taxes on labour income, environmental taxes and recurrent taxes on immovable property. It could also raise additional revenue from social security contributions (SSCs) to provide supplementary funding for the welfare system. Kosovo yields the least revenue by far from SSCs among the WB6 (10% of total tax revenue in 2019 compared to a 28.8% WB6 average). However, SSC rates raises should be designed carefully and balanced against other policy objectives – an increase in SSCs may raise labour costs and further increase the large informal economy, which is a significant issue for Kosovo and other WB economies.

**Table 22.7. Kosovo's tax revenues as a share of GDP**

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| Kosovo | 1.3% | 2.3% | 2.6% | 19.3% | 23.4% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 10.9% | 33.8% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions.
Source: OECD (2019[71]), OECD.stat https://stats.oecd.org/ (2019 for overall tax/GDP ratio and 2018 specific tax/GDP ratio).

Kosovo levies a standard 10% rate for CIT (Table 22.8), which broadly aligns with the 11.5% WB average (2020). This rate is significantly below the 23.3% OECD average (2020). This low CIT rate is also to some extent reflected in Kosovo's tax revenue. For instance, CIT revenue accounts for 1.3% of GDP in Kosovo, which is below WB6 (1.8% in 2019) and OECD (3.1% in 2018) averages. Kosovo introduced a CIT reform

in 2019 that restricted the companies that can benefit from a special turnover tax in certain sectors. In particular, the turnover eligibility threshold for small taxpayers was reduced from EUR 50 000 to EUR 30 000. Under this preferential regime, taxpayers with an annual gross income of up to EUR 30 000 can opt for preferential rates applied to gross income – 3% on income from trade, transport and other activities, 9% on income from services and entertainment activities, and 10% on income from rental activities.

Capital gains are considered as business income and taxed at the standard 10% rate. Interest and royalty payments made to resident companies are subject to a withholding tax at the rate of 10%. However, dividend income is excluded from the CIT base, and no tax is withheld upon payment to resident and non-resident shareholders. Concerning the taxation of international business income, Kosovo operates a worldwide taxation system in which resident corporations pay taxes on domestic and foreign-sourced income, while non-resident companies are liable only for taxes on income originating in Kosovo. A worldwide taxation system is currently adopted in all WB economies. Such systems have become increasingly less common among OECD countries in recent years, particularly for small open economies.

### Table 22.8. Selected tax rates in Kosovo

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| Kosovo | 10.0% | 10.0% | 10.0% | 18.0% |
| WB | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions. CIT and PIT averages for WB and OECD are based on top statutory rates. PIT for Kosovo is the top statutory rate.
Source: (OECD, 2020[72]), OECD.stat, https://stats.oecd.org/, (2020 for CIT and VAT, 2019 for PIT and SSCs).

Corporate **investment incentives** in Kosovo involve both cost and profit-based incentives. Profit-based incentives (which generally reduce the tax rate applicable to taxable income) are targeted at small companies and include amortisation, special allowances and loss-carry forward. As mentioned above, Kosovo also implements profit-based incentives through special turnover tax rates applied to the gross income of small companies in specific sectors. It also implements a series of targeted cost-based incentives, which lowers the cost and increases the size of the investment. These incentives include depreciation across different categories,[36] a research and development incentive for investment in the exploration and development of natural deposits of minerals and other natural resources, and the full deduction of expenses paid by an employer to an educational institution for its employees. Research shows that cost-based incentives are preferable to profit-based incentives, which risk leading to high redundancy of expenditure as the investment may have proceeded anyway (UNCTAD, 2015[73]). Overall, Kosovo provides an attractive corporate tax environment for investment through a low standard CIT rate, special turnover tax rates and several corporate tax incentives. However, these measures also come at some cost to tax revenue. As a result, Kosovo may wish to investigate empirically whether the use of profit-based tax incentives involve redundancy of expenditure and continue to be value for money.

PIT revenue is low in Kosovo, which is common in the region. PIT revenue as a share of GDP was 2.3% in 2019, in line the 2.7% WB6 average (2019), but drastically below the 8.1% OECD average (2018). Kosovo currently operates a progressive PIT rate schedule, with four different rates: 0% for annual taxable income under EUR 960, 4% between EUR 960 and EUR 3 000, 8% between EUR 3 000 and EUR 5 000, and 10% over EUR 5 000. While Kosovo raises PIT revenue in similar proportion to regional levels, these rates are low compared to other WB economies. The other WB economies with a progressive rate schedule, Serbia and Albania, have a top rate of 18% and 23% respectively, while economies with a flat PIT rate had an average rate of 9.8% in 2020. Furthermore, input from local stakeholders indicates that the top PIT threshold is slightly below the average wage in Kosovo (EUR 5 400). This low and progressive taxation of labour income may encourage informal workers to enter the formal economy. However, the informal economy remains large, estimated at 31% of GDP (European Commission, 2018[74]). To further

help the registration of informal workers, one option for PIT reform could be to redesign the PIT rate schedule to more effectively target high earners. This shift in the tax burden could help provide additional relief for low earners as well as an incentive to leave the informal sector. It would also help Kosovo increase wealth redistribution in its economy, as other taxes on labour income, such as SSCs, are mostly levied at the same rate across income levels.

Regarding the taxation of personal capital income, although **capital gains** are subject to PIT at the general progressive rates, other types of passive income are taxed at special rates: **interest** and royalties paid to resident individuals are subject to a 10% withholding tax, and rental payments to a 9% withholding tax.[37] **Dividends** are excluded from the PIT tax base, and in general exempt from any tax liability. The diverse tax rates on personal income create a difference between the taxation of labour income and the taxation of capital income. This difference, mostly fostered by the absence of dividend taxation, incentivises entrepreneurs to incorporate and receive income in the form of capital rather than salaries. Limiting these distortive effects by harmonising the taxation of labour and capital income could be explored as a policy option.

Contrary to most WB economies, funds from **social security contributions** are relatively low in Kosovo. In 2019, SSCs as a share of GDP were 2.6%, which is significantly lower than the 9.3% WB average (2019) and the 9.0% OECD average (2018) (Table 22.6). Kosovo is by far the least reliant of the WB economies on SSC funds – the second least reliant (Albania) levies twice as much revenue from SSCs proportionally. In principle, such low reliance on SSC funds may pose some challenges in funding welfare payments. The size of SSC funds in Kosovo could partly be explained by the economy's low SSC rates. Employers and employees are both liable for a 5% SSC payment on gross salary. Further voluntary contributions of up to 10% are possible for taxpayers. A maximum contribution of 15% of gross salary is therefore possible for both employees and employers. The total mandatory SSC liability amounts to 10% of gross salary, which is slightly above a third of the OECD and WB averages (26.9% and 29.4% in 2020, respectively). This is by far the lowest combined rate among WB economies (the second lowest is Albania with 27.9%). In addition to this below-average rate, the balance between employer and employee SSC is atypical by regional and international standards. While Kosovo levies the same rate for employers and employees, OECD countries tend to place a higher average SSC burden on employers (17.8% for employers and 9.8% for employees in 2020), and WB economies tend to do the opposite (9.5% for employers and 19.9% for employees in 2020). This trend in OECD countries is possibly linked to the fact that PIT rates are higher on average than in the WB6. Self-employed individuals are liable for a 10% minimum contribution, with an additional voluntary contribution of up to 20% (30% maximum overall contribution). The minimum contribution rate is far below the average rate for self-employed individuals in WB economies (29.7% in 2020). There is scope to redesign the current SSC framework by replacing part of the voluntary contributions with mandatory contributions.

Tax revenue from consumption is high in Kosovo. In 2019, taxes on goods and services as a share of GDP were 19.3%, the second highest among WB economies (15.9% WB average in 2019) (Table 22.6). This ratio is also above the OECD average (10.9% in 2018). The standard VAT rate in Kosovo is 18%, which is slightly below the 19.3% OECD average (2020) and the 19% WB average (2020). This rate is the second lowest of the WB economies (after Bosnia and Herzegovina). Kosovo also has a reduced 8% VAT rate for certain goods and services, including the supply of electricity and water, some food products, textbooks and medicine supplies. OECD research has found that reduced rates are generally not an effective way to target individuals on low incomes, and in some cases may even be regressive (OECD, 2018[75]). The threshold required to register for VAT in Kosovo was reduced in 2015 from EUR 50 000 to EUR 30 000, which aligns with the CIT thresholds introduced after the 2019 CIT reform. However, the VAT threshold is relatively low compared to the average threshold found in OECD countries. The reduction in the VAT registration threshold could also be complemented by VAT simplification measures, such as the less frequent filing of VAT returns and simplified accounting methods. As for **environmental taxes** in Kosovo,

excise duties are levied on gasoline and diesel, but not on carbon emissions. An “ecology tax” mandates that vehicle owners must pay EUR 10 or 30 each year, depending on the vehicle type.

Kosovo’s official economic **modelling and forecasting** is carried out using the Kosovo Macro Projection Model, which forecasts future tax revenue using macroeconomic indicators and effective tax rates from the previous year. It has been developed for most taxes, with the exception of property tax. Currently, the Tax Administration of Kosovo (TAK) does not use micro-simulation models, unlike many other WB economies that are currently implementing (or implemented recently) such models. Kosovo would benefit from a more disaggregated approach to its revenue forecasting, which micro-simulation models would foster.

Kosovo does not currently operate a regular **tax expenditure report**, unlike several other WB economies. For example, Albania implemented a tax expenditure report in 2019 and North Macedonia and Montenegro are currently in the process of implementing them. The development of a regular tax expenditure report would allow Kosovo to monitor the use and effectiveness of tax incentives along with tax revenue forgone (OECD, 2010[76]). To do this, the cost of tax expenditure must be identified, measured and reported in a way that enables the comparison of the monetary value with direct spending programmes (IMF, 2019[77]). Cost-benefit analysis could also be conducted to evaluate whether specific tax incentives meet their stated objectives and, if not, whether they should be abolished or replaced.

Governments have taken rapid and unprecedented action to address the health crisis and the fall in economic activity caused by the outbreak of COVID-19. Containing and mitigating the spread of the virus has rightly been the first priority of public authorities. With containment measures in place, the immediate policy reactions focused on alleviating hardships and maintaining the productive capacity of the economy (OECD, 2020[78]).

Among its responses to the COVID-19 pandemic, Kosovo carried out a number of tax policies, including:

1. Tax filing and payment extensions for all tax types and pension contributions.
2. An exemption from VAT on imports of raw materials used in the production of bread and its products.
3. The calculation of interest and fines for the non-payment of property tax was suspended until 31 December 2020.
4. Wage subsidy scheme for employees affected by the pandemic.
5. Public loan guarantee scheme.

Kosovo has implemented a relatively narrow set of responses to COVID-19 compared to other WB economies. For example, it did not introduce a direct cash transfers to households, or the deferral of households’ and businesses’ fixed costs.

### *Sub-dimension 4.2: Tax administration*

The TAK is responsible for all main taxes, while the Customs Service collects customs duties and VAT on imports. The TAK carries out all the main **tax administration functions**, including tax fraud investigations that are generally carried out by a special police department in other WB economies. Its internal organisation matches the various functions of a tax administration (such as tax collection or audits), while special divisions exist for large taxpayers and SMEs. OECD research shows that a unified body that covers all taxes and all core tax administration functions is an important factor in strengthening the efficiency of the tax administration (OECD, 2018[37]). The TAK is regularly assessed by several domestic and international institutions. The Office of the Auditor General in Kosovo, as well as the International Monetary Fund (IMF) and the European Commission, carry out annual assessments leading to periodic strategic plans.

**Tax compliance assessment and risk management** is overseen by the TAK using a risk-based analysis which identifies taxpayers showing certain abnormalities regarding a predetermined set of risk criteria. This function is supported by the Division of Tax Audits Procedures and the Division of Risk Management within the tax administration. The analysis leads to the issuance of a Risk Response Plan, which classifies taxpayers into different revenue risk groups. OECD research shows that risk-based selection is a key element of effective and efficient compliance programmes as it allows administrations to make effective trade-off decisions and make the best use of their resources (OECD, 2018[37]). No legal framework has been implemented to guarantee procedural justice during tax audit procedures, which could be an area for improvement moving forward. The Division of Tax Audits Procedures monitors the audit implementation plan. Segmentation models are also used by the Division of Risk Management.

In terms of **independence and transparency**, the TAK has full operational autonomy within the Ministry of Finance. A legal framework establishes its legal status and defines its duties and responsibilities, as well as the procedures linked to its functions. While its budget is not independent from annual budgeting procedures, which fix the level of resources, the TAK has autonomy over its yearly expenditure. The director general of the TAK presents an annual report to the Ministry of Finance. As mentioned above, the TAK is regularly audited by the Office of the Auditor General in Kosovo, which produces annual reports on its performance, including independence and transparency. These reports provide recommendations that are mandatory for the management board to implement.

Concerning **tax filing and payment procedures**, most taxes can be filed and paid electronically or manually. Only e-filing is available for VAT, wage withholding tax and pension contributions. Most taxes are filed quarterly or annually. Taxes for which e-filing is mandatory are declared monthly. Overall, e-filing is widely used in Kosovo: 95% of declarations are undertaken electronically, and this figure has been constantly increasing since e-filing was introduced for the 2011 fiscal year. The whole tax filing procedure is regularly assessed by external auditors, including the IMF and the TAK itself.

Various **taxpayer services** are offered by TAK and its regional services, and online access to information, electronic communications and in-person inquiries are at the public's disposal. Kosovo's tax legislation also provides for a taxpayer advocate that protects the rights of citizens against the tax administration. The monitoring and assessment of taxpayer services is carried out in co-operation with relevant stakeholders. Surveys assessing taxpayer satisfaction are conducted every two years.

### *Sub-dimension 4.3: International tax co-operation*

Kosovo has not engaged extensively in **international tax** reforms since the last report. As it has not joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), it has not formally launched any related initiatives. However, it is using the OECD Model Tax Convention as a basis for its double-tax treaties, which informally leads to the implementation of some BEPS minimum standards. Kosovo has yet to engage in administrative co-operation or exchange of information initiatives, but indicates that it is in the process of reviewing domestic legislation to determine necessary actions in these fields. In 2016, Kosovo drafted its Administrative Instruction on Transfer Pricing, based on OECD Transfer Pricing Guidelines and recommendations from the BEPS project. Kosovo would benefit from closely following OECD developments in these areas. This would allow Kosovo to align its tax system with international standards and facilitate potential adhesion in the future.

Kosovo has launched some limited initiatives in the field of **digital taxation**. Although it levies VAT on cross-border digital services, it has yet to implement international VAT/GST (goods and services tax) guidelines. In Kosovo, VAT is levied in the place where the service supplier is established, which differs from the "destination principle" – the cornerstone of international VAT/GST guidelines. Furthermore, Kosovo does not include individuals' income received from digital platforms in the PIT tax base, and thus fails to capture a growing revenue from the digital economy. Kosovo has not participated in the discussions on Pillars 1 and 2 of the OECD's Tax Challenges Arising from Digitalisation proposal. These developments

taking place at the OECD level could have a great impact on the taxation of corporate income in Kosovo, especially under Pillar 2. The Global Anti-Base Erosion Proposal (GLoBE) intends to define the minimum taxation of corporate profits. Although the final rate will depend on ongoing discussions, Kosovo has a low CIT rate, one of the lowest in Europe, and is at great risk of being impacted by GLoBE. If the minimum rate is set higher than 10%, Kosovo would be faced with a choice of either raising its rate or risk forgoing tax revenue (other jurisdictions would collect revenue from economic activity that has its source in Kosovo). The GLoBE proposal might also restrict Kosovo's use of tax incentives, particularly those which are profit-based. This topic will have great importance in the near future, and Kosovo may wish to evaluate its position and prepare an action plan accordingly.

Kosovo is engaged in moderate **regional co-operation** with its WB neighbours, usually through memoranda of understanding or double taxation agreements. Kosovo is also part of the Regional Cooperation Council's SEE Strategy 2020 implementation programme. Its main regional co-operation partners are Albania and North Macedonia, with which Kosovo exchanges best practices on taxation and staff training.

### *The way forward for tax policy*

To enhance the tax policy framework and achieve objectives, policy makers may wish to:

- **Broaden its support for economic recovery in light of COVID-19, with targeted tax and subsidy measures**. Kosovo has implemented a relatively narrow set of measures to mitigate the effects of COVID-19 on its economy and citizens. Policy makers may wish to broaden existing efforts, while focusing on measures that could spark an economic recovery.
- **Increase tax revenue and diversify the tax mix by strengthening the role of CIT, PIT and SSCs**. Kosovo is heavily reliant on taxes on goods and services, and there is scope to diversify the tax mix. Additional funds from SSCs would help to finance the welfare system. Increased CIT and PIT could bring more progressivity into the tax system and raise additional revenue. Developing other taxes, such as property taxes or environment related taxes, could also be explored as a policy option.
- **Assess the design of the PIT rate schedule to bring more targeted progressivity into the tax system**. Kosovo's current PIT design places the top income threshold just below the average wage. The design could be strengthened to further target high earners and enable more wealth redistribution in the tax system.
- **Reinforce efforts to curb the informal economy and encourage businesses to register in the formal economy**. Kosovo has a significant informal economy, which reduces its tax base. Increasing efforts to curb the informal economy could bring additional tax revenue.
- **Consider making voluntary SSCs mandatory to widen the scope of welfare protection**. Of the WB6 economies, Kosovo yields the least revenue by far from SSCs in proportion to its economy. Redesigning the SSC system by replacing part of the voluntary contributions with mandatory contributions could be explored as a policy option. However, such an option should be balanced against the effect of high SSC rates, particularly for employees, on labour market outcomes (which could deter the registration of informal workers and businesses).
- **Assess the merits of differentiated taxation of labour and capital income**. Such differentiated taxation creates a considerable incentive for entrepreneurs to incorporate and receive income in the form of capital rather than salaries.
- **Avoid the use of profit-based tax incentives**. Kosovo's CIT is competitive through its low rate, which excludes the need for overly generous profit-based tax incentives which may create redundancies.

- **Strengthen capacities and tools to assess the effects of tax policies on the economy**. Kosovo has limited capacity in tax expenditure reporting and forecasting tax revenue. Instigating a regular and systematic tax expenditure report, and developing the use of micro-simulation models, should be encouraged to assess tax measure and reforms.
- **Re-evaluate the merits and disadvantages of worldwide taxation for resident companies**. For small open economies such as Kosovo, worldwide taxation may entail high administrative costs without necessarily raising significant revenue.
- **Follow the discussions of the OECD/G20 Tax Challenges Arising from Digitalisation project, in particular the work on Pillar 2 that aims to introduce a global minimum tax**. This reform would incentivise Kosovo (and other WB economies) to increase its CIT rate and redesign CIT incentives.
- **Strengthen engagement with the international tax community and implement international best practices**. Since the last CO assessment Kosovo has not carried out significant measures to align its tax system with recent international tax trends. It would benefit from closely following developments in the OECD concerning the BEPS project and its minimum standards. This would allow Kosovo to align its tax system with international standards and facilitate potential adhesion in the future.
- **Foster regional co-operation and co-ordination on common tax issues within the WB region**. Kosovo shares common challenges with other WB economies, and enhanced collaboration might be favourable for all economies involved. Areas such as tax compliance, training of tax administration staff and exchange of information would greatly benefit from a co-ordinated regional approach.

## Competition policy (Dimension 5)

### *Introduction*

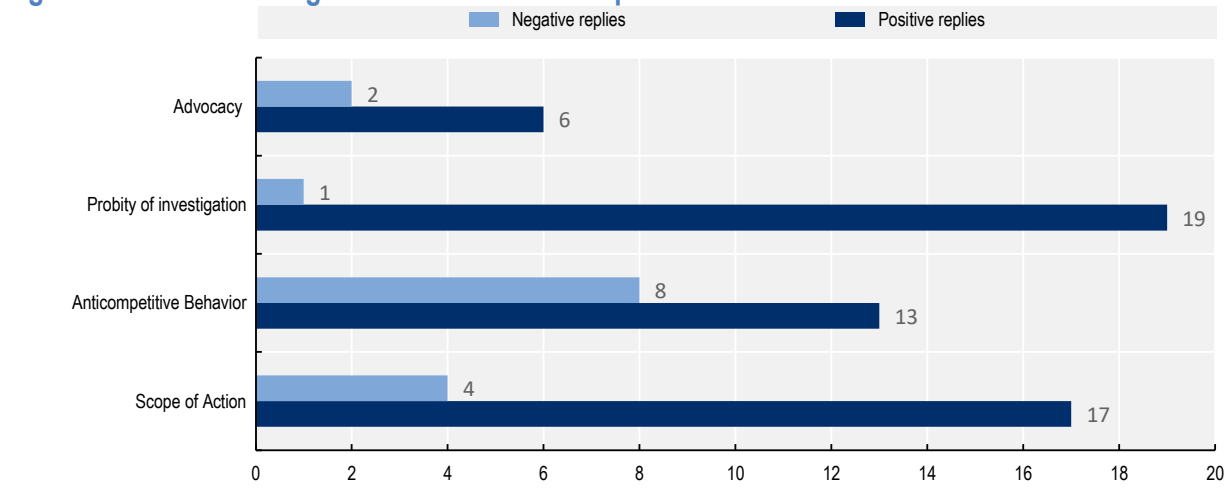
Kosovo is in the process of aligning its legislative framework on competition with international best practice, and particularly with the EU competition *acquis*. Although this requires further steps, the main provisions on prohibited agreements and abuse of dominance, as well as the criteria for *ex ante* merger control, reflect EU rules. Furthermore, over the last few years Kosovo has adopted several pieces of secondary legislation to address gaps that hinder the implementation and enforcement of competition rules.

The Kosovo Competition Authority (KCA), established in 2008 as an independent authority, is responsible for implementing the Law on Protection of Competition in Kosovo. It may initiate investigations, conduct onsite inspections, impose fines and remedies, and prohibit anti-competitive mergers. It has adopted its Strategic Plan for 2020-2023. The KCA did not operate between 2013 and 2016 as the members of the commission had not been appointed.

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas (i.e., scope of action, anticompetitive behaviour, probity of investigation and advocacy, plus a new area: implementation). Scoring is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administered by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy areas has a different number of possible criteria that can be stated as having been adopted. Each policy area is assessed through data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

Figure 22.8 reports the number of positive (alignment with good practices) and negative answers to a question on alignment for each of the four policy areas listed.

### Figure 22.8. Kosovo's legal and institutional competition framework




Source: Based on the OECD assessment.

## *State of play and key developments*

### *Sub-dimension 5.1: Scope of action*

The Kosovo Competition Authority, the public institution responsible for applying competition rules in Kosovo, was established in 2008 by the Law on Protection of Competition. The KCA is governed by the Commission for Protection of Competition. The members of the commission, including the chairman, are granted a five-year mandate, with possibility of extension.

There are 19 staff in the KCA, in addition to the 5 council members, with the number of employees steadily increasing between 2015 and 2019. The organisational structure includes two departments: 1) the market surveillance department handles competition issues and consists of three divisions specialising in agreements, abuse of dominance and mergers; and 2) the administration and legal affairs department deals with administrative matters. Five employees work on administrative issues, while the others exclusively focus on competition issues.

The budget of the KCA has increased from EUR 233 000 in 2017 to EUR 350 000 in 2019. The budget is determined annually by the Ministry of Finance and then approved by parliament. The salary of KCA staff recently increased to compensate for the risks borne by officials in carrying out their duties.

In terms of competitive neutrality, the competences of the KCA encompass both private and public undertakings. The Law on Protection of Competition stipulates that its provisions apply to all forms of competition restriction by firms in Kosovo, or outside if those actions have impacts in Kosovo, irrespective of ownership, seat or residence.

The KCA has appropriate powers to investigate and powers to sanction possible anti-trust infringements, i.e. restrictive horizontal and vertical agreements, and exclusionary or exploitative practices by dominant firms.

The KCA may impose cease and desist orders and remedies on firms that have committed anti-trust infringements. It may also adopt interim measures in case the alleged competition breach poses a risk of irreparable damages. It can do this on its own initiative or following a request by the parties involved. It may also accept commitments offered by the parties to remove the competition concerns and close the investigation.

The KCA may compel investigated firms and third parties to provide relevant information, and may perform unannounced inspections on the premises of the parties to the proceedings, subject to a warrant by the competent court. The assessment of alleged anti-competitive conduct follows a thorough scrutiny of the collected evidence, which may include an economic analysis of the competitive effects of vertical agreements or possible exclusionary conduct.

The KCA has the power to impose fines of up to 10% of the aggregate turnover of the undertaking.

The Law on Protection of Competition also contemplates a leniency programme, which grants total or partial immunity from sanctions to firms that report to the KCA the existence of the agreement and submit appropriate evidence.

The law also covers the *ex ante* control of mergers, following the principles of the EU Merger Regulation. The KCA can prohibit concentrations that significantly restrict effective competition, particularly as a result of the creation or strengthening of a dominant position. It may authorise the transaction subject to structural and/or behavioural remedies suitable to address the competition concerns – i.e. divestiture of assets and/or obligations to act or refrain from acting in a certain way.

In the course of the investigation, the KCA may compel merging firms and third parties to provide relevant information and may perform unannounced inspections of the parties' premises. The assessment of

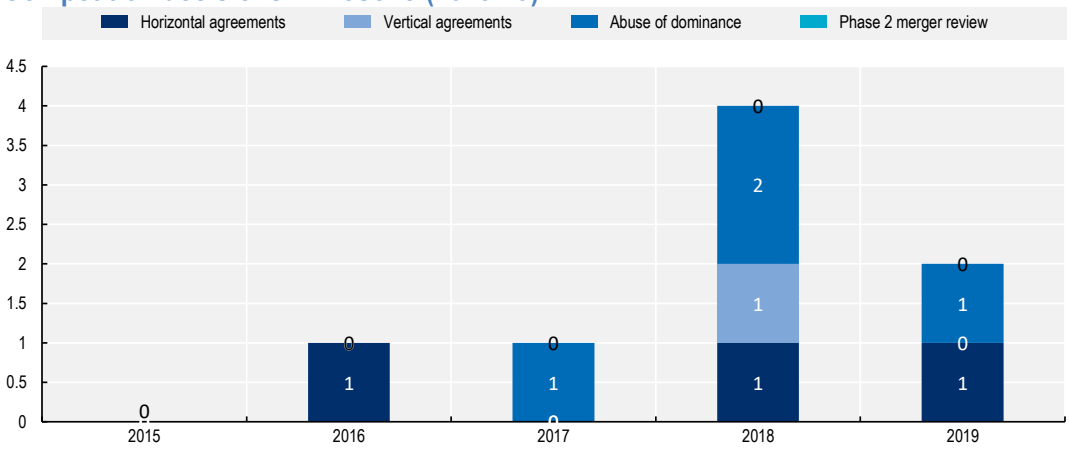
notified mergers should follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration.

Regarding private enforcement, individuals, firms and consumers – either collectively or through consumer associations – can bring a legal action before the courts to seek damages from firms that have committed anti-trust infringements.

*Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. The implementation of the provisions mentioned above through competition enforcement is still very limited in Kosovo (Figure 22.9).

**Figure 22.9. Competition decisions in Kosovo (2015-19)**




Source: Data provided by the authorities.

From 2016 to 2019 the KCA investigated very few **horizontal and vertical agreements** (two in 2018 and one in the other years), without imposing any fines. It accepted commitments and closed the cases given the limited awareness of competition rules in domestic firms. However, in 2020 the KCA concluded a major investigation regarding a horizontal agreement on prices by 13 oil companies and imposed overall sanctions of more than EUR 1 million. The KCA has carried out four investigations into alleged abuses of dominant position (**exclusionary conduct**), one in 2017, two in 2018 and one in 2019, but without finding infringements.

No leniency application has been submitted to the authority, and the KCA has never performed unannounced inspections.

In the period 2015-19, the KCA received a total of 10 **merger** notifications. All mergers were unconditionally cleared in phase 1, as the KCA did not identify possible competition concerns that would require an in-depth review.

*Sub-dimension 5.3: Probity of investigation*

The KCA is independent from the government and accountable to the Assembly of the Republic of Kosovo, pursuant to Article 24 of the Law on Protection of Competition. The government cannot give binding directions to the KCA. The Commission for Protection of Competition, which governs the KCA, is composed of five members who are proposed by the government and approved by the Kosovo Assembly.

Nevertheless, it should be highlighted that the KCA was not operational in the period 2013-16 because the Members of the Commission had not been appointed.

In terms of procedural fairness, the Law on Protection of Competition stipulates that the decisions of the KCA must be notified to the parties to the proceedings and published in the domestic Official Gazette. A non-confidential version of the decision is also published on the KCA webpage.

The KCA must deliver the decision to initiate formal proceedings to the parties. For investigations on both alleged competition infringements and merger reviews, the parties have the right to be heard and present evidence before a decision is adopted. Prior to scheduling a hearing, the KCA must provide the parties with a written notification covering the facts of the case.

The KCA publishes annual reports which are submitted to the Commission of Economy and Trade and then approved by parliament. Every three months the KCA reports to the Ministry of European Integration, and its recommendations are incorporated into the Kosovo EU Progress Report.

The decisions of the KCA may be appealed at the administrative court and eventually before the appeal court.

The KCA has published guidelines to clarify substantive or procedural issues, including the Regulation on Procedural Fairness, administrative instructions on horizontal and vertical agreements, as well as on the review of mergers. All documents are available on the KCA website.

### *Sub-dimension 5.4: Advocacy*

According to the Law on the Protection of Competition, the KCA may provide opinions to the Parliament and Government of the Republic of Kosovo on laws, regulations and other bylaws that significantly affect competition, as well as to central and local bodies of public administration. It may also provide opinions to promote awareness of competition and its role.

The KCA has actively engaged in competition advocacy in several sectors, particularly in the last few years. For example, it has issued opinions and recommendations to the Central Bank of Kosovo to ensure that insurance companies compete in terms of the prices and quality of services they provide, to the Ministry of Health on price regulation for medicinal products and equipment, and to the Tax Administration of Kosovo on administrative barriers to the provision of cash register equipment.

The KCA can also conduct market studies, for example in 2019 it published an analysis of the telecommunications sector and an analysis of the energy sector. Market studies are a tool used to assess how competition in a sector or industry is functioning, detect the source of any competition problems, and identify potential solutions. Competition problems that can be uncovered in market studies include regulatory barriers to competition and demand-side factors that impair market functioning. Market studies are a versatile tool that allow the examination of a broader set of issues than competition enforcement, and therefore their use is growing. International organisations, notably the OECD and the International Competition Network (ICN), have developed a wide range of documents on market studies, including the OECD Market Studies Guide for Competition Authorities (OECD, 2018[13]).

In 2019, the KCA concluded memoranda of understanding with the Energy Regulatory Office, Kosovo Railways, the Electronic and Postal Communications Regulatory Authority, the Water Services Regulatory Authority and the Central Bank of Kosovo. It has also discussed the scope for possible co-operation with several regulators and drafted a number of additional memoranda of understanding that are expected to be finalised soon. Notably, the KCA has been in contact with the Public Procurement Regulatory Commission, the Central Procurement Agency and the Public Review Body.

In the framework of the EU funded IPA,[38] specific activities have been planned to offer training to judges.

The KCA has organised many advocacy events aimed at developing competition culture, including with the Ombudsperson, the State Aid Commission, ministries, municipalities and chambers of commerce. Other advocacy initiatives have involved universities, the media and other stakeholders.

### *The way forward for competition policy*

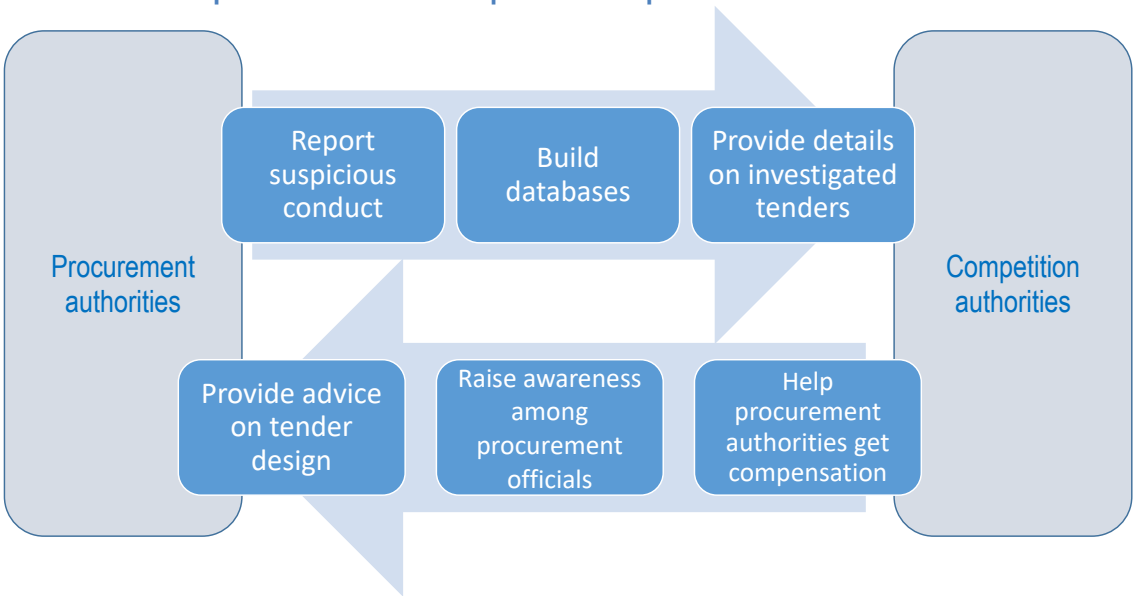
The priority concern of the KCA in recent years has been the promotion of competition principles and the spread of competition culture. The KCA has engaged in a broad set of advocacy initiatives to address competition restrictions in existing and draft law, and to increase awareness about the role and objectives of competition policy.

These efforts are commendable, particularly by such a young agency, but should be complemented with proactive competition enforcement and the imposition of severe fines to tackle infringement, ensure deterrence and encourage competition compliance by firms. Competition enforcement by the KCA has been weak to date, although the case concluded in 2020, which for the first time led to the imposition of high fines on cartelists, is a promising sign for the future. Policy makers in Kosovo may wish to consider the following:

- **Shelter the KCA from political influence, and carefully preserve its independence.** OECD Competition Committee research has found that it is an ongoing challenge to ensure that a competition agency enjoys the requisite levels of independence, remains transparent and receives appropriate resourcing. Even well-established regimes may deviate from these standards, with detrimental consequences for the quality of competition enforcement, law and policy; however, it is essential that such standards are maintained. As indicated, the KCA was not operational between 2013 and 2016 as the members of the commission had not been appointed. This shows that political action or lack of action can have a strong impact on competition policy.
- **Prioritise strengthening cartel enforcement and increasing fines**. Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. The efforts of the KCA should be focused on detecting cartels and imposing heavy fines on infringers to deliver a strong message that firms engaging in collusion risk severe punishment. If the fine amount sufficiently exceeds illicit gains, offences can be deterred even when the probability of paying a fine is low. The fear of fines is also a key driver of leniency applications, thus fostering the effectiveness of the leniency programme – which has been unproductive in Kosovo so far – and further boosting detection. The KCA might engage in expanding its detection skills, for example by further strengthening the fight against bid rigging (see point below on public procurement), and start using its power to perform on-site inspections to collect evidence.
- **Pay specific attention to public procurement, particularly during the COVID-19 crisis.** Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm to the public budget and to taxpayers, dampening innovation and causing inefficiencies. The KCA should work closely with the Public Procurement Regulatory Commission and the Central Procurement Agency to reduce the risks of bid rigging through careful design of the procurement process, and to detect bid-rigging schemes during the procurement process. Figure 22.10 shows how co-operation between competition and procurement authorities can help detect and avoid bid rigging. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012[79]) calls for governments to assess their public procurement laws and practices at all levels of government in order to promote more effective procurement and reduce the risk of bid rigging in public tenders. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[80]), which form a part of the recommendation, are designed to reduce the risks of bid rigging through the careful design of the procurement process and to detect bid-rigging conspiracies during the procurement process. The OECD can also provide assistance through helping to assess the main rules governing the procurement of public

works and the procurement practices of major public buyers. It can provide recommendations to design competitive procurement and fight bid rigging in accordance with international good practices. It can also offer training for both competition and public procurement officials, based on the Guidelines on Fighting Bid Rigging in Public Procurement.

**Figure 22.10. How co-operation between competition and procurement authorities could work**




- **The KCA should make wider use of its power to perform market studies**. The OECD's Competition Division can assist competition authorities, regulators, ministries or other policy makers with market study projects. This could be particularly valuable in Kosovo, where the KCA and policy makers have limited experience with such tools.
- **Expand international co-operation and training.** International co-operation and targeted training initiatives are necessary in a fast-moving economic environment. In the face of increasing complexity of anti-trust issues and the frequent cross-border nature of competition infringements, the management and staff of the KCA should have regular opportunities to meet and share good practices with international competition experts and colleagues from other jurisdictions. International organisations such as the OECD, the ICN and the United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities in this regard. The OECD-GVH Regional Centre for Competition in Budapest provides an ideal forum to explore competition related issues. The KCA is already a regular participant in the centre's events and would benefit from actively continuing its participation. Additional training initiatives would further enable KCA staff to reach their full potential.

## State-owned enterprises (Dimension 6)

### *Introduction*

State ownership responsibilities for Kosovo's main portfolio of 17 SOEs are exercised by an inter-ministerial government commission whose work is supported by an SOE monitoring unit in the Ministry of Economy and Environment (MEE). Despite these ownership arrangements, several SOEs are loss-making, which indicates that there is scope to clarify SOE performance expectations and address structural shortcomings. Nevertheless, Kosovo achieves an above-average score in the governance and efficiency sub-dimension (Table 22.9), reflecting its strongly centralised ownership arrangements and the separation of ownership and regulatory functions. Kosovar SOEs are subject to high standards of financial disclosure, resulting in an above-average score in Sub-dimension 6.2. Kosovo also performs better than other WB6 economies when maintaining a level playing field with private companies (Sub-dimension 6.3), reflecting the fact that all SOEs operate as joint-stock companies and are thus subject to general company law. However, many SOEs do not earn economically significant rates of return and many benefit from state guarantees, which may result in an uneven playing field with private companies. Kosovo's performance on the state-owned enterprise dimension has not changed significantly since the 2018 Competitiveness Outlook (Figure 22.1), but the authorities report plans to update the Law on Publicly Owned Enterprises in 2021, which could lead to changes in scores depending on the direction of the planned reforms.

### Table 22.9. Kosovo's scores for state-owned enterprises

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 3.1 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 3.2 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 3.0 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising SOEs | n.a. | n.a. |
| **Kosovo's overall score** | | **3.1** | **2.6** |

Note: For comparability with the previous assessment, the new sub-dimension (6.4) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

Kosovo's state-owned enterprise portfolio consists primarily of 17 SOEs (Table 22.10). At the local level, Kosovo's municipalities own 43 local enterprises, mostly in the transport and public utilities sectors.

### Table 22.10. Kosovo's main state-owned enterprises

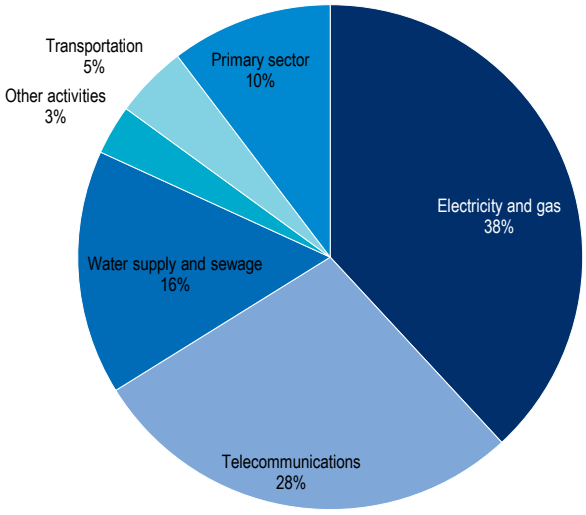
| Name of enterprise | Main sector/activities | Number of employees |
|---|---|---|
| KEK | Electricity | 4 145 |
| Telekomi i Kosoves | Telecommunications | 2 289 |
| Posta e Kosoves | Telecommunications | 1 013 |
| NKEC | Electricity | 3 |
| KRU Mitrovica | Water supply and sewage | 246 |
| KRU Prishtina | Water supply and sewage | 560 |
| KRU Gjakova | Water supply and sewage | 265 |
| Hidroregjioni Jugor | Water supply and sewage | 324 |
| KMDK | Waste | 82 |
| Trainkos | Transport | 233 |
| Infrakos | Transport | 315 |

| Name of enterprise | Main sector/activities | Number of employees |
|---|---|---|
| HE Iber Lepenc | Multi-sectoral | 274 |
| Radoniqi Dukagjini | Irrigation | 65 |
| Drini I Bardhe | Irrigation | 36 |
| Hidro Drini | Water supply and sewage | 216 |
| Hidro Morava | Water supply and sewage | 153 |
| Trepča Mine | Mining | 1 217 |
| KOSST | Electricity transmission | 340 |
| **Totals** | **18 enterprises** | **11 776 employees** |

Note: Enterprise names, sectors of operation and employee numbers are as reported by the Kosovo authorities for this assessment, with the exception of the employment figure for KOSST, which is based on online disclosures.

The Privatisation Agency of Kosovo (PAK) – by its own online disclosure – also holds administrative rights for over 500 previously "socially owned" enterprises (whose ownership was considered shared social property under the former Yugoslavia regime). Legally, the PAK holds these enterprises "in trust", with responsibility for administering legal claims on their ownership and overseeing their eventual privatisation or liquidation. The PAK's establishing legislation allows it to exercise a wide range of functions with respect to the enterprises, including appointing board members and senior management, approving business and investment plans, and revising corporate by-laws. Although legally the PAK may not "own" these enterprises directly, it has legal authority to exercise several important ownership rights, which makes it a *de facto* owner of a large portfolio of SOEs. According to the OECD definition, enterprises owned by the state, even if slated for privatisation, are considered SOEs and should thus be governed according to high standards of corporate governance until they are privatised.

### Figure 22.11. Sectoral distribution of SOEs by employment




Note: Employment figures are for 18 companies, including the main centrally managed portfolio, plus the electricity transmission operator KOSTT, which is owned directly by parliament.
Source: Calculations based on information provided by the authorities of Kosovo.

SOEs in Kosovo account for an estimated 3.3% of domestic employment, which is slightly above the OECD average and in between the share for neighbouring Serbia (2.9%) and Montenegro (3.3%).[39] SOEs' estimated share of domestic employment increased slightly (from 2.9%) when the state took majority ownership of the Trepča Mine in 2016. SOE assets in Kosovo account for the lowest share of GDP compared to other WB6 economies, based on estimates by the EBRD (EBRD, 2020[81]).[40] Although these estimates show that SOEs in Kosovo do not constitute a particularly large share of the economy, their presence in structurally important sectors such as electricity, telecommunications and transportation makes their efficient operation important for broader economic outcomes Figure 22.11.

Some of Kosovo's most prominent SOEs have suffered losses in recent years, indicating structural issues that impede their performance. For example, Kosovo Telecom was recently on the brink of bankruptcy owing to EUR 26 million of unpaid debts (BalkanInsight, 2020[82]). In 2017, Kosovo Railways operator, Trainkos, cut some of its domestic passenger services for two months, stating that revenue was not sufficient to cover operating costs and citing EUR 5 million of accumulated losses over the previous five years (IRJ, 2017[83]). SOE losses appear to sometimes stem from under-compensated public policy objectives (as may be the case for the aforementioned passenger rail service), or from broader structural issues such as overstaffing.[41]

Concerning the **clarification of ownership policy and rationales**, Kosovo adopted a state ownership policy in 2008 that clearly outlines the rationales for state ownership and establishes several basic principles for the state to follow in its role as shareholder. The first overarching objective for state ownership is to maximise value for shareholders by achieving sustainable positive income and ensuring the appropriate involvement of the private sector. The establishment of value maximisation – which can include both financial value and societal value – as an objective of state ownership is in line with the good practice guidance of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[84]). Additional principles set forth in Kosovo's policy include the following: SOEs should implement sound corporate governance and transparency practices; their capital structures should maintain SOEs' financial discipline and minimise their dependence on the state budget; state capital provisions for major investments should be decided through the standard public budget process; and the private sector should be included in SOE operations where needed to increase efficiency and quality of services. The ownership policy states that government ownership should only be maintained in enterprises to protect the public interest and not purely as a result of historical factors.

While Kosovo's state ownership policy provides a sound foundation to support professional ownership practices and includes several good practice principles, more information on the success of its implementation would be useful, particularly as it was adopted 12 years ago. One shortcoming of the policy is that in its emphasis on the ownership responsibilities of the Government of Kosovo as a whole it does not provide detailed information on the roles of subsidiary state bodies in implementing the ownership policy. Stakeholders interviewed for this assessment communicated a general perception that Kosovo's ownership policy has been successful in introducing more professional governance arrangements and attracting some additional private capital (e.g. the public-private partnership with the domestic airport) to Kosovo's 17 main SOEs; however, the board member selection process (outlined in the state ownership policy) remains problematic in practice, with politicisation hindering the commercial performance of SOEs in many cases.

Kosovo has established predominantly centralised state ownership arrangements, wherein the Government of Kosovo has exclusive responsibility for ownership decisions, which are agreed upon by an inter-ministerial committee by simple majority vote. Efforts to **professionalise state ownership** practices in Kosovo are underpinned by the state ownership policy and the Publicly Owned Enterprise (POE) Monitoring Unit. The POE Monitoring Unit's main roles are to collect SOEs' annual financial statements, prepare a consolidated report on SOE financial operations, and review the performance of SOE boards of directors to help inform government decisions on the continuity and composition of each board. These arrangements are set out in the Law on Publicly Owned Enterprises, which also establishes some basic criteria for the composition of the inter-ministerial committee, notably that it must always include the Minister of Economy and Environment (who leads the committee), the Minister of Finance, the Minister of Trade and Industry, the Minister of Infrastructure and the Minister of Regional Development. There are subsidiary regulations for the rules of procedure of the inter-ministerial committee.

By establishing a central monitoring unit and ensuring that state ownership decisions are taken by the whole of government (and not individual line ministers), Kosovo has taken steps to harmonise ownership practices and separate ownership decisions from regulatory decisions. However, there is one SOE, the electricity transmission system operator KOSTT, that operates outside of these prevailing arrangements,

as it is owned by parliament. The current ownership arrangements also mean that according to the authorities there is no process in place through which the state shareholder sets performance objectives for individual SOEs. Dividend expectations from certain individual SOEs are decided through the annual public budget process, but the process for setting other quantitative performance targets varies across the SOE sector and seems to be mostly driven by SOE management rather than by the state as shareholder. In particular, SOE business plans developed by senior management and subsequently approved by the board include financial and operational performance targets.

Kosovo has taken some initial steps to establish an SOE **board nomination framework**, but the process and criteria used for appointing (and in some cases dismissing) individual SOE board members is not particularly transparent. According to the Law on Publicly Owned Enterprises, SOE board recruitment procedures are led by recommendation committees established for each SOE, which are made up of seven individuals and must comprise senior civil servants or qualified external experts with relevant industry, financial or corporate governance expertise. The composition of these recommendation committees is decided by the Permanent Secretary of the Prime Minister's Office. Final decisions on SOE board nominations are made by the Government of Kosovo, but all board appointees must be among those preselected by the relevant recommendation committee. Although the general process for SOE board recruitment is clearly established by law, there is limited transparency regarding the criteria and procedures used by each recommendation committee to identify, vet and agree on candidates. For example, it is not clear if all board vacancies are subject to an open and competitive procedure, although the authorities report that board vacancies are indeed publicly announced. Regarding professional qualifications, SOE boards (which must comprise five to seven members) are required to include at least two individuals with adequate knowledge of accounting and must meet certain independence criteria, discussed below. There is scope to strengthen the professional qualifications criteria applicable to all SOE board members so that boards have adequate professional competencies and are clearly selected on merit.

External stakeholders interviewed for this review indicated a recurring practice, often following political cycles, of dismissing SOE boards and appointing "temporary boards" in their place. The interviewees noted several recent SOE board dismissals perceived to be politically motivated. The government maintains that the boards in question were dismissed owing to their non-compliance with requests to postpone the appointment of senior management to allow for the participation of an external professional advisory entity. Given that senior management appointments are legally the responsibility of SOE boards in Kosovo, these recent disagreements point to an inadequate or unclear separation of responsibilities between the state as shareholder and SOE boards of directors.[42]

Although Kosovo has established some criteria to **promote independent and professional boards** in SOEs, several media reports indicate a perception that board appointments are sometimes made on the basis of personal connections, for example with the ruling political parties.[43] Interviews with stakeholders conducted for this assessment echo this perception, which means that SOE corporate decision making, for example related to procurement or recruitment of senior management, is frequently subject to political influence. This practice contrasts sharply with the apparently sound formal criteria for SOE board membership, which emphasises independence and the absence of conflict of interest. According to the Law on Publicly Owned Enterprises, all SOE board candidates must not have had any business relationships with the SOE in question or have been elected officials, political appointees or decision makers in any political party for the three years preceding their application. Concerning their fiduciary duties, SOE board members are required to act in the best interest of the enterprise according to both the company law (the Law on Business Organisations) and the Law on Publicly Owned Enterprises. The law also states that when SOEs do not meet their performance targets set out in annual business plans for two years in a row, the state shareholder must consider board dismissal. SOE board members are subject to the Code of Ethics and Corporate Governance in Publicly Owned Enterprises, according to which all board members should ensure that sufficient procedures are in place to protect the assets, reputation and long-term interests of the enterprise. Despite the existence of these formal requirements, the apparent

perception that SOE board seats are not consistently based on professional merit indicates shortcomings in SOE board recruitment criteria and procedures. Authorities in Kosovo also report that SOEs are expected to comply with the Law on Gender Equality, which sets the ambition of 50% representation of each gender in decision-making bodies in all legislative, executive and judiciary bodies. The authorities report that SOEs fall under the scope of this law, but that no SOE complies with its requirements, demonstrated by the very low number of female applicants to related positions.

### *Sub-dimension 6.2: Transparency and accountability practices*

Concerning **financial and non-financial reporting**, SOEs are required to submit their annual financial statements, audited by an external auditor, to the POE Monitoring Unit housed in the MEE. Financial statements are subsequently made available online, creating a channel for public accountability. Most SOEs appear to respect these disclosure requirements. For example, the websites of the Ministry of Finance and the MEE publish enterprise-specific reporting documents for all 17 SOEs that include annual reports on financial statements, business plans and corporate statutes. There are sometimes delays in making annual reports available online.[44] While SOEs are subject to apparently high standards of financial reporting, there is limited information available on their non-financial reporting requirements and practices. Although the requirement for SOEs to make their business plans available online might be considered a means of increasing corporate accountability, there is also a risk that it could jeopardise their commercial situation, for example if information on plans to expand in competitive markets is made public. Regarding disclosure at the state level, Kosovo appears to be the only WB6 economy to produce a consolidated financial report on SOEs, which is prepared by the POE Monitoring Unit and presented to parliament annually. The latest example of this report was produced in 2016 and is available online.[45] The authorities report that they are currently preparing a 2018/19 annual aggregate report; however, publication of this report, which is subject to parliamentary approval, has been postponed due to the COVID-19 pandemic and changes in the government and parliament.

Concerning **auditing practices**, as mentioned above all SOEs are required to have their financial statements audited by an external auditor in accordance with internationally accepted standards of auditing. However, in practice the state audit office sometimes performs SOE financial audits instead of external firms, which is not consistent with relevant OECD recommendations. Kosovo's related requirements are set forth in the Law on Publicly Owned Enterprises, which also establishes strict criteria for ensuring the independence of the audit firm selected to undertake the external audit. The audit firm is selected by the SOE's procurement officer, with assistance from the board audit committee. The Law on Publicly Owned Enterprises also establishes that both the National Audit Office and parliament can undertake additional audits of individual SOEs as deemed necessary. The authorities report that in cases where the National Audit Office undertakes an audit of an SOE's financial statements, an audit by an external audit firm is not required or undertaken, which is not consistent with OECD guidelines. As an example of such ad hoc audits, the National Audit Office audited Kosovo Telecom for the 2018 financial year, which assessed the credibility of the company's financial statements and the robustness of internal controls and the internal audit function (National Audit Office, 2019[85]). The Office of the Auditor General concluded that the 2018 financial statements did not present a true and fair view of the company's financial situation. A similar public audit of Kosovo Railways (Trainkos) was undertaken in 2019, and also concluded that the company's 2018 financial statements did not present a fair and accurate view of its financial situation. While this only concerns two SOEs, it points to scope for investigating the quality of other SOE financial statements to address any weaknesses and ensure that these statements can reliably inform the state's efforts to address structural problems that may limit SOE efficiency.

Concerning the legislative framework for the **protection of minority shareholders** – which will be relevant if the state decides to broaden the ownership of SOEs to include private investors – external assessments by the World Bank indicate that Kosovo has some basic legal requirements in place on the extent of shareholder rights.[46] However, the absence of an active stock market excludes Kosovo from receiving a

score from the World Bank in some of the indicators related to minority shareholder protections. Broader issues related to weaknesses in the judicial system, highlighted by an example of the US Department of State (US Department of State, 2020[86]), could make it difficult for minority shareholders to obtain redress if their rights are violated, even if basic rights are adequately enshrined in law. Currently, only one of Kosovo's SOEs, the Trepča Mine, has non-state minority shareholders as it is 20% owned by employees and 80% owned by the Government of Kosovo.[47] As mentioned, the state took ownership of the mine in 2016 by a decision of the parliament just before it was due to initiate bankruptcy proceedings. The legislation applicable to Trepča Mine establishes that the supervisory board is elected by shareholders in proportion to their shareholdings and in accordance with the Law on Publicly Owned Enterprises. It is not clear from these two pieces of publicly available legislation how exactly the employees of Trepča Mine participate in the nomination of board members in proportion to their 20% shareholding; stakeholders interviewed for this assessment highlighted that the related procedures may be detailed in the enterprise's corporate statutes, but that these are not publicly available.

### *Sub-dimension 6.3: Ensuring a level playing field*

Concerning **legal and regulatory treatment**, all SOEs in Kosovo are incorporated as joint-stock companies, and thus subject to the company law also applicable to privately owned companies. The authorities in Kosovo also confirm that SOEs are subject to the same regulatory treatment as private companies. This provides a sound initial foundation for establishing a level playing field with private companies. However, a recent dispute between state-owned Kosovo Telecom and the privately owned Z-mobile points to some potential competition barriers where SOEs control the network infrastructure used by competitors. The dispute involved claims by the private mobile services operator that Kosovo Telecom was not respecting its contractual responsibilities to provide access to network infrastructure.[48] The dispute went to international arbitration, which concluded in favour of the private operator. This case illustrates that aligning SOE legislation with that of private companies is often not sufficient to ensure fair competition between SOEs and their private competitors.

Concerning **access to finance**, most SOEs obtain financing from the commercial marketplace, and some SOEs benefit from explicit state guarantees of their commercial debt. While such advantageous conditions for SOEs distorts the playing field, the fact that several SOEs are loss-making arguably constitutes a much more problematic structural issue. Just as advantageous operational conditions can favour SOEs and crowd out private sector competition, disadvantages faced by SOEs – such as under-compensated public policy objectives or employment expectations that impede efficiency – also distort the playing field and lead to inefficiencies in companies and markets. A 2015 external assessment by the GAP Institute for Advanced Studies identified overstaffing as a crucial structural problem in the SOE sector, often the result of political influence (GAP Institute, 2015[87]). In terms of responses to the COVID-19 pandemic, the authorities report that some SOEs have received funding from an emergency fund, and that state aid rules have been relaxed in the context of the pandemic.

### *Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

Concerning **recent SOE reform**, in 2015 the Kosovo authorities amended the Law on Publicly Owned Enterprises to establish a new local SOE and set forth additional regulations for the state-owned Trepča Mine. The authorities report that there are plans to further amend this law, with parliamentary consideration of new amendments foreseen in 2021. The planned amendments span a wide range of issues, including developing a state strategy for SOEs; board member nomination, duties, remuneration and sanctions; strengthening SOE financial and operational reporting; and criteria for the mandatory restructuring of SOEs.

The government does not currently have any announced plans to **privatise** any of the 17 SOEs under the MEE. It had previously announced its intention to privatise Kosovo Telecom in 2019, but this did not take

place and the authorities report that its performance will need to improve prior to privatisation to increase its attractiveness to potential investors.[49] Separately, PAK maintains a portfolio of over 500 formerly socially owned enterprises, for which privatisation or liquidation efforts continue. PAK is an independent public institution established in 2008 as the successor to the former Kosovo Trust Agency. It is mandated to privatise enterprises primarily through corporate spin-offs and/or liquidation.[50] According to the legislation establishing PAK, many of the enterprises under its remit are subject to conflicting ownership claims. PAK is legally tasked with ensuring that any individuals claiming to hold ownership or creditor rights in the enterprises receive due process and, as relevant, adequate monetary compensation.[51] Concerning the legislative framework for the potential privatisation of the 17 SOEs under the MEE, the Law on Publicly Owned Enterprises regulates the process, notably requiring the establishment of a government commission for privatisation. The commission is not a standing body, but rather established if the government adopts plans to privatise any of the 17 centrally managed SOEs, which it has reportedly not done in the past few years.

### *The way forward for state-owned enterprises*

SOEs operate at the nexus of the public and private sectors, and their operations are affected by both the quality of public governance and the prevailing corporate and boardroom culture. As is the case in most Western Balkan economies, ensuring that SOEs in Kosovo operate efficiently, transparently and on a level playing field with private companies will necessitate reforms in multiple policy areas that cannot be undertaken all at once. Choosing the appropriate sequencing of reforms is just as important as their content, and largely depends on the domestic political climate and current reform priorities.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[84]) provide a guidepost for reforms that the authorities of Kosovo can use to inform their policy efforts in this domain. Based on the state of play of SOE policy development in Kosovo, the following priority reform areas – which are in line with OECD guidelines – could offer a basis for discussions with the authorities:

- **Update the state ownership policy.** The state ownership policy was drafted in 2008 and has not been updated since. The policy contains several sound principles to underpin professional state ownership practices, but it is unclear how well public authorities and SOEs have implemented its principles. The state should assess implementation of the ownership policy and use the results of this assessment to inform an update of the policy, in consultation with all relevant government bodies. In line with the OECD guidelines, the ownership policy should clearly articulate the rationales for state ownership of commercial enterprises, outline the state's role in the governance of SOEs and define the respective responsibilities of all state bodies involved in its implementation. Key elements of Norway's ownership policy, as outlined on the state's website, are provided in Box 22.5 as an example.
- **Ensure that SOE board member recruitment is transparent and merit based.** While the state has established a general framework for SOE board nominations, which involves setting up SOE-specific "recommendation committees" to lead recruitment procedures, the criteria applicable to the recruitment of individual board members are not transparent. There is a perception that SOE board seats are often not accorded based on merit, pointing to shortcomings in the criteria used and/or the transparency of the process. Strong qualifications criteria are necessary to ensure that SOE boards are equipped with the right mix of professional competencies to effectively oversee corporate strategy, with a view to maximising their commercial efficiency. The authorities could also consider the use of professional staffing agencies to improve the efficiency and professionalism of the process.
- **Strengthen monitoring and reporting on SOE performance.** Kosovo has established a sound mechanism for developing a central overview of the financial performance of SOEs through the POE Monitoring Unit's collection of SOE annual financial statements. The functions of the POE

Monitoring Unit could be expanded to include more in-depth reviews of individual SOE performance, with a view to identifying the structural weaknesses limiting their efficiency. The results of such in-depth assessments could also be made public to strengthen accountability and incentivise improvements. The two recent public audits of Trainkos' and Kosovo Telecom's financial statements, which resulted in qualified opinions that the statements did not present a fair and accurate view of the financial situation, point to weaknesses in the quality and credibility of SOE financial reports. The authorities should take steps to address these weaknesses so that SOE financial reports can be relied upon to for identifying structural shortcomings that hold back SOE performance.

### Box 22.5. Norway's state ownership policy

The website of the Norwegian Government provides clear information to the public on the state's policy positions regarding state ownership, including explanations of why the state owns enterprises, what its portfolio contains and how state ownership is exercised by public authorities. Excerpts from the website are provided below:

- **Why the state is an owner**: "The Government believes that private ownership should be the main rule in Norwegian business and industry. The state should only have ownership interests in companies when this is the best means of meeting the state's needs."
- **What the state owns**: "The state has direct ownership, managed through the ministries, in 72 companies. […] The state regularly assesses the rationale for its ownership and its goal as an owner in each company, to ensure that they are updated and relevant, and to help the state to efficiently solve different tasks or safeguard different needs."
- **How state ownership is exercised**: "The Government's ambition is that the Norwegian state's exercise of ownership shall be in accordance with best international practice […] Together, the state's principles for good corporate governance and the state's goal as an owner form the basis for how the state exercises its ownership. The key elements of the framework for the state's exercise of ownership – about which there has been a broad political consensus over time – are included in the state's ten principles for good corporate governance."

Source: (Norwegian Ministry of Trade, Industry and Fisheries, 2020[88]), *State Ownership*, https://www.regjeringen.no/en/topics/business-and-industry/state-ownership/id1336/.

## Education policy (Dimension 7)

### *Introduction*

Table 22.11 shows Kosovo's scores for the four education policy sub-dimensions and the cross-cutting dimension on system governance, and compares them to the WB6 average. Kosovo has the highest score (along with Serbia) of the WB6 economies for the early childhood and school sub-dimension, driven by its above-average ratings for the indicators on early childhood education and early school leaving prevention. It also scores highest (along with North Macedonia) for the system governance cross-cutting dimension. However, it scores below the WB6 average for the sub-dimension on teachers.

**Table 22.11. Kosovo's scores for education policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 3.5 | 3.0 |
| | Sub-dimension 7.2: Teachers | 2.3 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 3.3 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 2.8 | 2.8 |
| | Cross-cutting dimension: System governance | 4.0 | 3.3 |
| **Kosovo's overall score** | | **3.2** | **3.0** |

### *State of play and key developments*

Kosovo has several well-designed education policies that are similar to many European and OECD economies, including a sophisticated system for reducing early school leaving, and learning standards for each level of pre-university education. While Kosovo's education policy scores have remained generally stable since the 2018 Competitiveness Outlook, there have been some improvements in specific sub-dimensions. Kosovo's overall performance is slightly above the regional average in the education policy dimension (Table 22.10), but there are signs that policy implementation remains a major challenge. Data on the education system are very limited compared to other Western Balkan economies. Moreover, student learning outcomes in Kosovo, as measured by PISA, remain low, and a significant share of students do not achieve baseline proficiency levels in reading and mathematics (OECD, 2020[89]). Considering that Kosovo has one of the youngest populations in Europe, strengthening the education system will be crucial if future generations are to support the economy's long-term development and competitiveness.

Similar to economies around the world, Kosovo was faced with a rapid shift from classroom to remote learning in 2020 to help slow the spread of COVID-19. Working with donor agencies, including Microsoft, UNICEF and Save the Children, Kosovo's government introduced distance-learning opportunities for each education level. In the area of early childhood education it launched the online platform, Distance Education – Care, Development and Early Childhood Education for 0-6 year-olds, in April 2020. The platform provided learning and information materials for educators and parents, as well as guidance on how to explain the COVID-19 pandemic to children. To leverage the platform's potential, MEST, in co-operation with UNICEF, organised online training that reached 1 543 educators working in preschool institutions and at the pre-primary level across Kosovo. For the reopening of preschools, MEST, in co-operation with donors, issued the "Protocol for facilitation measures to resume the work of preschool institutions in Kosovo". Even after preschools reopened, the Distance Education platform continued to be active, and its content has also been broadcast on radio and television since October 2020 to provide equal access to all children at the pre-primary level.

Beyond the preschool level, Kosovo rolled out the online Learning Passport, which has provided digital curriculum materials and open-source content to support and guide learners. Other organisations working in Kosovo have also introduced initiatives to address the educational challenges presented by the

pandemic. For example, the Organization for Security and Co-operation in Europe started a project to train teachers on how to support the mental health of students during the crisis.

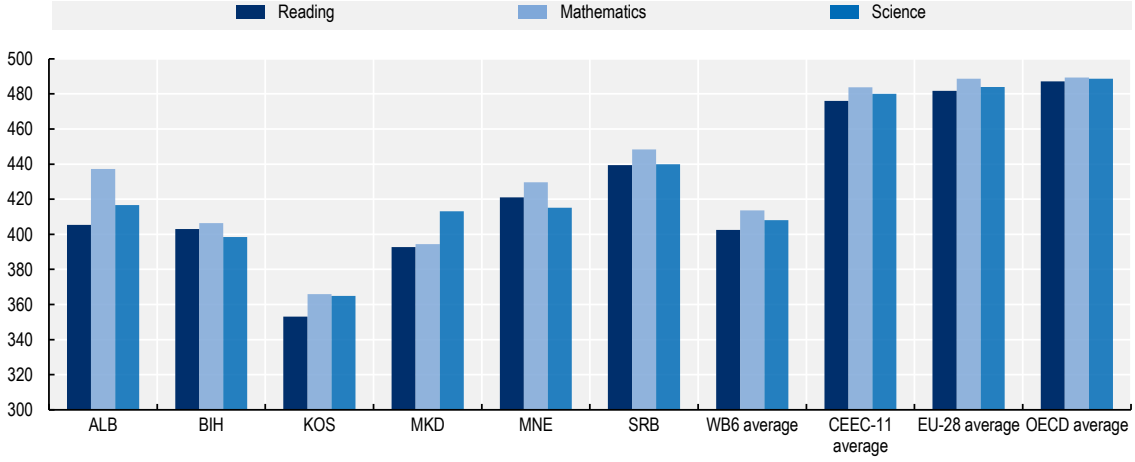
### *Sub-dimension 7.1: Early childhood and school education*

Kosovo's score in this sub-dimension is slightly above the Western Balkan average, largely because of its policies to address early school leaving. Since the last CO assessment, Kosovo has made progress in implementing new Early Learning and Development Standards for children aged 0-6, and developing infrastructure to better monitor and respond to early school leaving. Although internationally comparable data on Kosovo's education system are limited, the economy reports universal participation in primary education. However, the share of students enrolled in lower secondary and upper secondary education has been decreasing over recent years, and in 2018 was 90.5% and 86.8%, respectively. This trend is similar to what is observed in other WB6 economies.

In terms of learning outcomes, Kosovo's average performance is much lower than other Western Balkan and European economies (Figure 22.12). Only 21% of students in Kosovo attained baseline levels of proficiency in reading, compared to the OECD average of 77% (OECD, 2020[89]). This share was similar in mathematics, where 23% of students achieved at least baseline proficiency, compared to the OECD average of 76%. These findings suggest that there is a significant learning crisis in Kosovo that is not being addressed by the economy's well-designed education policies. These results also have implications for Kosovo's long-term development, as students without basic skills are less likely to attain better paying and more rewarding jobs. However, it is positive that Kosovo has managed to maintain performance levels in reading and mathematics across PISA cycles[52] while simultaneously increasing its coverage index by 13 percentage points[53] (OECD, 2020[90]).

## Figure 22.12. Performance in reading, mathematics and science in Western Balkan education systems (2018)

PISA 2018 mean scores




Note: CEEC: Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (OECD, 2020[89]), *PISA 2018 Database, Tables I.B1.4, I.B1.5 and I.B1.6*, www.oecd.org/pisa/data.

StatLink https://doi.org/10.1787/888934255741

Kosovo's performance in the **early childhood education** indicator is above the regional average. There is a strong strategic framework for early childhood education (ECE) with clear objectives, and an implementation timeline and budget that aims to increase inclusion and participation at this level of education. The sector is also recognised as a core element of Kosovo's broader development strategy, and there is a high level of engagement by international donor agencies. Kosovo's Early Learning Development Standards for children aged 0-6, which describe expectations for child behaviour and

performance in different areas of development and learning, is a key strength of the system, and there is some variety in the data available to monitor and evaluate the sector. However, data on ECE staff are limited, making it difficult to support ECE educators and therefore improve the quality of provision. Despite an impressive ECE policy framework, Kosovo reports that as of 2018/19, the gross enrolment ratio of children in early childhood education and development (International Standard Classification of Education, ISCED, level 0) was only around 20%. While this is slightly lower than North Macedonia's reported enrolment rate (24%), other Western Balkan economies with available data reported at least 48% enrolment at this level. Research suggests that Kosovo's low levels of ECE participation are in part caused by the inadequate number of public kindergartens, which are distributed unevenly across the economy, and a limited number of subsidised ECE places for children from vulnerable groups (UNICEF, 2017[91]). At the time of this review, Kosovo was revising its Law on Early Childhood Education, which is expected to help make ECE more inclusive.

The **instruction system**[54] in Kosovo performs slightly below the regional average, despite several positive policy features. For example, the Quality Assurance Strategy for Pre-University Education 2016-20 sets out objectives for improving educational quality and equity with clear and measurable targets, allocations of responsibilities, and a budget and timeline for proposed activities. However, there have been no comprehensive evaluations of the entire instructional system. Since 2016, Kosovo has been implementing a competency-based curriculum framework and core curriculum, which describe learning standards. Kosovo uses a combination of continuous, formative and summative classroom assessments, in addition to external examinations, to assess students against the curriculum. External examinations are administered to students at the end of lower secondary education (Grade 9) for selection into either general or vocational pathways, and at the end of upper secondary (i.e. the Matura in grade 12) to certify the completion of upper secondary school. Positively, Kosovo is developing a centre for assessment that will become responsible for managing all central-level assessment instruments. The development of this centre would align with many OECD countries and other education systems in the region that have specialised bodies to manage student assessments.

Kosovo has a strategy for quality assurance in school education, and the curriculum framework sets out a list of indicators for measuring teaching and learning. These indicators are monitored by municipal and regional inspectors and by school directors, who mainly have managerial and administrative responsibilities. Although Kosovo has established processes for external school evaluations, there does not seem to be a clear set of school quality standards. In many OECD and European education systems, these standards define the vision and dimensions of quality schooling and serve as the main reference for evaluation (OECD, 2013[92]). Without such standards, it may be difficult for actors in Kosovo to identify the strengths and areas of improvement for individual schools.

Kosovo has sophisticated systems to tackle **early school leaving.** These have contributed to a decline in the early school leaving rate from more than 18.4% in 2013 to 9.6% in 2018, thus achieving the EU target of less than 10% by 2020 (Eurostat, 2021[93]). While Kosovo does not have a specific strategy for early school leaving, several policies and initiatives to address the issue include work plans developed and reviewed every two years to support schools and municipalities in dealing with dropouts. There are also targeted initiatives to support students at risk of early leaving, such as needs-based scholarships for upper secondary school, career guidance programmes and efforts to engage parents and other actors. Kosovo also collects a range of information about early school leaving and its contributing factors, which is centrally stored within the Education Management Information System (EMIS). Since 2017, the EMIS system has included an early warning system of abandonment, and in 2019/20 Kosovo introduced a rewards system to encourage schools to report data accurately. Kosovo analyses its early school-leaving data to inform policy decisions. For example, students transferring from one school to another made it difficult to track attendance and other early school-leaving factors. In response, the government has started changing the procedures around school transfers so that this does not create a problem for tracking early school leaving.

### *Sub-dimension 7.2: Teachers*

Kosovo's score in the sub-dimension on teachers is slightly below the average for Western Balkan economies (Table 22.11). While there are a number of administrative instructions and laws that regulate initial teacher education and their professional development and management, data on the profession are very limited and it is difficult to determine the extent to which policies have been implemented. As a result, Kosovo was unable to provide data on the educational background and experience of practising teachers.

Despite the challenges of collecting data on teachers, Kosovo is building the legislative framework to strengthen **initial teacher education (ITE)**. There is an accreditation process for ITE programmes based on professional teacher standards, which are defined by the Teachers Professional Development Strategy 2017-2021 and the curriculum framework. This means that ITE providers must demonstrate how their programmes help candidates develop the specific competencies needed to teach. In 2018, Kosovo also introduced a new administrative instruction that requires new teachers to complete an internship during their studies, pass a professional examination and complete one year of work in a school (i.e. a probation period). Following the successful evaluation by the school director, they can officially be contracted as a teacher. While these are positive practices found in many European education systems, Kosovo does not have minimum entry requirements for selecting ITE candidates, and there are no targeted efforts to recruit teachers into the profession.

Kosovo's clear strategy for the **professional development and management** of teachers defines the standards of the teaching profession and breaks down the competencies required at different stages of the teaching career. The 2017 administrative instruction on the licensing system and teacher development sets out a progressive career structure linked to financial incentives. There are four categories of licensed teacher in Kosovo: career teacher, advanced teacher, mentor teacher and merit teacher. The categories (depending on the level) consider years of work experience, professional development requirements and passing an appraisal process. While there is some variety in the type of professional development activities and programmes available in Kosovo, there are no observations or visits to other schools or professional learning networks/communities. Moreover, there is evidence that Kosovo's budget allocation for professional development is insufficient, and that the uneven implementation of relevant policies has not contributed to improvements in the quality of professional development, nor to a "change in teachers' approaches to their professional practice" (Mehmeti, Rraci and Bajrami, 2019[94]). It will likely be difficult for Kosovo to improve teaching practices without more comprehensive and meaningful evaluation and support to help teachers improve.

### *Sub-dimension 7.3: Vocational education and training*

Kosovo's score in the sub-dimension on vocational education and training (VET) is similar to the Western Balkan average (Table 22.11). Professionally oriented education typically starts in upper secondary school, when students are allocated into either a general (gymnasium) or vocational or professional school. Kosovo's VET system is organised by specialised profiles, but there are general concerns that these do not align with labour market needs (World Bank, 2019[95]). Available data suggest that enrolment in VET has increased in Kosovo in recent years, and as of 2017/18 the majority of upper secondary students (53%) attended VET schools (Kosovo Agency of Statistics, 2021[3]). While caution should be used when comparing different data sources, international data suggest that VET participation in Kosovo is much higher than Western Balkan (29%), EU (27%) and OECD (23.5%) averages (UIS, 2020[96]). Similar to other economies, data from PISA 2018 found that boys are more likely to attend vocational programmes than girls in Kosovo (OECD, 2020[89]).

A range of public bodies are responsible for the **governance of VET** in Kosovo, which is guided by the Kosovo Education Strategic Plan 2017-2021 and the broader development strategy (2016-21). Key institutions include the MEST, the Agency for Vocational Education and Training and Adult Education,[55] the National Qualification Authority,[56] the Council of Vocational Educational and Training and for Adults

(CVETA), as well as municipalities and VET schools that implement policy decisions on VET. Social partners participate in the advisory boards of the central VET agencies and participate in drafting standards, curricula and teaching materials. While legislative acts regulate the roles of various VET actors in this complex governance system, there is occasionally overlap in the allocation of responsibilities. To ensure the quality of VET, Kosovo has clear processes for accrediting VET programmes, and providers are subject to regular evaluation and inspection. Although the government collects information on the completion rates of VET programmes, Kosovo did not report having information on employment rates, hiring after work-based learning or the earnings of VET graduates. As a result, Kosovo cannot undertake analysis to provide adequate career guidance and support learners in making informed decisions about their futures.

Kosovo's comprehensive education strategy identifies harmonising the VET system with labour market requirements as one of seven strategic objectives. It recognises the importance of **work-based learning** (WBL) by calling for "all students…to carry out practical learning in school and professional practice outside the school" (MEST, 2016[97]). Kosovo's new curriculum framework sets out the amount of WBL for each grade level. An administrative instruction for WBL also provides guidelines for VET schools and companies on the implementation of WBL, quality assurance and safety standards. In April 2020, the government raised the budget for VET to cover the costs of equipment, insurance and travel for students in an effort to encourage participation in apprenticeships and other forms of WBL. The MEST and municipal education directorates provide scholarships for women and socio-economically disadvantaged students to encourage their participation in WBL, with 140 women supported through these scholarships in 2020. Kosovo uses broad public awareness campaigns, presentations to social partners and companies, and dedicated career placement services to help match learners with WBL places. There are also online portals listing WBL opportunities. Although these are positive features, donor agencies continue to play an important role in developing and implementing Kosovo's WBL policies, and there is limited data to monitor participation and the outcomes of programmes.

### *Sub-dimension 7.4: Tertiary education*

Kosovo's score in the tertiary education sub-dimension is on par with the Western Balkan average (Table 22.11). Despite having several institutional bodies and policies that support the two respective qualitative indicators in this sub-dimension (equitable access to higher education, and labour market relevance and outcomes of higher education), the transition between education and the labour market remains a significant challenge. For example, Kosovo has the highest share of youth (aged 15-24) who are not in employment, education or training (NEET) among Western Balkan economies, around 33% as of 2019 (ETF, 2020[98]). The share of the labour force (aged 15+) who have attained some form of tertiary education (ISCED 5-8) is around 27%, similar to other economies in the region (ETF, 2020[98]). While individuals with higher levels of education and skills are more likely to be employed, Kosovo has one of lowest formal employment rates in the world, and women are especially at risk of having limited opportunities – see Employment policy (Dimension 8).

Some policies promote **equitable access to higher education** in Kosovo, and the Law on Higher Education requires that all students who wish to study at this level receive equal access to opportunities (Official Gazette of the Republic of Kosovo, 2011[99]). There are transparent processes for selection into higher education,[57] and scholarships are available for students who earn high grades or who represent certain categories (e.g. students with disabilities, veterans). However, there are no incentive mechanisms in place to encourage institutions to enrol these groups of students. Some data on equity in the tertiary sector are collected through Kosovo's System for Information Management in Higher Education platform, such as enrolment and completion by age, gender and minority background. However, there are no proxies for socio-economic background, and challenges remain regarding the participation of Roma and Egyptian students. Moreover, no evaluation or analysis has been undertaken to identify associations between student factors and higher education participation.

Kosovo's current education strategy addresses the **labour market relevance and outcomes of higher education**. There are already mechanisms in place that help increase the labour market relevance of higher education, such as career guidance in higher education institutions (HEIs), scholarships for in-demand programmes and communication/awareness campaigns to inform prospective students about study options. Kosovo also has several initiatives to support the internationalisation of higher education, such as participation in the EU Erasmus Plus programme and grants for students who wish to study abroad. Several public agencies collect data on the labour market and higher education system using surveys of employers and graduates, quantitative forecasting models and sector studies. Moreover, Kosovo's Employment Agency, supported by international donors, recently set up the Kosovo Labour Market Barometer, which centralises data from 12 different public institutions and makes it publicly available in an online portal.[58] While there are no data on employment rates by field of study, and labour market information is not yet used to inform curriculum design, the Labour Market Barometer plans to start connecting labour market data with information from higher education institutions. This tool has the potential to support sector analysis that could help improve the quality and relevance of Kosovo's higher education system. Currently, quality assurance is regulated by law and the Kosovo Accreditation Agency, which uses EU standards and practices such as requiring HEIs to monitor and review their programmes to ensure that they achieve set objectives and respond to the needs of students and society.

#### *Cross-cutting dimension: System governance*

Kosovo's score for this cross-cutting dimension is slightly above the Western Balkan average, as several of the economy's **system governance** features align with policies and practices found in European and OECD education systems. For example, there is a clear and comprehensive education strategy (and accompanying action plan) that was developed in consultation with stakeholders and that covers all levels of education. Importantly, this strategy has been evaluated, and there are technical reports on the overall system and thematic issues. While there has also been some independent research and analysis on Kosovo's education system, this has mostly been led by donor agencies. Another strength of Kosovo's system governance is the Kosovo Qualification Framework, which was developed in line with the European Qualification Framework. The economy also has a clear indicator framework for monitoring the education system, and donor agencies are working with the government to strengthen Kosovo's EMIS. This system includes information on student learning outcomes available through participation in international assessments and economy-level exams. However, Kosovo does not have a system-wide standardised assessment to measure student performance, unlike many Western Balkans economies which have either established one or are in the process of doing so. Despite some positive features of system governance, Kosovo has struggled to improve teaching practices and learning outcomes, suggesting that the implementation of these well-designed policies may be an issue.

### *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education can help Kosovo increase its regional competitiveness and create opportunities for more individuals to develop the competencies needed for sustainable development and social cohesion. The government will need to reflect on the economy's political, social and fiscal environment to determine how best to achieve Kosovo's education goals. The following considerations can provide insights for discussions on the way forward to enhance education:

- **Strengthen data collection and management across the system**. Kosovo is already working with international partners to strengthen the interoperability of EMIS, but there is a clear need for more rigorous, timely and comparable data on the education system. To this end, it is important that Kosovo continues participating in large-scale international surveys that generate valuable comparable data, and establishes protocols for mapping and defining indicators and co-ordinating

data collection among public agencies (to avoid overlap across the government). The education information system in Estonia could be a useful example for Kosovo to explore (Box 22.6).

- **Improve evaluation and reporting on the education system**. Although Kosovo already publishes an annual statistical report on the education system, the government should consider producing an analytical state of education report. This report should be published regularly and draw on data from the improved EMIS, which would support the monitoring of education legislation and policies at all levels of the system. These analyses and reporting practices would help hold education actors accountable for achieving Kosovo's education goals.
- **Continue to develop and refine teacher policies**. Kosovo has already taken steps to strengthen the teaching profession by introducing new requirements for initial teacher preparation and reforming the teacher licensing processes. However, it will be important to monitor the implementation of teacher policies and refine them if necessary to improve the quality of teaching and learning. Importantly, Kosovo will also need to ensure adequate and sustainable funding to support reforms to teacher preparation and professional development.

### Box 22.6. The Estonian Education Information System

Estonia is known for having a sophisticated digital civil registration system. Most of the country's public services are available online, and even voting can be done through a secure digital identification process available for all citizens via their national identity card, a mandatory document that establishes a person's identity. This personal identification system is also used in the education sector. As a result, the web-based Estonian Education Information System (EHIS) is able to link all education databases with each other and with over 20 different information systems across the economy, such as the Population Register (used for example, to calculate the number of out-of-school children) and the Estonian Examination Information System.

The EHIS follows clear guidelines about how information can be accessed and presented, which helps protect personal and statistical data from being misused. In particular, access to the EHIS requires registered authorisation. Only individuals performing a duty prescribed by law that requires information from the database are able to access personal information about students, teachers and school staff. To obtain approval, individuals must submit a written application to the Ministry of Education setting out what data they require and how they intend to use it. These features enable the EHIS to serve as an important tool for monitoring and guiding policies in Estonia's education system.

Source: (e-Estonia, n.d.[100]), *Education, e-Estonia*, https://e-estonia.com/solutions/education/; (Lao-Peetersoo, 2014[101]), *Introduction of Estonian Education Information System (EHIS)*, http://www.oecd.org/education/ceri/Birgit%20Lao-Peetersoo_Introduction%20to%20the%20Estonian%20Education%20Information%20System%20EHIS.pdf; (Abdul-Hamid, 2017[102]), *Data for Learning: Building a Smart Education Data System*, http://hdl.handle.net/10986/28336.

## Employment policy (Dimension 8)

### *Introduction*

Limited progress has been made to align labour market regulation, including laws on occupational health and safety, with EU directives. The implementation of the labour law and occupational health and safety (OHS) legislation, as well as the framework for the work of labour inspectorates, remains deficient, and the capacity of labour inspectorates still needs to be increased. More progress is needed to reduce the high levels of skills mismatch and to develop and implement an adult education system. Very limited progress has been made in the area of bilateral and tripartite social dialogue, and the low minimum wage has remained unchanged. Introducing a comprehensive social security system is still on the agenda, and progress needs to be made in the reform process. Limited progress has been made to address the extremely high gender employment gap and facilitate women's labour market access. Important progress in the area of employment policies has been made by setting up public employment services in 2017. However, limited progress has been made to strengthen their capacities and enhance the level and scope of targeted ALMPs to have a sizeable impact on reducing unemployment and bringing vulnerable groups into work.

Table 22.12 shows Kosovo's scores for the four employment policy sub-dimensions, and compares them to the WB6 averages. Kosovo scores below the regional average in all four employment policy sub-dimensions, leading to a dimension score below the WB6 average. There has been a very limited increase in the score compared to the last assessment (Figure 22.1), showing the need for more progress in this policy dimension.

### Table 22.12. Kosovo's scores for employment policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 1.8 | 2.6 |
| | Sub-dimension 8.2: Skills | 1.0 | 2.2 |
| | Sub-dimension 8.3: Job quality | 1.5 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 2.0 | 2.9 |
| **Kosovo's overall score** | | **1.6** | **2.6** |

### *State of play and key developments*

### Table 22.13. Key labour market indicators for Kosovo (2015 and 2019)

| | Kosovo | | WB6 average | EU average |
|---|---|---|---|---|
| | 2015 | 2019 | 2019 | 2019 |
| **Activity rate (15-64)** | 37.6% | 40.5% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 25.2% | 30.1% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 32.9% | 25.7% | 16.3% | 6.4% |

*Note*: WB6 average rates are based on author's own calculations using simple averages.
Source: (Kosovo Agency of Statistics, n.d.[103]), Labour Market Yearly Indicators, https://askdata.rks-gov.net/PXWeb/pxweb/en/askdata/askdata__Labour%20market/?rxid=c3e44c2e-1aff-4e4a-b55b-2ca64a485a50; (Eurostat, n.d.[104]), Labour Force Survey data base, https://ec.europa.eu/eurostat/web/main/data/database.

Between 2015 and 2019, the working-age population (15-64 years old) rose by 9.4%[59] and the number of young people entering the labour market every year increased (Government of Kosovo, 2017[105]). As seen in Table 22.13, the activity rate of the population aged 15-64 increased from 37.6% in 2015 to 40.5% in 2019 (Kosovo Agency of Statistics, 2020[106]). Between 2015 and Q2 2019, the strongest increase in activity rate was recorded among young people (15-24) and older people (55-64). The activity rate of older workers increased strongly between 2015 and 2017 (by nearly 6 percentage points), but fell by 3.4

percentage points between 2017 and Q2 2019, possibly as a result of the Law on War Veterans passed in 2016 (WIIW and World Bank, 2020[107]).

In 2019, the activity rate in Kosovo was still far below the EU average and the 71.2% average of five Eastern and South East European transition economies that could serve as peer economies (Bulgaria, Romania, Hungary, Slovenia and Croatia). The employment rate increased from 25.2% in 2015 to 29.8% in 2017, and has risen only slightly since then, reaching 30.1% in 2019 – the lowest in the region and far below the WB6 average and the EU average (Eurostat, 2020[108]). Between 2015 and 2019, the employment rate rose among all age groups, driven by employment growth in the wholesale and retail trade sector, the construction industry and agriculture.[60] The unemployment rate fell steadily from 32.9% in 2015 to 25.7% in 2019 (with a marked drop between 2018 and 2019 of 3.9 percentage points). However, as the employment rate only rose by 1.3 percentage points during this period, this implies that people exited unemployment either for inactivity or migration.

Estimates on the basis of the Labour Force Survey (LFS) show that the employment rate fell from 29.1% in the first quarter of 2020 to 24.1% in the second quarter. Employment growth resumed in the third quarter, with the employment rate reaching 30.1%. The unemployment rate increased from 25% in the first quarter of 2020 to 27.2% in the second quarter, and fell to 24.6% in the third quarter. Variations in the employment rate have thus had a bigger impact on inactivity than on unemployment (Kosovo Agency of Statistics, 2020[109]).

The number of registered jobseekers rose noticeably between March 2020 and May 2020, from around 120 000 to 187 000, and continued to rise to 201 000 in October 2020, according to administrative data. This increase is caused by expected benefit receipts linked to the COVID-19 pandemic and the discrepancy between the recording of LFS unemployment and registered jobseekers, indicating a possible misuse of benefits. The government guaranteed that all individuals who lost their jobs due to COVID-19 would receive monthly payments of EUR 130 from April to June 2020. All payments to social welfare recipients were planned to be doubled during April and May.

Support was also available for private sector activity and employment. Eligible firms received EUR 170 a month for each employee on their payroll for March and April 2020, as well as EUR 206 for each new employee hired on a minimum one-year contract during the crisis. Wage supplements were paid during the crisis by the government to vital health and safety personnel such as doctors, police officers and firefighters (EUR 300 per month in additional wages), and to workers in pharmacies, grocery stores and other essential businesses (EUR 100 per month in additional wages). By 11 May 2020, over 170 000 workers had applied for salary compensation, unemployment benefits and other social welfare measures included in the emergency fiscal package (OECD, 2020[29]).

A scheme to regularise informal employment has been established. To help transform undeclared work into declared work, employers who voluntarily disclose to state authorities that they previously employed unregistered employees are provided with access to the short-term financial assistance available during the 2020 coronavirus pandemic if they employ the workers on a declared contract of at least one year. By May 2020, formal employment had increased by 2.6% (Williams, 2020[110]). While these are initial indications that the regularisation scheme may be effective, misuse has been reported, and it may take time until more unregistered enterprises are convinced to participate in the scheme.

The economic recovery plan, approved in August 2020, allocates EUR 365 million to support businesses, create jobs and stimulate aggregate demand. Out of this budget, the government allocated EUR 67 million to increase employment, with a specific focus on groups of workers with a lower probability of finding employment during the crisis. Firms can receive subsidies covering 50% of their rental expenses and access professional support to help them operate effectively during the pandemic, including guidance on moving operations online, working from home and digitising key business practices. The plan also foresees that citizens can withdraw up to 10% of their pension trust contributions for a period of four months,

although this may not have a big impact on income as the rate of people employed in the formal economy is very low (OECD, 2020[29]).

### *Sub-dimension 8.1: Labour market governance*

Regarding the **regulatory framework** in Kosovo, the current Law on Labour was first prepared in 2010. The level of transposition of EU directives is only partial, and the European Commission has stressed the need to undertake more efforts in this area (European Commission, 2019[111]). In 2018, the Ministry of Labour and Social Welfare (MLSW) prepared new draft laws on labour and on maternity and parental leave, which transpose 17 EU directives.[61] The drafts had not been adopted at the time of writing.

According to the current labour law, non-standard forms of work include fixed-term employment contracts and contracts for specific tasks (up to 120 days a year). Employees for specific tasks do not enjoy various rights, such as annual leave. The new labour law proposes several other forms of employment contract, such as temporary agency work contracts and contracts/agreements on specific tasks.

The share of workers on temporary contracts (including contracts for specific tasks) is extremely high in Kosovo, although it fell from 72% in 2015 to 60.5% in 2019, which is still largely above the WB6 average of 21.9% in Q2 2019 (WIIW and World Bank, 2020[107]) and the EU average of 13.6% (Eurostat, 2020[108]). As shown on the Labour Force Survey, individuals with temporary contracts were asked why they had this kind of contract, and 92% reported that there was no other contract type available. Only 5.3% of employees surveyed said that they had the right in their main job to benefit from the social security scheme at work (Kosovo Agency of Statistics, 2020[112]). In general, there is a link between a higher level of employment protection of permanent workers and a high share of less protected temporary workers. In 2016, the gap between regular and fixed-term contracts in the strictness of employment protection legislation was far higher in Kosovo than in the other economies in the region. Kosovo showed the lowest level of employment protection for fixed-term contracts (OECD, 2016[113]).[62]

The self-employment rate has slightly increased from 21.2% in 2015 to 22.4% in Q2 2019 (near the WB6 average of 23.1% in Q2 2019). Some 18.8% of employed persons were in “unstable employment”, according to Labour Force Survey data of the Kosovo Agency of Statistics. Unstable employment refers to workers in unstable jobs who are either self-employed without employees or who work without pay in a family business. These two groups of workers are vulnerable and are more likely to be informally employed than wage earners. Men are more likely to be in unstable employment than women (Kosovo Agency of Statistics, 2020[106]).

The social security system is not fully developed. Non-standard workers without an employment contract or with a contract for specific tasks are not covered by all branches of the social security system. The Concept Note on Pension Reform and Social Security was drafted in December 2018 but had not been adopted at the time of writing.

Kosovo’s legal framework for OSH covers to some extent specific areas regulated by EU directives, and progress has been made in this area in recent years. This progress needs to be built on to close the gap with the EU *acquis* (European Commission, 2019[114]).

The implementation of the labour law, OHS legislation and the framework for the work of **labour inspectorates** remains deficient, and no progress has been made to improve the work of labour inspectorates. According to the Law on Labour Inspectorate, labour inspectorates’ tasks include: 1) ensuring implementation of the labour law, conditions of work and protection at work; 2) providing technical information and advice to employers and employees on the most effective means of observing legal provisions; 3) notifying the Minister of Labour and Social Welfare or other competent authorities on any deficiencies in the applicable law; and 4) supplying information and advice to employers and employees on issues relating to the labour law and the protection of employees if an enterprise is reorganised or restructured. In practice, labour inspectorates mainly carry out inspections of workplaces, review

complaints and requests, carry out investigations of accidents at work, certify OHS experts and license OHS services. It is the key supervisory body regarding OHS, which means that its tasks also include the collection, processing, analysing and publishing of information in the area of employment relationships and safety and health at work. This information is gathered at the domestic, regional, sectoral and company and workplace level to investigate the causes of injuries and occupational diseases. Fines can be imposed in the range of EUR 500 to 35 000 for violations of the Law on Health and Safety at Work, and EUR 100 to 10 000 for violations of the Law on Labour; however, these fines appear to be rarely imposed. The Strategic Development Plan for Labour Inspectorates was established for the period 2017-2021 but there is no evidence that major measures have been taken to implement this plan.

There is no comprehensive monitoring system set up by labour inspectorates. There has been an increase in the number of fatalities related to workplace accidents, from 14 in 2017 to 21 in 2018, which points to weaknesses in preventing accidents and occupational diseases and investigating complaints (European Commission, 2019[114]). Fatal accidents happen mainly in the construction sector. The labour inspectorate does not follow up on these cases properly and there are concerns regarding the accuracy of data on workplace accidents and occupational diseases, and the under-reporting of fatalities. Available data also point to a poor record on detecting and combatting child labour. According to the latest data from April 2019, 10.7% of children in Kosovo, mainly from Roma and Ashkali communities, are involved in work, 6.8% of whom work in hazardous conditions. However, labour inspectorates have not reported a single case of minors engaged in work (European Commission, 2019[114]). The number of labour inspectors is low, although increased slightly in 2018 (European Commission, 2019[111]).[63]

As shown in an analysis of strengths, weaknesses, opportunities and threats (SWOT) included in the Labour Inspectorate Strategy 2017-2021, there is little trust in labour inspectorates and no awareness-raising activities to remedy their poor image or advocate for compliance with the law (Government of Kosovo, 2016[115]). Labour inspectors are mainly law graduates who receive little or irregular continuous training (depending on external funding) and whose working conditions are poor. The strategy identifies a risk of high staff turnover and other weaknesses including the lack of a work plan, action plans not being implemented, a lack of statistics, poor social dialogue and corruption. Inter-institutional co-operation is neither regular nor systematic. The strategy contains a number of planned measures to improve the capacities of labour inspectors and inter-agency co-operation;[64] however, there is no evidence of their implementation. In 2019, the Strategy for Prevention and the Fight against Informal Economy, Money Laundering, Financing Terrorism and Financial Crimes 2019-2023 was adopted. This also contains measures to improve the work of labour inspectorates (see Cross-cutting policy areas: Informality); however, there is no evidence that implementation has started. A new Law on Labour Inspectorates of Kosovo, which mainly concerns changes regarding OSH, was in the process of approval by the Assembly of Kosovo at the time of writing.

The **employment policy framework** comprises the Sectoral Strategy and Action Plan of the MLSW 2018-2022, the Action Plan for Youth Employment 2018-2020 and the Employment Policy 2019-2021, which defines the activities of Kosovo's public employment service (the Employment Agency of Kosovo, APRK). The Employment Policy also includes small measures to bring vulnerable groups into employment (in particular Roma, Ashkali and Egyptian communities, and women from rural areas). These groups are particularly vulnerable, and the unemployment rate in Roma and Ashkali communities is assessed to be above 90% (European Commission, 2019[114]). The members of these communities usually work in the informal sector and few are registered as unemployed.

The Sectoral Strategy of the Ministry of Labour and Social Welfare (2018-2022) addresses the lack of a complete and functional system of safety and health at work. There is a basic labour market information system[65]; however, there is no monitoring system for policy outputs. The MLSW is in the process of drafting a policy paper addressing OHS issues (intersectoral strategy).

There is a legal framework for **tripartite social dialogue** and collective bargaining in Kosovo. Several basic laws and sub-legal documents specify the nature and type of collective bargaining that can take place. Nevertheless, social dialogue is weak.

Workplace representation exists only in the public sector, except for a limited trade union presence in the private sector mainly in former public/socially owned enterprises. There is no other workplace representation (e.g. works councils) in Kosovo. Trade unions are not present at the company level (data for 2016, there is no new information). Two new initiatives (one in banking and one in the arts sector) were undertaken in 2016 to establish trade unions that also cover the private sector (Shaipi, 2017[116]).

The Union of Independent Trade Unions of Kosovo is the only trade union confederation in Kosovo. It is represented in the public sector, although healthcare and education have been formally disengaged from the confederation for some time. Progress has been made in these two sectors following a sector collective agreement signed between the Ministry of Health and the Federation of Health Trade Unions of Kosovo (FSSHK) in 2015 and 2018. A collective sectorial agreement was signed between the MEST and the United Trade Union of Education, Science and Technology. The first collective agreement was signed at the firm level between the Municipality of Kamenica and the United Science Education Union in 2019. Aside from these examples, collective bargaining occurs mainly at the economy level, and even there it is not representative. The Social Economic Council (SEC) meets regularly, but has been weak in terms of pushing forward its agenda effectively (see below) (SBASHK, 2017[117]) (FSSHK, n.d.[118]).

The general collective agreement signed by social partners in 2014 and negotiated at the SEC expired before it was fully implemented either in the public or social sector. The general scope of the collective agreement includes the establishment of labour relations; working hours and leave; salaries and other compensations for employees; contract terminations; and the rights and obligations of employers and employees, as well as conflict resolution between the two.[66] The agreement is largely not respected in the private sector. The most problematic aspect identified by businesses concerns the fact that permanent contracts will only be signed after an employee has successfully performed in a position for three continuous years. Another significant item is the inclusion of experience as a factor in annual salary increases that amount to 0.5% for every year of professional experience. In the private sector, this provision has barely been implemented and in the public sector it has not been well implemented as it affects the state budget.

The members of the tripartite SEC include five members of the Union of Independent Trade Unions (BSPK),[67] which has been criticised by consecutive EU progress reports for lack of representation.[68] Employers are represented by the Kosovo Chamber of Commerce (three members) and the Kosovo Business Alliance (two members). Representatives of five ministries are also members. The SEC is involved in negotiations regarding the minimum wage (no new agreement since the 2018 CO), the general collective agreement (no new agreement), amendments to the labour law, and reforms of the pension system and the law on SEC (Kosovar Stability Initiative, 2016[119]). Within the SEC there are five professional commissions that cover tripartite legislation; finance, economy and privatisation; salaries, prices and pensions; employment and vocational training; and the health and safety of the working environment. Although the SEC meets regularly, its influence is weak. Nevertheless, there have been some instances when the government has considered the requests of social partners (e.g. the establishment of a social security fund, as noted by the trade union confederation).

At the regional level, the FSSHK, which is the federation of health workers in Kosovo's public institutions, has established regional bodies that take part in Ministry of Health and MLSW working groups and play a significant role in social dialogue. It is one of the first unions bringing the dialogue to the grassroots (local) level. There are also various economic chambers at the regional level that are not represented on the SEC but that play a role in ministry working groups.

Consultations on new policies are generally conducted with all stakeholders, including social partners (employer and employee organisations) and civil society. Initially, individual meetings are held with key

stakeholders to present the ministry's objective for the proposed policy and the field of implementation. Workshops are then organised with larger groups, where written comments are accepted and at the end of the process a report is published with the justification for accepting or not accepting the comments (Government of Kosovo, 2011[120]; Government of Kosovo, 2016[121]).

So far, there have been no strategies or action plans addressing tripartism and social dialogue. However, the MLSW is in the process of drafting a Strategy for Tripartite Social Dialogue.

### *Sub-dimension 8.2: Skills*

Key indicators point to a significant **skills mismatch** in Kosovo. The extremely high youth unemployment rate (15-24 years old), at roughly 49% in 2019, indicates major problems in the school-to-work transition, even though the rate has been slightly decreasing in recent years (57.7% in 2015). The youth unemployment rate is largely above the WB6 average of 35.6%[69] and the EU average of 14.6% in 2018 (Eurostat, 2021[122]). Poor labour market outcomes for young people are linked to weaknesses in the education system, in particular the poor quality of education at all levels, the failure of educational programmes to meet market demand, and insufficient practical work in school and enterprises, which leads to a lack of practical experience and ties to employers. A lack of advice and career guidance leads to horizontal skills mismatches (Government of Kosovo, 2017[105]).[70]

The NEET rate among all 15-24 year-olds rose from 31.4% in 2015 to 32.7% in 2019, which represents a major labour market risk for these young people and is far above the 2018 WB6 average of 22.1%. The employment rate of low-educated individuals is extremely low according to Labour Force Survey data, at 11% in Q2 2019 (WIIW and World Bank, 2020[107]). This rate may even be underestimated as it probably does not consider the high share of informal employment, which is typically taken up by low-skilled individuals. Data show that the employment rate increases considerably with skill level. The employment rate of medium-educated individuals increased by 10 percentage points between 2015 and 2019, reaching 63% in Q2 2019. Between 2018 and 2019, employment growth in Kosovo was driven by the increased employment of low- and medium-skilled individuals, and the unemployment rate was highest among the low educated (34.2%) and lowest among the high educated (22.4%) (WIIW and World Bank, 2020[107]). Entering the labour market through informal employment is widespread as only slightly more than half (54.8%) of young people have an employment contract (Government of Kosovo, 2017[105]). Similar to some other economies in the region, Kosovo is participating in a project to develop skills mismatch indicators supported by the European Training Foundation (ETF), which will deepen insights on skills mismatches.

Despite the high unemployment rate, skills shortages hinder the growth of companies. According to the Skills Towards Employment and Productivity (STEP) employer survey conducted by the World Bank in 2015, 18% of employers indicated that a skills gap in general education was a major obstacle for business expansion, 22% noted gaps in technical and vocational education and training (TVET), and 36% identified gaps in workers' experience (WIIW and World Bank, 2020[107]). According to the same survey, more than half of hiring companies faced a skills problem. Horizontal skills mismatches are prevalent: there are popular professions that young people especially continue to aspire to that have abundant applicants, but a lack of professional institutions that provide training and education for professions in which jobs are available. For example, there is high demand for workers in the IT sector, yet a large number of students graduate from law school every year and cannot be absorbed by the labour market. In general, many job postings require computer skills as well as foreign language skills, which are lacking in Kosovo (Brancatelli, Marguerie and Brodmann, 2020[123]). Low pay in the private sector also discourages people from undertaking training and education in particular professions.

A basic **adult education** framework is in place. There was a Strategy for Adult Learning for the period 2005-2015, but it had no major impact. The staffing and infrastructure of adult learning institutions are inadequate, and learning content needs to be better adapted to labour market needs (Haxhikadrija, Mustafa and Loxha, 2019[124]).

The STEP household survey indicated that 37.3% of adults lack basic reading skills (well above the OECD average of 19.7%) (WIIW and World Bank, 2020[107]). Some learning programmes for remedial education (grades 6-9) and adult education programmes within VET schools are being developed and supported by international donors (Haxhikadrija, Mustafa and Loxha, 2019[124]). Some specific programmes are also being offered, such as "Literacy for women and girls" for Roma, Ashkali and Egyptian communities. However, developing an efficient and quality adult education system remains a key challenge. Most firms do not provide continuous training to their workers, according to the STEP employer survey (the situation is similar in Serbia, worse in Albania and better in Bosnia and Herzegovina). According to the World Bank study, on-the-job training is more common among firms that had problems hiring due to inadequate skills among applicants, larger firms, firms that invested in research and development, and foreign-owned firms (Cojocaru, 2017[4]). Progress has been made on offering training to unemployed individuals, however (see Sub-dimension 8.4: Activation policies). The Kosovo qualification system is being revised, which could serve as a framework for the recognition of prior learning (Alija, 2018[125]).

As in many European countries, SMEs in particular need support for upskilling their workers. Some good practice examples are given in Box 22.7.

### Box 22.7. Incentives for SMEs to train their employees, Belgium (Flanders)

In Belgium (Flanders), the SME Wallet (KMO-portefeuille) programme offers specific incentives to encourage SMEs to train their employees. It targets SMEs exclusively and is designed to help them grow and become more competitive through skills investments. The SME Wallet covers 30-40% of training costs, depending on the size of the enterprise. SMEs can apply for subsidies on line. Employers determine their own training needs, and there is no targeting element. A recent impact assessment determined that participating firms achieved higher growth than a control group.

Other countries have developed similar programmes targeting SMEs exclusively, including the Chèque Formation in Wallonia, Belgium; Profi!Lehre and Weiter!Bilden in Austria; the Consortium for HRD Ability Magnified Program (CHAMP) in Korea; the Industry Skills Fund in Australia; and the Formação-Ação in Portugal.

Source: (OECD, 2019[126]), *OECD Skills Strategy 2019: Skills to Shape a Better Future*, https://doi.org/10.1787/9789264313835-en.

### *Sub-dimension 8.3: Job quality*

Real wage development has been moderate in recent years. While labour productivity declined in 2016 and 2017, it grew in 2018. This meant that unit labour costs increased in 2016 (+9.2%) and 2017 (+5.2%), but fell in 2018 (-1.6%) (WIIW and World Bank, 2020[107]). Breaking the low wage/low productivity cycle is a major challenge.

A minimum wage set at a moderate level may be a good tool to raise wages at the bottom of the wage ladder, and can prevent poor **quality earnings** (OECD, 2018[127]). In Kosovo, the minimum wage is low compared to average gross wages, and thus likely has little impact. At the beginning of 2019, the minimum wage amounted to 28% of average monthly wages, by far the lowest rate in the region (WIIW and World Bank, 2020[107]). For comparison, in 2019 minimum wages were 40% of gross wages on average in Austria, Bulgaria, Croatia and Hungary (WIIW and World Bank, 2020[107]). The minimum wage for employees over the age of 35 is EUR 170 a month, while for those under the age of 35 it is EUR 130. The minimum wage is below the average wage paid in the agricultural sector, a sector in which wages are usually low (Government of Kosovo, 2011[128]). In contrast to other economies in the region, the minimum wage has not increased since 2011, although the Government of Kosovo is supposed to define a minimum wage at the end of every calendar year based on SEC proposals. It is questionable whether the minimum wage has significant coverage among formal employment, but data are not available to confirm.

The highest wages in Kosovo are paid in the state-owned enterprise sector, while the lowest wages are in the private sector.[71] In private companies, workers have longer working weeks (45.8 hours) on average than in the government sector (35 hours) and in state-owned enterprises (39.2 hours). Some 31.4% of respondents to the 2019 Labour Force Survey reported to sometimes work on Sundays, while 6% reported to do so usually (Kosovo Agency of Statistics, 2020[106]). The low wages and poor working conditions in the private sector quite likely push workers to seek employment in the public sector or abroad, which exacerbates the skills shortage in the private sector. Improving working conditions and wages in the private sector would need to go hand in hand with a strategy to increase the sector's productivity.

Due to the very low work intensity in Kosovo, poverty remains high, and many people do not have access to essential services such as health care. According to the latest poverty estimates from the Kosovo Agency of Statistics, 18% of the population were living below the poverty line in 2017 (set at EUR 1.85 per day), while 5.1% were living below the extreme poverty line (EUR 1.31 per day). Low-educated individuals and female-led households are more likely to be poor. Roma and Ashkali communities face disproportionately high levels of poverty and social exclusion given their low education and marginal employment levels (European Commission, 2018[74]).

Only 13.9% of working age women (aged 15-64) were employed in 2019, an increase from 11.5% in 2015 (Kosovo Agency of Statistics, 2020[106]; WIIW and World Bank, 2020[107]). This is well below the EU female employment rate (64.1%) (Eurostat, 2020[108]), and extremely low compared to other economies in the region (the WB6 average **female employment rate** was 45.8% in Q2 2019, and the female activity rate was 53.7% (WIIW and World Bank, 2020[107])). The male employment rate was 46.2% in 2019, which shows that the gender employment gap is extremely high, the largest in the region. The activity rate of women was only 21.1% in 2019, a slight increase since 2015, but no increase since 2017. The female unemployment rate was 34.4% in 2019 and the female youth unemployment rate was 62.9% (in Q2 2019, an increase from 38% in 2015). The female unemployment rate was 36.3% among medium-educated women, 26.6% for low-educated women and 31.1% for high-educated women (WIIW and World Bank, 2020[107]).

Key explanations for the low female employment rate include traditional gender roles, family responsibilities, limited access to quality and affordable child and elderly care, conservative social norms and discrimination, and women's limited access to assets and productive inputs (World Bank, 2017[129]; Haxhikadrija, Mustafa and Loxha, 2019[124]). Migration by men further reduces women's possibilities to combine work and family life. Despite improvements among younger cohorts, women in Kosovo have significantly lower levels of education than their male counterparts (e.g. 50% of working-age women are not educated beyond lower secondary education compared to 27% of men) (World Bank, 2017[129]). Career breaks further reduce women's likelihood of accessing employment. The female part-time employment rate is low (4.3% in Q2 2019) (WIIW and World Bank, 2020[107]), indicating that employers may not be willing to offer suitable working hours for women that would permit them to reconcile work and family life (Government of Kosovo, 2020[130]). Article 49 of the Law on Labour regulates the principles, conditions and criteria for the use of maternity leave. Although the law is generous in protecting mothers, it sets disincentives for hiring women due to the added financial burden on employers (World Bank, 2017[129]). Secondary legislation for implementing the Law on Protection from Discrimination has not yet been adopted. In the reporting period, the Ombudsperson received a similar volume of discrimination cases as in previous years, but the number of *ex officio* investigations on discrimination grounds doubled. Institutions continue to perform poorly in processing and investigating cases of discrimination (European Commission, 2019[111]).

The Sectoral Strategy of the Ministry of Labour and Social Welfare (2018-2022) includes women as a target group. However, they remain under-represented among the Employment Agency's beneficiaries: while women represented around 45% of all registered jobseekers, they only represented 34% of participants in active labour market measures (World Bank, 2017[129]).

The Agency for Gender Equality has prepared the Kosovo Programme for Gender Equality 2020-2024, which outlines highly relevant activities to improve skills and the reconciliation of work and family life, as well as combat discrimination in the labour market. The related action plan for 2020-2022 has a budget of EUR 13.7 million. Some EUR 2.6 million will be funded by Kosovo's own budget, with EUR 11.1 million covered by donors (Government of Kosovo, 2020[130]). In the long run it will be important to include these social investments in the economy's budget.

### *Sub-dimension 8.4: Activation policies*

The MLSW's draft Sectoral Strategy for Employment and Welfare for 2018-2022 and the related action plans for the Employment Agency of the Republic of Kosovo (APRK), form the policy framework for **public employment service** (PES) activities. The APRK was created in April 2017. Previously, employment services and ALMPs were offered by the MLSW. The APRK has a tripartite committee and provides services and measures for unemployed individuals through its mechanisms at regional and local levels. It has 28 employment offices, 8 centres of vocational training and 5 mobile centres (Government of Kosovo, 2017[105]). The range of services provided corresponds to standard PES tasks,[72] but resources are low. The APRK employed 294 staff in 2019, 92 of whom provide employment services to jobseekers.[73] In 2017, when the APRK was set up, the average caseload per job counsellor was 1 020, the highest in the region. Progress has been made to reduce the caseload to 769 in 2019, which is still higher than in other economies of the region and more than eight times the average caseload of counsellors in a range of EU Member States with well-developed PES.[74] The reduction in Kosovo's average caseload was largely linked to the fall in registered unemployed individuals, from 93 866 in 2017 to 70 970 in 2019.[75] In 2017, 71.5% of unemployed individuals were long-term unemployed, while in Q2 2019 this figure was 63.6%, according to Labour Force Survey data (WIIW and World Bank, 2020[107]). The long-term unemployed made up 90% of total registered jobseekers in 2016 (Government of Kosovo, 2017[105]).

The employment offices register and profile unemployed individuals and other jobseekers.[76] Unemployed individuals are segmented into three groups that define the services provided to them:

1. **Low risk of becoming long-term unemployed**. These individuals are advised to use self-service instruments and, if necessary, will be provided assistance in using them, as well as in activating social networks and advice on how to contact an employer directly to find a job.
2. **Medium risk of becoming long-term unemployed**. Employment services are provided to these individuals that include job mediation, job search assistance, labour market information and training.
3. **High risk of becoming long-term unemployed**. For this group the counsellor should offer intensive support and counselling that combines job search skills, career guidance, motivation during the job search period and creating an individual employment plan. In-depth and individual counselling is provided for those who are long-term unemployed during an interview lasting about 30 to 45 minutes.[77] The counsellor informs and advises the unemployed client to participate in the various ALMP measures, taking into account the categories and funds available.

The budget for ALMPs was EUR 6.6 million in 2019, corresponding to 0.08% of GDP, which is very low compared to OECD standards (0.36% on average in 2018, and 0.46% if including placement services and PES administration) (OECD, 2020[131]). In 2019, 11 500 people participated in ALMPs (including training measures), 37% of whom were young people and 40% women (women were well targeted as they represented only 30% of unemployed according to LFS data). In 2016, only 3.9% of registered unemployed individuals benefited from employment services for placement into regular employment, and 10.2% participated in ALMPs according to administrative data (Government of Kosovo, 2017[105]). Among ALMP participants, most were enrolled in vocational training courses (7.6% in 2016), 0.8% participated in public works, 0.5% in wage subsidies, 0.4% in practical work and 0.1% in self-employment schemes. There is no information available on whether these shares have risen since.

Data for 2016 show that more than 60.9% of registered unemployed individuals had not attended school or were enrolled only in primary school, while 31% had not gone higher than secondary school (Government of Kosovo, 2017[105]). There are no recent data available on the composition of registered unemployed individuals. However, Labour Force Survey data indicate that more than two-thirds of the unemployed are long-term unemployed.[78] Given the high caseload of counsellors and the low budget for ALMPs, employment services for the vast majority of jobseekers cannot be delivered in an effective and meaningful way. Consequently, the placement rate is low (12.4%), particularly among those with professional skills (9.3%).[79]

The PES identified 12 511 job vacancies in 2017, which is not enough given the high number of registered unemployed. Progress has been made, however, with the number of registered vacancies increasing to 15 647 in 2019.

The Employment Agency has a performance management module, undertaken through the Employment Management Information System, with monitoring data issued every three months and annually; however, detailed results are not publicly available. A customer satisfaction survey was also conducted that targeted PES users. The results obtained from this research are reflected in the work plan of the Employment Agency, but not published.

There is currently no unemployment benefit system (although benefits have been exceptionally allocated during the pandemic). As part of the reforms of the social protection system, arrangements for unemployment benefits are planned. A concept paper is part of the government work plan for 2020, but has not yet been approved.

The Social Assistance Scheme (SNS) is the main social assistance programme in Kosovo. The amount of family benefit is based on the number of family members and starts at EUR 60 a month for a one-member family and goes up to EUR 180 for a family of 15.[80] Coverage is low, social assistance does not sufficiently target the poor, and spending has been declining (Government of Kosovo, 2017[105]) (European Commission, 2018[74]) (European Commission, 2019[111]). A concept paper for reforming the SNS was drafted and approved in September 2020 by the Government of Kosovo. It aims to improve the scheme's impact on poverty alleviation and expand the coverage of poor families. Able-bodied social assistance recipients must register at the PES and actively search for work, otherwise they get sanctioned. Electronic data management and information exchange systems have been established. All social assistance recipients must register with the PES to qualify for assistance; however, monitoring and follow-up on job searches is weak. Kosovo has not implemented a general health insurance scheme.

In the absence of unemployment benefits, and with the low coverage of social assistance, the implementation of activation requirements is weak compared to many OECD and EU countries (OECD, 2015[132]; Langenbucher, 2015[133]). Jobseekers must report to the employment office every three months, which is not frequent enough (e.g. in the United Kingdom jobseekers must report every two weeks). If a person registered as unemployed does not appear within six months in an employment office they are automatically cleared by the information system and considered passive. Although it is useful to clear the registry data regularly, more could be done to ensure that jobseekers are actively searching for employment, particularly those receiving welfare benefits.

The Sectoral Strategy for Employment and Welfare 2018-2022 points to the lack of co-ordination between different programmes and services for social inclusion, although some co-ordination takes place within the MLSW.[81] In particular there is no integrated delivery of social and employment services at the local level.

Despite poor labour market outcomes among marginalised Roma and Ashkali communities, Kosovo's latest revised action plan on the integration of these communities does not include measures specifically targeting them in **ALMPs**, unlike elsewhere in the region (European Commission, 2019[114]). Strategic documents define the target groups for ALMPs as women from rural areas, women without other income, young NEET, long-term unemployed, people with disabilities and repatriates. While increasing employment

among youth and the Roma, Ashkali and Egyptian community are stated objectives of the 2018-2022 sectoral strategy, there is no evidence that these groups are well targeted by ALMPs. The Action Plan for Youth Employment (adopted in 2018) has limited scope (European Commission, 2018[74]). ALMPs should continue to focus on women, young people and marginal groups.

The Economic Reform Programme for Kosovo 2019-2021 sets out plans to improve the delivery of ALMPs. These include the objective to increase referrals to ALMPs by 10% and to develop and implement self-employment and entrepreneurship programmes, on-the-job training programmes for newly graduated from higher education, and support voluntary work initiatives. An evaluation of ALMPs is planned for 2021.

Kosovo has made progress in strengthening institutional capacity to deliver ALMPs to vulnerable groups through the adoption of the Law on Social Enterprises approved by the Assembly of Kosovo. In August 2020, four bylaws were adopted that enable the registration and operation of social enterprises in the Republic of Kosovo. In co-operation with the EU, a grant support programme has been developed for social enterprises implementing active labour market measures. It is expected to be finalised by the end of 2020, and several NGOs and businesses should be contracted.[82]

### *Cross-cutting policy areas: Informality*

The size of the informal economy in Kosovo is estimated to be above 30% of GDP (Government of Kosovo, 2019[134]). Although informal sector employment is not covered by the economy's Labour Force Survey, it is also estimated to be high. The incidence of informal employment is higher for men, young and elderly people, and the low educated (WIIW and World Bank, 2020[107]). The main sectors for informality are construction, manufacturing and social services, according to a MLSW Report. Data on time use show that informal workers work 52 hours per week on average, while those employed formally work 44 hours per week (Social Impact, 2018[135]).

The Strategy for Prevention and the Fight against Informal Economy, Money Laundering, Financing Terrorism and Financial Crimes 2019-2023, adopted in 2019, plans to develop approaches to formalise informal employment. The objectives of the strategy are:

- Improving the analysis and monitoring of informal employment, and establishing a register for employed people at MLSW.
- Conducting public information campaigns on the consequences of informal employment and the benefits of formal employment, and informing employers about the consequences of informal employment.
- Organising joint activities with social partners to address informal employment.
- Deepening inter-institutional co-operation in combating informal employment.
- Conducting an analysis of the state of informal work and an assessment of good practices for its reduction.
- Building the capacity of labour inspectors through training.
- Establishing an efficient system for supervising and evaluating the work of labour inspectors.
- Establishing a methodology to ensure better targeting, based on risk.
- Improving the working conditions for labour inspectorates through the establishment of an information management system and the improvement of technical working conditions.

This strategy is highly relevant, and it should begin to be implemented.

### *Cross-cutting policy areas: Brain drain*

Although there are no data, there is evidence that significant numbers of medium and highly educated workers have left Kosovo to seek better opportunities abroad (e.g. in the construction sector). Brain drain

in Kosovo has been happening for a long time and is caused by, for example, limited opportunities for highly skilled people and/or very low compensation for workers and professionals, and poor working conditions such as health and safety at work and long working hours. There are no policies to address brain drain in Kosovo.

### *The way forward for employment policy*

To improve employment policy, policy makers should consider the following recommendations:

- **Implement as a minimum the Strategic Development Plan for Labour Inspectorates 2017-2021 and the Strategy for Prevention and the Fight against Informal Economy, Money Laundering, Financing Terrorism and Financial Crimes 2019-2023.** It is particularly important to improve the monitoring system of labour inspectorates and increase transparency, implement preventive measures, and effectively impose fines in cases of clear infringements of the law. The capacities of inspectorates in terms of training, hardware and software need to be improved, and inter-agency co-operation needs to be strengthened. Labour inspectors need to be trained to detect child labour.
- **Establish a complete and functional system of health and safety at work**. The first step will be to develop a strategy document on occupational safety and health, to implement preventive measures, and to strengthen worker representation for OHS-related issues at the company level. Labour inspectorates' capacity to reduce accidents at work and occupational diseases should be increased.
- **Use the whole education and training infrastructure in the economy, including VET institutions, to provide remedial education and vocational upskilling to adults**, as also recommended by the ETF (ETF, 2019[136]). In order to build on the already acquired skills and knowledge of the working population, and given the high level of informality, it is recommended to develop a framework for the recognition of prior learning combined with upskilling activities.
- **Scale up childcare facilities and support for elderly care**. International experience shows that the labour market participation rates of women depend on the availability of childcare and after school care (OECD, 2016[137]). Amend the maternity leave law to remove the financial burden on employers for generous compensation during maternity leave (e.g. by tax financing the leave). This should reduce the barriers to employing young women. Implement all employment relevant measures of the Kosovo Programme for Gender Equality 2020-2024.
- **Continue to enhance the number of job counsellors and significantly reduce their caseload.** This is necessary given the high incidence of long-term unemployed and unemployed individuals with multiple employment barriers. In order to serve vulnerable groups and hard-to-place jobseekers the number of counsellors would need to be multiplied by eight to reach the caseload of well-developed PES such as those in Germany in France. It is also recommended that for vulnerable groups, job counsellors should co-operate with social and health services at the local level, as employment barriers are often complex. This is increasingly implemented in the EU (Konle-Seidl, 2020[138]). Jobseekers should be followed up more regularly (e.g. every two to four weeks).
- **Introduce the planned comprehensive social protection system that includes an unemployment benefit scheme and a general healthcare scheme, and reform the social assistance scheme to better target the poor.** The system should include the possibility to top up low incomes with means-tested welfare benefits to encourage the taking up of work and to activate recipients to participate in the labour market, as in a number of EU Member States.
- **Use time-limited (e.g. six months) exemptions to social security contributions to transform temporary contracts into permanent ones**, as in Portugal (Düll et al., 2018[139]). At the same

time revise the employment protection legislation of temporary and permanent contracts to increase the use of permanent contracts and ensure that temporary employed individuals enjoy the same basic employment rights and working conditions (working time, paid holidays, etc.) and have equal access to social protection.

- **Continue implementing the scheme to regularise informal employment (set up in the context of COVID-19), and implement awareness-raising campaigns.** Evaluate the scheme and make the necessary adjustments in programme design and implementation to limit misconduct and fraud.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Table 22.14 shows Kosovo's scores for science, technology and innovation (STI), and compares them to the WB6 average. The economy scores below average in all three sub-dimensions and ranks fifth out of the six Western Balkan economies in STI and public research systems, and sixth in business-academia collaboration indicators. Kosovo's performance in this dimension has been constrained by a lack of system-level STI priorities and the limited implementation of relevant policy initiatives. In particular it is difficult to fully assess Kosovo's progress since the previous assessment cycle due to inadequate monitoring and evaluation activities. The resulting scarcity of relevant data has also slowed ongoing reform efforts, most notably the Smart Specialisation Strategy being developed in partnership with the EU.

**Table 22.14. Kosovo's scores for science, technology and innovation**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Science, technology and innovation dimension** | Sub-dimension 9.1: STI system | 1.8 | 2.4 |
| | Sub-dimension 9.2: Public research system | 1.3 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 0.7 | 1.6 |
| **Kosovo's overall score** | | **1.3** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 9.1: STI system*

Kosovo's STI system is in the early stages of development, and limited progress has been made since the previous assessment cycle in 2017. Without a clearly defined system-level policy framework, policy makers and stakeholders struggle to prioritise and effectively engage in STI activities. Kosovo does not have a clear **STI strategy** in place, as the most recent strategy on research expired in 2016. Instead, the strategic framework consists of two high-level strategies: the Kosovo Research Programme (NRP), which outlines Kosovo's overarching development agenda and sets research priorities, and the Kosovo Education Strategic Plan (KESP) 2017-2021. The lack of a dedicated and uniform STI strategic framework has prevented Kosovo from addressing challenges to its STI system and formulating targeted policy actions, and implementation remains highly uncoordinated. The Kosovo Strategy for Innovation and Entrepreneurship provides some high-level guidance but does not provide a comprehensive roadmap for STI policy making or tools to co-ordinate implementation efforts. Other relevant policy documents include the Kosovo IT Strategy, which includes provisions to promote innovation and research and development within the IT sector, and the University Strategic Plan.

Since the previous assessment, the government has drafted the Strategy for Supporting Innovation and Entrepreneurship 2019-2023, adopted in March 2019. Efforts to develop a smart specialisation strategy, in line with Joint Research Centre methodology are underway, but remain in the early drafting stages. However, the lack of comprehensive statistical data collection practices for relevant STI indicators has hindered this process and slowed the necessary mapping of Kosovo's innovation ecosystem.

The **institutional framework** of the STI system remains complex, with a number of government ministries and institutions, private sector groups and international organisations overseeing various aspects of STI policy development and innovation. Following a governmental reshuffle in early 2020, innovation is now within the competency of the MEST, whereas previously responsibility lay with the Ministry for Innovation and Entrepreneurship (MIE). Established in 2017, the MIE was intended to co-ordinate innovation activities between government institutions, academia and the private sector. Although it did not act as an independent implementing agency for innovation, it oversaw a specific budget allocation for innovation.

Responsibility for developing and implementing STI policy remains fragmented. Without a functioning mechanism for identifying and resolving issues through inter-ministerial co-ordination, the development and implementation of STI policies suffers from inadequate co-ordination and overlapping areas of responsibility. In addition to the MEST, the Kosovo Research Council and the Scientific Innovation Council (SIC) oversee similar policy domains. MEST plays an extensive role within STI policy and is responsible for promoting scientific research and technological development, as well as overseeing the higher education system. It also oversees the implementation and funding of the STI objectives outlined in the NRP,[83] and is responsible for promoting knowledge and technology transfer within the economy.[84] The SIC aims to monitor the creation and commercial application of new innovations and is overseen by MEST; however, it has not yet been fully established and remains inoperative.

Kosovo's **regulatory framework** for the STI system is primarily defined by the Law on Scientific Research Activities, which oversees scientific research, knowledge and technology transfer and innovation. As such it regulates research institutions, scientific councils, financing for STI activities and conditions for researchers. The law requires the government to allocate at least 0.7% of its annual budget to support STI activity, although this requirement has yet to be upheld in practice.

The Law on Scientific Innovation and Transfer of Knowledge and Technology defines which organisations and institutions operate within the STI sector, and identifies multiple sources of funding used for innovation and knowledge and technology transfer. The law also requires MEST to establish the SIC, and outlines its mandate to monitor the development and commercial application of new innovations. The Law on Higher Education distinguishes between various types of HEI and outlines their primary objectives, including a commitment to knowledge creation and transmission as one of their core functions. Kosovo does not participate in EURAXESS.[85]

There have been no major changes to the regulatory framework since the previous assessment cycle, and implementation of the legal framework, including the requirement to develop an economy-wide research programme, is somewhat lagging. Kosovo adopted amendments to the Law on Patents in 2019, which brought the economy's legal framework for intellectual property somewhat closer to the EU *acquis*. The capacity of the Agency for Industrial Property has also been strengthened, which has helped to clear the backlog of patent applications accumulated in recent years. However, enforcement of intellectual property (IP) rights remains low, and public awareness of the use of IP, especially amongst the business community, needs to be increased.

Kosovo engages in extensive **international collaboration** to further its STI objectives and participate in international initiatives and research projects. However, the impact of these efforts remains limited amid the underdeveloped domestic STI policy framework, which restricts the potential to fully exploit access to international programmes and meet international commitments. With only 72 applications submitted from 2014 to 2019, Kosovo's participation rate in Horizon 2020, the EU research and innovation funding programme[86] in which Kosovo participates as an international co-operation partner, is lower than other Western Balkan economies. To date, Kosovo has participated in 18 projects and received over EUR 2.5 million in funding. However, since the previous assessment cycle, Kosovo has taken a number of steps to expand its contact points network and raise awareness among researchers about available opportunities associated with Horizon 2020. As a result the economy performed well in 2019, with a 20.4% success rate for applications from Kosovo compared to an average of 12% among all Horizon 2020 participants. As part of Horizon 2020, Kosovo also participates in the European Cooperation in Science and Technology (COST).[87]

As a participant in the European Research Area (ERA), Kosovo has strong incentives to increase its **alignment with EU STI policies**. However, it has made relatively little progress since the previous assessment cycle in achieving its commitments and further integration into the ERA due to the insufficient collection of the necessary statistical indicators. Overall, the lack of readily available and reliable data makes it difficult to assess the economy's progress in this policy area.

### *Sub-dimension 9.2: Public research system*

Kosovo's public research system remains underdeveloped and lacks adequate budgetary, administrative and strategic support. The Law on Higher Education regulates the overall structure and organisation of the public research system in Kosovo, which is mainly populated by public universities and private HEIs.[88] Kosovo has yet to develop a new strategic approach to research since the previous research strategy expired in 2016, and has made limited progress in implementing its existing objectives.

The **institutional structure of the public research system** remains ineffective. The expired Kosovo Research Programme was largely unimplemented and based on outdated guidelines and standards for scientific research drafted by the Kosovo Science Council, which ceased operation in 2011 amid political turmoil. There are 26 HEIs in Kosovo, of which 7 are public universities and the rest are private colleges. Although all public HEIs include commitments to pursuing research in their mission statements, most prioritise teaching over research in practice. Coupled with often poorly equipped research labs and other key research infrastructure, the quality of HEI research in Kosovo remains below potential (Kaçaniku, Rraci and Bajrami, 2018[140]). For example, since the previous assessment Kosovo has been unable to implement plans to install new research labs in five HEIs due to budgetary constraints, and there have been no new initiatives to maintain or update lab equipment in the economy (Mehmeti, Mehmeti and Boshtrakaj, 2019[141]). The Kosovo Accreditation Agency is not part of the European Association for Quality Assurance in Higher Education or the European Quality Assurance Register for Higher Education, which further limits quality research outputs.

Limited **public research funding** is a key constraint to the development of STI, as the sector is systemically underfunded. Although required by law to allocate at least 0.7% of its annual budget to support scientific research activities, government spending on science and research amounted to only 0.1% of GDP in 2019 (European Commission, 2020[39]). However, absolute funding for scientific research, which is predominately institution-based, has increased significantly in recent years (albeit from very low levels), suggesting an increasing commitment by the authorities to invest in the system.

Grants valued up to EUR 10 000 per year are available to fund small projects, mainly within the HEI sector. These grants cover expenses such as short-term visits and conferences, specific laboratory equipment and software, and costs for external advisors. Although researchers in Kosovo are eligible to access funding through Horizon 2020 and COST, Kosovo's participation in these initiatives remains low compared to other Western Balkan economies. Low levels of domestic expenditure on research activity and reliance on foreign donors inhibit the development and implementation of strategic investment in research infrastructure and programmes.

The development of **human resources for public scientific research** remains limited, as HEIs tend to prioritise teaching over research and apply uneven criteria for promoting scientific research excellence. The quality of postgraduate programmes in terms of preparing students for research careers is poor, and academic staff are not typically required to engage in research activities. Furthermore, there are few mechanisms to monitor or evaluate their research (Kaçaniku, Rraci and Bajrami, 2018[140]). Subsequently, the number of publications published in international peer-reviewed journals was less than a quarter of the Western Balkans regional average in 2018 (World Bank, 2018[142]). There is also limited support available for researchers to engage in international research projects and attend international events and conferences. Although international initiatives and donors such as Horizon 2020 and COST provide additional resources to researchers, the low awareness of these programmes and the limited resources to support access to them continues to restrict their impact in the economy.

### *Sub-dimension 9.3: Business-academia collaboration*

Kosovo does not appear to have a formal **collaboration promotion framework** to support business-academia collaboration. Such collaboration is not explicitly recognised in the STI policy

framework and there are no concrete promotion measures or objectives in place. Consequently, technology absorption capacity remains limited and investment in research and development by the private sector remain low compared to other Western Balkan economies.

There are some **financial incentives for collaboration**; however, most are oriented towards the private sector to promote innovative companies and do not specifically promote business-academia collaboration. An innovation voucher scheme overseen by the Ministry of Innovation and Entrepreneurship is in place but has reportedly been underutilised, with few applications submitted. It is unclear whether low participation rates are due to lack of interest or awareness among firms and academics. **Non-financial incentives for innovation** remain similarly underdeveloped in Kosovo. Researchers have few incentives to participate in business-academia collaboration as they are still assessed against conventional performance criteria. The funding and efforts of the MEST are geared to providing full or partial scholarships for students to study abroad, mostly for master's courses, and there are few opportunities for PhD/postgraduate research.

Kosovo has made some progress since the previous assessment in developing stronger **institutional support for collaboration**. A number of innovation centres operate in major cities throughout the economy (Box 22.8), and EUR 1.1 million was allocated to fund labs and equipment at two regional innovation centres. The establishment of four innovation centres and training parks across the economy have strengthened Kosovo's innovation infrastructure. These centres have played an important role during the COVID-19 pandemic in supporting domestic innovative solutions to the challenges presented, including the fabrication of face shields and distance-learning tools for primary school students. However, these institutions are primarily oriented towards business incubation and may not fully accommodate scientific research activities.

### Box 22.8. Innovation Centre Kosovo

The Innovation Centre Kosovo (ICK) was founded in 2012 to support entrepreneurship, innovation and commercially based business development in Kosovo. It aims to create new jobs and promote green energy. The centre supports both start-ups and existing companies with the potential for growth.

An integral element of the ICK is the incubator, which provides pre-incubation, incubation and virtual incubation services to both start-ups and early-stage companies. In addition to the incubator, various innovation and ICT-related support programmes are implemented via the ICK, including Junior Geeks, Angel Club, a Tech Boost Programme and the Start-up Social Workshop.

Since 2018, the ICK has administered a small-scale "Innovation Fund" grant scheme, which makes available co-financing of up to EUR 50 000, supported with donor funding. To date, two calls have been successfully completed, awarding over EUR 500 000 to 13 SMEs in 2018 and 2019.

Overall, more than 390 start-ups have successfully worked with the ICK, and over 2 100 have been created.

Source: (Innovation Centre Kosovo, 2021[143]), *Innovation Centre Kosovo homepage*, https://ickosovo.com/.

## *The way forward for science, technology and innovation*

Kosovo has made limited progress in developing science, technology and innovation since the last assessment. The development and prioritisation of targeted policy measures remains a major challenge amid the absence of an overarching strategic support framework for STI and a lack of funding. To improve the situation, Kosovo should consider the following:

- **Establish an overarching strategic view and develop mechanisms to co-ordinate policies across the whole of government.** The Smart Specialisation Strategy represents an important opportunity to develop a strategic approach to STI policy making, especially if coupled with the adoption of a new research strategy.
- **Identify and map the research and development infrastructure** to gather economy-wide data on labs and researchers. If these efforts are further complemented with the expanded collection of statistical data related to STI, Kosovo will be able to meet its commitments under the ERA and prepare for a research infrastructure roadmap.
- **Increase investment in public sector research and encourage research excellence.** Comprehensive financial and non-financial programmes to upgrade research as a profession, including though investment in better equipment in research labs, increased assistance to encourage international collaboration and research exchanges, will increase the quality and quantity of research outputs in the medium term and should stimulate the integration of academic research with the business community.
- **Maintain momentum and continue to improve participation in international STI collaboration.** Further actions should be taken through the contact points network under Horizon 2020 to provide more training and awareness raising about the opportunities of international initiatives. Measures could include better linkages of researchers through increased mobility and the exchange of best practices.

## Digital society (Dimension 10)

### *Introduction*

Table 22.15 shows Kosovo's scores for digital society and compares them with the WB6 average. Kosovo has continued digital society policy reforms since the last assessment cycle, but progress has been slow in most of the sub-dimensions. The economy nearly reached the WB6 average for the access sub-dimension as broadband development has shown stable progress, with the rural broadband infrastructure programme launched in 2019 already demonstrating solid impact on the Internet connectivity of remote areas. Although the regulatory framework on electronic communications continues to be improved to facilitate investment in network infrastructure development, alignment with the EU framework is not yet complete, and the market suffers from some persisting competitive distortions. There has been widespread discussion of the potential of the ICT sector in Kosovo; however, there is also a lack of reliable data to support data-driven decision making, which affects all aspects of digital society development, including digitalisation, jobs, inclusion and trust. Kosovo scores below the WB6 average in the sub-dimensions of use and society, and has average ratings for jobs and trust. The contribution of the ICT industry to GDP stagnated at 1.9% in 2018 and 2019 (Kosovo Agency of Statistics, 2021[144]). The digitalisation of SMEs is stagnant, and although the IT industry continues to work mostly in international markets, there is limited evidence to indicate that it is ready to move focus from outsourcing and exploit the promise of data-driven innovation. There is evidence that e-commerce reforms, boosted by the new conditions imposed by the COVID-19 pandemic, are creating a new e-commerce culture in Kosovo, although limited resources have been allocated since 2018 to building trust in the digital society domain. Privacy, personal data protection and free access to information remain critically underdeveloped.

**Table 22.15. Kosovo's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 2.8 | 2.9 |
| | Sub-dimension 10.2: Use | 1.8 | 2.4 |
| | Sub-dimension 10.3: Jobs | 2.3 | 2.3 |
| | Sub-dimension 10.4: Society | 1.5 | 2.1 |
| | Sub-dimension 10.5: Trust | 2.2 | 2.2 |
| **Kosovo's overall score** | | **2.3** | **2.4** |

### *State of play and key developments*

#### *Sub-dimension 10.1: Access*

Kosovo is in the process of completing an ambitious rural **broadband infrastructure** programme that promises to connect every household and every public and private institution in the territory with high-speed Internet. The Electronic Communication Sector Policy – Digital Agenda for Kosovo 2013-2020, along with the overarching Kosovo Digital Economy (KODE) project for 2018-2023, have created a broadband development framework that facilitates private sector investment. The data collected by the Regulatory Authority of Electronic and Postal Communications (ARKEP) suggest that fixed broadband penetration increased from 15.1% at the end of 2017 to 20% in Q3 2020 (ARKEP, 2020[145]). According to ICT usage survey data from the Kosovo Agency of Statistics, 96.4% of households in Kosovo had Internet access at home in 2020, which is the highest percentage in the region, surpassing even the EU average (90% in 2019) (Kosovo Agency of Statistics, 2021[146]). The same survey indicates the type of access from home is 95.1% through fixed lines and 54.7% through mobile connections. However, just over 70% of the population uses 3G/4G mobile broadband (ARKEP, 2020[145]).

To cover scarcely populated areas, the government secured a World Bank loan of EUR 20.7 million for a rural broadband infrastructure development project under the KODE project. The overall objective of the project is to improve the quality of digital infrastructure throughout Kosovo to deliver at least 100 Mbps, upgradeable to 1 Gbps, to all households. Implementation started in 2019 with the announcement of eight competitive calls for co-financed infrastructure development projects[89] covering 85 specific "white"[90] areas, 48 schools and 17 healthcare centres. In total, 30 grant agreements were signed with different Internet service providers (ISPs) for respective sub-projects. During 2020, another 6 calls were published, which resulted in the financing of 21 new sub-projects to cover 62 white areas, 27 schools and 9 healthcare centres, offering free Internet access for five years. Along with public institutions, 4 000 families in 147 white area villages will benefit from free-of-charge high speed Internet connections for the same duration. These projects are co-financed up to 50% by the state, according to state aid rules that are aligned with the EU Guidelines on the Rapid Deployment of Broadband Networks (2013/C 25/01). The target of the project was to cover 100% of Kosovo households with broadband Internet by the end of 2020, which is close to actual monitored data. KODE also started the pilot project in 2020 of connecting mobile towers with fibre optic and 5G-ready active equipment. This project will continue until the end of 2022. The KODE Project Implementation Unit within the MEE acts as the broadband competence office and provides programme co-ordination and implementation monitoring. The MEE also monitors the implementation of the digital agenda.

In co-operation with ARKEP, the MEE has developed a comprehensive Broadband Electronic Atlas[91] to map fixed and mobile infrastructure and services. Kosovo, supported by the World Bank, takes part in the Balkans Digital Highway Project with other WB economies to investigate regional interconnectivity improvements through infrastructure sharing of the optical fibre ground wire installed by local energy utilities. During July 2020, ARKEP further improved the regulatory environment for network infrastructure investments by adopting a number of regulations to facilitate broadband infrastructure development and shared use (e.g. regulations on open access to the local loop or to the curve and bitstream, on technical and operational issues of access to networks in bitstream, and on interconnection services). These were in addition to the regulations adopted during the 2018/19 period (e.g. regulations on the shared use of associated facilities, on general authorisations, and on the quality of electronic communication services). ARKEP adopted regulation on the rights of way and common use of infrastructure in 2012. The government has prepared draft legislation on measures that reduce the cost of deploying high-speed electronic communications networks, in accordance with the EU's Broadband Cost Reduction Directive (2014/61/EU), but the law has not yet been adopted.

The **ICT policy regulatory framework** is constantly improving its alignment with the EU *acquis*. The existing electronic communications framework is almost fully aligned with the EU 2009 regulatory framework, which is positively reflected in market developments. The domestic regulator, ARKEP, is fully staffed and has the resources to ensure the active improvement of the regulatory framework through adjustments that support private sector investment in communications infrastructure development. However, the only pending issues to complete alignment with the EU framework are the financial independence of ARKEP, which is not ensured,[92] and relevant EC recommendations that have not yet been implemented (European Commission, 2020[39]). A persistent challenge for the Ministry of Economy and Environment and the regulator is the outstanding privatisation of the incumbent state-owned operator, Kosovo Telecom, after failed attempts to sell the company and the large debt it has accumulated since 2015. In 2019, the Ministry requested EBRD assistance to prepare Kosovo Telecom for privatisation.[93] In the meantime, government-imposed competition restrictions continue, as public institutions are still obliged to use services solely provided by Kosovo Telecom. In a positive move, the regulator reviewed pricing policies for frequency allocation, leading to a 30% price drop for the currently allocated frequencies for mobile telephony services. ARKEP is also reviewing pricing policies for new frequency allocations and annual regulatory fees. ARKEP monitors the electronic communications market and regularly publishes reports and indicators on its development. Although citizens have online access to regulations and open consultation outcomes, regulatory impact assessments for new regulatory proposals are not being

conducted, and human resource capacity in this field remains low. ARKEP and MEE took part in preparations for the Regional Roaming Agreement, which was signed in April 2019.

A basic legal framework on **data accessibility** is in place in Kosovo to enable data sharing within and across the public sector; to allow data openness; and to guide the transparent collection, access and control of data. The adoption of the 2019 Law on the Right for Access to Information, the new Law on Personal Data Protection and subsequent regulations on fees for access to public documents, are major legislative improvements. The international Open Data Charter[94] was adopted as a strategic framework for data accessibility in 2016. The Open Data Readiness Assessment, performed in 2018 following World Bank methodology, concluded that there is limited understanding of the significance of data formats and licences in the public sector, and that demand for open data is still limited in the industry because an ICT-outsourcing mindset prevails (Ministry of Public Administration, 2018[147]). It also noted that key data for enabling FDI and business development, such as a business registry, are not fully available or searchable (Ministry of Public Administration, 2018[147]). With the assessment, an action plan, co-ordinated and monitored by the Unit for Open Data in the Information Society Agency (AIS), was developed to address the identified shortcomings.

The AIS also manages the government's Open Data Portal,[95] created in 2016, as well as the State Electronic Data Centre and ICT infrastructure for public institutions. Over 205 datasets from 14 different public sector organisations were published on the portal by August 2020, using a variety of closed and open formats and licences, because of the absence of specific, formal guidance. Regulations and corresponding technical support for the re-use, sharing and commercialisation of data are not yet in place. There is also no database of indicators on data accessibility and openness to assist data-driven policy making. However, the Ministry of Public Administration has formally put in place a process for the general secretary of every ministry to nominate official open data focal points in each ministry with specific role and duties.

### *Sub-dimension 10.2: Use*

The current **digital government** framework is based on the Strategy on the Modernisation of Public Administration 2015-2020, whose publication was a positive step towards rationalising, optimising and digitalising administrative processes. However, its implementation has not progressed as planned, as noted by the European Commission in its report on Kosovo in May 2019, where it recommended increasing efforts to implement e-government frameworks and services (European Commission, 2020[39]). Since then, the AIS has prepared and proposed a new e-government strategy in its role as the central co-ordination point for digital government.[96]

The draft Strategy for Electronic Governance 2020-2025 and its action plan are expected to provide the new digital government framework for the next period; however, the document was still under consultation with stakeholders in late 2020. Until the strategy is adopted, a number of other policies cover aspects of digitalisation in Kosovo, including the Digital Agenda 2020, the KODE project and the Strategy on the Modernisation of Public Administration 2015-2020. These policies promote digital technologies for civic engagement in policy design, legal and regulatory reform, online public services and tools, public officials' asset disclosure, and fiscal transparency. Positive results from the implementation of these policies include the development of Kosovo's interoperability framework, based on the European Interoperability Framework model; the creation of some e-government services; and the adoption of the Law on Electronic Identification and Trust Services in Electronic Transactions in late 2020. This law supplements the Law on Information Society Services to create an enabling legal environment for electronic services.

Recent initiatives include launching the Ministry of Finance's public consultations online platform[97] and transparency portal,[98] backed by the strong commitment of government for collecting and investigating public officials' asset declarations. Since 2017 all public sector institutions, including local authorities, have been legally obliged[99] to use the public consultations platform for every policy or legislative proposal. The

Prime Minister's Office, which is tasked with implementation monitoring, reported positive trends in fulfilling the minimum standards of public consultations in 2019, despite challenges. Impressively, the number of participants in the public consultation process has more than doubled since 2018. Although tax authority services have been largely digitalised, Kosovo is still a long way from achieving a fully digital government, and the need for increased co-operation and support in building the capacities of public officials for developing and maintaining e-services is still high (Office on Good Governance, 2019[148]).

Improving the e-business environment and encouraging **private sector ICT adoption** to increase companies' efficiency and competitiveness is one of the high-level objectives of the Digital Agenda 2020; however, the document does not outline specific measures to promote the adoption of ICT by firms. As in the previous assessment cycle, there has been limited or no government funding for programmes that provide IT training or consulting support for the digitalisation of private sector companies. However, the government has reduced VAT for ICT equipment to 8%, and ICT is exempt from VAT and customs duties on import. The government depends on donor-funded projects to offer digital skills training for employees of traditional businesses to enable the exploitation of digital technologies for increased productivity and exports. Such projects include the IPA II projects EU Support for the Competitiveness of Kosovo's ICT Sector[100] and EU Support to Digitalisation of Businesses through ICT.[101] However, use of ICT by business has stagnated, reflected in 2019 ICT usage data presented by the Kosovo Agency of Statistics which shows that only 52.4% of enterprises declared they had business web pages, down from 63.1% in 2018 (Kosovo Agency of Statistics, 2021[149]).

Although e-commerce is a significant driver of private sector ICT adoption, a comprehensive legal framework to support its regulated use still needs to be developed. Bottlenecks include the poor security of online payment systems and the fact that banks in Kosovo still charge 2.5% to 3% in fees for each international online credit card payment transaction (TEB, 2021[150]). The logistics and transport infrastructure needed for e-commerce is also inadequate. The government has not built a critical mass of transactional e-services for businesses, which would stimulate the adoption of ICT by private sector companies.

### *Sub-dimension 10.3: Jobs*

The Kosovo Education Strategic Plan (KESP) 2017-2021 is the main policy document for the development of education at all levels. Although it does not directly address **digital skills for students**, it draws attention to the need to accelerate the integration of ICT in schools and to prepare digital teaching material. The use of ICT and modern teaching technologies in Kosovo's education system is relatively low. In 2017, the reported computer-student ratio in Kosovo was 1:46, which is much lower than the EU average (1:7). According to the MEST, 44.4% of schools had ICT equipment in 2017, but equipment maintenance continues to be poor. The MEE, via the KODE project, is gradually improving Internet connectivity speeds for schools[102] in under-served areas, as well as building a data centre for research and education that will serve as a hosting facility for a video conferencing platform and other online services and platforms. During 2020, 12 municipalities in Kosovo received high school IT equipment worth EUR 160 000 to fulfil distance learning requirements imposed by the COVID-19 pandemic. However, despite the technological investment, the number of teachers able to prepare and use electronic content in the learning process is very limited. Teacher training and qualification testing on digital skills has not received adequate attention, even though it is key to ensure high-quality education. The MEST depends heavily on donor support to provide teacher training in ICT. For example, the EU Support for the Competitiveness of Kosovo's ICT Sector project offers free IT courses for ICT teachers and trainers/instructors.

Students' digital skills are developed through classes on information technology, taught from the sixth grade of primary education through secondary education. However, the curriculum is outdated, mainly providing basic information on how to use a computer and the background on how it functions, which does not meet the actual needs of 12-year-old pupils, most of whom started using digital devices at preschool

age. The situation is further exacerbated by tech-shy or ill-trained teachers. The IT subject is graded annually and tested in economy-wide achievement tests. Curricula are designed by the MEST in co-operation with working groups that comprise municipality, academia and civil society representatives. According to the KESP this role was supposed to be transferred to the Agency for Curriculum, Assessment and Standards (AKVS), but this agency is yet to be established. The MEST is monitoring progress of the implementation of the KESP, but data collection on digital skills is not systematic. High schools and universities lack the data-driven approach required to create up-to-date learning programmes. As a result, the curricula, especially in tertiary education, do not meet the needs and requirements of IT companies, which adversely affects the industry's competitiveness.

The KESP also provides a basic policy framework for **digital skills for adults**. The framework includes formal and informal training systems, public services, support programmes and social protection to address barriers to learning faced by low-skilled and disadvantaged adults, and the use of digital learning and mentoring platforms to increase the accessibility of training opportunities. Legislation on adult education and vocational training has been in place since 2013. The Agency for Vocational Education and Training and Adult Education plans, implements, oversees and improves the professional education and adult education system. The Ministry of Labour and Social Welfare, through the Employment Agency, manages eight vocational training centres in seven regions of Kosovo, where ICT is one of many training programmes for unemployed individuals. It is also foreseen that the VET school Gjin Gazulli in Pristina will be upgraded to a new centre of competence for ICT, where six IT professional profiles will be developed. Non-formal learning options, including IT training, are widely available from private sector providers, some of which are accredited by the National Qualification Authority and licenced by the MEST. However, not all available ICT programmes, including university programmes, offer quality training that addresses labour market needs. The Kosovo Association of Information and Communication Technology (STIKK) has repeatedly signalled the poor quality of digital competencies and IT skills acquired through the education system. This is reflected in the Kosovo IT Strategy 2020, which emphasises improving IT education and promoting HR excellence in Kosovo. On a positive note, the MEE[103] has introduced a project to provide advanced digital and business skills training for around 1 500 current and newly trained ICT professionals. The first cohort of trainees, which was balanced in terms of gender, have already been trained, and follow-up activities on their employability in the local ICT market are being conducted. The KODE Project launched its youth training activity under the Youth Online and Upward (YOU) programme in 2020, which aims to train 2 000 young people in digital and soft skills by 2023.

**ICT sector promotion** has been driven by the private sector, mainly STIKK, in co-operation with line ministries and government agencies. Currently, the main policy instruments for ICT sector promotion are the Electronic Communications Sector Policy – Digital Agenda for Kosovo 2013-2020; the KODE project that supports growth for the communications sub-sector; and the IT Strategy 2020[104] that promotes the IT sub-sector. Although some progress has been made, the implementation of the IT Strategy 2020 has been slow as the allocation of financial resources has been limited and it has been given low priority by all recent governments. Kosovo's Smart Specialisation Strategy, which will probably highlight ICT as a priority, is still at a very early preparation stage. The ICT sector, including outsourcing, has 1 249 registered companies, 621 of which registered in 2019 (Kosovo Agency of Statistics, 2020[151]; 2021[152]). Some 61% of IT companies work in international markets, with most revenue coming from exports to EU countries; 39% of IT companies operate in the local market (STIKK, 2019[153]). IT companies are not highly specialised or differentiated in terms of technologies, target industries (vertical specialisation) and specific functional areas (horizontal specialisation). IT companies represented by STIKK have repeatedly signalled the mismatch between skills taught at different levels of the education system with the skills required by the industry. Among IT companies there is a lack of knowledge (e.g. IT market and technology trends, especially regarding potential export markets) and resources to underpin IT sector growth (STIKK, 2019[153]). Access to finance is another bottleneck. The IT Strategy foresees that the Ministry of Finance will draft a legal act to stimulate the supply of venture capital, but the process is still in an initial phase.

Preliminary consultations with stakeholders have begun to identify the most suitable model for a venture capital instrument.

Programmes and activities for ICT sector promotion in recent years have focused on fostering technology start-ups and ICT innovation companies. Under the Economic Reform Programme, STIKK, line ministries and government agencies were supposed to establish the first digital Tech Park in Pristina, where ICT would be the leading sector. However, the Tech Park was still not operational by the end of 2020. The ICK was also created to support entrepreneurship, innovation and commercially based business development with a focus on ICT start-ups (Box 22.8). Under the scope of the Innovation Fund, the ICK implemented a dedicated scheme to support a selected number of start-ups in the ICT and technology sector. Some 220 companies were financed through this scheme with a total of EUR 1.8 million in the period 2018/19.[105] The ICK has also managed other financial support programmes for MSMEs that were co-funded by the German Development Cooperation (GIZ). During the same period, significant financial resources were invested in the establishment and operation of the regional centres for innovation and entrepreneurship. However, all these financial support tools focus on technology innovation and start-ups in general and cannot be considered as direct support schemes for ICT sector promotion, even though ICT sector companies may be the main beneficiaries. IT training has not been financed by any of these schemes. In the STIKK survey for the IT Barometer 2019, a majority (83%) of companies declared that they face a deficit of skilled (qualified) workers. ICT companies cope with this deficit by investing in training (in-house or other specific training) and multiple international certifications (such as Project Management Professional, Microsoft) (STIKK, 2019[153]). However, donor-funded projects under the IPA II instrument, such as the EU Support for the Competitiveness of Kosovo's ICT Sector project, also provide ICT training.

### *Sub-dimension 10.4: Society*

The **digital inclusion framework** is only partly covered by policies for education and for the rights of individuals with disabilities, fostering social inclusion, non-discrimination principles and accessibility of information. The Strategy on the Rights of Persons with Disabilities (NSRPD) 2013-2023, co-ordinated by the Prime Minister's Office/Office for Good Governance, aims to set up a unified system of data on persons with disabilities. The Law on Electronic Identification on Trusted Services in Electronic Transactions (transposing eIDAS Regulation, EU No.910/2014), adopted in 2020, stipulates that services should be equally accessible to persons with disabilities. A project funded by IPA II (2019) will support the MEE with EUR 4 million to implement the eIDAS Regulation and the establishment of the electronic identification and authorisation scheme. However, Kosovo has not yet adopted obligatory e-accessibility regulations and guidelines for public sector websites that meet international standards – Web Content Accessibility Guidelines (WCAG) 2. These are vital to ensure equal access to public sector information and services for all citizens.

Digital inclusion is also considered in policies and legislation on the development of electronic communications that tackle universal service requirements and network infrastructure development in remote locations. The KODE project actively contributes to reducing the gap in ICT connectivity between urban and remote areas in Kosovo. According to the Kosovo Agency of Statistics, in 2020, 96.4% of households in Kosovo had access to the Internet from home, from any device. During the previous assessment period, a project to train women in IT, the Women in Online Work pilot,[106] achieved significant impact by increasing women's competitiveness and opening new opportunities for them to join the digital market. Although this project was not extended into the current period (2018-20), significant digital skills training activities have been launched under the KODE project, also focusing on closing the gender gap in using modern technologies. Positive results are already reflected in 2020 statistics, which report that while Internet use by men remains fairly stable at 57.4% in 2020, use by women has increased to 40.2% in 2020 from 35.4% in 2018 (Kosovo Agency of Statistics, 2021[154]). Although a steady improvement of the percentage of people over 65 years using the Internet at home has been registered (10.1% in 2020 from

8.4% in 2018), this group largely remains excluded from the digital society (Kosovo Agency of Statistics, 2021[155]).

### *Sub-dimension 10.5: Trust*

The legal framework on digital **privacy protection** is aligned with the EU framework, but not practically enforced. The new Law on Access to Public Information and Law on Personal Data Protection (PDP), transposing the General Data Protection Regulation (GDPR) (EU 2016/679), were adopted in 2019. Before the adoption of the new PDP law there was no mechanism in place to perform compliance inspections, and thus enforcement of the existing framework was limited. The new PDP law designated the Information and Privacy Agency as the competent independent authority to supervise the enforcement of the new framework and perform inspections. However, given that the agency has lacked a commissioner for the last three years, it has been facing serious operational and administrative problems and has conducted no inspections. During this time, complaints and sanctions have had to go through the court system, which in practical terms has made digital privacy protection an unrealistic cause. The implementation of the new framework requires the adoption of by-laws deriving from both laws on data protection and access to public information to enable the Information and Privacy Agency to perform its duties (e.g. impose fines). However, without the appointment of a commissioner, neither inspections nor regulation adoption can take place. The new PDP law also obliges controllers and processors of personal data to be certified. The Information and Privacy Agency is tasked with issuing this certification based on criteria and procedures that will be specified in the sub-normative acts, which are also still pending. The latest competitive process for the selection of the commissioner was launched at the end of May 2020, but none of the three candidates for the post received the required 61 votes in the Assembly on 14 August, which was the third time in two years that the parliament has failed to appoint a person to the position (Xhorxhina, 2020[156]; Assembly of the Republic of Kosovo, 2020[157]).

**Consumer protection in e-commerce** is mainly regulated by the Law on Consumer Protection, which was adopted in 2018 and includes provisions on e-commerce. E-commerce is regulated by the 2012 Law on Information Society Services, which transposes the e-Commerce Directive (2000/31/EC). The new Law on Consumer Protection came about as a result of the implementation of the Programme on Consumer Protection 2016-2020. This was adopted on the recommendation of the EC under the Stabilisation and Association Agreement to ensure further alignment of the legislation, to strengthen and develop administrative capacity, and to increase consumer information and education. The Consumer Protection Council is designated to co-ordinate activities among all institutions responsible for consumer protection in Kosovo.

E-commerce is growing fast in Kosovo, boosted by restrictions imposed to address the COVID-19 pandemic. Citizens' online shopping culture is changing (the share of the population who has never ordered or bought products online decreased from 63.6% in 2018 to 43.1% in 2020) (Kosovo Agency of Statistics, 2021[158]), and trust is increasing with gradual improvements of e-payment systems. Nevertheless, bank fees in Kosovo are the highest in the WB region (some banks are charging consumers 1% to 3% of the amount they spent online), and only 10% of people in Kosovo have credit cards (TEB, 2021[150]; PWC North Macedonia, 2020[159]). Some well-known e-commerce websites, including Amazon, Aliexpress and ASOS, recently added Kosovo to the list of countries they ship to, which has simplified purchases and increased the number of online transactions. In a positive move, the Ministry of Trade and Industry published a report in May 2020 that includes data on complaints relating to online shopping. However, a widespread awareness campaign or website with guidelines has not been implemented so far to inform citizens about their rights in e-commerce, how to exercise them, and which competent institutions are tasked to assist consumers.

Positive progress in the implementation of the domestic **digital security risk management** framework is limited by the small allocation of resources for cybersecurity. However, there is some evidence of

implementation of the Cyber Security Strategy and Action Plan 2016-2019, such as the adoption of the new Law on Electronic Identification on Trusted Services in Electronic Transactions in 2020, and the Law on Critical Infrastructure in 2019, based on the EU Directive on the Identification and Designation of Critical Infrastructure (2008/114/EC). However, the draft law transposing the Directive on Security of Network and Information Systems (NIS Directive), to achieve a high common level of security of network and information systems with EU Member States, is still under preparation, and is expected to be finalised by the end of 2021. The follow-up policy document on cybersecurity for the next period has not yet been adopted. The Kosovo Cybersecurity Council has been monitoring the implementation of the strategy and collecting relevant data, but reports are not publicly available.

The operation of the domestic cybersecurity team, KOS-CERT, continues to be challenged by insufficient human and financial resources. KOS-CERT is still operating under the authority of ARKEP, which provides basic services with only two staff members. Donor programmes[107] have been leveraged to support capacity building and sharing good practices. KOS-CERT signed a memorandum of understanding for co-operation with the domestic computer emergency response teams (CERTs) of Albania (AL-CSIRT) and North Macedonia (MKD-CIRT). The government is funding a new project for upgrading KOS-CERT with equipment and smart services[108] in 2020. During 2021, the MEE, together with KOS-CERT, plan to address cybersecurity in 5G networks through the EU toolbox for risk mitigating measures. The MEE, in co-operation with other stakeholders from the energy sector, is also planning to establish a sectoral CERT for energy during 2021.

### *The way forward for digital society*

Despite some important steps taken to improve the digital society policy framework, the government of Kosovo should pay more attention to the following aspects:

- **Update legislation to ensure the financial independence of the domestic regulatory authority for electronic communications, in accordance with the EU framework**. Strengthen efforts to update existing legislation on public finance so that the domestic regulatory authority for electronic communications, ARKEP, is able to use the funds generated by respective regulations for the purposes described in the Law on Electronic Communication.
- **Accelerate the adoption of data re-use, sharing and commercialisation legislation, and strengthen the demand for open data innovation through inclusive co-creation processes**. Promote guidelines that regulate data formats, interoperability and data licences, and provide technical support on these issues to public institutions. Co-operate with civil society organisations to raise public awareness on data openness. Allocate sufficient resources to build the capacity of public officials and develop public-private partnerships on open data innovation for the creation of e-services and applications for citizens and businesses.
- **Ensure that the new Strategy for Electronic Governance 2020-2025, which is pending adoption, provides a concrete vision of digital transformation across government bodies and public institutions, and promotes the creation of high-quality online transactional services**. Address all remaining obstacles in public administration legacy legislation and remove bottlenecks in online payment systems. The new strategy will need to provide an overall vision for the digitalisation of the government and its commitment to deliver high-quality electronic services to citizens and businesses. Sufficient financial and human resources will need to be ensured for building capacity in the public administration to create and maintain e-services. The government could also consider reorganising the Information Society Agency so that it co-ordinates the development, interoperability and maintenance issues of e-services, directly managing or collaborating with the IT staff of line ministries and public institutions.
- **Accelerate the establishment of the Agency for Curriculum, Assessment and Standards (AKVS) and improve co-operation with the private sector for high-quality ICT education that**

**meets labour market needs**. It is important to transfer responsibilities from line ministries to the AKVS, as foreseen in the KESP 2017-2021, and to strengthen collaboration among state institutions, academia and the ICT industry (through STIKK) in redesigning curricula and adjusting the qualifications acquired by students and adults at all levels of the education system. New curricula should focus on preparing a skilled ICT workforce that will support the digital transformation of businesses and underpin ICT sector growth. The monitoring of indicators on digital skills will also need to be systematised to enable informed decision and policy-making processes.

- **Adopt obligatory guidelines that ensure that e-accessibility of public sector websites meet international standards (e.g. WCAG 2.0), and develop a database of digital inclusion indicators**. The government should consider appointing a government body, such as the Information Society Agency, to monitor and enforce e-accessibility regulations and to provide technical support to public sector institutions for implementation. A complete set of indicators to monitor digital inclusion should be adopted and regularly monitored by a competent institution to support a data-driven approach to reviewing and designing digital inclusion programmes.
- **Appoint a commissioner to head the Information and Privacy Agency, and allocate sufficient human and technical resources to allow the agency to complete and implement the legislative framework**. Personal data in Kosovo remain largely unprotected, despite the transposition of the GDPR (EU 2016/679) into domestic legislation. The government will need to resolve persisting bottlenecks in electing a commissioner to lead the Information and Privacy Agency. This will accelerate the adoption of necessary implementing legislation for the new PDP law. Regulations on guidelines and procedures for the certification of data controllers and data processors will also need to be prioritised.
- **Prioritise the design and adoption of a new policy on cybersecurity and prepare legislation on security of network and information systems to transpose the NIS Directive**. The new cybersecurity policy will need to consider the outputs from the implementation of the previous strategy and ensure cross-sectoral participation. It will also need to ensure the transposition of the Directive on Security of Network and Information Systems (NIS Directive) to achieve a high common level of security of network and information systems with EU Member States. The allocation of sufficient human and financial resources for the domestic KOS-CERT will also need to be guaranteed to ensure that the team improves the quality and diversity of services it provides for the benefit of the public and the private sector in Kosovo.

## Transport policy (Dimension 11)

### *Introduction*

Since the last assessment, Kosovo has made some progress in the railway and asset management sectors, but the remaining fields of the transport policy dimension have stagnated (Figure 22.1). Kosovo's performance in the transport dimension is substantially below the WB regional average (Table 22.16). Given this significant gap there is still considerable progress to be made in this policy area to reach EU performance levels. The initial goal should be to achieve the WB regional average by exchanging good practice ideas with the other WB economies.

**Table 22.16. Kosovo's scores for transport policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 1.5 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 1.5 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 1.2 | 1.3 |
| **Kosovo's overall score** | | **1.4** | **2.0** |

### *State of play and key developments*

#### *Sub-dimension 11.1: Planning*

Since the previous assessment there have been no significant improvements to the **transport vision.** A new Law on Roads and a Law on Road Transport are in the adoption process. Kosovo has also developed a Sectorial Strategy for Multimodal Transport (SSMT) for 2015-2025 (Government of Kosovo, 2015[160]) with a corresponding five-year action plan. This strategy covers all transport modes and is proposed to be revised every five years. A working group for updating the SSMT was established in October 2020. The development of the SSMT involved consultation processes with all relevant stakeholders as per local legislation. The strategy includes clear and measurable objectives, with proposed activities and measures, follow-up indicators for each mode of transport, and a timeframe for implementing measures. However, the level of policy implementation is not entirely known as there are no available monitoring reports of implemented strategies. Some legislation has been adopted since the last CO assessment as a result of the previous and ongoing transport strategy, which are presented in the transport modes below. Overall, less than 15% harmonisation with the Transport Community Treaty (TCT) has been achieved.

The SSMT prescribes that the Transport Planning Unit, merged in 2011 with the Department for European Integration and Policy Co-ordination into a Policy Co-ordination Division, should be responsible for assessing, reporting, monitoring and updating the SSMT; however, stakeholders report that this body does not exist, and monitoring reports are not available. The monitoring reports must be used to report on the lessons learnt and assist in defining countermeasures to fill out legging activities, although it remains to be seen how they will be used to inform future strategy updates. The SSMT overlaps with the National Development Strategy 2016-2021 (Government of Kosovo, 2016[161]), which lists activities related to the development of road and railway links. The ultimate goal of the government should be a systematic and regular update of the vision/strategy based on monitoring reports, development of the strategy, impact assessments, as well as the assessment of the recommended measures through the transport model.

No transport model of Kosovo was developed during the preparation of the SSMT, and therefore could not be used to prioritise the proposed measures. The SSMT recommends using such a model to forecast future traffic flow demand and the capacity utilisation of the planned transport network/link over the estimated time horizon (e.g. 20-30 years). However, the SSMT does not recommend assessing or prioritising proposed measures within the strategy, hence the strategy and the transport model will lose their purpose.

The impact on tourism has not been assessed in the SSMT or other strategies, showing the lack of a holistic policy-making approach. Transport-related strategic documents have not been aligned with the previous European Commission Staff Working Document (CSWD) from 2019, although the current update of the SSMT should be aligned with the latest CSWD issued in October 2020 (European Commission, 2020[39]), which will directly influence the harmonisation process with the EU *acquis*. Developing and upgrading transport policy and infrastructure through a fully integrated and jointly implemented approach with tourism policy and other relevant strategies will improve the attractiveness of Kosovo and the region and make the market more competitive.

Co-operation with other WB economies to exchange experience, as recommended in the previous assessment cycle, has not occurred, other than in the Transport Community Permanent Secretariat's (TCPS) regular working meetings. Co-operation with other WB6 economies and regular exchange of good practice needs to be enhanced and intensified, as the effective development of a transport vision and planning can only be conducted through regular regional discussions that lead to a single and competitive transport market.

Since the last CO assessment, no progress has been visible in the **transport project selection** field. The project identification and selection framework is still the same as the single project pipeline (SPP)[109] for infrastructure projects developed in 2015 (Government of Kosovo, 2015[162]). This covers 11 transport infrastructure projects costing around EUR 1.19 billion. The efficiency of the SPP methodology applied to select and prioritise transport projects is undermined by the lack of a financial and economic assessment and an understanding of full social impact. This means that it is not clear if the proposed investment is for infrastructure that could generate the greatest return. There are no economy-wide guidelines for the development of cost-benefit analysis, but international practices and guidelines are used. Environmental impact assessments are conducted according to domestic legislation (Assembly of the Republic of Kosovo, 2009[163]; Official Gazette of the Republic of Kosovo, 2010[164]; Official Gazette of the Republic of Kosovo, 2010[165]), while social impact assessments are conducted using international financial institution (IFI) procedures.

Since the last CO assessment there have been no changes to **implementation and procurement processes**. The Law on Public Procurement (currently being amended) was adopted in 2011 and prescribes alternative procurement procedures for projects funded through public-private partnerships, IFI funds or other public contracts. *Ex post* evaluation of implementation and procurement processes exists, but frameworks have not yet been revised based on the results. Although the roles and responsibilities of government bodies[110] are defined, they lack the human and financial capacity to execute their procurement and implementation tasks and have not been given oversight roles for the procurement and monitoring of public-private partnerships.

There is no co-operation with WB economies during implementation and procurement, and therefore best practices and lessons have not been shared. Box 22.9 contains good examples of project implementation and monitoring tools used in Albania and Serbia to help control funds and invest in the projects that generate the best for society and the economy.

The **asset management system**[111] is in the early development phase in Kosovo. Legislation has been drafted and adopted based on the 2018 Technical Assistance to Connectivity in the Western Balkans (CONNECTA) study – Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6 (Transport Community, n.d.[166]). Based on this, the railway infrastructure manager, Infrakos, prepared a seven-year maintenance plan for 2019-2025. In order to continue with developments in this field, a policy framework for the institutionalisation of the road asset management system needs to be developed. The key objective of a well-developed asset management system is to provide justification for the maintenance budget and to help direct limited funds towards areas where the return on investment will be the greatest. Such a system should be considered as an integral component of transport planning, identification, prioritisation, implementation and monitoring. A good example recently established in the region is the Albanian financial management system that also includes asset costs; other good examples can be found in North Macedonia and Serbia (road asset database, bridge asset databases, etc.). Co-operation with regional authorities could be worthwhile to exchange good practice. If transport infrastructure assets are well regulated and well operated it leads to a well-developed and maintained transport network, which is a pre-requisite for regional transport integration and the building of a competitive regional transport market.

### Box 22.9. Effective tools to manage transport projects in Albania and Serbia

Albania and Serbia are the only two economies with a sound tool for transport project identification, selection, prioritisation and implementation in the WB region.

In 2018, **Albania** adopted the Decision on the Public Investment Management Procedures. For the purpose of budget planning on investment expenditure, the projects are divided into two groups: 1) capital administrative expenditure on equipment, furniture, computers, IT, etc; and 2) expenditure on investment projects, including capital expenditure on infrastructure such as new constructions, reconstructions, rehabilitation with design costs, expropriation costs, purchase of larger technological equipment, implementation of works and supervision; and capital expenditure for capacity development, including research projects, technical assistance and capacity building.

The following project management cycle is applied:

1. Project identification based on an analysis of the public's needs.
2. Project evaluation and preparation, including an evaluation of the economic and financial justification.
3. Project approval and financing.
4. Project implementation.
5. Monitoring of project implementation, which should ensure that project activities are in line with planned activities.
6. Evaluation and audit, including implementation-related reporting and financial audit through the project performance indicators.

The following steps are applied based on the project cycle presented above:

1. Identify the project idea based on an analysis of public needs.
2. Review the draft idea (project management team leader and responsible authorities).
3. Prepare detailed project and evaluation, and a shortlist of alternatives.
4. Submit investment project proposal to the ministry responsible for investment projects.
5. Review the proposal (Council of Ministers).
6. Final approval, after the approval of investment projects within the annual budget.

As per Decision No. 290 of 11 April 2020, a financial management information system has been installed in every spending unit, including in all ministries, and is integrated into various departments to be used for all steps in the project management cycle.

In **Serbia**, the procedure for project identification, analysis of relevance, pre-selection, funding, implementation and monitoring is clear and publicly available, and co-ordinated through the Ministry of Finance. This procedure was adopted in 2019 though the Rulebook on the Management of Capital Projects.

The prioritisation process, which is applied to all projects, applies a cost-benefit analysis, an environmental and social impact analysis, and a safety assessment, among other things. Once the project is approved for financing there is a special procedure, similar to the one in Albania, that forms the preparation of a plan for project implementation. During project implementation there are specific procedure forms for reporting. One type of report is the interim report for the presentation of the current project status, which covers the activities carried out and the plan to execute the remaining project activities. At the end of the project, a final report needs to be developed.

There are three categories of project: 1) less than EUR 5 million; 2) between EUR 5 and 25 million; and 3) over EUR 25 million. *Ex post* monitoring is conducted for the third category three years after completion, which is a significant advancement on local legislation.

Source: (Republic of Albania, 2018[167]), *Albania – Decision of the Council of Minster No 185/2018*, http://80.78.70.231/pls/kuv/f?p=201:Vendim%20i%20KM:185:29.03.2018; (QBZ, 2020[168]), *Albania – Decision of the Council of Minster No 209/2020*, https://qbz.gov.al/eli/vendim/2020/04/11/290; (Ministry of Finance, 2019[169]), *Serbia – Rulebook on the management of capital projects*, https://www.mfin.gov.rs/UserFiles/File/podzakonski%20akti/2019/Uredba%20o%20upravljanju%20kapitalnim%20projektima.pdf; (Ministry of Finance, 2020[170]), *Serbia – Project cycle process – Forms*, https://www.mfin.gov.rs/dokumenti/saobracaj/.

### *Sub-dimension 11.2: Governance and regulation*

Since the last CO assessment, regulatory reforms have continued in the field of **aviation regulation**. The Single European Sky (SES) I package has been transposed and is in the process of implementation, bringing Kosovo significantly closer to the EU *acquis*. The SES II package has not yet been fully transposed, and the full transposition cannot be conducted until Kosovo enters the EU. Some legislation has not been implemented yet due to political reasons beyond the control of the Civil Aviation Authority. Monitoring of SES implementation is only done by the independent observer (based on European Common Aviation Area agreement assessments, as well as through the European Union Aviation Safety Agency), and not through internal bodies and agencies in Kosovo. Kosovo does not have its own air traffic management (ATM) Plan,[112] and is not a member of the European ATM Network or Eurocontrol. Kosovo is not a member of any functional airspace block, which reduces safety, limits capacity and increases costs. In addition, Kosovo does not receive revenue from upper airspace management and therefore cannot utilise and invest in capacity and infrastructure development.

The Airport Charges Directive has been transposed and is being implemented. This states that airport charges must be set and monitored based on the EU non-discrimination and transparency principles, and that quality standards for the service level agreement for services provided at the airport must be applied. A supervision authority has been established, whose mission is to supervise the air traffic management regulatory framework. The market is not monitored yet as per Air Service Regulation, which provides an economic framework for air transport regarding the granting and oversight of community air carriers' operating licences, market access, airport registration and leasing, public service obligations, traffic distribution between airports if needed, and pricing. In terms of safety culture,[113] a programme covering safety risk assessment and safety assurance has been adopted.

Air traffic is growing in Kosovo: the total number of passengers transported from all airports increased in the period 2017-19 by approximately 25.7%, amounting to 2.37 million passengers in 2019. This could be

considered a significant increase in comparison with the world average increase of 11.7% (IATA, 2020[171]) over the same period. Given the significant growth of air travel and its projected importance for the economy, it is important that Kosovo continues regulatory reforms and brings the governance of the aviation sector closer to European standards and international best practice.

There have been many positive efforts in the **railway regulation** sector in Kosovo since the last CO assessment, but substantially more effort is needed to align legislation with the EU *acquis* and the TCT. Although the network monopoly is unbundled, the railway market is officially open and liberalised for international companies if they have valid licences and comply with local legislation to establish a legal entity (Sub-dimension 2.2: Services trade restrictiveness). Hence, the market should be fully opened and non-discriminatory. Structural reforms were adopted in 2011, and the vertical separation of the dominant state-owned railway company, Kosovo Railways, was implemented based on the Law on Railways (2012). There is only one state-owned infrastructure manager in the market and two operators (railway undertakings) – one state-owned and one private (since 2015). Of the currently applicable railway legislation in Kosovo (only 2% is considered not applicable), 19% of the of the legislation prescribed by the TCT is fully transposed and implemented, 39.5% is partially transposed and implemented, and 39.5% not transposed, while the rest remains unclear (information provided by the government). Harmonisation has been achieved since the last CO assessment in calculating direct costs, railway safety, interoperability, and maintenance; however, substantially more efforts are needed in these and all other fields to align legislation and market conditions with European railway standards.

The main oversight body for the railway sector is the Railway Regulatory Body, with responsibilities such as licensing, safety, market regulation and interoperability. Network statements for infrastructure and services facilities are regularly issued to ensure transparency and non-discriminatory access to rail infrastructure and to services in service facilities. The Investigation Body, whose purpose is to undertake accident investigation as a key input to improve the safety performance of railways, is under control of the Prime Minister's Office.

The Interoperability Directive 2016/797, which is important for the development of international railway transport, is partly transposed. The Register of Railway Vehicles was established in 2012 as a database on all used vehicles, owners, entities in charge of vehicle maintenance and vehicle technical information, as well as limitations on vehicle use. However, it should be transformed into the centralised registry for European Vehicle Register as per Commission Implementing Decision 2018/1614 by 2024. In terms of rail passengers' rights and obligations, Directive 1371/2007 has been transposed, which prescribes the framework to safeguard users' rights and improve the quality and effectiveness of rail passenger services in order to help increase the share of rail transport in relation to other modes of transport. The Rail Freight Corridors Regulation 913/2010 will need to be transposed into domestic legislation and implemented to enable the high-quality capacity of freight transport and a competitive modal shift to rail. Railway authorities signed the Declaration on European Railway Safety Culture in 2019 (ERA, 2019[172]), which should increase awareness and promotion of a higher standard of safety culture throughout the railway transport sector.

Bilateral co-operation is satisfactory, and an agreement on the incorporation of the railway networks of North Macedonia and Kosovo has been signed between the two economies, which should facilitate border crossings. The total number of transported passengers fell by 22.3% in the period 2017-19, amounting to 0.12 million passengers in 2019, while the total number of transported tonnes increased significantly, by 29.3%, amounting to 0.55 million tonnes in 2019. Kosovo's rail network and fleet utilisation are presented in Table 22.17.

### Table 22.17. Trends in rail transport in Kosovo (2017-19)

| Rail network utilisation | Change over 2017-19 (%) | 2019 | Share of EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of track) | +110 | 3 293 | 0.15 |
| Freight (tonnes*km/km of track) | +87 | 77 385 | 3.99 |
| **Rail fleet utilisation** | **Change over 2017-19 (%)** | **2019** | **Share of EU average (2017) (%)** |
| Passenger (passengers*km/train*km) | +141 | 6 | 0.04 |
| Freight (tonnes*km/train*km) | +22 | 329 | 10.4 |

Source: (European Commission, 2019[173]), *Statistical Pocketbook: EU Transport in Figures*, https://ec.europa.eu/transport/facts-fundings/statistics/pocketbook-2019_en; Information provided by the government for this assessment.

Rail freight's share of transport modes in Kosovo was 11.6% in 2019. The freight mode share is low compared to the inland EU average, where road share accounted for 75.3% and rail share for 18.3% in 2018 (Eurostat, 2020[174]). There is potential to increase Kosovo's share of rail freight after it finishes rehabilitating the railway network (Route 10 and Route 7), which will reconnect the unbundled network and increase both speed and reliability (European Commission, 2015[175]). There is still much to be done (e.g. full opening of the market, incentives for shifting from road to rail, development of rail freight corridors, development of multimodal facilities) to achieve trends that will show the intensified development and cost-effectiveness of railway transport in Kosovo, and to reach EU average levels of rail network and fleet utilisation. An increase in the railway mode share could have direct positive impacts on air pollution and climate change.

There has been no visible positive improvement to **road market regulation** since the last CO assessment. Substantial additional efforts are needed to align local legislation with the EU *acquis* and the TCT. The Law on Road Transport is expected to be amended in 2020, while the existing law has been harmonised with some EU *acquis* regulation. Only 7% of the legislation prescribed by the TCT has been fully transposed, none of which has been fully implemented, 30% is partially transposed, and 57% is not transposed yet. Therefore, considerable efforts are needed in most fields to align the local market with European standards.

Kosovo does not participate in the multilateral quota system of the European Conference of Ministers of Transport (ECMT) (ITF/IRU, 2014[176]), which enables hauliers to undertake unlimited multilateral freight operations in 43 participating European member economies. Indicators[114] to measure the road network's performance have not been established yet. Kosovo will expand its bilateral agreements by signing new agreements with Latvia, Lithuania, Estonia and Finland on the transport of goods and passengers. The implementation of market access agreements and EU legislation is not monitored in Kosovo.

The high share of road freight, around 88.4% (a higher share than the EU average as presented above), has clear negative effects on air pollution and climate change. Therefore, incentives for shifting freight from road to rail could have a positive impact on reducing air pollution and climate change impacts.

The COVID-19 outbreak is affecting the transport and mobility market all over the world, including in WB economies. As a result, in the second quarter of 2020 Kosovo introduced measures at its border and customs control to enable the provision of essential goods and medical equipment. Kosovo introduced "green lane" measures in the major corridors for the transport of emergency goods. It should take no longer than 15 minutes to pass through the green lane border crossings (including any checks and screenings), and procedures should be minimised and streamlined. The implementation of these measures could directly impact how border crossings are treated in the future. Installing other measures based on regional experiences could also have positive impacts, such as the measures to minimise crossing time that include the implementation of one-stop shops (OSSs) for road border crossing point (BCP) Preševo/Tabanovce between Serbia and North Macedonia, the automation of customs procedures, and traffic management measures that transfer physical queues into virtual queues through an electronic queuing management system (e-QMS) installed in Baltic countries.[115]

Monitoring indicators to assess the performance of all transport modes either do not exist or are not properly established (indicators generally should include infrastructure conditions, average user costs, travel time satisfactory level [reliability], value of assets, market research and customer feedback, quality of user information, audit programmes). Regular data surveys are neither planned soundly (including the purpose and level of data needed and budget allocated) nor conducted regularly. The surveys that have been conducted have only been for the purposes of specific projects and not for general transport infrastructure assessment and planning. Therefore, there is no basis for a quality assessment of the transport network performance.

### *Sub-dimension 11.3: Sustainability*

Further efforts are required to improve **road safety** in Kosovo. A Road Safety Strategy (RSS) and related action plan have been developed for the period 2015-20, and the Ministry of Infrastructure has recently appointed a working group to review the RSS and draft a new action plan. The RSS defines the overall budget per year, but is not allocated to specific action plan measures. There are no indicators for each of the proposed measures either, which could make monitoring difficult. In any case, the RSS is currently not monitored and there are no available monitoring reports so far. Monitoring should be conducted by the secretariat of the Road Transport Safety Council and reported to the council at least twice a year, but this does not happen. The action plan also assigns responsibility to the beneficiary for each proposed measure. It is not clear if the staff of the Road Transport Safety Council are sufficient for implementing the strategy, and there is also a shortage of financial resources.

The RSS is partially compliant with EU legislation and the TCT (the outstanding parts not included in the strategy include road infrastructure safety management, road safety audit, road safety inspection, speed management, safe system approach, and "forgiving" roads). Full alignment is expected in the new strategy in 2021. Kosovo applied to become a member of the International Safety Data and Analysis Group (IRTAD) (ITF, n.d.[181]), but its request was rejected, which means that Kosovo cannot currently contribute to international co-operation on road accident data and analysis. The regional Road Safety Action Plan (Transport Community, 2020[182]) was endorsed by the Ministerial Council of the TCPS in October 2020, and Kosovo needs to align domestic plans to achieve the goals set within this plan (strengthening road safety management, promoting safe infrastructure, protecting road users, enhancing co-operation and exchanging experiences).

The total number of fatalities fell in the decade 2010-20 by approximately 59% (Table 22.18), amounting to 80 in 2020 (Kosovo Agency of Statistics, 2020[183]). This represents the best achievement in the region, and complies with the goal of the European Commission's Policy Orientation on Road Safety 2011-2020 (European Commission, 2010[184]) to reduce road fatalities by 50% between 2010 and 2020 (as per the Decade of Action for Road Safety 2011-2020, officially proclaimed by the UN General Assembly in March 2010). The RSS defined goals to reduce the number of fatalities by 50% by 2020 (it achieved 43.6%), the number of injured road users by 20%, and the number of all accidents by 10%. It will be known if these goals have been met once 2020 detailed traffic accident data are available.

**Table 22.18. Road safety trends in Kosovo (2010-20)**

| | Change over 2010-20 (%) | Change over 2017-20 (%) | 2020 |
|---|---|---|---|
| Number of fatalities (Kosovo) | -59 | -38.9 | 80 |
| Number of fatalities (EU) | -23* | -2.5* | - |
| Number of fatalities per million inhabitants (Kosovo) | - | - | 44.9 |
| Number of fatalities per million inhabitants (EU) | - | - | 51 |

* Data refers to the period until 2019. EU average includes all 27 Member States.

Source: (European Commission, 2019[185]), *2019 road safety statistics: What is behind the figures?*, https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004; (Eurostat, 2021[186]), *Victims in road accidents by NUTS 2 regions*, https://ec.europa.eu/eurostat/databrowser/view/tran_r_acci/default/table?lang=en; (Kosovo Agency of Statistics, 2020[183]), *Statistical Yearbook of the Republic of Kosovo*, https://ask.rks-gov.net/media/5641/vjetari-2020-final-per-web-ang.pdf.

The goal of the European Union's "Vision Zero" strategy is to zero deaths or serious injuries on Europe's roads by 2050 (European Commission, 2019[28]). The strategy has an intermediate goal of a 50% decrease in road fatalities between 2021 and 2030. Kosovo has made positive progress but must continue harmonising its legislation with the TCT, as well as permanently carrying out activities in the fields of education, awareness campaigns, enforcements, etc. to achieve better results and comply with the requirements for the next steps (Box 22.10).

Kosovo has an **environmental sustainability strategy**, and some environmental sustainability transport related parameters are partly covered through the Kosovo Environmental Strategy 2013-2022 (Ministry of Environment and Spatial Planning, 2013[187]) and the Kosovo Environmental Plan. These strategies set different objectives and goals (without measures) related to environmental sustainability in the transport sector.[116] All of these objectives and goals should be followed up by specific actions and measures and linked with the domestic transport framework, which needs to define clear and measurable indicators with timelines, budgets, and a responsible body for implementation, as none of these have been set in the strategy and plan. The Strategy for Environmental Protection and Sustainable Development is planned to be drafted by the government in 2021.

**Combined transport**[117] is the most cost-efficient transport mode, reducing environmental pollution, and increasing co-operation between the freight forwarding network companies. The legal and regulatory framework to support combined transport is not yet defined, although the transport strategy has set some priority actions. Co-modality is proposed in the SSMT through, for example, creating a multimodal organisational framework, connecting a multimodal system with the EU networks, and improving an existing terminal and constructing a new terminal in Miradi. However, there is no separate strategy for logistics and co-modal solutions. There is both a lack of multimodal infrastructure facilities and insufficient understanding of multimodality to develop a framework for combined transport.

Data collection needs to be one of the key actions to assess the performance of all sustainability areas. A strategy for data collection is needed as a basis for assessing the transport sector and to directly influence the prioritisation processes within transport policy in general.

### *The way forward for transport policy*

Kosovo has taken some important steps to develop a competitive transport sector, as presented above, but special attention should be paid to the following remaining challenges:

- **Update the transport strategy regularly.** The update should be based on the findings and conclusions from strategy implementation monitoring of the first five years, and include measures to implement activities not implemented in the period 2015-2020. The update should also consider the TCT and the findings from the implementation monitoring of other related strategies (e.g. environmental, climate, tourism).
- **Develop a tool for project identification, selection, prioritisation and implementation and apply it consistently and regularly**. This tool should be applied to all transport projects in Kosovo. Good examples could be followed from the region, such as in Albania and Serbia (Box 22.9). The project systems in these economies cover all processes, from project identification to the *ex post* monitoring of implemented projects, as well as the financial management IT system that is planned to be implemented in all spending departments of government institutions and implementing agencies.

- **Focus on continuing rail reforms**. These reforms should speed up harmonisation with the EU *acquis*, and therefore the transposition and implementation of all necessary legislation from the TCT needs to be faster. Enhancing the human and financial capacities of the regulatory authorities is one of the first priorities. Interoperability activities are very important for the development of international railway transport and should be continued, but gradually, as interoperability takes time and funds. Rail freight corridor regulation will need to be transposed into domestic legislation and implemented to enable the high-quality capacity of freight transport and a competitive modal shift to rail.
- **Ensure efforts to become a member of the ECMT remain a key priority**. The ECMT system could enable hauliers to undertake an unlimited number of multilateral freight operations in 43 participating European member economies. Once Kosovo becomes a member it will need to upgrade existing legislation to comply with the road haulage qualifications standards for companies, managers and drivers under the Quality Charter for Road Haulage.
- **Develop and tailor cost-benefit analysis (CBA) guidelines specific to Kosovo.** It is very important for each economy to develop its own CBA guidelines with accompanying technical instructions. The guidance needs to be updated often, on a maximum two-year basis. A good example is the United Kingdom's Transport Analysis Guideline (UK Government, 2019[188]), which provides information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure the consistency of the discount rates used for similar domestic projects it is necessary to develop a benchmark for all technical and economic parameters, including the financial and economic discount rate in the guidance documents, and then apply it consistently in project appraisals at the economy level. Empirical research needs to be conducted at the economy level to generate input data for the calculation of externalities.
- **Ensure that transport facilitation is a key priority.** It is necessary to implement one-stop shops[118] and other measures as per the regional Action Plan for Transport Facilitation (Transport Community, 2020[178]), endorsed in October 2020. These measures include improving and upgrading existing ICT infrastructure, constructing or modernising infrastructure to remove physical and technical barriers and to increase capacities, and capacity building to improve performance efficiency. The implementation of these measures will be a key trigger for integration of the Kosovo transport market into the regional transport market, which will increase the competitiveness and connectivity of the WB region and drive deeper integration into the broader European market. Good examples from the region include North Macedonia and Serbia, which have recently introduced a well-developed one-stop shop system and are currently in the initial stages of implementing a pilot project for an electronic queuing management system.
- **Develop a combined transport strategy.** The development of this strategy will promote sustainable transport as it will help to shift freight transported from road to rail, which is a more environmentally friendly mode of transport**.** As the rail and road Routes 7 and 10 (European Commission, n.d.[189]) are being modernised, the timely development of a combined transport framework in Kosovo could generate substantial benefits for the economy. Combined transport saves time and resources for shipping companies. Therefore, incentives for shifting freight to combined transport are needed.
- **Develop an integrated environmental and transport action plan.** This plan needs to integrate existing indicators and to include new ones in a framework for environmental sustainability in the transport sector. A good example is the Transport and Environment Reporting Mechanism (EEA, n.d.[190]) developed by the European Environmental Agency, which prescribes indicators for tracking transport and environmental performance in the EU.[119] Existing measures and indicators should be applied in the relevant strategies, including the new transport strategy.

### Box 22.10. Innovations in road safety: Road safety social impact bonds, Montenegro

In 2018, the United Nations Development Program (UNDP) in Montenegro, in co-operation with the key domestic players in road safety, developed the idea of road safety social impact bonds as an innovative and alternative performance-based public financial instrument that shifts the policy framework from inputs and outputs to outcomes and value-for-money. This innovative idea involves the private sector investing in road safety improvements to strengthen sustainability together with the public sector. The public partner commits to paying the outcome payments to the investor if (and only if) the predefined and measurable social goals are met. This idea has great potential to help other economies in the region (and beyond) replicate and scale-up the model.

Source: (UNDP Montenegro, 2014[190]), *Rethinking Road Safety in Montenegro*, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

## Energy policy (Dimension 12)

### *Introduction*

Kosovo has made significant progress across all sub-dimensions of the energy dimension (Figure 22.1). Overall, Kosovo scored 3.0 compared to 2.3 in the last Competitiveness Outlook. The most significant progress relates to unbundling and third-party access, where Kosovo is almost fully aligned with international good practice. Kosovo has also shown significant improvement on energy efficiency, and to a lesser extent renewable energy, where the adoption of several strategies, secondary legislation and regulation has led to the increased implementation of international practices.

Kosovo's overall progress is confirmed by the Energy Community Secretariat (Energy Community Secretariat, 2020[191]), which scores Kosovo's transposition of the Third Energy Package at 64%, the third highest within the Western Balkans; implementation is scored at 56%. Despite this achievement, there is further room for improvement. The key challenges lie in finalising the transposition and implementation of the Third Energy Package (Box 22.11), continuing with market liberalisation and deregulation, promoting competition in the retail and wholesale market, and pushing forward with regional integration.

This need for improvement is also reflected in the regional perspective, where Kosovo, compared to other WB economies, has lost some ground since the previous Competitiveness Outlook when it was among the leaders in the Western Balkans, with a score above the regional average. However, in this assessment cycle the score is more in line with the regional average (Table 22.19). Driving this fall in relative performance is the rapid development in other economies, coupled with limited progress in Kosovo on energy policy, the legal and institutional framework, the energy regulator, the natural gas and electricity supply framework, and regional integration indicators (for details please see the respective sub-dimensions below). This does not mean that there was no progress in these sub-dimensions, but that progress was muted, especially when compared to the regional performance.

**Table 22.19. Kosovo's scores for energy policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Energy policy dimension** | Sub-dimension 12.1: Governance and regulation | 3.3 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 2.8 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 3.0 | 3.0 |
| **Kosovo's overall score** | | **3.0** | **3.0** |

### *State of play and key developments*

#### *Sub-dimension 12.1: Governance and regulation*

Kosovo's energy sector is governed by an extensive **legislative framework**.[120] However, although the primary legislative environment almost fully transposes the EU Third Energy Package (see Box 22.11), the lack of adoption of secondary legislation and regulations, as well as their actual implementation, means that the final implementation of the Third Energy Package in Kosovo is not complete. The Energy Community Secretariat rates Kosovo's transposition at 64%, one of the highest of the WB6, and implementation at 56% (Energy Community Secretariat, 2020[191]). However, it notes that 22% of the Third Energy Package remains partially transposed and 14% is not transposed at all, particularly regarding renewable energy. The Secretariat also notes that implementation is lacking across all sub-dimensions, particularly natural gas, although this is partly due to Kosovo not having a natural gas market. Furthermore, the list of secondary legislation mandated by Kosovo's primary legalisation (Energy Community Secretariat, 2020[192]) shows that a variety of secondary acts are missing. Overall, the gaps in transposition and implementation of the Third Energy Package, and the lack of adoption of secondary legislation, means that Kosovo's market does not fully reflect international best standards and practices reflected in the EU

Third Energy Package. Consequently, Kosovo is unlikely to be as efficient in allocating energy as it could be.

### Box 22.11. The Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Co-operation of Energy Regulators, ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all of the WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies as members of the Energy Community, whose acquis reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude, the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

Legislation is complemented by a comprehensive **energy policy** that consists of a variety of strategies and action plans. However, these action plans and strategies are mostly dated and do not extend into much beyond 2020. Two new long-term strategies are being drafted and are expected to be adopted by the end of June 2021: the Energy Strategy of the Republic of Kosovo 2021-2030 and the National Energy and Climate Plan 2021-2030. The government reported as part of this assessment that more than 75% of the Energy Strategy Implementation Program 2018-2020 had been implemented.[121]

The action plans and strategies are supplemented with a strategy for liberalising the electricity wholesale and retail market. However, the OECD understands that price liberalisation and deregulation has been suspended for customers connected to 35 kV and 10 kV power lines (i.e. their price remains regulated),

and that all customers (even unregulated) are still with the universal supplier, the Kosovo Electricity Supply Company (KESCO). The liberalisation and deregulation of the retail market was postponed by the regulator in July 2020, partly due to the COVID-19 pandemic, with the decision to extend the coverage of universal supplier obligations for KESCO to March 2021. Of the seven licensed supply companies, only the universal supplier, KESCO, is active. This means that although supplier switching is embedded in legislation, de facto competition is absent in the market, and customers have no choice but to be supplied by KESCO. So far, little has been done to promote competition or market liquidity.

Regarding market monitoring, it appears that extensive data and indicators are collected frequently. However, the precise nature of the indicators collected is not clear. Furthermore, most of the data are not shared with the public, or are only shared based on annual reporting by the Ministry of Economic Development and the regulator. This could be improved as part of a drive to increase transparency and promote competitive market behaviour by all participants. Strategies and action plans are evaluated on a regular basis and revised if needed. The Ministry of Economic Development revises the energy strategy every three years and designs a new strategy for the next 10 years.

Regarding the **institutional framework**, public institutions in the energy sector have specific roles and responsibilities, as detailed in Table 22.20.

### Table 22.20. Kosovo's institutional framework for energy policy

| Entity | Roles and responsibilities |
|---|---|
| Assembly of Kosovo | Monitors the regulator and chooses the regulator's board members. Approves the energy strategy and legislation. |
| Prime Minister's Office | Supports the preparation of energy policies and government approval of relevant acts. |
| Ministry of Economic Development | Drafts energy policy and legislation, and adopts certain secondary acts. |
| Ministry of Finance | Monitors subsidies and other financial aspects of government commitments to the energy market in Kosovo. |
| Ministry of Trade and Industry | Registers enterprises, including those within the energy sector. |
| Ministry of Environment and Spatial Planning | Develops environmental policies, monitors the implementation of environmental policies by energy companies, issues environmental compliance for energy companies and implements legislation on energy performance in buildings. |
| Energy Regulatory Office (ERO) | Monitors the energy market, licenses energy enterprises, adopts secondary legislation that regulates the energy market. |
| Electricity Transmission and System Operator, KOSTT | Operates the transmission system and energy market. |
| Electricity Distribution System and Supply Operator, KEDS | Operates the distribution system. |
| Kosovo Energy Corporation, KEK | Key state company that generates electricity and operates coal mines. |
| Independent Commission for Mines and Minerals | Licenses coal enterprises. |
| Kosovo Electricity Supply Company (KESCO) | Supplies electricity and acts as universal supplier until March 2021. |

Note: The owner of KEDS and KESCO is the consortium made up of Çalik Holding and Limak.

Although these entities report that they currently have adequate resources, some expressed concerns that these resources might not be sufficient to meet new challenges stemming from the deployment of the EU-style electricity market.

Kosovo's **energy regulator**, the Energy Regulatory Office (ERO), conforms with the Third Energy Package, at least theoretically regarding its autonomous position, as reflected by the 77% score assigned by the Energy Community Secretariat (Energy Community Secretariat, 2020[191]). This score was partly assigned to reflect ERO's continuous efforts to transpose new *acquis*, including the integration of network codes, regulations on wholesale energy market integrity and transparency, and nominated electricity market operator rules.

Nonetheless, there are three concerns regarding possible infringements of ERO's independence. The first issue relates to the absence of a separate account for the regulator. Currently, the regulator's financing is a line item in the government's budget and accounts and is subject to government budget limitations. While in practice this might not lead to interference with the regulator's independence, assuming no steps are taken by the government that hinder the regulator in undertaking financial transactions, it would be better to separate the account of the regulator, according to international best practice. The second issue relates to staff salaries, in particular recent public administration reforms that envisage reducing the already low salaries of ERO staff. ERO is already struggling to acquire and retain the required skilled staff, and any further reduction in salaries will see it stripped of skilled labour. The third issue relates to the selection of ERO board members. Currently, the government pre-selects candidates before presenting a list to parliament. This means that the nomination is subject to political influence and considerations. This can partly be seen in the vacant chair and two additional board positions (since December 2020), leaving the board without enough members to have a quorum (i.e. no decision can be made). While the nomination and approval of board members is a lengthy process, prevailing political circumstances in Kosovo appear to contribute to delays in the nomination and approval of board members.

**Infrastructure management** is guided by the Ten-Year Network Development Plans (TYNDP) for the transmission service operator (TSO) and distribution service operator (DSO). The TYNDP provides an overview of energy infrastructure and its future developments, and aims for system stability, security of supply, diversification of energy sources and energy efficiency. The TYNDPs are supplemented with five-year investment plans. Both plans are reviewed annually and revised if needed. Kosovo also undertakes extensive monitoring and operational planning of infrastructure, supported by an asset maintenance planning policy and asset database used to identify the state of assets and need for maintenance. Nonetheless, based on information provided as part of this assessment, this system appears to be a tool of simple design used to monitor assets in six-month cycles.

### *Sub-dimension 12.2: Security of energy supply*

Kosovo does not have a natural gas market; however, there are ongoing efforts and plans to invest in natural gas infrastructure and eventually deploy a natural gas market, thus improving **the gas supply framework**. Efforts are also underway to put in place the relevant legislative framework, as reflected by the 2016 adoption of the Law on Natural Gas.[122] The Energy Community Secretariat (Energy Community Secretariat, 2020[191]) rates transposition as high in this sector, although implementation is low given that there is no natural gas market. Kosovo is currently looking into establishing natural gas supply via Albania and North Macedonia. A pre-feasibility study for the interconnector with Albania has been completed and is underway for the interconnector with North Macedonia.

There are policies in place[123] and a comprehensive monitoring system[124] for Kosovo's **electricity supply framework**. The monitoring of energy policy implementation is undertaken quarterly by the Ministry of Economic Development as part of the reporting on the implementation of the government action plan. Every year the ministry prepares an annual report on the Energy Strategy Implementation Program. Public transparency and the frequency with which indicators are published could be improved, according to the Energy Community Secretariat (Energy Community Secretariat, 2020[191]), which noted that Kosovo has fully transposed and complies with data collection and dissemination standards, including those concerning the energy supply framework, but lacks monthly statistics. Before COVID-19 there was an attempt to fully implement monthly statistics collection and dissemination based on best practices; however, this project has been suspended due to the pandemic.

However, there are some more pressing concerns regarding the electricity supply framework. It is not clear to what extent Kosovo has transposed and implemented EU Regulation 2019/941 on risk-preparedness in the electricity sector. The regulation represents EU best practice on preparing for possible electricity emergency situations. It establishes certain requirements in terms of planning, preparing, identifying and

managing such a crisis. Kosovo does have some measures in place, and it is not mandatory for it to transpose this EU regulation as part of its status as an Energy Community Contracting Party; however, it is advisable for Kosovo to check, clarify and fully transpose and implement the regulation if this has not already been done.[125]

Another concern relates to the Energy Strategy of the Republic of Kosovo 2017-2026, which contains the objective of increasing power generation from coal. More precisely, approximately 450 MW of additional coal capacity is to be built after 2023 to replace the 270 MW that will be lost when TPP Kosovo A (a coal plant) is retired in 2023, and to support generation while the remaining coal plant, TPP Kosovo B, is refurbished in 2023 and 2024. However, the construction of the first plant has encountered difficulties with the withdrawal of the contracted company. Despite no concrete decision having been taken in response, the government has not changed its policy related to expanding coal-fired power generation, and plans to establish a new coal mine. Overall, Kosovo plans to spend EUR 1.5 billion to support the expansion and retirement of coal-fired power plants. It is not clear what drives this continued reliance on coal, nor whether the greenhouse gas costs were explicitly included in the decision to rely on coal-fired power generation.

The reliance on coal-fired power generation does not mean that Kosovo does not envisage increasing **renewable energy use**. The renewable energy sector is guided by an array of legislation, regulation, strategies and action plans, including the National Renewable Energy Action Plan 2011-2020 (adopted in November 2013) and the National Action Plan on Energy Resources of the Republic of Kosovo 2011-2020, and associated progress reports. Moreover, several reports have or are being drafted on Kosovo's renewable energy, and there has been a study on the options for the least costly integration of renewable energy into the grid. Kosovo has introduced a simplified administrative procedure for renewable energy projects with the adoption in April 2018 of regulation for a one-stop shop for renewable energy sources. This effectively establishes a single point of contact for information and applications relating to renewable energy within the Department of Energy at the Ministry of Economic Development. Furthermore, an extensive monitoring scheme is in place, associated with active policy revision if needed.

In line with international practices, self-consumption (prosumers[126]) is recognised by legislation, and connection and priority dispatching are guaranteed, although the associated costs are not published, which reduces transparency. Overall, Kosovo is on track to achieve the 2020 target that 25% of gross final energy consumption, and 45.6% of heating and cooling, will be from renewable sources.

Regarding transport, Kosovo is unlikely to achieve the 2020 target of 10% renewable energy in transport energy consumption, as set out in National Renewable Energy Action Plan 2011-2020. One aspect hampering the growth of renewable energy in transport is deficiencies in the support scheme for promoting renewable energy in transport, in particular the support schemes and sustainability criteria for biofuels and bioliquids. Moreover, Kosovo has not transposed any aspect of the EU Directive on the Promotion of the Use of Energy from Renewable Sources. This directive establishes the foundation of renewable energy within the transport sector, including targets, as well as the framework for increasing renewable energy.

There are several issues and concerns relating to renewable energy use in Kosovo. First and foremost is the current approach to supporting renewable energy. Kosovo should consider, in line with latest international good practices, moving away from a feed-in-tariff support scheme to a feed-in-premium or contract-for-difference scheme, at least for bigger projects (Box 22.12). The second issue relates to the lack of competitive assignment of new renewable energy source (RES) projects. However, the government does plan to adjust the support scheme soon and execute its first RES auction.[127]

Much like renewable energy, Kosovo's **energy efficiency** sector is guided by an array of legislation, regulation, strategies and actions plans.[128] The legislative framework establishes the approach to, and the requirement for, the energy efficiency certification of newly constructed buildings or buildings undergoing major reconstruction, as well as the minimum energy performance of buildings. Moreover, the legislative framework is in place for the concept of near zero energy buildings, and Kosovo expects to undertake several pilot projects in 2020. The sector has clearly established entities with specific roles and is guided by a dedicated energy efficiency agency, the Kosovo Agency for Energy Efficiency (KAEE), and an operational energy efficiency fund, the Energy Efficiency Fund (FKEE).

### Box 22.12. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated, independent of the electricity market price (Banja et al., 2017[193]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in-tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (European Commission, 2013[194]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (European Commission, 2013[194]), which is a particular problem as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (European Commission, 2013[194]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al., 2017[193]). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (European Commission, 2013[194]).

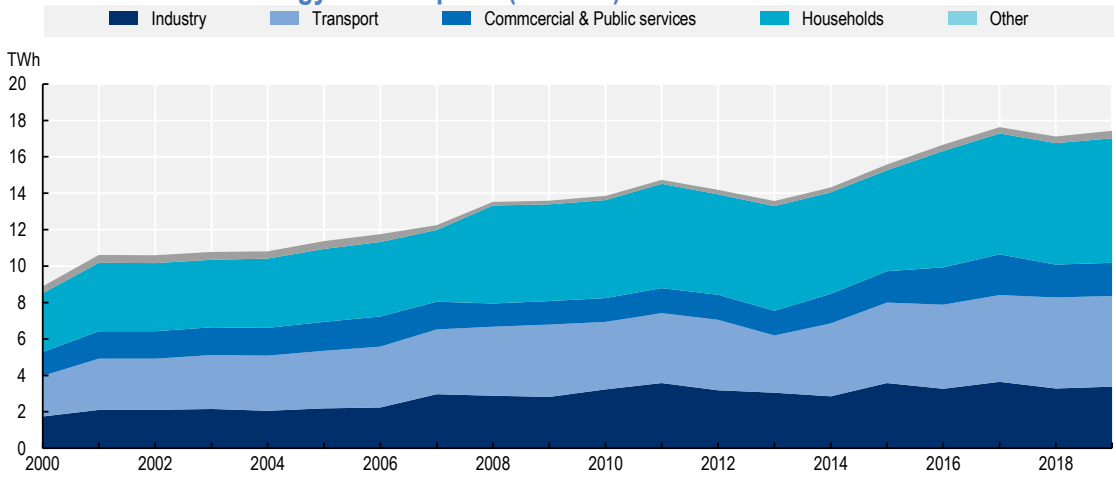
The European Commission (2013[194]) suggests using a feed-in premium scheme in combination with the following good practice recommendations:

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable projects and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

The Council of European Energy Regulators (2018[195]), reports that in 2016/17, some 17 of the 27 EU Member States still used some form of feed-in tariff (although mainly for small projects), while around 16 used feed-in premiums, including to complement feed-in tariffs.

For more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.
Source: (Banja et al., 2017[193]), *Renewables in the EU: an overview of support schemes and measures*, http://dx.doi.org/10.2760/521847; (CEER, 2018[195]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (European Commission, 2013[194]), *European Commission guidance for the design of renewable support schemes,* https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (European Commission, 2014[196]), *Communication from the Commission – Guidelines on State aid for environmental protection and energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Figure 22.13. Kosovo's energy consumption (2000-19)




Source: (Eurostat, 2020[199]), *Complete Energy Balance*, https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nrg_bal_cv&lang=en.

StatLink https://doi.org/10.1787/888934255760

The energy efficiency sector in Kosovo is facing several issues. First and foremost, a variety of secondary legislation still needs to be adopted, particularly regarding energy product labelling, where Kosovo has only implemented 3 out of 12 regulations and is therefore far from implementing best practices and standards. Data and indicator collection and publication also need to be improved. The sector's public entities are understaffed and in urgent need of additional human resources. Furthermore, the energy efficiency fund is mainly active with regard to public buildings, and limited financial support is available for private investment. There is currently no dedicated energy efficiency strategy for the industrial sector, with industry accounting for around 20% of final energy consumption.

### *Sub-dimension 12.3: Energy markets*

Although Kosovo is working towards deploying an operational organised **energy market** according to international standards and best practices, it is still far from achieving this goal. Kosovo currently has deregulated the (bilateral) wholesale market, using auctions to connect generators and public service providers. However, the liberalisation and deregulation of the retail market has been postponed, partly due to the COVID-19 pandemic, with the decision to extend KESCO's universal supplier obligation until March 2021.

Regarding the deployment of an organised wholesale market, KOSTT has signed a shareholder agreement with the transmission system operator of Albania to jointly establish a power exchange company called ALPEX. The company was established and registered in October 2020, and the agreement foresees that ALPEX will establish a branch in Kosovo and operate two separate bidding zones

(Albania and Kosovo) that will eventually be coupled. ALPEX is supported by the United States Agency for International Development (USAID) and the International Financial Corporation, which are helping Kosovo develop the necessary agreements, procedures and codes for operation, etc.

Kosovo's most significant progress since the last Competitiveness Outlook regards **unbundling and third-party access**. Both the TSO, whose ownership was unbundled, and the DSO which was fully unbundled, are unbundled and separate from generation and supply activity, and are thus in line with EU directives. Relevant compliance programmes and officers are in place. Non-discriminatory third-party access is established and guaranteed by legislation.[129] Nonetheless, there are two outstanding issues. The first regards the apparent separate branding of companies KEDS and KESCO.[130] The second issue relates to whether the regulator has adopted and published non-discriminatory rules for the connection of direct lines. These rules are mandated by the law and are part of a non-discriminatory third-party access regime. However, the regulator's website does not list this rule as being adopted.

With regard to **regional integration,** as of 14 December 2020 KOSTT began operation as a "Control Area"[131] within the Albania-Kosovo Control Block (Control Block AK).[132]

Following the entry into force of the Connection Agreement with ENTSO-E (the European Network of Transmission System Operators for Electricity), the allocation of cross-border capacities for the borders with Albania, Montenegro and North Macedonia is performed by SEE CAO (the Coordinated Auction Office in South East Europe), with the first auction having taken place at the end of 2020. The allocation of capacities with Serbia is still outstanding, subject to finalising and signing the agreement between the Electro-Power Industry of Serbia (EPS) and KOSTT for capacity calculation and allocating.

Based on the recommendation of the Energy Community Regulatory Board, ERO has adopted the rules for setting the procedure to designate the Nominated Electricity Market Operator (NEMO), in line with EU regulation on capacity allocation and congestion management. Once designated, the NEMO should accommodate international trade flows and the optimised use of interconnector capacity. Expectations are that the NEMO will be up and running towards the end of 2021.

### *Cross-cutting sub-dimension: Energy incentives – direct and indirect subsidies in the energy sector*

There appears to be significant direct and indirect subsidisation in Kosovo. There are four forms of subsidies that need to be tackled:

1. Deviations in the payment conditions for public entities vs. domestic standards.
2. The blanket use of universal suppliers to supply all consumers, including all households and small consumers, with regulated prices. This stifles competition and possibly leads to price formation being significantly different to a competitive market. The regulator should investigate and recommend options to promote supplier competition and encourage consumer switching to a non-price regulated supplier.
3. The price regulation for thermal energy. While there is an appreciation that there is limited competition in the market, the continued blanket use of regulated prices can potentially lead to long-run deviation from competitive market equilibrium and prohibit new market entries.
4. The requirement for renewable generators to only pay 25% of their imbalance cost. This encourages renewable generators to forgo good forecasting practices to the extent where imbalances become greater. The resulting increased imbalances is a security of supply risk and an avoidable extra cost carried by consumers in a non-transparent manner.

### *The way forward for energy policy*

Although Kosovo has made significant progress since the last Competitiveness Outlook, there remain some key areas that need to be tackled:

- **Ensure additional human resources**. These are needed in a variety of areas, including for energy efficiency and for the regulator's activities throughout its areas of operation.
- **Draft and implement policies to promote competition and liquidity within energy markets**. Part of the solution will also be reinitiating **market liberalisation and deregulation**. These two areas should support the market in achieving a competitive market equilibrium.
- **Improve market monitoring and transparency**. Extending the collection of data and its publication, including frequency, will allow all stakeholders, including policy makers, to take more informed decisions and will support increased competition. Kosovo needs to collect and disseminate comprehensive monthly data to allow a closer to real-time analysis of the market and contribute to identifying issues. This is one of remaining aspects that needs to be finalised with regard to implementing the Third Energy Package data collection elements.
- **Design and implement a decarbonisation strategy and phase out coal**. These measures should support the development of a sustainable electricity sector in line with EU good practice. The strategy should also include or be supplemented by the introduction of a **greenhouse gas pricing mechanism** that eventually transforms into a **greenhouse gas certificate market/trading scheme** (Box 22.13). Together, these activities should support efforts to achieve a sustainable and climate-resilient energy market that is efficiently decarbonised in a competitive and efficient manner using economic market forces.
- **Improve the approach to renewable energy project assignment and support** to encourage renewable growth, and improve the **deployment of energy efficiency** measures to limit demand growth and volatility. Both actions will support the decarbonisation of the energy sector while easing the economic impact of possible greenhouse gas pricing, and should in the medium to long run create economic downward pressure on electricity prices.[133]
- **Improve regional integration**. The size of the electricity market in Kosovo does not lend itself to many generators with generation portfolios that benefit from economies of scale. To fully harness the benefits of a competitive market Kosovo needs to pursue regional integration, as trade will enhance the competitive forces at play in Kosovo and increase the liquidity of its energy market. There are additional benefits to regional integration and market coupling, including price stability due to shared demand and supply (Baker, Hogan and Kolokathis, 2018[200]; Booz&Co, 2013[201]; Böckers, Haucap and Heimeshoff, 2013[202]).
- **Finalise the transposition and implementation of the EU's Third Energy Package** to complete the implementation of international good practice and fully align local legislation for the governance of the energy sector with the EU *acquis* (Box 22.11).

#### Box 22.13. Greenhouse gas pricing in North Macedonia

North Macedonia does not have a current greenhouse gas pricing mechanism. However, its Energy Development Strategy foresees the "introduction of carbon price and its convergence to the Emission Trade Scheme (ETS) level" (Government of North Macedonia, 2019, p. 60[197]). North Macedonia plans to introduce greenhouse gas pricing via a progressive introduction that starts with the direct taxation of $CO_2$ emissions followed by the introduction of requirements equivalent to joining the EU Emission Trade Scheme (EU ETS). Although North Macedonia cannot participate in the EU ETS at this stage it plans to undertake certain preparatory steps, including mapping installations that fall under the EU ETS and defining the scheme's scope, arranging the allocation of allowances through a designating authority

and defining procedures, and designing auction platforms with built-in safeguard arrangements. Furthermore, emissions monitoring, reporting and verification should be addressed both within the scope of deploying the tax and prior to joining the EU ETS.

Source: (Government of North Macedonia, 2019[197]), *Strategy for Energy Development of the Republic of North Macedonia until 2040*, http://economy.gov.mk/Upload/Documents/Adopted%20Energy%20Development%20Strategy_EN.pdf; (Macedonian Academy of Science and Arts, 2020[198]), *Climate Change Mitigation in Third Biennial Update Report on Climate Change of the Republic of North Macedonia*, https://klimatskipromeni.mk/data/rest/file/download/64d2a5b8a5db3bcaa3ce23194512060f9a6a8072c504c31dc7f8396d6b8e3291.pdf.

## Environment policy (Dimension 13)

### *Introduction*

Kosovo has slightly improved its performance in the environmental policy dimension since the 2018 Competitiveness Outlook, from 1.8 in the last cycle to 2.1 in the 2021 assessment (Figure 22.1). Progress has been made on enhancing the frameworks for climate change mitigation and adaptation and air quality. Kosovo's score in the environment policy dimension matches the regional average of 2.1, and ranks fourth out of the six Western Balkan economies (Table 22.21).

### Table 22.21. Kosovo's scores for environment policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 13.1: Resource productivity | 1.8 | 2.0 |
| | Sub-dimension 13.2: Natural asset base | 2.2 | 2.1 |
| | Sub-dimension 13.3: Environmental quality of life | 2.2 | 2.3 |
| **Kosovo's overall score** | | **2.1** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 13.1: Resource productivity*

Although no major changes have occurred to the legislative framework for **climate change mitigation and adaptation** since the last CO assessment, there have been some positive developments to the policy framework – most notably the adoption of the Climate Change Strategy[134] (2019-2028) and related action plan. The main objectives of the strategy concern both climate change mitigation and adaptation, as well as building the capacity of central and local partners, actors and stakeholders to integrate climate change issues into development processes and documents (Box 22.14). However, this strategy is not aligned with other strategic documents. As part of activities under the new strategy, the government was developing a Concept Document for Climate Change at the time of drafting. This document aims to set the scene for drafting the Climate Change Law, which should further align the legislative framework with the EU *acquis*. Implementation of the strategy started in 2020 and is running to plan; however, monitoring, which was planned to be conducted twice a year, had not been undertaken at the time of drafting.

Key institutions in this field are the Ministry of Economy and Environment (MEE) and its body, the Kosovo Environmental Protection Agency (KEPA), as well as the Ministry of Agriculture, Forestry and Rural Development (MAFRD). These organisations all lack qualified staff and are in need of continuous capacity building sessions, envisaged as a key measure under the new Climate Change Strategy. Horizontal co-ordination happens through the Council on Climate Change, which includes all relevant institutions. Inter-institutional co-operation is strong, with all parties constantly co-ordinating and fulfilling their obligations defined by the legislation for reporting to KEPA. They are also active participants in drafting legislation and strategic documents.

### Box 22.14. Kosovo's Climate Change Strategy

The Climate Change Strategy of Kosovo (2019-2028), and related action plan, were adopted in February 2019. The strategy covers both climate change mitigation and adaptation actions and objectives. As the power sector accounts for around 75% of total greenhouse gas (GHG) emissions in Kosovo, followed by road transport with 12%, mitigation objectives aim to reduce GHG emissions in mainly the energy and transport sectors, as well as in the forestry and industry sectors. In this context, concrete activities are listed in the Energy and Climate Plan (2021-2030), which was being developed at the time of drafting and which should determine GHG emission reduction targets.

Regarding climate change adaptation, the major climate-related risks identified concern: 1) rising intensity and frequency of precipitation extremes such as heavy rain events, and more severe droughts; 2) flash floods in mountain areas, and river floods in plains and lowlands; 3) increased temperatures leading to heatwaves and forest fires, more uncertain rainfall, and reduced runoff, combined with socio-economic developments and increased pressure on limited water resources; 4) ecosystem degradation and reduction of ecosystem services; and 5) increasing and new forms of pollution and water-related diseases. Adaptation measures envisaged in the new strategy mainly relate to landscape restoration and reforestation actions, and the creation of more secure facility locations and infrastructure. Reforestation of 140 km of riverbanks, or 28% of the length of rivers flooded (491 km of rivers are at risk of flooding), as a flood prevention measure should be implemented in the period 2019-21.

Source: (KEPA, 2018[203]), *Annual Report of the State of the Environment in Kosovo in 2017*, https://www.ammk-rks.net/repository/docs/Raporti_M_2017_english.pdf; (Government of Kosovo, 2018[204]), *Climate Change Strategy 2019-2028 and Action Plan on Climate Change 2019-2021*, https://gzk.rks-gov.net/ActDocumentDetail.aspx?ActID=29356.

Minimal changes have been noted in relation to developing a **circular economy framework** in Kosovo since the last assessment. The topic is indirectly covered under the new Integrated Waste Management Strategy (2020-2029) and Action Plan (2020-2022), which outlines three main objectives: 1) raising awareness of the importance and benefits of managing and recycling waste; 2) encouraging innovation to prevent waste generation; and 3) creating re-use and recycle systems based on extended producer responsibility schemes.

The recycling rate of municipal waste in Kosovo is quite low, at around 5% (Eurostat, 2018[205]). However, according to relevant authorities, the recycling industry is currently gaining momentum in Kosovo as the private sector takes advantage of a lucrative opportunity for exporting secondary material within the region and to several EU Member States. At the time of drafting, Kosovo was in the second phase of development of its deposit refund system,[135] expected to be completed by 2022. There were also some educational awareness-raising activities on waste management organised in schools during 2018, as well as a project on reducing bio-waste through composting organised for several thousand households in the municipalities of Prizren and Fushe Kosove/Kosovo Polje. However, these activities are conducted on a rather ad hoc basis.

**Municipal waste management** in Kosovo has seen some developments since the last assessment, but is still generally weak. Although the municipal waste generation per capita of 227 kg is much lower than in the EU (492 kg per capita in 2018), and the lowest in the Western Balkans, its collection is somewhat problematic as it covers only 57.7% of the population, with significant discrepancies noted between urban and rural areas (Eurostat, 2018[205]; KEPA, 2018[203]). Furthermore, most landfill sites do not comply with sanitary standards, and waste is largely disposed of untreated. The illegal dumping of waste is a normal practice in Kosovo, especially construction and demolition waste, mostly due to the lack of dedicated landfill sites for this kind of waste. Despite efforts to close down illegal dumpsites, they continued to proliferate

(from 1 572 in 2017 to 2 529 in 2019) and represent a serious public health risk, in particular due to hazardous waste and groundwater contamination (European Commission, 2020[39]).

No major changes in the legislative framework have been recorded since 2017. The new Integrated Waste Management Strategy (IWMS) (2020-2029), which continues the Waste Management Strategy (WMS) (2013-2022), has been developed but had not been adopted at the time of drafting due to delays. The government has not produced any reports on the implementation of the WMS, thus there is no information on whether its targets have been reached. Several projects in this area have been implemented that aimed to clean up illegal landfill sites and decrease their number, increase the waste service coverage and improve the waste collection rate, and provide supply equipment for waste collection.[136] However, most of the measures from the WMS were just rolled over to the new IWMS.

Most municipalities in Kosovo (34 out of 38) have drafted their municipal solid waste management plans, in line with their mandate; however, the WMS is only partly reflected in local planning documents (European Commission, 2020[39]). Municipalities implement and continuously review the objectives deriving from the plans, but there is no appropriate monitoring, except for the obligatory annual reports that municipalities submit to KEPA.

According to the Law on Waste (2004), municipalities in Kosovo are obliged to organise a system of waste separation at source by developing appropriate infrastructure. However, limited efforts have been undertaken in this regard. The primary separation of waste has been introduced in several municipalities to pilot separation at source.[137] These pilots aim to raise awareness and ensure the full participation of citizens and businesses, enhance the implementation capacities of municipalities (and scale up across the territory from 2021), as well as provide a sustainable operator for the collection of recyclables and ensure the financial sustainability of the system. These pilots take into consideration the integration of informal waste collectors from vulnerable groups. Kosovo is also currently piloting three systems in various municipalities to tackle organic waste (e.g. in Pristina).

Similar to other WB economies, waste collection and treatment infrastructure in Kosovo is financed through budget and donor funds, while waste collection and treatment services are funded from waste collection fees. Although waste collection tariffs have not changed since the last CO assessment, most municipalities in Kosovo have undergone the process of cost recalculation, client profiling and tariff setting for waste management services, as required in the Law on Waste, to introduce new waste collection tariffs.

Actions to combat the illegal dumping of waste have been undertaken. In particular, the government is implementing the Performance Grant–Clean Environment Race (2017-2021) project[138] that aims to decrease the number of illegal landfill sites. According to the project, municipalities that show good performance in waste management (e.g. improved collection rate or increased service coverage) win financial grants to be used for the sustainable removal and rehabilitation of illegal landfill sites, and further improvements of the waste management system. An additional measure to combat illegally dumped waste involves improving data collection by requiring municipalities to register illegal landfill sites (using applications for GPS co-ordinates) and report them to KEPA through the annual report. The MEE has also revised the Administrative Instructions on Mandatory Fines, which stipulates strict fines for littering, burning and the illegal dumping of waste.

### *Sub-dimension 13.2: Natural asset base*

Water resources in Kosovo are relatively scarce and unevenly distributed (among the five main river basins). By regional comparison, the levels of rainfall and renewable resources per person are much lower (estimated at about 1 600 $m^3$ total renewable water resources per person, which is the lowest in the Western Balkans), water resources are highly polluted, and the levels of water storage are among the lowest in the Western Balkans (World Bank, 2018[24]; 2020[206]). Households are major users of water (52%), followed by agriculture (41%) and industry (8%) (Government of Kosovo, 2017[207]). The gap between growing water demand and available quantities of good quality water has been widening in recent

years leading to water shortages and interruptions in water supply and irrigation services (World Bank, 2020[206]). The already precarious situation with water resources might be further aggravated if the normalisation of political relations with Serbia regarding the management of water resources does not occur, especially given the disputes over water resources in the northern part of Kosovo,[139] which supplies around one-third of the population.

**The freshwater management framework** is only partially developed in Kosovo, and no major changes in legislative and policy framework have been noted since the last CO assessment. The provisions of the Law on Water (2004) apply to all surface and groundwater, the prevention of pollution at source, emissions control and water quality standards, as well as prevention and protection against flood risks. The mapping of hazard and risk of floods has not yet started yet, although it is being planned. The planning and management of hydropower plants do not conform with relevant EU legislation, and there have been many cases in which licences for hydropower plants (HPPs) were given before an environmental impact assessment (EIA) report was issued, or before taking into consideration the results of the EIA. Current practice in Kosovo shows that several of the built or planned HPPs are in nature reserves, which has a severe impact on biodiversity as well as water resources (CEE Bankwatch Network, 2019[208]). There is a system for the prior regulation and/or specific authorisation for water extraction from groundwater and/or surface waters, but a river basin management system has not been developed yet, nor has the river basin district authority become operational. Co-operation with neighbouring economies in this regard has been established, especially with those in the White Drini Basin.

The implementation of the Water Strategy for Kosovo (2017-2036) has been rather limited. The main area of progress is the establishment of several drinking water reservoir dams to improve drinking water supply. However their safety and management remain inadequate, especially given the water stress resulting from climate change (European Commission, 2020[39]). No implementation reports have been produced and no monitoring or evaluation mechanisms set. The strategy is not aligned with the sectoral strategies (agricultural or irrigation strategy).

Data and projections on water demand from agriculture, industry (including energy) and households are not available, and thus do not guide decisions about handling competing uses now and in the future. The government was working on introducing a water pollution cadastre at the time of drafting. Activities to establish a water information system, initially planned for 2020, have not begun. Some data on water risk management are collected, such as on historical water disasters and vulnerability/exposure to risks.

Kosovo hosts rich **biodiversity**, especially its flora, which is largely endemic. However, its ecosystems are threatened by illegal construction, illegal tree logging, hunting, the mushrooming of hydropower plants in protected areas and forest fires (KEPA, 2018[204]). **Forests** make up a large share of total land area of Kosovo (around 45% in 2018), which is around the WB average of 42%[140] (World Bank, 2020[210]).

There have been no major changes in the legislative framework targeting biodiversity and forest management since the last CO assessment. Regarding the policy framework, both the Strategy for the Development of the Forestry Sector (2011-2020) and the Strategy for Biodiversity (2011-2020) have been revised, and the MEE is preparing the updated Strategy for Biodiversity until 2030, which will be adopted as part of a wider Strategy of Environment Protection and Sustainable Development 2021-2030. The preparations of the new Forestry Strategy (2021-2030) started in September 2020, and its adoption is planned for the first trimester of 2021. Although no implementation reports have been produced, certain activities under the Strategy for Biodiversity have been realised, such as harmonising and strengthening the legislation for nature protection in line with the EU *acquis*; building capacity of competent bodies for implementing and enforcing measures and actions on biodiversity conservation; increasing the area of protected areas to 11.5% of the terrestrial territory (although very little progress has been noted since 2017); adopting a Red Book of Fauna in Kosovo in 2019 (Ministry of Environment and Spatial Planning, 2019[211]); and developing and implementing projects for increasing awareness of the importance of nature

and preservation of biodiversity. Kosovo became a member of the International Union for Conservation of Nature (IUCN) in 2019.

Information on biodiversity, including the conservation status of threatened species and habitats, is collected by the Kosovo Institute of Nature Protection (KINP), whereas the MEE and its Department for Environmental Protection and Waters is the main body responsible for biodiversity. The Department for Forestry under the MAFRD is responsible for forest management. The human and financial resources of both bodies are not adequate to execute their main responsibilities.

The Strategy for the Development of the Forestry Sector includes forest fire prevention measures; however, according to the government the effectiveness of these measures remains limited. The latest economy-wide forest inventory system was created in 2012, but there is no economy-wide forest programme. Although the systematic monitoring of the condition of forests is not undertaken in Kosovo, it is conducted somewhat indirectly through the monitoring of climate change adaptation and mitigation actions. Illegal tree logging is mostly treated under the Law on Forests, with penalties of up to EUR 25 000. However, sanctions are rarely enforced due to lack of staff, as competences lie at the local level where there are only a few inspectors. There is also little readiness from legal institutions to impose sanctions.

**The land-use legal and policy framework** remains underdeveloped in Kosovo, and no major changes have been recorded since the last CO assessment, with the exception of several amendments to the laws that regulate this area. The main strategic document, the Land Consolidation Strategy (2010-2020), was being revised at the time of drafting, along with the updated Agricultural Land Consolidation concept document. However, implementation of the strategy remains largely limited. The main activity realised in this area relates to the ongoing (to be finalised by the end of 2021) agricultural land consolidation in 21 cadastral zones and 10 municipalities through the Strengthening Spatial Planning and Land Management (SSPLM) Project. This project aims to provide technical assistance for the preparation of municipal land development plans, including rural spatial plans and the drafting of municipal zonal maps to protect agricultural land from ad hoc and illegal construction. However, policy making and implementation are not supported by any indicators related to land-use management.

Numerous bodies are responsible for land-use management in Kosovo (MAFRD, MEE, Ministry of Finance and MTI). Reportedly, these bodies all have qualified staff and financial resources. Horizontal institutional co-operation seem to be functioning well through the inter-ministerial committee that meets twice a year, but vertical co-ordination appears non-existent. Limited capacity building and training courses have been conducted for responsible bodies, but the measures envisaged under the SSPLM project will address this issue.

### *Sub-dimension 13.3: Environmental quality of life*

Poor **air quality** in Kosovo represents one of the major threats to health. This becomes an even greater concern in the context of COVID-19 given that exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to the virus (OECD, 2020[212]). Kosovo has one of the highest concentrations of air pollution in Europe, with annual mean exposure to particulate matter ($PM_{2.5}$) of 27 micrograms per cubic metre (μg/m$^3$), which is almost three times higher than the WHO recommended highest levels (10 μg/m$^3$), and higher than the average values of the WB region (25.77 μg/m$^3$), the EU (13.1 μg/m$^3$) and the OECD (12.5 μg/m$^3$) (World Bank, 2020[210]; OECD, 2020[213]). Urgent action is needed on uncontrolled pollution, notably from outdated thermal power plants (coal and lignite combustion at existing power stations[141]), household heating (using coal as a low-cost source of energy), traffic, industrial emissions and the incineration of waste and other toxic materials (European Commission, 2020[39]).

No major changes in the legislative and policy framework have been recorded since the last CO assessment. In 2018, the government adopted the Action Plan for Air Quality (2018-2020) as part of the Strategy on Air Quality (2013-2022), which represents a major strategic document in this area and includes

measures on air quality in the household, energy, industry and transport sectors. However, authorities have failed to implement these measures. Kosovo's government signed an agreement with the London-listed power generation company ContourGlobal in December 2017 to start the construction of the 500 MW "Kosova e Re" coal-fired power plant, aimed at replacing the 40-year-old Kosovo A plant. However, in 2020 ContourGlobal withdrew from the project and cancelled construction. In addition, the 2018 ban on the use of coal for heating in public buildings to reduce heavy air pollution has not proven effective so far.[142] In particular, most public schools could not comply with the ban as it was not accompanied by any financial support to facilitate the transition from coal to alternative energy sources, mainly due to budgetary constraints and weak overall planning and management.

A new action plan for air quality was being developed at the time of writing through activities as part of the Capacity Building for Air Pollution Control (2017-2020) project and the Environmental Data (2018-2021) project. These projects involve identifying air pollution sources, preparing an air emissions inventory (one central air quality portal was being developed at time of drafting), modelling pollutant distribution, and setting air pollution control measures. The results of these activities will also be useful when developing local air quality plans, envisaged for the 2020-2025 period, which are urgently needed, especially in zones where pollutant levels regularly exceed limits.

The Supply of Project Management, Air Quality Information Management, Behavioural Change and Communication Services (2019-2021) project[143] aims to support the Kosovo Hydro-Meteorological Institute (KHMI) in air quality monitoring and introduce an information management system, as well as collect and disseminate information on air quality. Through this project a significant increase in technical and human capacities for air quality monitoring and information management system is expected.

Air pollution monitoring consists of self-reporting by industries through the Pollutant Release and Transfer Register. However, at least twice a year the Environmental Inspectorate, in co-operation with the KHMI, measures emissions from the industrial sector. Limit values for the main atmospheric pollutants are determined by Administrative Instruction No. 02/2011 on Air Quality Assessment, transposed from Directive 2008/50 EC for Air Clean in Europe. Some of the indicators/polluters, such as PM, ozone ($O_3$), $NO_2$ and sulphur dioxide ($SO_2$), are aligned with WHO guidelines for the daily average, while annual average limits are higher than the WHO standards. When the alarm threshold is exceeded, there are clear administrative mechanisms established and immediate action is undertaken – normally within three days. Information on air quality is made available promptly, and the public has access to real-time data and information on air quality from 12 monitoring stations[144] through the webpage of the KHMI and via a smart phone application called "Kosovo Air Quality".

Most of Kosovo's population has access to safe **water and sanitation** services (92% have access to a piped water within their dwelling). Although 72.5% of the population have access to sanitation services, 11.6% have only partial coverage and 15.9% have no sewers. Only 1% of the population is connected to wastewater treatment systems, and almost all water is discharged untreated into rivers (World Bank, 2018[24]). However, this percentage might increase soon as three new urban wastewater treatment plants were being constructed in high-density urban locations at the time of drafting.

Since the last assessment, the policy framework has been complemented with the new Strategic Plan for Regional Water Companies (RWC) (2018-2022) that aims to apply and advance the legislation, improve the performance of RWCs, enhance service standards, and ensure RWC financial sustainability. A key priority in addressing water security issues for RWCs is to reduce their non-revenue water,[145] which currently stands at 58% (World Bank, 2018[24]). Implementation is on track, with regular annual implementation reports that underline the achievements of tariff targets. The latest assessment of this strategic plan found that clear progress had been made in reaching service standards and the financial sustainability of the RWCs, but a major challenge remained regarding the high level of water losses, although certain measures to decrease water losses in the system were introduced. The strategic plan set an annual target of a 2% reduction in water losses by RWCs (a total of 10% at the end of the

implementation period in 2022), and RWCs are not allowed to change the level of water tariffs if this target is not achieved.

Current water tariffs cover operational and maintenance costs, as well as part of capital investments, whereas the main sources of funds in infrastructure come from the donor community. Water services are considered affordable for the majority of citizens,[146] except for the poorest households,[147] who are left without any targeted assistance in this regard.

There have been no major changes in the **industrial waste management** legislative and policy framework since the last assessment. Industrial waste, with the exception of waste from the extractive industry, will be part of the Integrated Waste Management Strategy (2020-2029). The chemicals register is currently being developed, and labelling rules for chemicals have already been set. The Pollutant Release and Transfer Register system is not functional.

The Seveso-III directive (Directive 2012/18/EU) regarding managing and controlling industrial risks and accidents has been fully transposed. There are no hazardous waste disposal facilities, although the government planned to start constructing a central disposal facility for hazardous waste[148] in 2018 in the municipality of Fushe Kosove, and organised several rounds of consultations with citizens. However, an agreement to build the facility was not reached. The funds for this project are secured by the European Commission but have not yet been used as the alternative location has not yet been found.

There is no policy or legislative basis for soil protection, but there have been some developments regarding the identification of contaminated areas. During 2018-19, KEPA produced a report on Kosovo hotspots that identified over 100 contaminated and hazardous sites for human health and the environment. This led to a World Bank financed project called Green Land[149] (2020-25), which aims to clean up contaminated areas. Three polluted areas are prioritised to be cleaned and the land rehabilitated. The project also aims to support the government in developing and implementing a long-term action plan for contaminated land remediation and redevelopment in Kosovo. This should contribute to the improvement of contaminated land management to reduce associated health risks and realise economic, environmental and social values from land redevelopment, such as the creation of urban green spaces, commercial development and renewable energy production. No soil monitoring system has yet been put in place.

### *The way forward for environment policy*

Despite some positive developments recorded since the last assessment cycle, further improvements are needed in a number of areas, mostly related to implementation. Going forward, special attention should be paid to the following:

- **Advance waste management by enforcing measures to separate and reduce waste, and increase recycling and recovery in line with circular economy principles**. Although some actions in this regard have already been planned and undertaken in the WMS, implementation has remained limited as most actions were simply rolled over to the new IWMS. The government needs to step up its enforcement efforts, and stronger co-operation with local governments will be essential. At the municipal level, incentives for the separation of municipal waste at source, i.e. before it is collected and recycled or converted to energy, should be offered (e.g. rewarding households for sorting waste, decreasing utility bills) together with regular awareness-raising activities on waste prevention and recycling (through brochures, information campaigns).
- **Improve air quality by decreasing dependence on fossil fuels in the energy mix, improving household heating systems and reducing emissions from the transportation sector**. Kosovo has one of the highest concentrations of air pollution in Europe due to power generation from polluting sources (coal and lignite), household heating, and an inefficient transport system and ageing vehicle fleet. Kosovo should undertake the following activities regarding energy, heating and transportation:

- **Energy**: phase out subsidies to coal (in the period 2015-17, more subsidies were paid for coal than renewable energy) and start supporting efforts to develop the natural gas market – see Energy policy (Dimension 12). Moreover, Kosovo should start implementing renewable support schemes that are fully aligned with the EC's Guidelines on state aid for environmental protection and energy 2014-2020 (CEE Bankwatch Network, 2019[208]). Shutting down the old Kosovo A Power Plant and installing the best-known contemporary filters at the Kosovo B Power Plant is highly recommended. In relation to renewables, priority should be given to using solar and wind energy over hydropower to address the current support imbalance and negative practices that have led to harming biodiversity.
- **Heating**: A large share of pollution is linked to poor socio-economic conditions, with most citizens using coal for heating because it is considered a low-cost source of energy. Subsidies could be considered for other forms of heating, such as solar space heating. Measures that ban the use of coal for heating in public buildings have not been effective – therefore, improved enforcement and financial support are needed through enhanced vertical co-ordination between different government levels.
- **Transportation**: Recommended measures include low-emitting buses, and ecological vehicle taxes that differentiate by age and level of $CO_2$ emissions to influence private vehicle purchasing and renewal decisions (World Bank, 2019[214]). Regarding vehicle tax an example from France may be useful for Kosovo. In 2008, France introduced the "feebate" system for new cars, which imposes a fee on vehicles with high $CO_2$ emissions or fuel consumption (i.e. those exceeding a certain threshold) and provides a rebate to vehicles with low $CO_2$ emissions or fuel consumption (those below this threshold) (Manea et al., 2019[215]).

## Agriculture policy (Dimension 14)

### *Introduction*

Kosovo has slightly improved its performance in the agriculture dimension since the last Competitiveness Outlook, with its score increasing from 2.0 in 2018 to 2.4 in 2021 (Figure 22.1). Most progress has been made in terms of agro-food capacity. However, Kosovo still scores low in comparison to other Western Balkan economies (Table 22.22).

### Table 22.22. Kosovo's scores for agriculture policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 2.9 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 2.3 | 2.9 |
| | Sub-dimension 14.3: Agriculture support system | 2.1 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 2.5 | 2.6 |
| **Kosovo's overall score** | | **2.4** | **2.7** |

### *State of play and key developments*

Kosovo's agriculture sector has gone through a significant transformation in the last decade. In 2008, it lacked commercial market orientation and there was no system in place to efficiently link producers and buyers. Today, agriculture is an important economic activity that contributes 8.1% to GDP and accounts for over 23% of total employment (Kosovo Agency of Statistics, 2020[216]; 2020[217]). Around 363 000 people are involved in agriculture, and there are 130 775 registered farmers (these figures exclude four municipalities in the north part of Kosovo) (Kosovo Agency of Statistics, 2020[218]).

The total area of used agriculture land is 418 581 hectares (ha), while arable land represents 188 359 ha. The land use increases among the most important crops (fruits and vegetables). There has also been a significant increase in tree plantations (over 40%) and greenhouses (11.6%) between 2014 and 2019 (Table 22.23). The average farm size is 1.76 ha. The government recognises that land fragmentation is a factor for low productivity and aims to improve the regulation and consolidation of agricultural land.

### Table 22.23. Area covered by most important crops (2014-19)

Hectares

| | 2016 | 2017 | 2018 | 2019 | 2019/2014 in % |
|---|---|---|---|---|---|
| **Vegetables in the open field (first crop)** | 7 864 | 8 033 | 7 818 | 8 319 | 5.47 |
| **Vegetables in greenhouses (first crop)** | 457 | 467 | 468 | 517 | 11.61 |
| **Tree plantations** | 5 493 | 6 247 | 7 687 | 9 244 | 40.58 |
| **Vineyards** | 3 112 | 3 199 | 3 271 | 3 367 | 7.57 |

Source: (Kosovo Agency of Statistics, 2020[183]), *Statistical Yearbook of the Republic of Kosovo*, https://ask.rks-gov.net/en/kosovo-agency-of-statistics/general-statistics/statistical-yearbook.

Kosovo is a net importer of agricultural products due to a surplus of consumption over production. Surrounded by more developed agriculture sectors in neighbouring economies, it faces challenges in remaining competitive and maintaining agricultural productivity. Land fragmentation, lack of efficient irrigation, limited research and slow improvement of production technologies are among the key factors impacting productivity. Recent production trends, however, illustrate a growing awareness of the natural potential of agriculture in Kosovo and a slow but certain increase in the interest of young entrepreneurs working in this sector.

Kosovo has been severely hit by the COVID-19 crisis, with GDP decreasing by 8.8% in 2020.

The total number of unemployed increased from around 94 101 in January 2019 to 111 899 in January 2020 to 198 063 to October 2020. The persistence of COVID-19 is stifling services exports, private consumption and investment. Without the increase in remittances and the economy's counter-cyclical fiscal policy response, the economy's contraction would be stronger.

The agriculture sector has faced many challenges, such as limitation of movement, market closures, decreased demand and logistical difficulties.

Kosovo has approved a EUR 20 million budget increase for grants and subsidies to the Ministry of Agriculture, Forestry and Rural Development, the Ministry of Culture, Youth and Sports, and municipalities affected by the pandemic. The support is to be distributed through existing mechanisms. Agriculture businesses and farmers are eligible for subsidies for monthly salaries and rental costs, and can benefit from interest-free loans, financial liquidity measures, export support measures and increased social assistance measures.

The imports of goods declined by 9% by July 2020, and are expected to be down by 12% by year end. By July 2020, imports of durable goods were down by more than 16%, imports of passenger cars by over 19%, and intermediate goods for industrial processing by 11.3%. Exports decreased by 8.3% in the same period.

Kosovo has demonstrated its fragility during the crisis. The pandemic is exerting unprecedented pressure on economic activity and the livelihoods of people. The high unemployment rate, which has doubled in 18 months, decreased labour opportunities and overall market value decreases are indicators that the risk of high poverty will last much longer than the COVID-19 crisis itself.

### *Sub-dimension 14.1: Agro-food system capacity*

Kosovo has made progress in expanding its **rural infrastructure** and digital framework in rural areas; however, access to electricity in rural areas is irregular and unstable. Based on the National Development Strategy (NDS) 2016-2021,[150] Kosovo identifies infrastructure as a priority for further improvement. According to the NDS, increasing agricultural production and agro-food industries are of paramount importance given the need to reduce the trade deficit. Nevertheless, "strengthening the sector is very difficult because of the limited agricultural infrastructure", which is especially true for the irrigation system, high land fragmentation and the unstable energetic system.

Kosovo has achieved considerable results in improving road infrastructure in the past decade. The new motorway network connecting Pristina with the borders of Albania and North Macedonia has enabled the much faster transfer of goods. These investments have increased the potential competitiveness of certain productions, particularly in the Dukagjini region, that lend themselves perfectly to labour-intensive horticulture. At the same time, investments in rural infrastructure are underway in several rural municipalities through public-private partnerships, donor assistance and long-term loans. However, the supply of electricity in rural areas remains a challenge. The situation has moderately improved since the last assessment cycle, but there are still power cuts and an unstable supply, especially during the winter period when consumption is higher.

Kosovo is making a great effort to improve its digital infrastructure in rural areas. As part of the Kosovo Digital Economy Project (KODE) 2018-2023, supported by the World Bank with USD 25 million, more than 200 villages, i.e. almost all of Kosovo's open-air settlements, will get broadband connections by 2023 – see Digital society (Dimension 10). Most rural areas in Kosovo are therefore expected to have broadband Internet access within the next five years. This will enable farmers to increase opportunities for digitalisation (market information systems, weather/climate data for prevention measures, online promotion/sales, etc).

To improve access to information for farmers, the domestic telecommunication provider, IPKO, signed a contract with the USAID-commissioned TetraTech in 2018 to implement the IPKO-Agrologic Forecast

Project. This project aims to inform farmers of agrologic conditions in the economy and provides the necessary information for early disaster prevention via 16 automatic meteorological stations in Kosovo.

Although Kosovo has implemented several plans to improve **irrigation infrastructure**, it remains underdeveloped and inefficient. The responsibilities for irrigation are shared among the ministries, public company and municipalities. Co-ordination and co-operation among these authorities are limited and result in low efficiency in irrigation water management.

The irrigated 32 237 ha represent only 17.3% of Kosovo's arable land, and water network losses and lack of water storage facilities hinder efficiency. As a result of unsustainable irrigation infrastructure, a large number of small illegal irrigation systems have been built by local farmers, which are unknown to irrigation companies. The ability of regional water supply companies to collect revenue from water sales is only 30%, which has led to the Government of Kosovo vowing to increase the coverage of the irrigation system to at least 40% of arable land by 2036, according to the NDS. Parliament approved the Water Strategy 2017-2036 in 2017, which largely describes the challenges of irrigation and the measures to be taken.

In 2019, the Strategy for the Irrigation Sector and Investment Framework and the Irrigation Master Plan were established as part of the EUR 20.8 million Agriculture and Rural Development Project 2017-2021 (ARDP), funded by the International Development Association (IDA) of the World Bank. The objective of the Irrigation Master Plan is to expand existing irrigated arable land by 7 000 ha by the end of 2021.

As a result of the ARDP project, two master plans were drafted and presented to domestic institutions and municipality representatives. However, the final Irrigation master plan, initially planned to be finalised by July 2020, has not been completed due to delays brought on by COVID-19. In addition to the master plan, the MAFRD will select at least five investment schemes to develop that meet government priorities; however these are also on hold due to the pandemic.

The **agriculture education system** in Kosovo lacks sustainable financing and suffers from the loss of an educated agriculture workforce to emigration. The MEST is responsible for agriculture education in Kosovo, while several ministries (along with private companies and NGOs) are involved in the provision of non-formal education, which holds equal status with formal education institutions. The agriculture education system comprises three agricultural high schools and two vocational schools that offer specialist agriculture courses. University agricultural education takes place at the Faculty of Agriculture of the University of Pristina, while university programme studies on agribusiness, agro-ecology and food technology are offered by the University of Peja and the University of Mitrovica.

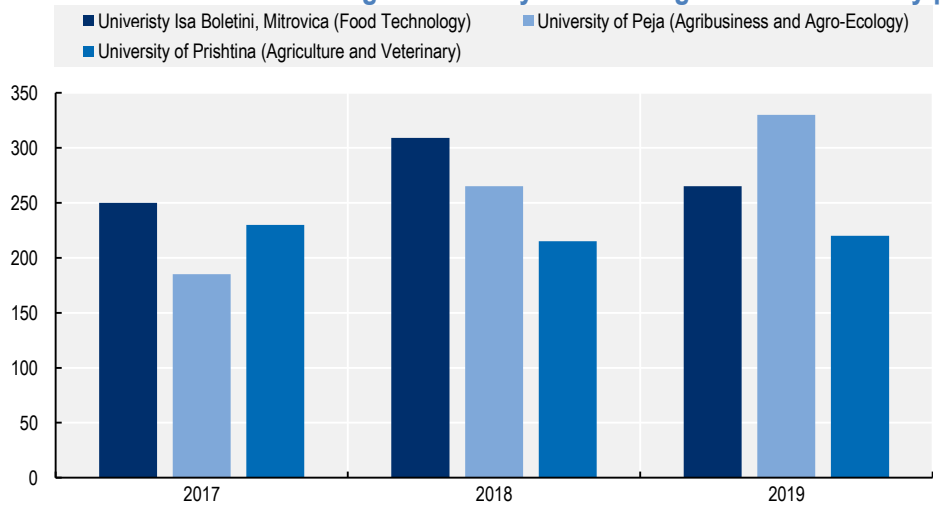
Basic education and skills training are recognised by the Government of Kosovo as key elements in enabling the rural population to diversify its activities and find a basis for sustainable development in remote rural areas. Several strategic documents and plans prepared by the Government of Kosovo emphasise education as a precondition for the improvement and development of sustainable agriculture: the NDS 2016-2021, the Green Report for Kosovo 2018, and the Agriculture and Rural Development Plan 2003-2016. However, due to current low budget expenditure and the lack of prioritisation of agriculture educational development there has been little progress in bringing these plans to action.

Agriculture high schools and vocational schools are supported by government institutions and donor agencies active in Kosovo, such as the Danish DANIDA, the Norwegian Red Cross and the Swiss Agency for Development and Cooperation. The main objective of their support is to increase practical training for students and adopt curricula that meet labour market demand. As funding is mainly based on foreign support, the institutions' sustainability is at stake once donor support ends. This affects both the financial aspect and the maintenance of established educational standards.

The market is in constant demand for a qualified and professional workforce ready to meet the challenges of new production technologies and competitiveness criteria. The number of students enrolled in the first year of university studies in agriculture is not decreasing (Figure 22.14), and interest in university programmes is still very strong among the young population. However, Kosovo is facing a shortage of skilled labour due to

the exodus of a large part of its agricultural workforce to EU countries. Students who have completed an internship in international education during university often use it as a one-way ticket for migration.

**Figure 22.14. Number of students enrolling in the first year of the agriculture university programme**




Source: (Kosovo Agency of Statistics, 2020[219]), Annual Statistics Books, 2020.

StatLink https://doi.org/10.1787/888934255779

*Sub-dimension 14.2: Agro-food system regulation*

**Regulations on natural resources** in Kosovo are limited; however, progress has been made in the organisation and planning of natural resource use. Although the Department of Natural Resources in Kosovo was abolished in 2018, the topic of natural resource remains under the auspices of the MAFRD. As the average farm size is 1.76 ha, fragmentation is the key factor for low productivity, and the government recognises the regulation and consolidation of agricultural land as a priority. Through the Strategy for Land Consolidation 2010-2020 the government has developed models for the consolidation process, including voluntary exchange and public-private partnerships.

The Zoning Map of Kosovo 2020-2028 was developed in 2019 to better plan the sustainable use of natural resources. It is a multi-sectoral document that uses charts, maps, photos and text to determine the planned use of space and action measures. These measures are based on the duration and projections of available public and private investment for the entire territory for a period of at least eight years.

The Kosovo Institute of Agriculture has been implementing the Domestic Program for Inventory of Agricultural Lands since 2017 with the aim of creating a domestic database using geographic information systems (GIS) for soil, irrigation water, vegetation and quarantine pests of plants. The data from this system will help to create measures for the efficient use of natural resources from environmental pressures and in the creation of sustainable farms related to the adaptation of climate change. This programme includes a large range of institutional and public stakeholders.

However, efforts to regulate natural resource use are limited, especially in terms of designing effective measures that will stop the loss of agricultural land[151] and improve legislation implementation by the provision of more efficient mechanisms of inspection/control. Inconsistent cadastral information and the lack of implementation of property rights legislation are holding Kosovo back from improving its natural resources regulations.

In terms of the **regulation of products,** those on seeds and propagation material are well monitored by advisory committees and institutions, but some regulations are not making much progress in terms of drafting and implementation. The regulations in this area are based on the Law on Seeds and the Law on Planting Material,[152] which regulate the production and marketing of agricultural crop seed varieties,

hybrids and seed potatoes. A new Draft Law on Seeds was prepared in 2018 as part of the Italian-Kosovo project, which is a partnership between the MAFRD and a department within the Italian Ministry of Agriculture to further EU harmonisation in the agriculture sector. The draft law is awaiting further legal procedure for approval.

The seed sector of the MAFRD is fully responsible for the import, marketing, production and packaging of seeds, as well as propagation material. Seed production is controlled twice during the vegetation period by phytosanitary inspectors. The registration of new varieties is organised through the Department of Agriculture Policies and Trade within the MAFRD. Applications submitted from both regional and EU-based commercial companies illustrate that there is specific interest in registering new varieties of wheat, barley, maize and potato. Under the auspices of the Institute of Agriculture in Peja, the variety potential and adaptability of seeds is assessed. Based on the assessment report, a special committee within the MAFRD approves the variety and includes it in the list of varieties.

The Law on Fertilisers determines the rules for protecting producers and consumers of fertilisers. Based on this law, the MAFRD has developed the Kosovo Artificial Fertilisers Advisory Board, which provides recommendations on implementing legislation and proposes updates and changes. However, by 2020 only one proposal by a private business entity had been submitted.

### *Sub-dimension 14.3: Agricultural support system*

Kosovo's **agriculture policy framework** includes multiple stakeholder consultations during the policy making process; however, the monitoring and evaluation of policy implementation remains limited. The agriculture policy framework is based on the Agriculture and Rural Development Plan 2014-2020,[153] which has been harmonised with EU directives in terms of priority areas and measures. The MAFRD uses this plan for preparing an annual programme guided by the available budget, and via a broad consultation process with all stakeholders, including the private sector (farmers, processors, co-operatives, etc.), experts, farmers' associations and local action groups. The annual programme is then submitted to the government for approval. It is currently being aligned with the EU's Common Agricultural Policy, but all support measures are financed from the budget.

Agriculture policy is implemented through the Agency for the Development of Agriculture, which is the disbursing agency for direct grants and rural development actions planned for future IPARD measures. The agency's administrative capacity for evaluation, monitoring and accounting is still limited. The process of integrated control and management of the Land Parcel Identification System is ongoing, while the Farm Accountancy Data Network is already established. The ambition of the authorities is that Kosovo should be ready to manage EU funds for agriculture and rural development in the coming two years; however, no substantive changes to meet the criteria have yet been accomplished.

**Domestic support** for agriculture in Kosovo remains underfunded. In 2019, agricultural domestic support, including direct payments and rural development investments, reached EUR 49.6 million, which is comparable to the other WB6 economies when taking into account the size of Kosovo and its agriculture output.

The MAFRD has continued subsidising farmers through direct payments for crops based on surface cultivated; however, no cross-compliance measures have been introduced. Support in the livestock sector is based on the number of animals by category, milk production according to quality, and subsidies on reported slaughtered cattle, as well as planting material.

While investment grants are divided according to the EU IPARD structure[154] they are only financed by the budget supported by World Bank loans within the framework of rural development programmes. Investments are co-financed with government participation at 60% and farmer participation at 40%.

Financial assistance for natural disasters has improved. In 2011, the MAFRD established a committee to verify the damage caused by floods, hail and other natural disasters in agriculture. The committee works

in co-operation with officials of the municipal departments for agriculture and officials of regional offices. The investment grant framework for 2019 introduced new measures that provide technical and financial assistance for natural disasters of EUR 500 000. As the budget (EUR 20 million) allocated for the measures envisaged in the Rural Development Programme has been almost spent, many applicants are being rejected due to insufficient budget following the application of the first-come first-served rule.

Kosovo's **agriculture trade policy** is based on international and regional trade commitments. There are no tariffs or VAT on agricultural inputs imports to stimulate agriculture development. However, in terms of trade policy, the general prospects are complex, and there are no export support measures for agricultural commodities.

Recently, the 100% tariff on goods imports originating in Serbia and Bosnia and Herzegovina were found to violate the CEFTA agreement. In April 2020, the tariffs were lifted and replaced by gradual trade reciprocity measures, which were subsequently abolished by the new government of Kosovo in June 2020. The tariffs seriously jeopardise the position of Kosovo consumers and provoke tariff and non-tariff barriers for the few Kosovo agriculture exporters trying to penetrate the regional market.[155]

Specific strategies for trade policies are to be developed within the Kosovo programme for implementing the Stabilisation Association Agreement.[156] Kosovo is currently at a very early stage, with the first working group for the preparation of a strategy regarding trade policies in the agro-processing industry established in 2020.

The Law on Common Market Organisations (CMOs) is still planned, but no progress has been made in the last two years, even though this is considered one of the indicators for the EU harmonisation progress by the European Commission. CMOs are designed to manage production and trade to ensure a steady income for farmers and a continued supply for consumers.

Kosovo's **agriculture tax regime** is liberal and reviewed annually, but no progress has been made in developing tax regulations in the last five years. Agriculture tax regulations are based on the Law on Taxes and annual customs tariffs, and overseen by the Ministry of Finance and the Customs Service. Income tax for the agriculture sector in Kosovo is 10%; however, some reductions on income tax are available. For those in the agriculture sector with an income of less than EUR 450 per month the tax applied is 10%, and for those with an income of more than EUR 450, the tax applied is between 8% and 14%, depending on income. Standard VAT in Kosovo is 18%, but VAT on machinery and certain varieties of plants and seeds is lowered to 8% as their production is low in Kosovo. Similar exemptions are applied to smaller products such as irrigation equipment and plastic sheeting for horticulture.

Kosovo has made progress in aligning **sanitary and phytosanitary (SPS) policies** with EU and international legislation, but education and training in the field remains limited. SPS measures are based on the Law on Food, which designates the Food and Veterinary Agency (FVA) as the competent authority with a mandate covering food safety, plant health and protection, and animal health and welfare. However, local inspectors are still performing official controls within their municipalities. The FVA is fully functional and has sufficient capacity to implement SPS measures, and no significant limitations regarding infrastructure, finances, technical support or training. The FVA has received support from in technical assistance in all fields of expertise from USAID and through EU mechanisms such as TAIEX or BTSF.

Kosovo has advanced in aligning food and feed safety legislation with EU standards, and has harmonised its operating procedures for food and feed checks and controls. The legal framework for plant protection products, fertilisers, plant quarantine, and seed and plant breeders' rights was completed in 2019 with 15 new administrative instructions. New standard operating procedures were developed between 2018 and 2020 for the implementation of administrative instructions and laws.

Regarding veterinary policy, Kosovo lacks a comprehensive disease monitoring and control system that is in line with EU legislation and World Organisation for Animal Health requirements. Animal health controls mostly take place on farms, while controls for the transport of animals are relatively rare. Animal

identification and registration is still an important issue, with the under-reporting of animal movement remaining a challenge. There is also a lack of in-service training and education programmes for field veterinarians.

To improve the collection and disposal of animal by-products, Kosovo was granted EU funding for a new, fully equipped rendering plant. Despite having been built two years ago, the plant is still not operational. The FVA was obliged to launch a call for tender and select a management company for the plant. Collection will only be able to start in 2021.

The border inspection control system is the only agriculture information system in Kosovo; however, an EU-funded project has been established to create a new system to support the FVA create an additional electronic secured system that will reach EU standards.

### *Sub-dimension 14.4: Agricultural innovation system*

**Agricultural research and development** institutions in Kosovo co-operate with international research institutions and organisations, but research outputs remain weak and the field is underfunded. The Kosovo Agriculture Institute is the public research institute, funded by the MAFRD. It covers scientific and applied research, as well as the implementation of development of projects in the fields of agriculture, food safety and the protection of cultivated environments. The work of the Kosovo Agriculture Institute is continuously evaluated and monitored through its membership in international organisations such as the International Seed Testing Association and the Global Soil Laboratory Network, as well as through participation in cross-laboratory comparison tests in international laboratories.

The MAFRD, as part of activities to improve the research capacity of the Kosovo Agriculture Institute, has signed an agreement with institutional parties on specific research topics. The agreement enhances co-operation with the University of Modena and Reggio Emilia in Italy for PhD programmes in agro-food sciences, technologies and biotechnologies for the academic year 2020/21. The agreement with the university is adapted to the needs of the Kosovo Agriculture Institute, which aims to contribute to the sustainable development of the agricultural sector and food safety at the domestic level, benefitting both academic sand research staff.

Apart from the work of the Kosovo Agriculture Institute, the field of applied science and research projects is not dynamic. Research is largely dependent on donor-funded projects, while the budget for such projects is very limited and restricts projects to an ad hoc basis only.

**Agriculture extension services** are widely available and very competitive. Many of the extension services available are established as a result of donor-supported projects. The continuous monitoring and support of both public and private licenced advisors will be required once the donor funds cease. The Law on Advisory Services and the Strategy of Advisory Services 2015-2020 aim to raise agriculture knowledge among farmers and disseminate information on training, standardisation and market demands.

Besides public advisory services, 13 private companies are licenced to perform advisory activities through the Department of Advisory and Technical Services within the MAFRD. Approximately 300 advisors for agriculture and rural development have been certified, with 100 more expected to be certified by the end of 2020.

The Department of Advisory and Technical Services plays a co-ordination role in harmonising and supporting other organisations in the extension field. Activities developed at municipal information advisory centres have been organised to support farmers with technical advice in the areas of livestock, beekeeping, viticulture, arboriculture and vegetables.

### *The way forward for agriculture policy*

- **Improve irrigation water management**. Increase investment to maintain the existing irrigation network and bring new areas under the irrigation system as a priority. The productivity of agriculture in Kosovo largely depends on irrigation, as well as a functional system of water management. It is necessary to reduce illegal irrigation systems, improve the system of monitoring and control, and increase the payment for irrigation services.
- **Enhance the land consolidation process**. The land consolidation process is crucial for improved productivity. Further implementation, along with the establishment of the Land Parcel Identification System (LPIS), will provide the structural reform of agriculture, as well as opportunities for the utilisation of EU funds, for which the existence of the LPIS is a precondition.
- **Improve the correlation between skills acquired in agriculture education and labour market needs**. This will mean that students may discover it easier to find practical work during studies or full-time employment on graduating. The mechanisms of accountability and certification in the education system will also improve as the labour market demand requirements will continuously call for the transfer of new knowledge.
- **Meet the preconditions and increase capacity for the facilitation of IPARD funding**. As part of the harmonisation with the EU Common Agricultural Policy further effort is needed to accelerate the IPARD accreditation process. The remaining obligation for introducing cross-compliance measures needs to be fulfilled (as part of the criteria for IPARD programme accreditation), the new Law on Common Market Organisations should be finalised, and administrative capacity for evaluation, monitoring and accounting increased within the Agriculture Development Agency.
- **Continuously upgrade the SPS system and harmonise it with EU requirements**. Further efforts to implement the integrated food control system and transferring inspections from municipalities to the FVA are a priority. Opening the existing rendering plant for animal by-product collection and disposal is necessary for the completion of the animal monitoring and control system.

## Tourism policy (Dimension 15)

### *Introduction*

The tourism policy framework in Kosovo is in its early stage of development. Table 22.24 shows Kosovo's scores for the five tourism sub-dimensions and compares them to the WB6 average. Since the last assessment, Kosovo has only made slight progress in tourism by improving its score for the availability of a qualified workforce sub-dimension, driven by improvements in the VET framework indicator where it scores above the WB6 average (Figure 22.1). However, Kosovo scores below the WB6 average in all other sub-dimensions, with its lowest score being in the tourism branding and marketing and the destination accessibility and tourism infrastructure sub-dimensions. Kosovo is currently developing its Tourism Development Strategy, which will set up the governance structure and institutional framework and define the main policy measures, timeframe and budget for their implementation. Until the strategy is developed and adopted, progress in all sub-dimensions will remain rather limited.

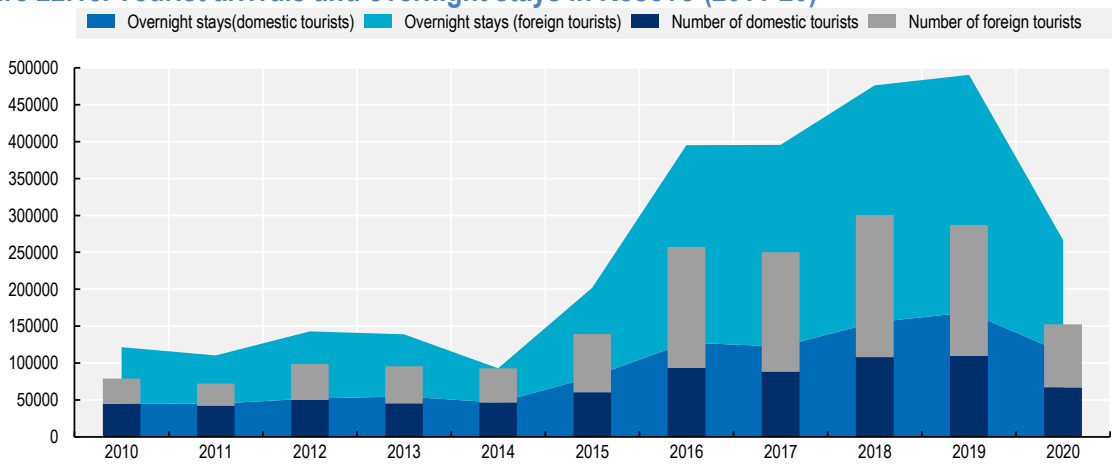
**Table 22.24. Kosovo's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Governance and co-operation | 1.9 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 1.5 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 1.8 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 1.2 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 0.5 | 1.6 |
| **Kosovo's overall score** | | **1.5** | **2.0** |

### *State of play and key developments*

In the last ten years, Kosovo has seen a steady increase in tourist arrivals and overnight stays. The highest increases were recorded in 2015 and 2016, when the number of total tourist arrivals, compared to the previous year, increased by 50% (2015) and 85% (2016), and the number of overnight stays by 117.4% (2015) and 96% (2016). The increase of foreign visitors and their overnight stays was faster than the growth of domestic visitors, reaching 160% in 2015 and 85% in 2016. However, over the last three years the increase in the number of tourist arrivals and overnight stays has slowed down, with 287 083 tourist arrivals and 490 402 overnight stays in 2019 (Figure 22.15), which is behind all other economies in the WB region. Around 50% of foreign tourists are from five destinations: Albania (19.6%), Germany (10.4%), Turkey (8.3%), Switzerland (7.9%) and the United States (5.8%). The main tourist destinations are Pristina, Peje/Pec and Prizren, where nearly 88% of tourist arrivals are registered.

## Figure 22.15. Tourist arrivals and overnight stays in Kosovo (2011-20)




Source: (Kosovo agency of Statistics, 2021[220]), *Hotel Statistics*, https://ask.rks-gov.net/en/kosovo-agency-of-statistics/economy/hotels-and-tourism.

StatLink https://doi.org/10.1787/888934255798

According to the available data from 2019, accommodation and food services contribute to 1.4% of GDP and 6.4% of employment (23 600 jobs) (Kosovo Agency of Statistics, 2019[221]). However, due to the lack of reliable statistical data, the actual contribution of tourism to economic development cannot be assessed.

Tourism is not perceived as a priority sector in Kosovo, despite recent growth. Tourism development is included in several strategic and policy papers: the National Programme for Implementation of Stabilization and Association Agreement (NPISAA); the Economic Reform Programme 2019-2021 (Measure 6: Enhancing competitiveness in the tourism and hospitability sector); the Government Programme 2020-2023; the National Strategy for Cultural Heritage 2017-2020; and the Strategy and Action Plan for Biodiversity 2011-2020. However, a comprehensive approach is still missing. This will hopefully be addressed through the development of an economy-wide tourism strategy being developed that aims to tackle several challenges, such as the lack of a coherent and effective governance structure and institutional set up at economy and local levels, the poor accessibility of tourist destinations due to underdeveloped transport infrastructure, the lack of a quality assurance system meeting international standards, low-quality tourist services and products, unexploited natural and cultural heritage, shortage of competent workforce, and the weak visibility of Kosovo as a tourist destination in international markets.

Due to the COVID-19 outbreak, Kosovo's economy contracted by 5.6% in the first nine months of 2020, and by 3.9% in 2020 compared to 2019 (OECD, 2021[222]). In March 2020, the government implemented containment measures that involved closing all schools and universities; suspending all public transportation services; closing all cafés, bars, restaurants and non-essential stores; cancelling all cultural and sporting events; and obliging all private sector employees to work from home (OECD, 2020[29]). The containment measures put a stop to the tourism industry: hotels were closed during April and May 2020, and Pristina airport only reopened on 28 June. In 2020, the number of local visitors decreased by 39% compared to 2019, and the number of nights they stayed decreased by 33%. The number of foreign visitors also decreased by 52%, with the number of nights they stayed decreasing by 52.5%. Overall, the number of visitors in 2020 was 47% lower than in 2019, and the number of overnight stays was 46% lower (Figure 22.15) (Kosovo Agency of Statistics, 2021[223]). Measures implemented to support the tourism industry include:

- To support the economy, the government cut the interest rate on loans for SMEs operating in the tourism sector by 50%, and the interest rate on loans for large companies by 15%.
- The Promoting Private Sector Employment project of the Swiss Agency for Development and Cooperation in Kosovo prepared a document on the Economic Impact of the COVID-19 Pandemic

in the Hospitality Sector in Kosovo (Swiss Agency for Development and Cooperation, 2020[224]). The report was submitted to the Ministry of Finance in Kosovo to support planning for economic mitigation measures.

- A fiscal package of EUR 180 million (2.5% of GDP) was adopted by the government, and 76% of the package had been executed as of 26 August 2020.
- The New Economic Recovery Programme, corresponding to EUR 384 million, was adopted by the new government. The programme includes projects foreseen under the emergency fiscal package.
- The Ministry of Finance has approached international financial institutions (e.g. IMF, World Bank, EU and EBRD) and other bilateral donors for financial support.

The COVID-19 crisis has emphasised the importance of a resilient tourism industry. Kosovo should assess the impact of COVID-19 on the tourism industry and design a specific recovery plan with an emphasis on the development of sustainable tourism. Kosovo should also put effort into moving away from the further development of mass tourism and start developing new, high-quality and personalised tourist experiences around natural and cultural sites. A dedicated co-ordination framework would guarantee the efficient implementation of policy responses. Moreover, the development of marketing and promotion strategies would contribute to accelerating the recovery.

### *Sub-dimension 15.1: Governance and co-operation*

Kosovo's **tourism governance and institutional set-up** is still at an early stage of development. The Department for Tourism within the MTI manages tourism development and is responsible for tourism marketing (an economy-wide tourist office has not yet been established). The tourism governance structure will be defined in the new Tourism Development Strategy. The mandate of the Kosovo Tourism Council (KTK), established in 2014, was renewed in 2017. The KTK is the main body for **partnerships with stakeholders** at the economy level and for **vertical co-operation** and meets at least four times a year. Its members include representatives of the Association of Municipalities, tourism experts, and representatives of NGOs as well as senior officials of the MTI, the MEE, the MEST, and the Ministry of Culture, Youth and Sports, which are also involved in the development of the tourism strategy and are responsible for the implementation of tourism policy measures.

Implementing the new Tourism Development Strategy will depend a great deal on the ability to establish and implement an effective governance structure at the economy level (and active inter-ministerial co-operation), as well as active co-operation and dialogue with the private sector, educational institutions, NGOs, municipalities and the donor community. This is strongly related to the ability and knowledge of public officials responsible for implementing the strategy.

Municipalities that consider tourism as an opportunity for local development have adopted tourism development strategies. In the western region of Kosovo, the Destination Management Organisation was established in 2015 as an NGO to provide support for the development and promotion of sustainable tourism in the region through joint work with local authorities, businesses, public agencies and strategic partnerships with relevant stakeholders. Although this is a good achievement, in most municipalities tourism governance and destination management remain rather weak. The main constraints, besides the lack of coherent governance at the economy level, are the lack of qualified human resources, lack of financial resources and, according to private tourism stakeholders, weak co-operation and dialogue with the private sector at the local level.

The tourism **data collection and interpretation** framework is formally in place. Since 2017, some progress has been made in tourism data collection with the introduction of new processes: a register of all accommodation facilities, the monthly collection of statistics from accommodation facilities, a new quarterly survey on demand-side statistics, and the preparation of a platform for electronic data collection. A memorandum of understanding was signed in 2016 with Kosovo Police on collecting data on the number

of foreign visitors. However, due to the large informal economy in the tourism sector,[157] and the large share of visitors who enter Kosovo to visit relatives and friends (76% of total border crossings in 2019), statistical data are still not reliable enough to assess the actual scope of tourism activity in the economy. The Tourism Satellite Account has not been implemented yet due to the lack of staff at the Kosovo Agency of Statistics dealing with tourism statistics (currently only one person works in tourism statistics) (Kosovo Agency of Tourism, 2020[225]).

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

There has been no progress in Kosovo regarding the **connectivity framework**, border crossings and visa requirements since the last assessment. Kosovo has established visa exemption agreements with 115 economies. Citizens of the EU Member States, the Schengen area and neighbouring economies can enter Kosovo with a biometric ID and can stay for up to 90 days over a six-month period.

Limited progress has been made on improving **accommodation capacity and the quality assurance framework.** The only development has been the establishment of a register of accommodation facilities. However, the categorisation of accommodation facilities is still voluntary and is not accompanied by awareness-raising campaigns and training for accommodation providers, which is necessary for Kosovo's international tourism competitiveness. There is also no monitoring or evaluation of the efficiency of the categorisation model. The quality assurance framework in Kosovo also needs to be improved. Incentives are currently limited to the provision of grants for SMEs in rural areas by the MAFRD to support rural tourism, with an annual budget of EUR 500 000. Investments in tourism are considered as strategic investments in the Law on Strategic Investments, adopted in 2017. However, no major investments have been made so far, and there is no regular evaluation of measures to develop accommodation facility to ensure the most efficient allocation of limited financial resources.

The **tourist information system** provides reliable information on tourist destinations, accommodation, attractiveness and tourist services. Information is available mainly in Albanian, English and Serbian on websites, road signs, in tourist information centres, etc., and is regularly updated by the Department for Tourism at the MTI. However, Kosovo has not yet established a framework for a tourism information system that includes the regular monitoring and evaluation of tourist information to ensure a systematic approach to the system at all levels down to destination level.

### *Sub-dimension 15.3: Availability of a qualified workforce*

A qualified workforce is one of the main factors for furthering tourism development in Kosovo, as it is the guarantee for improving the quality of tourist products and services, which is currently rather poor. According to the Government Programme 2019-2020, in recent years progress has been made in skills development, quality improvement and access to education. Human resources development in tourism is included in the Kosovo Education Strategic Plan (KESP) for the period 2017-2020. The new Tourism Development Strategy will also introduce **a skills supply framework** and specific policy measures. Kosovo is actively involved in the regional project, Towards Regionally-based Occupational Standards (TO REGOS), implemented by the Education Reform Initiative of South East Europe (ERI SSE) and the expert group, Western Balkans Alliance for Work-based Learning. This project aims to develop common qualification standards for tourism across the Western Balkans.

Overall, the **VET framework** is well advanced, with well-functioning co-operation with private tourism stakeholders. The Agency for Quality Assurance and Accreditation of VET is reported to be well equipped with sufficient financial resources. Curricula are updated according to the tourism industry's needs. Mandatory practical training is part of the VET framework, and the evaluation of activities and measures are planned in the KESP 2017-2020. The Kosovo Government Planning Office monitors the implementation of all strategies, including the strategic education plan. However, as the evaluation and

monitoring reports of the VET framework are not available yet, a more detailed assessment of the tourism VET framework could not be provided.

Kosovo does not have a specific **higher education framework for tourism**. However, institutions offering programmes in the field of tourism, such as the Faculty of Tourism and Environment at the University of Applied Sciences in Ferizaj/Urosevac, have developed strategies and curricula in collaboration with the MEST. Despite the strategies not being specifically focused on tourism, curricula are developed in line with the labour market as they are adopted by working groups that include members from management, academic staff, students, alumni administration and industrial boards. The legislation in force for higher education specifies that each HEI should collaborate with the Agency of Accreditation (responsible for quality assurance) and meet the standards for accreditation. Institutions cannot offer programmes without accreditation. The curricula of the programmes are reviewed during the accreditation process. If programmes meet the conditions for accreditation based on European standards such as the Standards and Guidelines for Quality Assurance in the European Higher Education Area, they are subject to evaluation by local and international experts. The Agency of Accreditation plays a key role during the process of accreditation, but quality assurance within the HEI, the budget, and the engagement of sufficient and professional staff in certain areas remain a challenge.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

A comprehensive **natural and cultural heritage enhancement framework** for tourism is being developed. Natural and cultural heritage will be included in the Tourism Development Strategy. The development of cultural tourism based on the principles of sustainable development is currently defined in the National Strategy for Cultural Heritage 2017-2020. This includes clear and measurable plans with timelines for the implementation of specific measures, organisational structure, division of tasks and responsibilities, and the human and financial resources needed for implementation. Natural heritage is included in the Strategy and Action Plan for Biodiversity 2011-2020. Monitoring and evaluation reports of implemented measures for both strategies are not available to enable a more detailed assessment.

The policy framework for the **promotion of sustainable tourism and operations within the tourism sector** will be defined in the new Tourism Development Strategy. Promotional activities such as increasing awareness and co-operation among all sectors for biodiversity are currently defined in the Strategy and Action Plan for Biodiversity 2011-2020. Sustainable tourism development is promoted through meetings held with businesses, associations and NGOs, and through media communications of Department of Tourism representatives. Awareness-raising activities on the importance of using certifications and tourism standards have been implemented. However, sustainability certification schemes, such as eco-labels and specific schemes for the certification of enterprises meeting sustainability standards, are not in place yet.

**The tourism investment and innovation policy framework** is not established yet, but is planned as part of the new Tourism Development Strategy. The challenge is to prepare a comprehensive analysis of tourism investment needs that will fully support the development of the main tourist products in the major tourist destinations, as defined in the new Tourism Development Strategy.

### *Sub-dimension 15.5: Tourism branding and marketing*

Kosovo's **tourism branding and marketing framework** has not yet been established. The Department of Tourism at the MTI manages the official websites that promote Kosovo tourism. Overall, tourism marketing is implemented by tourism stakeholders but in an uncoordinated manner. Kosovo still does not have an economy-wide organisation for tourism promotion and marketing, unlike most economies worldwide. Some progress in tourism promotion was made by KIESA, which participates in high-profile international tourism events such as ITB Berlin. However, this does not qualify as a comprehensive tourism and marketing framework.

The **digital tourism marketing framework** is not yet established. However, the Digital Agenda, which covers all sectors, began in 2020, supported by the Market Access and Digitalization Services for Kosovo Businesses (ACCESS) project, funded by the Austrian Development Cooperation and co-financed by the MTI and the MEE. A coherent tourism branding and marketing framework, including digital tourism marketing, is still needed to improve the visibility of the Kosovo tourist offer in international markets. Box 22.15 provides some ideas.

### Box 22.15. Approaches to managing tourism marketing and branding

The public sector has traditionally played a lead role in destination marketing and promotion activities, as the fragmented nature of the sector and small size of many tourism businesses makes it difficult for individual businesses to be visible to, and attract visitors from, remote tourism markets. More recently, economies have been exploring different tourism marketing models that draw on new funding sources, partnership opportunities and governance arrangements, as well as the development of digital strategies. Most economies have established economy-wide tourist organisations (NTO) or tourist boards as a central organisation responsible for tourism brand development and marketing in international markets, as well as the co-ordination of marketing and promotional activities of local tourist destination offices. However, due to high competition in the tourism market, NTOs are searching for new solutions to attract visitors using digital tools, and expanding their tasks to support tourist destinations through new tourist product development by providing market research and consultation to tourist destinations. NTOs are strengthening co-operation and dialogue with private sector stakeholders to ensure coherent and effective marketing and promotion in international markets.

Due to the rapid move to digital sales and distribution, economies are looking at new solutions to enable the small and micro-tourism business sector to be more easily connected to major online travel agents and other intermediaries. For example, in 2019 in South Africa the National Tourism Visitor Information System rebranded to become “Jurni”, which is an online platform connecting travellers and travel experiences across the country. Jurni acts as a booking tool and business application to help tourism SMEs overcome knowledge and resource constraints to reach global markets. It also acts as a central data hub providing insights to inform business strategies and decision making across the tourism value chain. A consumer-facing application also provides location-tailored information for tourists during their trip, based on geo-localised information, data analytics and artificial intelligence.

Economies with a more seasonal offer and an over-reliance on a limited number of high volume short-haul markets are seeking to diversify and expand into new markets or segments. This is both to increase the length of the season and to increase the demand for less popular destinations. Diversification can typically be based on cultural, heritage or urban products. Croatia, Greece and Turkey all have firm plans in this regard.

Many countries are also now giving greater prominence to marketing to their home markets, recognising that the volume of domestic tourism is often significantly greater than inbound tourism. Hungary, for example, is looking to use the domestic market as a way of spreading the benefits through extending the season and encouraging trips to lesser known destinations, and Slovakia and Romania have introduced recreational voucher schemes to incentivise employees to spend their holidays domestically.

There is a greater focus on the development of bookable products and experiences to attract visitors as part of the upstream marketing mix, which has translated into significant investment and specific programmes, as in for example Canada, Ireland and the United Kingdom.

Source: (OECD, 2020[226]), *OECD Tourism Trends and Policies 2020,* https://doi.org/10.1787/6b47b985-en.

### *The way forward for tourism policy*

- **Finalise and adopt the new Tourism Development Strategy**. This strategy should establish an efficient governance structure and institutional set up at the economy level, define clear policy measures, responsible institutions for their implementation, timeframe and budget allocation. The strategy should also provide policy measures for establishing the legislative and regulatory framework, starting with the adoption of the Law on Tourism. A monitoring and evaluation framework should be part of the strategy to ensure that the impact of the implemented measures on tourism development in the economy is assessed.
- **Establish an economy-wide tourist organisation** that will take over tourism branding and marketing in the economy. The development of a digital marketing framework is also of growing importance. The provision of a sufficient budget and a team of qualified staff working in the field of tourism marketing are preconditions for the successful launch and development of the economy-wide tourist organisation.
- **Include destination management organisations in the new Tourism Development Strategy to empower municipalities/tourist destinations to manage tourism development**. Policy measures should include capacity-building programmes for local tourist organisations, and sufficient budget should be secured for the start-up phase of organisations' development and operations. Donor support could be valuable for the development of destination management organisations as they can provide best practice cases from advanced tourism economies.
- **Introduce a framework for accommodation capacity and tourism quality** to increase the quality of tourist products and services. The adoption of a mandatory accommodation facility categorisation framework, accompanied by awareness-raising campaigns, training and advice for private stakeholders, is also recommended. A comprehensive tourism investment programme that includes a set of incentives for investing in private tourist infrastructure (including accommodation facilities), and improving the quality of tourist products and services, would help to increase the competitiveness of Kosovo tourism in international markets.
- **Develop a comprehensive framework for promoting sustainable development within the tourism sector**. This should include the mandatory consideration of sustainability criteria in all investments in tourist infrastructure. These investments should be supported by public incentives, and provide awareness raising and training for tourism sector stakeholders on developing their businesses sustainably. Using best practices from other countries, such as the Green Scheme by Slovenian Tourism,[158] is recommended.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 22.25 shows Kosovo's scores for the anti-corruption policy dimension and compares them to the WB6 average. All scores for Kosovo are below the WB6 average, with the score for anti-corruption law enforcement bodies closest to the average. In recent years, Kosovo has adopted several important laws to strengthen its anti-corruption framework and the rule of law more generally. Since the previous assessment, Kosovo has intensified anti-corruption awareness-raising and training activities. However, the limited capacity of key anti-corruption institutions remains a concern.

**Table 22.25. Kosovo's scores for anti-corruption policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 1.0 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 2.5 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 2.5 | 2.8 |
| **Kosovo's overall score** | | **1.8** | **2.5** |

Note: For comparability with the previous assessment, the two new sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 16.1: Anti-corruption policy framework*

In terms of **policy documents, co-ordination and implementation**, the latest adopted anti-corruption policy documents in Kosovo were the Anti-Corruption Strategy and Action Plan 2013-2017. According to the government, most of the measures have been implemented, but the latest published data suggest only partial implementation. For the period July-December 2017, the action plan envisaged 120 actions or measures; however, the Anti-corruption Agency (ACA) concluded that only 70 actions had been completed or were being implemented (ACA, 2018[227]).

The adoption of the Anti-Corruption Strategy and Action Plan 2019-2023 has been delayed. By law, the ACA is responsible for drafting the strategy in co-operation with other government and non-government institutions, which is then adopted by the Assembly of Kosovo. On 29 March 2019, the ACA forwarded the draft documents to the Committee on Legislation of the Assembly (ACA, 2020[228]). The documents were based on contributions by various institutions, and the action plan contains a separate column of budget for each activity (however, no exact amounts were envisaged in the draft submitted for the competitiveness policy outlook assessment). In 2020, the ACA launched renewed preparation of the Anti-Corruption Strategy and Action Plan (now for 2021-2023), which was approved by the government in December 2020 but at time of writing had not been approved by the Assembly (ACA, 2021[229]). The latest drafts were not evaluated within this assessment.

There is evidence of civil society involvement in anti-corruption policy planning. To prepare the draft strategies 2019-2023 (2021-2023), the ACA set up working groups and discussed the measures envisaged with involved public institutions and civil society participants.[159] Organisations such as the Democratic Institute of Kosovo; the GAP Institute; the Kosovo Law Institute; the Organization for Democracy, Anti-corruption and Dignity (ÇOHU); and the Riinvest Institute have been monitoring various aspects of the anti-corruption policy and measures. In 2012, the President of Kosovo established the National Anti-corruption Council, but no evidence is available regarding its recent activity.

Kosovo does not have legislation governing **corruption risk assessment**, and public authorities have no legal obligation to carry out such assessments. The Anti-corruption Action Plan 2013-2017 contained a requirement to adopt integrity plans in public bodies, but its implementation did not become systematic. According to the version of the draft Anti-corruption Strategy submitted for this assessment, as of 2017, 16 municipal institutions and 6 central-level institutions had completed integrity plans. The version of the draft action plan submitted for this assessment envisaged the drafting and monitoring of integrity plans in all public institutions, as well as reviewing the competences and mandate of the ACA, as necessary for assessing corruption risks. The UNDP Kosovo and the Council of Europe have supported some corruption risk assessments, such as for the Chamber of Notaries in 2019, the extractive industries sector in 2016 (UNDP, 2020[230]), the prosecution system, the judicial system and public procurement in 2017 (Council of Europe, 2020[231]).

Kosovo does not have a legal framework for **corruption proofing of legislation**. The draft Anti-corruption Action Plan submitted for this assessment envisaged giving the ACA the right and responsibility to provide an opinion/anti-corruption assessment of laws and sub-legal acts. However, the actual participation of the ACA in the development of legal acts has been ad hoc.

### *Sub-dimension 16.2: Prevention of corruption*

The ACA is the main corruption **prevention body** in Kosovo. According to law, the agency is an independent and specialised body responsible for implementing state policies to combat and prevent corruption. The ACA has a broad scope of competencies, such as supervising and preventing conflicts of interest, supervising property of senior public officials and implementing preliminary investigations into corruption. Legal safeguards for the independence of the ACA include an open competition for selecting the director of the agency, and the competence of the ACA to prepare and propose its own annual budget. The Assembly of Kosovo establishes the ACA's oversight committee. The ACA ensures transparency by publishing most of its decisions and opinions online. With approximately 40 officials and an annual budget of slightly above EUR 500 000, the ACA is among the smaller prevention agencies in the region, and is considered by independent experts to be severely under-resourced (SELDI, 2019[232]).

In 2018, Kosovo adopted the Law on Prevention of Conflict of Interest in Discharge of a Public Function, which replaced the previous law for the prevention of **conflicts of interest** (adopted in 2011). The new law addressed several loopholes, for example it broadened the definition of a person related to an official to include, among others, every legal or natural person who has had or has a joint pecuniary or non-pecuniary interest with the official. The scope of officials covered has been broadened to include not only senior public officials as under the previous law, but also any official person. The definition of conflict of interest covers actual, apparent and potential conflicts by referring to an interest "which influences, might influence or seems to influence the impartial and objective performance of official duties". Action in an official matter in a situation of an unresolved conflict of interest can be criminally punished in Kosovo, but the formulations in the law and the Criminal Code are somewhat inconsistent, with the scope of related persons being narrower in the criminal-law provision. Inconsistencies in the terminology are also found in comparison with the Law on Suppression of Corruption (Barboric et al., 2019[233]). In 2020, the ACA published a guide on the prevention of conflict of interest in public institutions (ACA, 2020[234]). According to the ACA, upon its request public institutions have appointed officers responsible for handling cases of conflict of interest within their institutions.

Every year the ACA handles several cases of breaches related to conflict of interest – 167 in 2019 (ACA, 2020[228]) – however, the application of sanctions is limited and available statistical data on sanctions are fragmented. Reportedly, in 2018 the ACA submitted fewer than 5 conflict of interest cases as minor offences and 10 cases for criminal investigation (European Commission, 2019[111]). In 2019, the ACA forwarded 2 cases of conflict of interest to the prosecutor's office and made 2 requests for

dismissal/proceedings of minor offence (ACA, 2020[228]). As of October 2020, 659 senior public officials reportedly held two or more positions, in violation of the law (European Commission, 2020[39]).

The Law on Declaration, Origin and Control of Property of Senior Public Officials and on Declaration, Origin and Control of Gifts of All Public Officials governs **asset declarations**. The law was last amended in 2014. The scope of persons subject to the declaration includes practically all senior officials. The contents of the declarations have some gaps, such as the lack of requirement to declare savings in cash, which is relevant for ascertaining the full economic situation of a person. The ACA publishes the declarations on its website with all but certain personal data.

The degree of compliance with the obligation to submit declarations is uneven: 98.8% of senior officials submitted their regular annual declarations on time in 2019, while 90.7% complied with the obligation to submit declarations upon assuming office and only 81.5% complied with the obligation to submit declarations upon completion or dismissal from office. The ACA carries out preliminary and full control of the declarations, with 20% of declarations subject to full control in 2019. Based on the control findings, the ACA forwarded 62 cases to its Department for Combating Corruption, the police and the prosecutor's office (ACA, 2020[228]). Data on outcomes of the forwarded cases were not available for this assessment.

The ACA has had a positive record of revealing hidden assets in the past (Hoppe et al., 2013[235]). Verification involves comparing data held by other institutions, rather than an analytical assessment of the plausibility of officials' declared financial situation. A key limitation is a lack of access to information from banks. Closer co-operation and exchange of data are reportedly necessary among the police, the tax administration, the financial intelligence unit, the land registry and municipal authorities (European Commission, 2020[39]). According to the government, work is underway to develop an advanced database for managing declarations, in co-operation with UNDP.

The track record on whistle-blowing and **protection of whistle-blowers** has been weak. A new Law on Protection of Whistle-blowers was adopted in 2018, replacing the previous law of 2011. The law is comprehensive and extends to both the private and public sectors. A whistle-blower is any person who reports or discloses information on threat or damage to the public interest in the context of their own employment relationship (defined broadly to include associates, volunteers, interns, trainees, candidates, contractors, etc.). Whistle-blowing can be internal, external (to a competent authority) or public. However, external and public whistle-blowing are subject to conditions. The conditions for external whistleblowing (e.g. there are reasonable suspicions that detrimental acts may be taken against the whistle-blower or that the evidence may be concealed or destroyed if internal whistle-blowing is carried out) may act as a deterrent and more restrictive than the approach envisaged in the Directive 2019/1937 of the European Parliament on the protection of persons who report breaches of EU law.

The law contains multiple provisions for protecting whistle-blowers, such as an obligation to keep information related to whistle-blowing confidential, nullity and voidness of any detrimental act taken against the whistle-blower by their employer due to the whistle-blowing, compensation of damages, reinstatement of a whistle-blower at their place of work, protection of persons associated with the whistle-blower, and the right to protection due to mistaken identity of a whistle-blower. The law expressly prohibits any action or omission aimed at preventing whistle-blowing. However, it does not envisage anonymous whistle-blowing, and it is unclear whether a person who reports anonymously but subsequently encounters retaliation would qualify for protection. The whistle-blower protection law itself does not clarify whether a reporting person is entitled to possible provisional protection before decisions on the acceptance of a whistle-blower report or the adoption of protection measures are made, or if they are entitled to free legal assistance. Secondary legislation, which would define procedures for reporting, is still being developed by the Ministry of Justice.

The ACA has undertaken various activities to implement the law, such as sending requests to public institutions to appoint responsible whistle-blowing officials, participation in developing and implementing regulations and the organisation of a workshop. However, the actual results in the area of whistleblowing have been modest. In 2019, the ACA received three external whistle-blower reports, all of which were

rejected. Only two whistle-blower reports were received by another institution (ACA, 2020[228]). According to the Kosovo Law Institute, the main reasons for the weak whistle-blowing track record are the lack of knowledge among public institutions about the law, and the neglect of implementation of obligations stemming from the law (Shala and Bajraktari, 2020[236]). Practical factors such as lack of secluded office space for responsible persons and secure storage for files in institutions also reportedly represent risks for the confidentiality of whistle-blowing (Shala, 2019[237]).

There is little recent evidence of the government carrying out general **awareness-raising** campaigns or disseminating information materials (leaflets, posters, stickers, etc.). The website of the ACA and its YouTube account only contains video from 2016. A brief video was published in November 2018 regarding the new law for prevention of conflict of interest. However, the ACA and multiple other stakeholders (civil society organisations, international partners) have organised various awareness-raising activities within annual anti-corruption weeks that take place every December. In co-operation with other institutions, the ACA continuously holds training on conflict of interest and other topics, and the training curriculum of the Academy of Justice has an anti-corruption programme (European Commission, 2020[39]). Training is expected to continue as the draft Anti-corruption Strategy contains training activities for each sector, including advanced training for investigators. The government has not allocated specific funding for anti-corruption awareness raising and education.

### *Sub-dimension 16.3: Independence of the judiciary*

The constitution and other laws provide safeguards for the **independence of the judiciary**. In 2018, Kosovo adopted the new Law on Judicial Council. The President of Kosovo appoints judges upon the proposal of the Judicial Council (JC,) and has adhered to all of its proposals (European Commission, 2019[111]). A matter of concern is the potential vulnerability of new judges who are appointed for the initial term of three years. The JC appoints presidents of courts, except the President of the Supreme Court, who is appointed by the President of Kosovo. The President of Kosovo, based on a proposal by the JC, can decide to dismiss a judge. The JC proposes the dismissal of a judge only upon their conviction of a serious criminal offence, an intentional violation of law or for serious neglect of duties.

The JC consists predominantly of judges (7 out of 13 members are judges elected by members of the judiciary; 6 members are elected by the Assembly of Kosovo, of whom at least 3 must be judges). As of September 2020, 11 members appeared to have been appointed, according to the website of the JC. The website publishes all decisions and notices of employment opportunities for positions of judges and staff in a user-friendly format to ensure transparency.[160] The JC also maintains a public searchable database of court judgements.[161] The composition of the JC, as well as appointment procedures and transparency of work, have the potential to significantly contribute to the independence and accountability of the judiciary. A risk for the independence and capacity of the JC, and the judiciary at large, reportedly stems from the regular practice by the Ministry of Finance of reducing budget requests submitted by the JC (Thaqi, 2019[238]). However, there were budget increases in 2019 and 2020 in comparison to 2018 (European Commission, 2020[39]).

In 2018, Kosovo strengthened the disciplinary liability of judicial officials by adopting the Law on the Disciplinary Liability of Judges and Prosecutors. The JC has responsibility for imposing disciplinary sanctions on judges. In 2019, the JC's Disciplinary Commission imposed two sanctions involving a salary reduction for three and six months (Kosovo Judicial Council, 2019[239]). The disciplinary procedure includes safeguards for accused persons, such as the rights of the judge or prosecutor against whom the proceedings have been initiated to hire a defence lawyer, access all evidence and the dossier of the case, and appeal against the disciplinary decision to the Supreme Court of Kosovo. Complaints against the decision of the council have a suspension effect, and disciplinary decisions are published.[162] The Judicial Performance Evaluation Committee of the JC has the power to conduct performance evaluations of judges with permanent tenure, initial tenure and those eligible for promotion. However, in 2019, the rating of "good"

or “very good” to 99% of judges with permanent mandates subject to evaluation was found to contrast with general domestic perceptions regarding judges’ professionalism (European Commission, 2020[39]).

Kosovo has made progress in introducing random case distribution in courts. However, depending on the conditions and practical possibilities, distribution still takes place both automatically and manually. In January 2020, the JC adopted criteria for the distribution of cases (Kosovo Judicial Council, 2019[239]). It has been reported that high-profile and sensitive cases are not always processed in a timely manner (European Commission, 2020[39]).

### *Sub-dimension 16.4: Business integrity and corporate liability*

Little evidence is available regarding measures for strengthening **business integrity**. Based on evidence available for the Competitiveness Outlook, it appears that company boards of directors do not have explicit statutory responsibility for overseeing the management of corruption risks. There are apparently no government incentives for companies to improve the integrity of their operations. No designated institution is specifically responsible for receiving complaints from companies about corruption-related matters, providing protection or helping businesses resolve their concerns. The Law on Business Organisations does not explicitly require information on beneficial owners of limited liability companies and joint stock companies to be submitted to the Business Registry (Evgeniev et al., 2019[240]).

The Law on Liability of Legal Persons for Criminal Offence and the Criminal Code define the criminal **liability of legal persons**. According to the Criminal Code, a legal person is liable for a criminal offence committed by a responsible person acting on behalf of the legal person and for their benefit or interest or to cause damage with that criminal offence. The legal person is liable if the criminal offence by the responsible person is a result of: 1) a power to represent the legal person, an authority to take decisions on behalf of the legal person, or an authority to exercise control within the legal person; or 2) lack of supervision or control that has made possible the commission of the criminal offence for the benefit of the legal person by a responsible person under its authority.

The liability of legal persons is general (liability possible for any criminal offence) and autonomous (the legal person shall also be liable for criminal offences when the responsible person has committed the criminal offence but was not sentenced). The liability of the legal person is based on the culpability of the responsible person. If criminal proceedings cannot be initiated or executed against the responsible person, the procedure shall only be initiated and executed against the legal person.

According to the Law on Liability of Legal Persons for Criminal Offence, fines and the termination of activity of the legal person are the main sanctions for criminal offences. The upper limit of fines is EUR 100 000, which is extremely low relative to the possible scale of large corruption transactions. Possible security measures include the prohibition of work or certain functions, confiscation of assets, confiscation of a material benefit, and publication of the judgement. Legal consequences following the conviction of a legal person may be the prohibition of work based on a licence, authorisation or concession issued by state bodies, and the prohibition to acquire such licence, authorisation or concession. The law does not allow due diligence (compliance) defence to exempt legal persons from liability or mitigate sanctions, nor does it allow the court to defer the application of sanctions on legal persons if they comply with organisational measures (as determined by the court) to prevent corruption.

The legal framework for corporate liability would benefit from guidance on anti-corruption compliance for the managerial and supervisory bodies of legal persons. The effectiveness of the corporate liability framework for combatting corruption could not be assessed due to the absence of relevant statistics.

### *Sub-dimension 16.5: Investigation and prosecution*

In 2015, the State Prosecutor established a joint team of representatives of law enforcement institutions for selection and targeting serious crimes. The State Prosecutor has created a database of “targeted

cases" of organised crime and **high-level corruption**. As of October 2020, 56 indictments (including 36 concerning corruption) had been filed in targeted cases. Final rulings had been reached in 13 cases, 8 of which ended with fully or partially guilty verdicts and the conviction of 15 individuals of corruption-related offences (European Commission, 2020[39]). These limited data point towards a relatively low conviction rate of approximately 60%.

Indictments against high-profile individuals constitute a minor part of the total volume of corruption cases heard in courts. In 2019, the Kosovo Law Institute monitored court hearings of corruption cases involving 443 low-profile individuals, 357 medium-profile individuals and 54 high-profile individuals. In January to September 2019, the Special Prosecutor's Office (SPO) did not file any indictment against high-profile individuals for corruption offences, and courts gave no effective imprisonment sentences for high-profile corruption offences. There is no evidence of the practice of sequestration or confiscation of assets unlawfully obtained through corruption (Musliu and Zekaj, 2019[241]), and the amount of confiscated assets generally remains low (European Commission, 2020[39]).

One example of a case involving high-profile individuals is the "Pronto" case, which concerned illegal employment in senior public enterprise positions. Prosecutors in this case have been criticised for failing to call to account all individuals involved, and the first instance court also allegedly committed violations in handling the case. The SPO started investigating this case in 2016. Despite criticism, this is one of the few prominent corruption cases against high-level public officials in which convictions have been made. The Supreme Court convicted three defendants, including a former member of parliament, in 2020 (Bugaqku, 2020[242]; Himaj, 2020[243]).

The SPO, established in 2007, qualifies as a **specialised anti-corruption prosecutorial body**. The SPO has extensive competence, which includes corruption crimes such as unjustified acceptance and giving of gifts, abuse of official position or authority, accepting and giving bribes, and misappropriation and fraud in office. As of October 2020, the SPO had 15 prosecutors out of 18 planned positions, and 4 prosecutors work in a new section specialised in high-level corruption cases (European Commission, 2020[39]). Most SPO prosecutors have received training over the past two years (in 2019 they attended 14 training courses). However, given that corruption is only one of several major areas of SPO competence, insufficient capacity remains a challenge. In February 2020, the Prosecutor's Office published a reorganisation strategy that envisages dividing prosecutors into four departments, including the Department of Corruption and Financial Crime (State Prosectutor, 2020[244]). According to information about the structure of the SPO on the website of the Prosecutor's Office, the reorganisation appears to have been completed (State Prosecutor, 2020[245]).

The Unit for Combating Corruption and Economic Crimes has been established at the Basic Prosecutor's Office in Pristina, subject to supervision by a committee established by the Prosecutorial Council (State Prosecutor, 2020[246]). Specialised anti-corruption prosecutors have also been appointed in other basic prosecutor's offices. Special departments in the Basic Court of Pristina and the Court of Appeals will handle cases brought by the SPO (European Commission, 2020[39]).

Kosovo has no independent **specialised anti-corruption investigative bodies**. Within the Kosovo Police, there is the Directorate for Investigation of Economic Crimes and Corruption within the Crime Investigation Division, as well as the Anti-corruption Task Force (Kosovo Police, 2019[247]). The anti-corruption units of the Kosovo Police do not have any safeguards of independence beyond the rules that apply to police units in general. The increased number of financial investigators working on organised crime and corruption cases is a sign of strengthening capacity (European Commission, 2020[39]).

### *The way forward for anti-corruption policy*

- **Adopt the new anti-corruption strategy and action plan** and improve public reporting on the implementation of the anti-corruption policy. The United Nations Convention against Corruption requires that states develop and implement or maintain effective, co-ordinated anti-corruption policies that promote the participation of society and reflect the principles of the rule of law, proper management of public affairs and public property, integrity, transparency, and accountability (United Nations, 2004[248]). Even though Kosovo is not a party to this convention, the substance of this provision is nevertheless relevant. Comprehensive strategies and action plans that define objectives and goals, allocate responsibilities, set deadlines, and determine necessary funds are widely recognised as the best way to frame anti-corruption policies. The absence of an approved strategy and plan, as well as regular comprehensive reporting on their implementation, has been a serious deficiency of Kosovo's anti-corruption policy for several years. Kosovo should adopt the strategy and action plan, start implementing them vigorously in 2021, and prepare and publish the first assessment of progress no later than 2022.
- **Adopt and implement legal obligations to carry out corruption risk assessments** and, at least selectively, the corruption proofing of draft and effective legislation. Corruption risk assessment allows for the detection of vulnerabilities to corruption even before corrupt acts happen. If carried out with commitment, due resources and skill, risk assessment is one of the most effective prevention tools. According to available evidence, few public institutions in Kosovo have carried out corruption risk assessments and developed related integrity plans. Kosovo should make efforts to ensure that this practice becomes universal across the public sector. Including the relevant obligation in the law, providing necessary methodological support, and centrally monitoring the quality of the assessments would be the most effective way to achieve this goal (see Box 22.16). Establishing the legal basis for systematic corruption proofing of legislation would be a key step to limit corruption risks that arise from deficiencies in the legal framework.
- **Strengthen the auditing of asset declarations of public officials** by developing methods to analytically assess the plausibility of their declared economic conditions. The Western Balkan Recommendation on Disclosure of Finances and Interests by Public Officials recommends that verification does not limit itself to comparing data, but that it aims to detect undeclared cash-flows and their possible illicit origin (ReSPA, 2014[249]). It is possible that a corrupt public official fills a declaration with data that correspond to sources verified by an oversight body, while still incurring expenses and accumulating assets that vastly exceed their legal income. Kosovo should ensure that the form of the declarations and the verification practice allow the ACA to detect illicit enrichment based on the economic plausibility of the declared information, even when it is not possible to pinpoint specific items of income or hidden assets.

### Box 22.16. Integrity assessment of public organisations in Korea

Assessments of corruption risks and integrity can be carried out in a variety of ways. An interesting example is the integrity assessment of public organisations in Korea. The model was first designed in 1999 and has been adjusted several times since then. It remains in use for annual assessments.

Objectives of the assessment are:

- Provision of basic data for improving the levels of integrity and enhancing the effectiveness of anti-corruption activities by measuring the levels of integrity in public organisations objectively and scientifically.
- Identification of priority areas and works in public service to increase the integrity levels of individual public organisations by diagnosing integrity levels in specific service units.
- Creation of an environment where each public organisation is motivated to voluntarily carry out anti-corruption activities through the disclosure of integrity assessment results to the general public.
- Creation of a consensus on the need to improve integrity not only in the public sector but also in society as a whole through the promotion of the integrity assessment and disclosure of its results.

The assessment model contains several key elements:

- External integrity: External public service users assess the extent to which government employees handle public services with transparency and accountability without committing corruption.
- Internal integrity: Employees of an organisation as internal customers assess the levels of corruption in the organisation's managerial activities, institutional practices and organisational culture.
- Policy customer evaluation: Policy experts, related personnel and people affected by policies evaluate the corruption level of a subject organisation in the processes of determining and executing the policies.
- Statistics on corrupt employees: The data on corruption cases are quantified by calculating the number of employees in a public institution who were disciplined for their corrupt practices in a given period, and the benefits derived from those practices.
- Acts lowering assessment reliability: Surveys and inspections aim to detect the acts conducted by the organisations subject to an integrity assessment to affect the assessment results in an improper way.

The Anti-Corruption and Civil Rights Commission in Korea collects basic data for the assessment (lists of target institutions and services, public service users and policy customers), manages assessment processes, and analyses and discloses assessment results.

Source: (ACRC, 2017[250]), *A practical guide to integrity assessment*, https://www.acrc.go.kr/en/file/file.do?command=downFile&encodedKey=Mjk2MzRfNg%3D%3D; (ACRC, n.d.[251]), *Integrity assessment of public organizations*, https://www.acrc.go.kr/en/file/file.do?command=downFile&encodedKey=Mjk2MzRfMQ%3D%3D.

- **Introduce a public register of beneficial owners of legal entities**. The EU Anti Money Laundering Directives envisages that beneficial ownership information is held in a central register and is accessible to competent authorities and financial intelligence units without any restriction, to obliged entities within the framework of customer due diligence, and to any member of the general public. It is also required that the information held in the central register of beneficial

ownership information is adequate, accurate and current, and that states put in place mechanisms to this effect.

- **Increase the maximum fines applicable to legal persons for criminal offences to ensure that sanctions are effective, proportionate and dissuasive in large-scale corruption cases.** International standards do not define the sufficiency of the sanctions in specific terms, but the OECD Working Group on Bribery in International Business Transactions has adhered to the standard that monetary sanctions should be sufficiently severe to impact large multinational corporations. In certain economies, statutory ceilings of sanctions even up to several million euro have been found to be insufficient (OECD ACN, 2015[252]). Although such levels of fines may appear irrelevant given the limited size of most companies in Kosovo, the law should provide the possibility to apply adequate sanctions in case a large business player engages in corruption.
- **Further strengthen the capacity of the SPO to investigate high-level corruption cases and hand down indictments** by filling all vacancies of prosecutor positions, ascertaining gaps in specialised knowledge and skills, and providing appropriate training. Ensuring the sufficient capacity of anti-corruption institutions is a widely recognised necessity. The United Nations Convention against Corruption envisages that the staff of bodies specialised in combating corruption through law enforcement should have the appropriate training and resources to carry out their tasks (United Nations, 2004[253]). While the capacity of the SPO has been strengthened in Kosovo, it still appears too limited for the major task of prosecuting high-level corruption.
- **Consider how to strengthen the independence of specialised anti-corruption units within the Kosovo Police**. The United Nations Convention against Corruption sets the standard that a body or bodies or persons specialised in combating corruption through law enforcement shall be granted the necessary independence, in accordance with the fundamental principles of the legal system of the state party, to be able to carry out their functions effectively and without any undue influence (United Nations, 2004[253]). This CO assessment did not evaluate in-depth the work of the units of the Kosovo Police, and hence does not argue whether any undue influence on their activities has taken place. However, Kosovo should consider introducing additional means to safeguard the independence of these units, such as the more public and competitive selection of management, strengthened guarantees, and transparency of dedicated budget funding.

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Xhorxhina, B. (2020), *Kosovo Lawmakers Play Politics with Personal Data*, BalkanInsight, https://balkaninsight.com/2020/09/21/kosovo-lawmakers-play-politics-with-personal-data/. [156]

## Notes

[1] Instrument for Pre-Accession Assistance (IPA) are funds provided by the European Union to help candidates align policies and strategies with EU standards.

[2] A person from Kosovo Investment and Enterprise Support Agency (KIESA) who co-ordinates the whole assessment in Kosovo.

[3] Staff from Kosovo Agency of Statistics who co-ordinate the statistical data collection.

[4] World Bank classification.

[5] Other relevant laws governing investment include: the Law on Late Payments in Commercial Transactions, the Law on Bankruptcy, the Law on Prevention of Money Laundering and Combating Terrorist Financing, and the Law on the Credit Guarantee Fund.

[6] According to the law, the strategic sectors are energy, infrastructure, mines, transport and telecommunications, tourism, manufacturing industry, agriculture and food industry, health, industrial and technological parks, wastewater and waste management.

[7] https://gzk.rks-gov.net/default.aspx?index=1.

[8] The strategy was developed in co-operation with OECD/Sigma programme.

[9] As of December 2020, the draft law to establish a Kosovo commercial court was at the public consultation stage. The draft has received wide and positive public response, according to key stakeholders.

[10] Key IPR regulations include the Law Amending/Supplementing the Law on Patents, the Law on Intellectual Property, the Law on Industrial Designs, the Law on Trademarks, and the Law on Geographical Indications.

[11] Kosovo's IPR laws were amended in 2015 to align with EU standards.

[12] As referred to in Annex VII of the EU Stabilisation and Association Agreement.

[13] The trademark registration process takes approximately 9 months, while patent approval takes about 18 months.

[14] In August 2020, a decision was taken to reorganise the NCED to become the National Council for Economy and Investments (NCEI). The NCEI should act as an active forum for economic and investment promotion, and is expected to be more active in the development and steering of KIESA. Detailed information on the new body and its mission are not yet available.

[15] ICT, food processing and packaging, mining and metal processing, energy, textile and leather processing, wood processing, and tourism.

[16] These events are organised in co-operation with the Ministry of Foreign Affairs, embassies, consulates and the Union of Kosovo Businesses in European Countries.

[17] Economic zones as defined by the law include free zones (determined by the custom and excise law), industrial parks, technological parks and business incubators.

[18] The National Committee for Trade in Services was established on 6 July 2020, with Protocol 01/3387, signed by the minister.

[19] Launched on 06 October 2020, the Contact Point on Services (CPS) platform database contains a section called Start a Business in Kosovo, which provides all the information needed. Another section covers accredited professions. Legislation is covered by two sections, horizontal legislation that regulates all services classified according to the Global Agricultural Trade System (GATS) definition of trade in services, and sectoral regulation covering primary and secondary legislation. The database provides easy links to the main sources of data on services. It provides a means of communication between interested parties and the Ministry of Trade and Industry, which is willing and ready to assist the business community in any way possible. This platform will also be used as a contact point for CEFTA. The platform can be found at https://cps.rks-gov.net/.

[20] https://konsultimet.rks-gov.net/.

[21] OECD member states and STRI key partner economies (Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa, and Thailand).

[22] The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member states and partners states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.

[23] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[24] Law No. 06/L-016 on Business Organizations, date 24.05.2018, Official Gazette of the Republic of Kosovo No. 9/ 2018, not updated since, Articles 33, 119.

[25] In order to facilitate comparison with OECD member states that have undergone the STRI exercise, the paragraphs below have been drafted in accordance with the methodology of STRI project publications. The OECD member country notes and the sector notes are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/.

[26] The Central and Eastern European Countries (CEEC) are: Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.

[27] Post and Telecommunications of Kosovo (PTK) is the public operator of Kosovo. PTK has three business units: Post of Kosovo, Telecom of Kosovo, and Vala, its mobile operator unit.

[28] Directive on electronic commerce 2000/31/EC.

[29] Directive on electronic commerce 2000/31/EC.

[30] The Draft Law on Electronic Identification and Trust Services in Electronic Transactions was approved at the 33rd meeting of the Government of Kosovo, with Decision No. 01/33, dated 28.09.2020, https://kryeministri-ks.net/wp-content/uploads/2020/09/PROJEKTLIGJI-P%C3%8BR-IDENTIFIKIMIN-ELEKTRONIK-DHE-SH%C3%8BRBIMET-E-BESUARA-N%C3%8B-TRA....pdf.

[31] As in almost all industries, a high level of concentration might lead to low levels of competition and higher interest rates.

[32] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks' risk management.

[33] The Pillar 2 Requirement (P2R) is a bank-specific capital requirement which applies in addition to, and covers risks which are underestimated or not covered by, the minimum capital requirement (known as Pillar 1). The P2R is binding and breaches can have direct legal consequences for banks.

The P2R is determined via the Supervisory Review and Evaluation Process (SREP). The capital the ECB asks banks to keep based on the SREP also includes the Pillar 2 Guidance (P2G), which indicates to banks the adequate level of capital to be maintained to provide a sufficient buffer to withstand stressed situations.

[34] Basel II is an international business standard developed prior to the 2008/09 crisis by the Basel Committee on Banking Supervision. It requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.

[35] Underground parking at the Faculty of Philology in Pristina awarded in 2019 (under construction); municipality of Peja – skiing resort awarded in 2017 (not yet implemented); municipality of Prizreni – cemetery in Landovica and Bajram Curri market awarded in 2016; Mitrovica municipality – overpass contract awarded in 2016; Gjilani municipality – school grounds and sport fields contract awarded in 2015.

[36]Depreciation rates by category are: 5% for buildings and other structures, between 20% for machinery and equipment, and 10% for other intangible assets.

[37] The amount of withholding tax is creditable against income tax levied on the total aggregate income.

[38] Instrument for Pre-Accession Assistance (IPA) are funds provided by the European Union to help candidate countries align domestic policies and strategies with EU standards.

[39] SOEs' estimated share of domestic employment is based on SOE employment figures provided by the authorities in the context of this assessment, concerning only the 17 SOEs under the remit of the POE Monitoring Unit. Estimates for the electricity system operator KOSTT are available on the United States Agency for International Development (USAID) website. Publicly available labour force statistics are from 2017.

[40] The EBRD comparison did not include Albania, but did include the other four WB economies. Kosovo had the third smallest SOE sector as measured by SOE assets as a percentage of GDP among the 20 mostly European countries included in the review. Only Moldova and Turkey had smaller reported shares. However, comparing enterprise assets to GDP has shortcomings, notably because assets are a stock variable and GDP is a flow variable. It would therefore be more pertinent to compare SOE value-added to GDP, but no such data are available. The ratio nonetheless allows for a telling cross-country comparison.

[41] Concerning alleged overstaffing in some SOEs, see for example (GAP Institute, 2015[87]).

[42] The board dismissals referenced here concern the following SOEs: KRU Prishtina, NPH Ibër Lepenc, Kosovo Electricity Corporation (KEK) and Southern Hydro. According to stakeholders interviewed for this assessment, the government had requested that these SOE boards postpone the appointment of senior

officials to allow sufficient time for the implementation of an agreement with the UK government involving support in the senior management recruitment procedures.

[43] See, for example, Prishtina Insight, "Controversy over new public enterprise boards", 3 April 2020, https://prishtinainsight.com/controversy-over-new-public-enterprise-boards/; and Balkan Insight, "Kosovo Govt Sacks Board of Failing Telecom", 20 February 2020, https://balkaninsight.com/2020/02/20/kosovo-govt-sacks-board-of-failing-telecom/.

[44] A November 2020 review of the Ministry of Finance's website found that the 2019 annual reports for the 17 SOEs under its remit had not yet been published online.

[45] The POE Monitoring Unit's 2016 annual aggregate report on SOEs is available online: http://www.mzhe-ks.net/npmnp/repository/docs/RaportiiPerformancesseNdermarrjevePublikepervitin2016.pdf.

[46] The World Bank's 2020 Doing Business report actually accords Kosovo a score of 0.0 on the extent of shareholder rights index, but this appears to be an error in aggregation, as a review of the sub-indicators that constitute the score concludes that all six minority shareholder rights that constitute the index are legislated in Kosovo (World Bank, 2020[384]).

[47] Each employee's ownership share of Trepča Mine is determined based on the value of assets of the business unit where the employee is employed.

[48] More information on the Kosovo Telecom dispute is available online: https://www.reuters.com/article/kosovo-telecom-court/state-owned-kosovo-telecom-may-face-bankruptcy-after-court-ruling-says-ceo-idUSL5N1EG23Y.

[49] The Government of Kosovo requested EBRD assistance in preparing for Kosovo Telecom's privatisation in 2019. For more information: https://www.ebrd.com/work-with-us/projects/tcpsd/privatisation-of-kosovo-telecom-preprivatisation-commercialisation.html.

[50] The spin-off method of privatisation involves the creation of a subsidiary company, where the parent company's assets are transferred, following which the subsidiary is sold. In some cases, spin-off privatisations are referred to as "special spin-offs" in Kosovo because they involve special conditions that are to be respected by the buyer post-privatisation, for example related to continued employment in the enterprise.

[51] The Law on the Kosovo Privatisation Agency is available online: http://www.pak-ks.org/desk/inc/media/EC4F2A29-9497-44C1-A5FA-A39BCC812359.pdf.

[52] Kosovo participated in the 2015 and 2018 cycles of PISA.

[53] According to PISA Coverage Index 3, which corresponds to the proportion of 15-year-olds represented by the PISA sample. For more information see: www.oecd.org/pisa/pisa-for-development/pisafordevelopment2018technicalreport/PISA_D_Chapter_11_SamplingOutcomes.pdf.

[54] For the purpose of this profile, instruction system refers to teaching and learning processes that take place in school education. It generally consists of curriculum, standards for schools and student learning, assessment and evaluation frameworks, and other elements that support instruction.

[55] The Agency for Vocational Education and Training and Adult Education (AVETAE) is responsible for ensuring the administration and leadership of Institutions of Vocational Education Training and for Adults

(IVETA) regarding the financial, human resources, construction buildings and infrastructure of the six public institutions of VET under its governing administration.

[56] The National Qualification Authority is responsible for establishing and maintaining the Kosovo Qualification Framework and its relation with the European Qualification Framework. It also regulates the award of qualifications and accreditation of VET providers to ensure the overall quality system for VET in Kosovo.

[57] Selection into higher education requires the successful completion of upper secondary education and a minimum score on the State Matura examination. Specific requirements are set by individual higher education institutions, which may also administer their own assessments.

[58] The Kosovo Labour Market Barometer includes centralised data from 12 public institutions on key population, labour market, education and business indicators. In the area of education statistics, the portal provides data on some key indicators, such as enrolment by education level, public and private institutions, and municipalities. For the tertiary sector it also includes graduation data by education level, gender and university, as well as data on accredited study programmes by public and private higher education institutions, department and education level. In the area of employment it includes data on (un-)employment by education level, gender and municipality. In the area of business statistics data are provided on vocational demand and supply by education level and municipality. See: https://sitp.rks-gov.net/.

[59] Q2, 2019. 6.1% between 2015 and 2018 (WIIW and World Bank, 2020[107]).

[60] The strongest growth rate in employment was recorded in the agricultural sector (+187%). Emplyoment growth was also significant in the construction industry, trade, transportation, information and communication, professional and scientific services and the real estate sector (with growth rates between 45 and 82%) (Kosovo Agency of Statistics, 2019[323])

[61] Information provided by Kosovo.

[62] Note that at that time employment protection legislation was also slightly less strict in Kosovo as compared to other economies in the region.

[63] The strategy on Labour Inspectorates states that there were 56 labour inspectors in 2016, including heads of divisions and regional co-ordination. This corresponds to 6 500 workers per staff, or 8 500 per inspector (assuming that 10 staff are heads of divisions).

[64] Some of the planned measures include increasing the number of inspections by 10%, hiring 10 new inspectors, supervising the work of inspectors, training measures, improving hardware and software equipment and buying cars, preparing an action plan for joint inspections, carrying out inspections according to a work plan, establishing an internet site and a call center, and awareness raising activities.

[65] Key employment indicators are: Rate of participation in labour force, Inactivity rate, Employment to population rate, Unemployment rate, Unemployment rate among young people, Percentage of young people NEET youth population, Percentage of unstable employment to total employment.

[66] Other provisions entailed in the general collective agreement concern the length of probation period, maximum length on internships, layoffs, re-location, working hours and conditions, paid and unpaid leave, continued qualification, compensation through salary and bonuses, sick leave, benefits upon retirement,

etc. Most of these provisions are the same as in the Labour Law, with minor cosmetic alterations of the wording introduced in the collective agreement.

[67] At the regional level, there are 18 trade unions registered with the appropriate authorities (Shaipi, 2017[116]).

[68] Information provided by Kosovo.

[69] And 30.4% in Q2 2019 (WIIW and World Bank, 2020[107]).

[70] When the type/field of education or skills is inappropriate for the job (ILO, 2014[377]).

[71] The average gross wage in 2018 according to the highest economic activities was in: Electricity, gas, steam and air conditioning supply (843 euro); Information and communication (717 euro); Mining and quarrying (639 euro); while the lowest wage was in Agriculture, forestry and fishing (256 euro) (Kosovo Agency of Statistics, 2019[299]).

[72] The tasks consist in: 1) registration of the unemployed; 2) employment counseling; 3) career orientation for the unemployed; 4) individual employment plan; 5) registration of vacancies; 6) contacting employers; 7) providing recruitment services and advice to employers; 8) MATP services; 9) advising and providing information on migration; 10) mediation in employment through the Information System (information provided by Kosovo).

[73] Information provided by Kosovo.

[74] In France and Germany for example, caseloads of hard-to-place jobseekers are around 70 jobseekers per employment counsellor, while caseloads may vary in these countries between 100 and 350, depending on how much individual guidance job seekers need and how autonomous they are in using self-help guidance tools. (OECD, 2015[378]; Manoudi et al., 2014[379]); (Pôle emploi, n.d.[380])

[75] Information provided by the PES.

[76] According to Law 04 / L083 on Registration and Evidence of Unemployed and Jobseekers, unemployed are all persons from age 18 to 65, who are unemployed (neither salaried nor self-employed), are actively looking for work and who are ready for work (Government of Kosovo, 2017[105]).

[77] Information provided by the PES.

[78] The long-term unemployment incidence was 89.1% in Q2 2019 (WIIW and World Bank, 2020[107]).

[79] Information provided by the PES.

[80] Information provided by Kosovo.

[81] Information provided by Kosovo.

[82] Information provided by Kosovo.

[83] According to the Law on Scientific Activity, No. 04/L-135.

[84] According to the Law on Scientific Innovation and Transfer of Knowledge and Technology.

[85] EURAXESS – Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated economies. It supports researcher mobility and career development and enhances scientific collaboration (https://euraxess.ec.europa.eu/).

[86] Horizon 2020 is the biggest EU framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020).

[87] European Cooperation in Science and Technology (COST) is an EU-funded, intergovernmental framework that currently gathers 38 Members and 1 Cooperating Member. It is a funding organisation for the creation of research networks (COST Actions), which offer an open space for collaboration among scientists across economies. COST funding is intended for collaboration activities and complements national research funds (https://www.cost.eu/who-we-are/about-cost/).

[88] Law No.04/L-037 on Higher Education in Kosovo.

[89] The KODE project offers grants to ISPs that cover 50% of deployment costs for building broadband infrastructure for unconnected settlements and public institutions (especially healthcare and educational institutions). The Grant Operations Manual (GOM) describes procedures and guidelines that are in line with the EU's guidelines for the application of state aid rules in relation to the rapid deployment of broadband networks (2013/C 25/01) (Broadband Guidelines), and relevant provision applications to broadband infrastructure of the Commission Regulation (EU) N°651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (General Block Exemption Regulation or GBER). The MEE received permission from the State-aid Commission of Kosovo to continue with grant applications for covering rural areas (https://kodeproject.org/en/grant-calls/).

[90] White areas are those without broadband infrastructure (access speeds higher than 30 Mbps) and where it is unlikely to be developed in the near future.

[91] The Broadband Electronic Atlas that maps fixed, and mobile infrastructure, and services in the Kosovo territory is regularly updated and used to conduct different studies and to develop plans for concrete network deployment projects. Some of the content is publicly available (https://broadband.rks-gov.net/med-atlas/).

[92] The financial independence of ARKEP is not secure as the Kosovo budget does not allow state agencies to be financed by their own generated funds. ARKEP has its own account in Kosovo's Treasury, and it is free to spend it as long as it takes into consideration legal frameworks for public finance. When drafting the Law on Electronic Communication, the MEE included sufficient provisions for full financial independence of the regulator, but the proposals were not approved by parliament.

[93] The MEE, on behalf of the Government of Kosovo, asked the EBRD to support a process of "Pre-privatisation commercialisation" of Kosovo Telecom. The government identified a need to review the structure, operations and practices of Kosovo Telecom in view of privatisation, along with recommendations for its restructuring, while still under state ownership. The objective was to achieve sustainable financial viability and to improve the financial, operational, technological, and human resource standing of the company. The project's call for expert consulting services was announced in July 2019. After this study completes, the government, in consultation with other stakeholders, will decide the future steps regarding restructuring and privatisation of Kosovo Telecom (EBRD, 2019[338]).

[94] The international Open Data Charter: https://opendatacharter.net/.

[95] The Open Data portal was created by the Ministry of Public Administration in co-operation with the Ministry of European Integration and the Information Society Agency (AIS), with support from civil society organisations (https://opendata.rks-gov.net).

[96] According to the Law on Government Bodies for the Information Society.

[97] The public consultation platform: https://konsultimet.rks-gov.net/.

[98] The transparency portal, developed in co-operation with the Project for Public Finance Reform in Kosovo, is implemented by the German Development Cooperation (GIZ): https://ptmf.rks-gov.net/.

[99] According to the Regulation on Minimum Standards for the Public Consultation Process (GRK).

[100] The IPA II project, EU Support for the Competitiveness of Kosovo's ICT Sector, aims to enhance the competitiveness of Kosovo's digital and traditional businesses by supporting the expansion of Kosovo's ICT sector leading to growth and new job creation. The project intends to bridge the digital and business skills gap, and increase the export of Kosovar ICT businesses and traditional businesses through the use of ICT. The project is focused on providing training and courses on ICT, digital skills and business management. The project duration is 42 months, starting from January 2020 until July 2023. The EU Support for the Competiveness of Kosovo's ICT Sector is an EU funded project managed by the European Union Office in Kosovo and implemented by WeGlobal, in partnership with European Projects Management Ltd and Prishtina REA (https://ictkosovo.eu/).

[101] The IPA II project, EU Support to Digitalisation of Businesses through ICT, aims to increase the efficiency and productivity of the private sector through ICT usage, create a proper e-business/e-commerce ecosystem, and improve electronic service delivery for citizens and businesses. These actions will contribute to government efforts to digitalise businesses through ICT to increase their efficiency and productivity, and will greatly increase the competitiveness and profitability of Kosovo businesses given the increased opportunities to improve how they operate securely nationally and across borders. By providing a proper e-ID system, and a good environment for e-business/e-commerce, cross-border interoperability between Kosovo and EU economies will be more productive and more efficient. The project has started being implemented and will last three years.

[102] Current internet connection speeds are below 10 Mpbs, which are insufficient to support school connectivity needs.

[103] In co-operation with the Employment Agency and with EUR 3 million in EU financial support provided under the IPA II project EU Support for the Competitiveness of Kosovo's ICT Sector.

[104] Since the adoption of the IT Strategy 2020, the MEE and other government entities have financed and implemented several projects that contribute directly to the implementation of the strategy. The main initiatives and projects are:

1. Creation of the steering committee.
2. New fiscal rules for import of ICT equipment. Customs removed completely.
3. Public eProcurement system established.
4. Kosovo Digital Economy Project.
5. Women in Online Work Project.
6. IPA 2017, Supporting Competitiveness of the ICT Sector in Kosovo.
7. IPA 2019 and eIDAS system.
8. New Innovation and Training Park in Prizren (ex- KFOR camp).
9. ICT Park in Bernica ect.

[105] The Innovation Fund is co-financed by the Ministry of Innovation and Entrepreneurship (MIE) of the Republic of Kosovo and the German Federal Ministry for Economic Cooperation and Development (BMZ) and implemented by the Innovation Centre Kosovo (ICK). The Direct Financial Support Scheme for Start-ups provided financial support to 156 start-ups with a total funding of EUR 1 163 168 in 2018, and to 74 start-ups with a total funding of EUR 631 411 in 2019 (https://ickosovo.com/innovation-fund).

[106] The Women in Online Work (WoW) pilot project was implemented by the MEE with support from the World Bank. The WoW pilot was looking to change the asymmetry in women's employment (80% of women in Kosovo are inactive in the labour market, and among those active, 37% are unemployed) by exploring the suitability of online work for young Kosovar women around the economy. The project started in 2016, when it was implemented in three municipalities of Kosovo: Lipjan, Gjakova and Pristina. The design and implementation was enriched by the insights of the ICT Association, academia, the private sector and NGOs. Through the initial pilot project, 150 women were trained to gain the skills needed to find jobs in international online platforms, acquiring digital and IT skills and soft skills to find work or develop entrepreneurship. During project implementation, 77 beneficiaries earned at least one online work contract and a cumulative EUR 25 000 in one year. The successful implementation of the first round led to the replication of the programme during 2017 in two municipalities, Gjilan and Pristina, with USAID support. A third round extending WoW in Mitrovica and Podujeva was supported by the Swiss funded Enhancing Youth Employment (EYE) Project. (http://www.mzhe-ks.net/sq/WoW; https://www.worldbank.org/en/country/kosovo/brief/kosovo-wow).

[107] KOS-CERT is engaged in project implementation for capacity building (e.g. the Virtual Threat Intelligence and Incident Response Platform project as a donation from the C3K project, Cyber Crime in Kosovo, implemented by the United Nations Development Programme [UNDP] and funded by the Norwegian Ministry of Foreign Affairs).

[108] The project Hardware Platform for Virtualisation, which is funded by the budget of the Republic of Kosovo to upgrade KOS-CERT hardware infrastructure and services through an early warning threat system.

[109] A single project pipeline (SPP) is a list of the projects developed based on the strategic tool for the project planning to avoid ad hoc approaches to planning preparation and the implementation of investment projects. The SPP helps to enable strong project prioritisation and the systematic and timely planning of resources, to provide a reliable basis for defining the proper sequencing of the priority axis and actions per sector, and to help link investment planning and programme budgeting.

[110] The Department of Road Infrastructure, Department of Road Transportation, Department of Civil Aviation and Department of Vehicles within the Ministry of Infrastructure and Environment. The railway infrastructure manager (Infrakos) and railway operator (Trainkos), and Pristina airport.

[111] An appropriate definition of "asset management" for the roads sector was proposed by the OECD in 2001: "A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organised and flexible approach to making the decisions necessary to achieve the public's expectations" (OECD, 2001[376]).

[112] The air traffic management plan defines the operational air traffic management concept, strategic airspace management, tactical airspace management, air traffic service, ait traffic flow management, flight operation, functional integration, crisis management, search and rescue, and regional air navigation plans and supplementary procedures.

[113] The State Safety Program (SSP) is an integrated set of regulations and activities that aim to improve safety (e.g. safety risk management, safety assurance).

[114] Some of the indicators for measuring the road network's performance include average user costs, travel time satisfactory level (i.e. reliability), value of assets, market research and customer feedback, forecasted value of assets, audit programme, quality of user information, allocation of resources, long-term programmes for investment, maintenance and operations, lowering of overhead percentage, state of certain type of infrastructure (depending on the mode of transport: bridges, facilities, etc.), permanent/automatic traffic flows counts per vehicle categories for the entire state road network, road traffic accident indicators as per the Common Accident Data Set (CADAS), and tolling statistics.

[115] For more details see: (Transport Community and CEFTA, 2020[177]), (Transport Community, 2020[178]), (Government of Serbia, 2019[179]) and (Estonia Border, n.d.[180]).

[116] The objectives and goals include: Subsidies for railways (passenger and freight transportation); Subsidies for public transportation, especially in cities, and supporting the non-use of personal vehicles; Differentiation of tax charges including custom and excise rates when importing motor vehicles (personal and commercial), taking into account amortisation, fuel costs, hybrids, whether or not they are equipped with catalytic exhaust systems; Increase of taxes for the use of motor vehicles; Increase of taxes for fuels containing high sulphur and lead content; Setting taxes for obsolete vehicles and scrap tyres in accordance with EU acquis; Co- ordinated mass transport system incorporating road, rail and air transport with public amenities, public private partnership (PPP); Reduction in air pollution caused by road traffic by implementing fuel quality standards and promoting catalytic converters on vehicles; Ensuring the import of old vehicles is restricted to "fit for purpose" only; Encouraging more services delivered through non- road transportation; Improving and investing in inter- city and trans- boundary railway system, using latest technologies for environmental protection (electrification, bio- degradable construction materials, energy efficient designs); Promoting the use of natural gas and other alternative fuels, as well as hybrid vehicles; Domestic and urban road network upgraded for increased volume of traffic; Upgrading public transportation and decommission obsolete public transportation vehicles; Implementing noise and vibration protection measures for vehicular traffic in urban and inner city areas; More urban planning for pedestrian zones and special bicycle paths.

[117] Combined transport refers to the transport of goods between Member States where the lorry, trailer, semi-trailer (with or without tractor unit, swap body or container of 20 feet or more) uses the road on the initial or final leg of the journey and rail or inland waterway or maritime services on the other leg, where

this section exceeds 100 km as the crow flies (Combined Transport Directive 92/106EC, amended by the Directive 2013/22/EU).

[118] A one-stop shop is a business or office where multiple services are offered, i.e. customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one location, instead of having to "drive all over town" to attain related services at different stores. A one-stop shop is a way of facilitating trade.

[120]For lists and access to the laws and secondary acts governing energy see https://www.ero-ks.org/zrre/index.php/en/legjislacioni/ligjet, https://mzhe-ks.net/en/energy-139#.X7_axGhKhhE https://mzhe-ks.net/en/administrative-instructionenergy#.X7_ayWhKhhE and https://mzhe-ks.net/en/rregullation-energy#.X7_ay2hKhhE.

[121] This is a three-year implementation strategy for the Energy Strategy of the Republic of Kosovo 2017-2026. Implementation progress of the Energy Strategy Implementation Programme (ESIP) is contained in the progress report for 2018 of ESIP 2018-2020. At this stage there is no information on the extent of the implementation of the Energy Strategy of the Republic of Kosovo 2017-2026.

[122] Law Number 05/L-082 on Natural Gas.

[123] The Energy Strategy of the Republic of Kosovo 2017-2026 defines five strategic objectives, two of which relate specifically to the electricity supply framework: 1) security of a sustainable, high-quality, safe and reliable electricity supply with adequate capacities for stable power system operation; and 2) the enhancement of existing thermal system capacities and construction of new capacities. The energy strategy is supplemented by the Energy Strategy Implementation Program 2018-2020, which includes 27 measures and respective objectives, foreseen for the period 2018-2020. Thus, a total 97 activities/projects are planned. Activities include legislative measures, construction, studies and promotions. The cost of implementing these measures over three years is estimated at around EUR 852 million.

[124] Indicators are collected across a variety of areas covering most importantly: N-1 criteria, renewable energy integration, loss reduction, increased security and quality of supply, market integration, system average interruption duration index, system average interruption frequency index, energy not served indicator, voltage and frequency quality, and service quality. They are collected by the regulator ministry, the transmission and distribution system operator, and the Kosovo Agency of Statistics.

[125] Chapter VII Emergency measures in energy supply in the Law no. 05/L-081 on Energy adopted in 2016 – supplemented with Administrative Instruction No. 04/2017 on Rules and Measures for Restricting Energy Supply in Emergency Situations – does transpose some of the EU regulation, but it is not clear to what extent.

[126] “The term ‘prosumers’ broadly refers to energy consumers who also produce their own energy from a range of different onsite generators,” (GfK Belgium, 2017[381]) but “mainly through solar photovoltaic panels on their rooftops, citizen-led energy cooperatives or housing associations, commercial prosumers whose main business activity is not electricity production, and public institutions like schools or hospitals” (European Commission, 2016, p. 1[354]).

[127] In July 2020, The government established a working group involving a variety of institutions to draft a concept document on renewable energy sources. This concept document will recommend the best option for implementing the support scheme and determining pathways towards a competitive project assignment scheme. According to the plan, this document will be approved in early 2021. International donors such as

the EBRD and the World Bank are assisting the government in designing the new support scheme and competitive assignment scheme through the submission of recommendations.

[128] Law No. 06/L-079 on Energy Efficiency (2018); Energy Strategy of the Republic of Kosovo 2017-2026; Kosovo Energy Efficiency Action Plan (KEEAP) 2010-2018.

[129] Law on Electricity No. 05/L-085; Electricity Market Rules; Law on Energy No. 05/L-081; Law on the Regulatory Office No. 05/L-084; Guidelines for unbundling of DS; Transmission Connection Charging Methodology, developed by KOSTT and approved by ERO; Connection Procedures; Procedure for Review of Complaints from Third Parties regarding Access to Network and Use of Transmission Grid.

[130] This topic was previously raised by the Energy Community and although the issue might have been resolved, a firm confirmation is outstanding.

[131] "A Control Area is a coherent part of the UCTE Interconnected System (usually coincident with the territory of a company, a country or a geographical area, physically demarcated by the position of points for measurement of the interchanged power and energy to the remaining interconnected network), operated by a single TSO, with physical loads and controllable generation units connected within the Control Area. A Control Area may be a coherent part of a Control Block that has its own subordinate control in the hierarchy of Secondary Control." (ENTSOE, 2004[382]).

[132] A Control Block comprises one or more Control Areas, working together in the Secondary Control function, with respect to the other Control Blocks of the Synchronous Area it belongs to" (ENTSOE, 2004[382]). An alternative explanation can be found under (Emissions-EUETS, 2019[383]).

[133] Although Kosovo is planning to change its approach to renewable energy project assignment and support, given the lack of clarity regarding design and timeline this aspect has been included in the recommendation for now.

[134] Kosovo is not a member of United Nations Framework Convention on Climate Change (UNFCCC) (and its Paris Agreement) so there are no nationally determined contributions (NDCs) prepared.

[135] The Deposit Refund System (DRS) combines a tax on product consumption with a rebate when the product or its packaging is returned for recycling, and is based on the scheme of extended responsibility of the manufacturers. For this initiative, support has been secured from German GIZ, and studies have been developed for suppliers, manufacturers, and consumers of beverage networks (packaged water, drinking liquids such as beer and wine), with the purpose of creating an overview of the amount of packages that are traded in Kosovo.

[136] At the time of drafting, the European Commission was financing a project for the expansion of the municipal waste dump, the opening of a new landfill and closure of the old one in the municipality of Peja/Pec, as well as the closure of the illegal landfill site in Istok/Istog.

A feasibility study for Regional Landfills at the central level was being conducted at the time of drafting as well as a feasibility study to introduce integrated waste management to the Pristina region.

One of the main issues in Kosovo remains disposing of construction and demolition waste and local municipalities were invited to solve this problem by dedicating dumpsites and landfills for this type of waste, with the support of the government and international community.

[137] According to the government, the main challenges to introducing the primary separation of waste relate to the absence of waste treatment and separation facilities, a lack of funds to scale up the system, an

inappropriate operator model for collection of recyclables, and a limited amount of recyclables to cover the operational costs for collection and re-separation.

[138] This project (conducted by the MEE, GIZ and EC) started in 2017 with 17 municipalities. The "race" they take relates to increasing the waste service coverage and waste collection rate, as well as cleaning up illegal dumpsites. The municipalities that "win" in the race can obtain funds for further improvements of the waste management system (a total of EUR 7 million is dedicated for this project – half of which is financed by donor funds and half by the budget). The objective is to have all 38 municipalities involved in this project by 2021. Only those municipalities that perform well are entitled to increase waste service fees in Kosovo.

[139] The Ibër Lepenc canal and the Gazivoda/Pridvorica Dam.

[140] Data from 2016.

[141] Two power plants (Kosovo A and Kosovo B) are among the most polluting in Europe (for air pollutants $PM_{2.5}$, $SO_2$ and NOx) (HEAL, 2016).

[142] According to the interview with Government of Kosovo representatives in October 2020.

[143] The project consists of four key components: 1) management and co-ordination – ensure collaborative management and co-ordination with key stakeholders and donors, and monitor activities following project indicators; 2) Air Quality Monitoring Network and sample analysis – include new monitoring and communication equipment for existing stations; and tools, equipment and training on maintenance, calibration and sample analysis (i.e. KHMI will be able to measure independently heavy metals in ambient particulate matter and will measure air pollution in 38 monitoring locations); 3) air quality and health advisory information management – provide a nearly real-time air quality reporting service (of monitored data), a short-term forecast service (integrating emissions data, air quality monitoring data and weather data to provide early warnings), and an open data platform for data sharing and dissemination; and 4) outreach and behaviour change – communicate air quality levels to the public, including the health impacts of air pollution, behaviours for reducing pollution and behaviours for minimising exposure to pollution.

[144] A total of 12 monitoring stations were established in 2013. However, in the following years maintenance problems occurred due to lack of budget, and some stopped working. Five stations have been rehabilitated since 2017, and the rest were in the process of rehabilitation at the time of drafting.

[145] Non-revenue water is water that has been produced and is lost before it reaches the customer.

[146] In a 2019 survey report for measuring satisfaction with water services provided by RWC Prishtina J.S.C, over 70% of respondents reported that they were very satisfied or satisfied with service provision. Among those moderately satisfied or not satisfied, none mentioned price as a factor. The same survey reported that over 93% of respondents regularly pay water bills. Less than 7% of respondents reported that due to poor social conditions they are not able to regularly pay water services (RWC, 2019[340]).

[147] Population that lives below the domestic poverty line of EUR 1.83/capita/day (in 2015) (World Bank, 2018[24]).

[148] Not for industrial waste or extractive remains, or huge amounts of industrial waste.

[149] A total of EUR 21 million will be invested as part of the project on the elimination and rehabilitation of contaminated land (hotspots). In the five-year implementation period the project components comprise: 1) identification of contaminated sites for cleaning and improvement; and 2) development of capacities for prevention and control of polluted land (development of policies and technical guidelines, training and awareness programme for the prevention and control of polluted places and green industries, development of an inventory of polluted land). Three areas have been identified: 1) ash landfill next to the thermal power plant Kosovo A; 2) polluted area around the Lepenc River; and 3) rehabilitation of the contaminated area in Artane (acidic water).

[150] As part of the NDS 2016-2021 the government envisages: 1) further development and support of land regulation projects and their subsequent integration into rural development projects; 2) implementation of structural reforms (with special focus on legal and institutional measures) to create better conditions for increased agriculture production; 3) creation of parcels of regular geometric shape that are suited to easier utilisation of agricultural machinery, and implement the Plot Identification System (LPIS); 4) establishment of field road networks that allow direct access to plots and eliminate seasonal servitude access to a property through someone else's property.

[151] The loss of agricultural land is a result of the limited environmental/nature conservation input when it comes to spatial/urban planning. The reclassification of land, land use conversion when agricultural land is reclassified for non-agricultural activity, residential, commercial, industrial.

[152] The implementation of this law and its guidelines are enabled through administrative instructions related to: 1) packaging and labelling of certified seeds; 2) tax for registration of subjects dealing with the test varieties for the production cultivation value; 3) printing labels for seeds; and 4) on-field inspections.

[153] The current document contains the following objectives: 1) enhancing farm viability and the competitiveness of all types of agricultural and primary food processing while progressively aligning with EU standards; 2) restoring, preserving and enhancing the ecosystem dependent on agriculture and forestry; 3) promoting social and economic inclusion, poverty reduction and balanced territorial development in rural areas; and 4) transfer innovation and knowledge in agriculture, forestry and rural areas and strengthen public administrative capacity in implementing rural development programmes.

[154] The investment support grants include: Measure 101 – Investments in physical assets in agricultural economies; Measure 303 – Implementation of local development strategies – Leader approach; Measure 302 – Diversification of farm and rural business development; Measure – Scheme for irrigation of agricultural lands; Measure 103 – Investments in physical assets in the processing and marketing of agricultural products.

[155] The 100% tax does not resolve trade problems with non-tariff barriers faced by Kosovo businesses exporting to Serbia. Empiric studies show that these barriers can become greater obstacles than tariff barriers, which were annulled with entry into force of CEFTA. As regards the impact on consumption prices, the tariff may have significantly increased consumption prices of food, which comprises the main expenditure in the Kosovars' consumer basket. Taking this into consideration, maintaining this tax for a longer period may increase poverty (GAP Institute, 2019[357]).

[156] The National Programme for the Implementation of the Stabilisation and Association Agreement 2020-2024, the fifth of its kind, aims to implement short- and medium-term reforms regarding political and economic criteria for adoption of EU *acquis* into domestic legislation.

[157] The Economic Reform Programme 2019-2021 (pg. 72) stated: "As several studies and assessment in the area of informal economy and tax gaps have shown the extent of informal economy in Kosovo is above 30% of GDP with substantial losses for major direct and indirect taxes." (Government of Kosovo, 2019[134]).

[158] More information at https://www.slovenia.info/en/business/green-scheme-of-slovenian-tourism.

[159] According to the government, examples of proposals by civil society organisations taken into consideration for the new action plan were the preliminary evaluation of internal control mechanisms, the publication of assets of officials kept in trust, and keeping minutes of recruitment and promotion interviews.

[160] Council Decisions page: https://www.gjyqesori-rks.org/vendimet-e-keshillit/; Job Opportunities page: https://www.gjyqesori-rks.org/mundesi-punesimi/?r=M&isJudge=1.

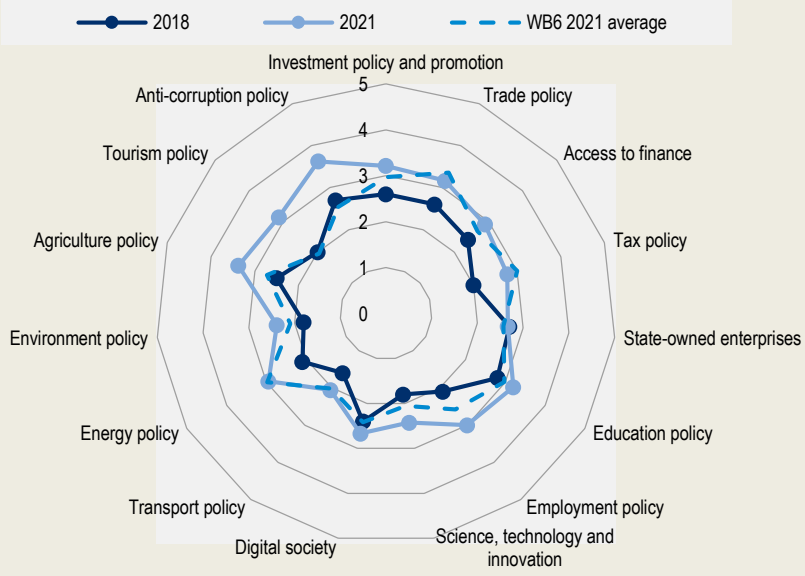
[161] Judgements page: https://www.gjyqesori-rks.org/aktgjykimet/?lang=en.

[162] Disciplinary Decisions and Statistics page: https://www.gjyqesori-rks.org/vendimet-e-komisionit-disiplinor/?r=M&tabId=1.

# 23 Montenegro profile

# Key findings

## Figure 23.1. Scores for Montenegro (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See Scoring approach section for information on the assessment methodology. Scores for Dimension 5 Competition Policy are not included in the figure due to different scoring methodology (see Scoring approach).

Montenegro has made progress since the publication of the Competititveness Outlook 2018 report in all the policy dimensions with the exception of State-Owned enterprises (Figure 23.1). Most of the improvements have been in the legal and regulatory environment, which forms a solid basis to improve the overall competitiveness of the economy. Its main achievements are as follows:

- **Significant new tax measures** have aligned Montenegro's tax system with recent international tax trends and have strengthened the scope for international tax co-operation. The economy joined the OECD/G20 Inclusive Framework on Base Erosion and Profit Sharing in December 2019. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes has started a peer review of Montenegro's readiness to exchange information on request (EOIR). Montenegro also signed the Convention on Mutual Administrative Assistance in Tax Matters in October 2019 and is in the process of amending its transfer pricing rules via a reform of the Law on Corporate Profit.
- **School participation levels are increasing**. As of 2019, Montenegro had achieved net universal primary school enrolment (99.9%), though lower secondary education is not quite there yet (92.3%). Net enrolment in upper secondary education (89%) has gradually increased and is on track to meet OECD (92.5%) and European Union (93%) averages in the coming years. Moreover, Montenegro has one of the lowest early school-leaving rates in the region (5% in 2019), well below the EU target of less than 10% of early school leavers by 2020.
- **Labour laws are aligned with EU standards**. Labour market flexibility and labour standards for workers in certain fields have improved. In addition, the capacity of the public employment services (PES) has been strengthened, in particular by improving the tools and instruments available to PES counsellors, such as a profiling tool for the unemployed.

- **The science, technology and innovation (STI) policy framework has advanced significantly.** Montenegro developed a set of guidelines for smart specialisation in 2018, and is the first of the six Western Balkans (WB6) economies to adopt a smart specialisation strategy (covering 2019-2024), which received a conditionally positive assessment by the European Commission services. Action plans are in place to support implementation of the strategic framework, and budget allocations have increased in recent years. A new Law on Incentive Measures for Research and Innovation Development and a revised Law on Innovation Activity strengthen the legal framework for STI.
- **The energy sector is guided by a comprehensive energy policy**. Three of the four pillars of the EU's Third Energy Package (transparency, non-discrimination and a strong regulatory framework) have mostly been implemented. This is confirmed by the Energy Community, which rates Montenegro as the highest performer in the Western Balkans regarding transposition and implementation of the Energy Package. Recent changes to the Energy Law have removed the requirement for government consent to the statute of the regulator, which is a step towards reducing the risk of political influence over the regulator and reaffirms its independence.
- **Tourism destination accessibility has increased**. The economy has expanded the eligible categories for removing visa requirements and adopted special regimes for border crossings for tourists during the high season. Accommodation capacity and quality has improved through measures to facilitate investments in high-quality accommodation, and a consistent accommodation quality standard framework based on EU standards.
- **Agro-food system regulation has improved**. Notably, phytosanitary and veterinary standards have been further harmonised with EU standards. Several regulations on seed products were updated in 2019, and there has been continuous improvement in harmonising by-laws and rulebooks on product regulations with EU directives.

### Priority areas

While Montenegro did not score below the WB6 average in 13 dimensions of the 15 policy dimensions scored in the assessment, there are several areas in which Montenegro still needs to step up its efforts (Figure 23.1):

- **Improve investment promotion and facilitation.** The recently established Montenegro Investment Agency (MIA) does not have a formal mandate to provide aftercare services**.** The government needs to clearly define the MIA's responsibilities for aftercare services, notably by expanding the agency's mandate and/or producing a clear system for enquiries. Providing aftercare services will require strong co-operation with other institutions and regulatory bodies. The many current incentives could prove difficult to navigate for foreign investors. Increasing the clarity and awareness of these incentives through more transparent qualification criteria, and targeting foreign investors through awareness-raising campaigns, would be beneficial for the overall competitiveness of the economy. The government should also reinforce mechanisms for evaluating the cost and benefits of the incentives, their appropriate duration, and their transparency.
- **Introduce alternative equity-based finance.** Businesses' access to finance heavily relies on bank lending. The use of alternative equity instruments, such as initial public offerings, business angels and venture capital, is limited. Integrating crowdfunding into the legislative framework could provide a feasible alternative source of finance. In addition, conducting awareness campaigns on the existence of capital markets and the advantages they offer to firms could also help to enhance the existing structure.
- **Review the effectiveness of the current state ownership arrangements and develop a state ownership policy.** Montenegro has not yet developed an overarching ownership policy

for state-owned enterprises (SOEs) that lays out why the government owns companies and how it expects them to create value. While ownership rights exercised at different levels that have diverse competencies (e.g. government, state funds, line ministries), the authorities should ensure that these state actors operate under a unified ownership policy. Given that the authorities have chosen to prioritise private investments in their SOE sector, they should review the need for the state to continue holding minority shares and also produce an aggregate report on the performance of the state's portfolio.

- **Continue to boost investment in the scientific research system**. With 734 researchers per million inhabitants, the number of researchers in Montenegro is much lower than the EU average (4 000 researchers per million inhabitants). More comprehensive measures should be put in place to build human resource capacity in priority STI areas and increase the attractiveness of research as a profession. Moreover, Montenegro should continue building a national and regional research infrastructure. Timely completion of the Science and Technology Park in Podgorica and affiliated impulse centres, coupled with sustained funding, will improve integration between academia and the private sector. Efforts should also be made to get the pilot technology transfer office at the Centre of Excellence at the University of Montenegro up and running.
- **Strengthen programmes for the digital transformation of the private sector.** The budget and the number of businesses applying for digital transformation programmes remain relatively low. Moreover, despite the proliferation of ICT training programmes, their lack of relevance to industry is widening the gap between the skills available and those sought by ICT sector companies. Developing a common digital competence framework for ICT professionals would help to meet the needs of the labour market. The government needs to review and evaluate existing support programmes to promote the adoption of e-business and e-commerce by small and medium-sized enterprises (SMEs), and to identify areas for improvement. In doing so, greater co-operation between ICT training providers and the private sector should be systematised following EU and international good practices
- **Introduce a land-use management framework**. Although there is a regulatory framework related to land-use management in place, little progress has been made to implement it. The pressure on land and soil resources is growing, especially in the context of a pronounced decrease in agricultural land, from 38% in 2012 to 18.5% in 2016. While the use of agricultural land is regulated by law, the legal framework does not prescribe the maximum concentrations of hazardous and harmful substances allowed on other types of land (industrial land, playgrounds, parks or residential areas). Montenegro needs a clear policy framework for cleaning up contaminated land, as well as concrete guidelines to help identify land that needs decontaminating.

## Economic context

### *Key economic features*

Montenegro is a small service-based economy with a large tourism sector. In 2019, services accounted for 58.7% of gross domestic product (GDP) and 73% of employment in Montenegro, with the highest contributions coming from wholesale and retail trade, accommodation related to the large tourism sector, real estate, and transportation and storage. Over the past decade, the services sector's GDP contribution has expanded considerably at the expense of both industry and agriculture. The GDP share of industry, including construction, declined from 22.3% in 2001 to 16.1% in 2019, while its contribution to employment declined from 25% to 19.1%. Currently manufacturing accounts for just 4% of GDP and 6.4% of

employment. Meanwhile, the contribution of agriculture, forestry and fishing to GDP has nearly halved since 2001, from 10.8% to 6.4%. Today this sector accounts for just 7.8% of employment, the smallest contribution in the Western Balkan (WB) region (World Bank, 2020[1]).

As a very small economy that is open to trade and capital flows but that lacks an independent monetary policy,[1] Montenegro is highly vulnerable to external shocks and business cycle fluctuations. As a result, the growth of its economy has been more volatile than the other WB economies. For example, in the run-up to the global financial crisis between 2005 and 2008, the Montenegrin economy was expanding at an average annual growth rate of 7.5%, well above most regional peers (World Bank, 2019[2]), on the back of a credit boom fuelled by high capital inflows (46% of GDP at their peak in 2008). During this period, progress on the privatisation and structural reform and business-friendly environment agenda helped to attract considerable foreign direct investment (FDI) and portfolio investment. However, the bust that followed the global financial crisis, when capital inflows declined dramatically, was much bigger than in neighbouring economies, resulting in a GDP contraction of 5.8% in 2009. Similarly, Montenegro experienced a more severe recession (2.7% decline in GDP growth) in the wake of the Eurozone crisis in 2012 (World Bank, 2019[2]). The most recent economic contraction caused by the COVID-19 pandemic is estimated at 15.2% in 2020, much more substantial than in the other WB economies (EC, 2020[3]). The low fiscal space and limited room for discretionary fiscal spending, especially in the wake of the current crisis, further limits the public sector's ability to absorb these external shocks.

Over the past few years, while growth has been buoyed by significant infrastructure investment and strong consumption growth, substantial imbalances have persisted. Gross fixed capital formation rose from 20% to 27% of GDP between 2013 and 2019 on the back of high growth in public infrastructure investment (mainly the Bar-Boljare Highway), as well as significant private investment in energy and tourism infrastructure. Public consumption has also contributed strongly to GDP growth despite fiscal consolidation. Export performance has also improved in recent years. Exports' contribution to GDP rose modestly from 40.6% in 2014 to 43.7% in 2019 (Table 23.1), supported by the tourism sector, which accounts for roughly half of total exports. However, the domestic production base remains low and consumption and investment are highly dependent on imports, which has led to persistently high external imbalances. The trade deficit in 2019 amounted to 21% of GDP, and the current account deficit has exceeded 15% of GDP throughout the last five years (World Bank, 2020[1]). These external imbalances have been exacerbated significantly by the COVID-19 crisis (see the COVID-19 section below).

Montenegro also suffers from a relatively undiversified export base, adding to its vulnerability to external shocks. Goods exports, which account for 14% of total exports (MONSTAT, 2019[4]), include mainly metals, which are highly susceptible to price fluctuations and offer relatively little in terms of value-added. Service exports are meanwhile dominated by travel and tourism services (65% of total service exports) (World Bank, 2019[5]), which are highly susceptible to external shocks, as witnessed during the latest crisis (see the COVID-19 section below).

Despite the strong growth, labour market challenges have persisted. At 64.8%, the labour market participation rate is low compared to the EU average of 73.3%, and lower than most other Western Balkan economies (World Bank, 2019[6]). The participation rate is particularly low for youth (36.5%) (World Bank, 2019[6]) and women (57.9%) (World Bank, 2019[7]). Unemployment remained high at 14.9% in 2019, particularly among the youth (29.3%) (EC, 2021[8]). The crisis has further exaggerated this challenge, with unemployment rising to 18.4% in 2020. Finally, the gains in employment over the past few years have been rather limited for vulnerable groups (World Bank, 2016[9]). The COVID-19 crisis has highlighted how labour market challenges stem from an insufficiently diversified economy that is more susceptible to external shocks (see the COVID-19 section below).

Long-term GDP growth and employment prospects are hampered by weak productivity, which reflects significant and deep-standing structural challenges in the economy. Labour productivity, measured as output per worker, is considerably lower than the EU average. The productivity gap is the largest in the

services sector, which employs the highest share of the labour force in Montenegro. Here the output per worker is more than four times lower than the EU average (World Bank, 2019[10]). The weak productivity growth in spite of significant capital accumulation over the past decade also points to weaknesses in the efficient use of this capital. Significant outstanding structural challenges explain these outcomes, including an inadequately skilled labour force, limited access to finance for SMEs, corruption and informality – see Structural economic challenges. The high increase in wages, which has outpaced the growth in productivity, has weakened competitiveness over the past decade (World Bank, 2016[9]).

### Table 23.1. Montenegro: Main macroeconomic indicators (2015-20)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 3.4 | 2.9 | 4.7 | 5.1 | 4.1 | -15.2 |
| GDP per capita[2] | Current international $ | 16 333 | 18 199 | 19 682 | 21 547 | 23 344 | 20 567 |
| National GDP[2] | USD billion | 4.05 | 4.37 | 4.85 | 5.50 | 5.54 | 4.78 |
| Inflation[1] | Consumer price index, annual % change | 1.4 | 0.1 | 2.8 | 2.9 | 0.5 | -0.8 |
| Current account balance[1] | % of GDP | -11.0 | -16.2 | -16.1 | -17.0 | -15.0 | -26.0 |
| Exports of goods and services[1] | % of GDP | 42.1 | 40.6 | 41.1 | 42.9 | 43.7 | 25.8 |
| Imports of goods and services[1] | % of GDP | 60.6 | 63.1 | 64.5 | 66.7 | 64.8 | 60.6 |
| Net FDI[1] | % of GDP | 16.9 | 9.4 | 11.3 | 6.9 | 7.0 | 11.2 |
| Public and publicly guaranteed debt[3] | % of GDP | 73.7 | 71.4 | 69.1 | 74.1 | 80.0 | 109.2* |
| External debt[4] | % of GDP | 166.2 | 162.6 | 160.6 | 164.7 | 170.2 | .. |
| Unemployment[1] | % of total labour force | 17.8 | 18.0 | 16.4 | 15.5 | 15.4 | 18.4 |
| Youth unemployment[2] | % of total labour forces ages 15-24 | 37.6 | 35.9 | 31.7 | 29.5 | 25.3 | .. |
| International reserves[1] | In months of imports of G&S | 3.4 | 3.6 | 3.7 | 4.0 | 5.1 | 8.2 |
| Remittance inflows[2] | % of GDP | 11.6 | 11.0 | 10.8 | 10.7 | 10.5 | 12.6 |
| Credit growth[1] | % year-on-year | 0.8 | 1.3 | 11.8 | 8.5 | 4.5 | 3.2 |
| Lending interest rate[5] | % annual average | 8.93 | 7.97 | 7.20 | 6.53 | 6.18 | 5.91 |
| Stock markets (if applicable)[1] | Average index | 11 956 | 11 115 | 10 952 | 10 390 | 10 980 | 10 336 |

Note: G&S = goods and services ; *estimates for 2020.
1. (EC, 2021[11]), EU Candidate Countries' and Potential Candidates' Economic Quarterly (CEEQ) Q1 2021, https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf.
2. (World Bank, 2021[12]), World Bank WDI data, https://databank.worldbank.org/source/world-development-indicators.
3. (World Bank, 2020[13]), World Bank Western Balkans Regular Economic Report, https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report.
4. (EBRD, 2020[13]) *Transition Report 2020-21*, https://2020.tr-ebrd.com/countries.
5. (IMF, n.d.[15]), IMF Data, https://data.imf.org/regular.aspx?key=61545855.

Improving the skills of the population and enhancing the prospects for the low-skilled and poorest groups are the most critical challenges for ensuring sustainable and inclusive long-term growth in Montenegro. In light of the unfavourable demographic trends and high outmigration – with emigrants making up 20% of the resident population (ILO, 2019[16]) – especially by high-skilled workers, the importance of strengthening labour productivity is critical. This will require rectifying the weaknesses in the education system in order to provide adequate and sufficient skills to meet the needs of the labour market; strengthening active labour market policies; and supporting adult education in order to create a nimbler workforce. Strengthening social safety nets whilst also expanding the employment opportunities of low-skilled workers will also be critical in ensuring that growth is more equitable and sustainable.

Strengthening the institutional environment and easing the outstanding frictions in the business climate will also be essential for strengthening SME investment and growth and attracting FDI in manufacturing and

service sectors with high export potential. This includes tackling corruption, further improving public services, reducing the administrative and regulatory burden on businesses, and tackling the still relatively widespread informality.

Last but not least, boosting macroeconomic growth and ensuring that it is more balanced and less volatile will also require stronger fiscal and financial policies. In the short to medium term this would entail fiscal consolidation and reducing the relatively large public debt that has further increased in the wake of the COVID-19 economic crisis. Ensuring long-term growth will also require removing structural obstacles to countercyclical fiscal policy development, which are critical in the context of the limited monetary policy options for addressing external shocks. In the same context of limited central bank tools for influencing the credit flow in the economy, strengthening financial supervision will also be important for ensuring macroeconomic stability.

### *Sustainable development*

Over the past decade, Montenegro has made progress towards the targets of Agenda 2030 for Sustainable Development, but considerable challenges still remain in achieving the Sustainable Development Goals (SDGs), as shown in Table 23.2. Montenegro is on track to achieve or has maintained the achievement of the SDGs in only two main areas: 6 and 17 – clean water and sanitation and partnerships for the goals. However, even in these areas some challenges persist.

**Table 23.2. Montenegro's progress towards achieving the SDGs**

| SDG | Current assessment | Trends |
|---|---|---|
| 1 - No poverty | Challenges remain | Moderately improving |
| 2 - Zero hunger | Major challenges remain | Stagnating |
| 3 - Good health and well-being | Significant challenges remain | Moderately improving |
| 4 - Quality education | Challenges remain | Moderately improving |
| 5 - Gender equality | Significant challenges remain | Stagnating |
| 6 - Clean water and sanitation | Significant challenges remain | On track or maintaining SDG achievement |
| 7 - Affordable and clean energy | Challenges remain | Moderately improving |
| 8 - Decent work and economic growth | Significant challenges remain | Moderately improving |
| 9 - Industry, innovation and infrastructure | Significant challenges remain | Moderately improving |
| 10 - Reduced inequalities | Major challenges remain | Information unavailable |
| 11 - Sustainable cities and communities | Significant challenges remain | Stagnating |
| 12 - Responsible consumption and production | Major challenges remain | Information unavailable |
| 13 - Climate action | Significant challenges remain | Stagnating |
| 14 - Life below water | Major challenges remain | Stagnating |
| 15 - Life on land | Major challenges remain | Decreasing |
| 16 - Peace, justice and strong institutions | Significant challenges remain | Moderately improving |
| 17 - Partnerships for the goals | Challenges remain | On track or maintaining SDG achievement |

Note: The order of progress (from greatest to least) is as follows: SDG achieved; challenges remain; significant challenges remain; major challenges remain.
Source: (Sachs, 2021[17]), *Sustainable Development Report 2021, the Decade of Action for the Sustainable Development,* https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

There has been moderate improvement in many areas. In the area of poverty, while the headcount ratio of those living on USD 1.90 per day is lower than the SDG target, the target for the headcount ratio of those living on USD 2.30 per day has not been achieved. Health outcomes have been improving, but the death rates due to cardiovascular disease, cancer, diabetes and other non-communicable diseases are still above the targets. In the area of quality education, the SDG target of 100% of net primary enrolment has been achieved, but at 89.9% the lower secondary completion rate has decreased. In the area of affordable clean energy, access to electricity is high but challenges persist in accessing clean fuels and

technology. High unemployment remains an important challenge despite progress achieved over the past decade. The share of the population using the Internet and with mobile broadband subscription has increased, but limited investment in research and development (R&D) is holding back progress towards the SDG on industry, innovation and infrastructure. Finally, in the area of peace and institutions, more progress is needed to reduce corruption, eliminate child labour, as well as improve property rights and the freedom of the media (Sachs, 2021[17]).

Progress towards a number of SDGs has stagnated. In the area of gender equality, significant challenges remain in access to family planning and the ratio of female-to-male mean years of education received has decreased. Air pollution and insufficient quality of the public transport network negatively impact the quality of city life. More action is also needed to reduce carbon dioxide ($CO_2$) emissions, particularly those stemming from energy use (Sachs, 2021[17]).

The most significant challenges according to the SDG assessment lie in the areas of inequality, responsible production and consumption, and life on land and below water. At 40.5, the Gini coefficient, which measures income inequality, is still well above the target value of 27.5. Montenegro continues to produce significant amounts of waste, and recycling and reuse remain limited. Last but not least, significant efforts are needed to protect terrestrial and marine biodiversity and reduce terrestrial and marine pollution (Sachs, 2021[17]).

### *Structural economic challenges*

Montenegro faces a number of key structural challenges that undermine its competitiveness, productivity, investment and exports.

#### *Skills gaps are a key obstacle to employment*

- **Skills gaps** contribute to unemployment and undermine economic upgrading. Despite high spending on education, which at 4.5% of GDP is nearly on a par with OECD economies, Montenegro's relatively weak student performance in international standardised tests points to considerable gaps in the provision of quality education. For example, in the latest Programme for International Student Assessment (PISA), just over 50% of students achieved the minimal level of proficiency in the three testing subjects (reading, mathematics and science), which is well below the OECD average of over 75% (OECD, 2020[18]).
- **Skills mismatches** negatively impact employment as well as firm growth. This is a particular challenge for innovative firms, 45% of which reported that a lack of skills was a problem in filling skilled manual labour vacancies (World Bank, 2018[19]). An inadequately educated workforce was also identified as a challenge by 10% of firms (World Bank, 2019[20]). Soft skills including language, leadership, critical thinking and initiative were the key missing skills, but many firms also cited challenges in hiring due to lack of technical skills (World Bank, 2018[19]). A study by the European Commission's Directorate General for Education and Culture (DG EAC) has found that for every ten students that enter the education system in Montenegro, only two find a well-matched job. Low-skilled workers face the biggest challenges in finding employment – the number of unemployed people in this category has tripled between 2013 and 2017 (ETF, 2019[21]).
- **Low labour force participation**, particularly among young people and women, brain drain and the ageing population exacerbate skills-related challenges and weaken long-term growth prospects. The capacities of the youth are particularly underused as the share of young people who are not in education, employment or training (NEET) remains high at 17.3%, while the youth labour force participation rate is low at just 37%. Female activity rates also remain below aspirational peers in the EU at 58%, reflecting constraints related to child-care and traditional values and norms regarding women's place in society. With many high-skilled workers emigrating to more developed countries, and in light of the shrinking labour force, addressing the skills

challenges is of utmost importance for setting Montenegro's economy on a higher and more sustainable long-term growth path.[2]

### *The business and investment climate faces persistent challenges*

Montenegro has significantly improved the business and investment climate, yet some notable challenges persist. Thanks to reforms that reduced the regulatory and administrative burden on businesses, Montenegro currently ranks 50th out of 190 economies in the World Bank's Doing Business report (World Bank, 2019[22]). Nevertheless, there are some areas where further progress is needed in order to create an environment conducive to investment and enterprise innovation, internationalisation and growth.

- **Starting a business** in Montenegro is more difficult than in most economies around the world. The process entails more procedures (8 compared to the 4.9 OECD average and 1 for the global leaders) and is more time-consuming than in other economies (12 days in Montenegro vs. 9 for the OECD average and 0.5 for the highest performers). Obtaining an electricity connection is also more costly and time-consuming: it takes on average 131 days in Montenegro to get connected, compared to 75 days for the OECD and 18 days for top performers. The cost is also more than twice as high as the OECD and well above the no-cost benchmark of the top performer (World Bank, 2019[22]).
- **Corruption** remains an important challenge for doing business in Montenegro. In the latest Business Environment and Enterprise Performance Survey (BEEPS), Montenegrin firms reported an above-average incidence of bribery and share of public transactions that require an informal gift compared to global and Europe and Central Asia region peers. The highest share of firms that responded to the survey noted expectations of gifts for obtaining licences and permits and for meetings with tax officials (World Bank, 2019[20]). Incidentally, Montenegrin firms are more likely to have to meet tax officials in person than in other peer economies.
- **Informal sector competition** represents an important constraint for businesses in Montenegro. In the latest enterprise survey, 58% of firms stated that they compete against informal competitors, and nearly a quarter of all firms identified informal competition as a major obstacle for their business. The impact is highest among SMEs, particularly in the manufacturing sector. The size of the informal sector is estimated at 28-33% of Montenegro's GDP and its share in total employment is estimated at over 20% (EC, 2019[23]).
- **Despite a notable rise in entrepreneurship over the past decade, firm growth is constrained by access to finance**. Strict collateral requirements represent an important barrier for businesses. While the share of loans that require collateral is in line with the OECD average at around 60%, the level of collateral required – at 209% of the borrowed amount – is more than double the OECD average of 88%.[3] The collateral requirements are particularly limiting for micro and small enterprises (MSMEs), which have limited assets. The banks' preference for real estate collateral further compounds this challenge for MSMEs – see Access to finance (Dimension 3). The high collateral requirements reflect in part the lack of adequate information on creditors. However, progress has been made in this regard as coverage of the public credit registry in Montenegro has increased from 30.8% in 2018 to 41% in 2019, and information is regularly updated.[4] Nevertheless, financing for start-ups and other higher risk ventures remains very limited.

### *Key sectors are being held back*

- **Tourism:** The tourism sector is one of the most important sectors in Montenegro. In 2019, travel and tourism accounted for 32% of GDP and 33% of total employment (World Travel and Tourism Council, 2020[24]). However, the sector still suffers from high seasonality, which reduces employment and skills development as well as accessibility – see Tourism policy (Dimension 15). This undermines the quality of service, which is critical for developing the low-density high-end

tourism compatible with Montenegro's geographical and infrastructural constraints. The growth in high-end tourism is also constrained by inadequate waste management, poor water quality and uncontrolled development as these are all detrimental to the environmental as well as cultural heritage – see Environment policy (Dimension 13).

- **Agriculture:** As a small and predominantly mountainous economy, Montenegro does not have a large agriculture sector. Even so, the sector contributes significantly to Montenegro's goods exports and has significant potential for further growth. As noted in the introduction, the share of agriculture, forestry and fishing in GDP is small and has declined significantly over the past two decades, from 10.4% in 2001 to 6.4% in 2019. However, in 2018, agricultural products represented a relatively high portion (18.8%) of total exports.[5] Agricultural productivity is undermined by high land fragmentation, lack of adequate infrastructure for irrigation, limited access to mechanisation and limited investment in R&D – see Agriculture policy (Dimension 14).
- **Information and communications technology (ICT):** The ICT sector has considerable potential to boost Montenegro's service exports and contribute to the development of the knowledge economy. Despite growth in recent years, the sector still faces significant challenges, especially the insufficient supply of skilled workers; their poor wage competitiveness (ICT sector wages are considerably higher in Montenegro than in other WB economies); underdeveloped collaboration between the sector and the relevant educational institutions; lack of access to finance, particularly for start-ups and high-risk venture capital; and weaknesses in the ICT infrastructure.[6]

### *A greener growth model would improve well-being*

- **Air pollution**: Air pollution is a significant concern in Montenegro, with the annual mean exposure to $PM_{2.5}$ (particulate matter) reaching 21 micrograms per cubic metre ($\mu g/m^3$).[7] This is twice the recommended limit of 10 $\mu g/m^3$ set by the World Health Organisation (World Bank, 2017[25]) (WHO, 2018[26]). The main sources of pollution include steelmaking, agricultural processing, and the aluminium and tourism industries. Air pollution is further elevated in the winter months when domestic heating by solid fuels is added to the mix (IAMAT, 2020[27]).
- **Climate change:** Montenegro has made great progress in advancing climate change mitigation legislative and policy frameworks. Nevertheless, the economic output per unit of $CO_2$ remains low (Environment Protection Agency, 2020[28]), and the highest emissions come from electricity and heat generation (61.4% in 2018, highlighting the fossil-fuel based energy production), and transport, which accounts for a little over 20% (Ministry of Sustainable Development and Tourism, 2020[29]). When it comes to climate change adaptation, a Disaster Risk Assessment was being prepared at the time of drafting and some flood risk management measures have been implemented, but more is needed to assess and adapt to the wide range of climate related risks going forward – see Environment policy (Dimension 13).

### *COVID-19 has exacerbated structural challenges*

Montenegro was the Western Balkan economy hit hardest by the COVID-19 pandemic. In the second and third quarter (Q) of 2020, GDP declined by over 20% year on year (y-o-y), driven primarily by a sharp decline in exports (55.9% y-o-y in Q2, 70.1% y-o-y in Q3 of 2020), which reflected the loss of the summer tourism season as well as the decline in economic activity in major trading partners in the EU and the Western Balkan region. Weakening domestic demand compounded the impact of lost exports on the Montenegrin economy. Consumption fell by 5.4% in 2020, while annual investment contracted by 12.3%. As a result, annual GDP fell by 15.2% (Table 23.1) (EC, 2021[30]; EC, 2020[3]).

The crisis has exacerbated internal and external imbalances. The current account deficits have widened as exports contracted more strongly than imports – the current account deficit reached 26% of GDP at the end of 2020. Meanwhile, the negative impact on tax revenues, combined with higher government

expenditures due to fiscal support and higher healthcare spending, resulted in a widening of the fiscal deficit to 11% of GDP in 2020. As a result, public debt rose to 105% of the GDP (EC, 2021[30]).

The labour market was strongly affected by the COVID-19 crisis despite the government's measures to stave off some of the impact of the crisis. Since the start of the crisis, the government has introduced four packages of fiscal support for enterprises affected by the pandemic (Box 23.1). These packages have included measures such as wage subsidies for employees in affected companies, deferral of tax and social security payments, exemptions from payment of utility bills, moratoria on loan repayments and moratoria on enforcement of claims against enterprises in affected sectors. The government also created an Investment Development Fund to provide liquidity support to affected enterprises.[8] The tourism and agriculture sectors were further supported by interest rate subsidies on new loans, and a reduction in the value-added tax (VAT) rate for the hospitality industry (from 21% to 7%). Despite these important measures, the effective loss of the tourism season – overnight stays declined by nearly 80% in January to November 2020 – resulted in a sharp increase in unemployment, from 15.4% in 2019 to 18.4% at the end of 2020, reversing a seven-year trend of steady improvement.

The impact on vulnerable households and poverty was mitigated by the government's support measures. Financial assistance was provided to low-income pensioners and social welfare beneficiaries, and health and education workers received domestic travel vouchers. Additional support was provided to individuals who lost their jobs a result of the crisis through social security schemes and employment programmes. Vulnerable households were also supported through electricity subsidies from the state-owned power distribution company, which were doubled in the second package of economic measures.

### Box 23.1. Montenegro's tax response to COVID-19

As part of its responses to the COVID-19 pandemic, Montenegro carried out a number of tax measures, which included:

1. Payments of income taxes by individuals, companies and the self-employed were deferred in March 2020 for 90 days.
2. A one-off EUR 50 cash transfer was paid to beneficiaries of material assistance and of pension and disability insurance.
3. Loan repayments were deferred for a period of 90 days, at the request of individuals and companies, starting in March 2020.
4. A public loan scheme to improve the liquidity of the self-employed and companies impacted by the crisis. It allowed for a maximum amount of EUR 3 million per beneficiary. This scheme benefits from a simplified procedure, no approval fee and an interest rate of 1.5%.
5. Tax-debt repayments were made more flexible, including no interest for late payments of tax arrears.
6. A 60-day deferral of payment for customs duty and VAT was put in place in March 2020 for companies that could not continue their activity as a result of the crisis.
7. The reduced VAT rate (7%) was extended to certain catering and accommodation services.
8. Donations of medical goods to public entities were exempted from VAT.

Montenegro implemented a relatively wide set of responses to COVID-19 compared to other WB6 economies. For example, few WB6 economies implemented a public loan scheme, deferred loan repayments or offered direct cash transfers to households, which are centrepieces of Montenegro's response to COVID-19. Montenegro's comprehensive COVID-19 response package broadly aligns with those of OECD/G20 countries (OECD, 2020[31]).

Despite this support, many of the economy's structural challenges have played a role in either amplifying the impact of the COVID-19 pandemic or limiting the scope of the policy responses to reduce its impact. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** The fiscal response has been important for reducing the economic fallout from the COVID-19 crisis, but has resulted in a significant deterioration in the fiscal position and an increase in public debt. In the context of weaker prospective revenues in the wake of the crisis, particularly if the recovery is slow, improving the efficiency of public spending will be critical over the coming months. It will also be vital to prioritise expenditures that can support the recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This includes increasing public investment, which has suffered significantly due to high and rising current expenditures. The crisis also highlighted the importance of rebuilding fiscal buffers in the post-crisis period. In addition to better management of expenditures this will also require tackling some of the structural constraints that undermine revenue performance and allow for more discretionary fiscal expenditures to counteract future shocks.
- **Innovation and technology adoption:** The COVID-19 crisis has starkly demonstrated the importance of firm adaptability to meet new challenges and changing circumstances. The crisis has also revealed the advantages that firms which have embraced digitalisation and modern practices have over others. The resilience of the post-COVID recovery will therefore depend on the extent to which structural issues limiting firm innovation and technology adoption are addressed and to what extent digitalisation and digital skills become mainstreamed.
- **Access to finance:** The crisis has highlighted the significance of a well-developed and diversified financial sector that can respond to the financing needs of enterprises – not only in times of crisis but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity to enterprises during the crisis came from the government through subsidised lending or lending guarantees. But a robust financial sector comprised of diversified financial institutions that can provide financing for riskier and innovative ventures – not just well-established enterprises with a long history of operation and significant assets – will be very important through the recovery phase and beyond.
- **Informality:** The large size of the informal sector, and the significant share of informal employment even within the formal sector, have limited the scope of the measures aimed at protecting the income and employment of people in the most affected sectors. Informality is widespread in the sectors most affected by the crisis, including retail trade and tourism, and this segment has not been able to benefit from the government subsidies and other relief and support measures. Developing a more resilient economy will also depend on the extent to which incentives for formalisation can be enhanced and the oversight and sanctioning of non-compliance improved.
- **Health sector:** Pre-existing poor health outcomes and inefficiencies in the health system have increased Montenegro's vulnerability to COVID-19 and any future pandemics. This challenge is compounded by relatively low spending on health care (8.42% of GDP in 2018 compared to 12.6% in the OECD).[9] Furthermore, health-sector revenues are highly sensitive to employment and economic downturns since they are financed largely by payroll contributions.[10] Going forward, Montenegro will need to strengthen the resilience of its health sector through more funding; better pandemic preparedness, including training health workers; and increasing the supply of equipment by strengthening supply chains for essential medicines and other supplies, etc.

### *EU accession process*

Montenegro began its EU accession journey in 2008 when it submitted its application for EU membership. The Stabilisation and Association Agreement (SAA) came into force in September 2010 and Montenegro was granted EU candidate status in December 2010. Since then, Montenegro has advanced relatively rapidly along the accession path compared to most other Western Balkan economies. Accession negotiations began on 29 June 2012 and as of February 2021, Montenegro had opened 33 out of 35 negotiating chapters, 3 of which had been provisionally closed.

Further progress in the accession process and Montenegro's eventual joining of the EU will strongly depend on adopting and aligning its legislation with the EU *acquis*, effective implementation of this legislation, and structural reforms that will enable the economy to meet the competitive pressures and other requirements of joining the EU bloc. The findings and recommendations published in this Competitiveness Outlook 2021 provide the monitoring and guidance needed for the government in meeting the requirements related to a number of critical chapters of the *acquis* when negotiating its accession to the EU. The Competitiveness Outlook also provides a good basis for assessing the critical challenges that the economy faces as a starting point for the development of the Economic Reform Programmes (Box 23.2).

#### Box 23.2. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:
- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[32]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[33]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

*EU financial and development support*

Montenegro has received considerable financial support from the EU, which has been its largest provider of financial assistance. Through the EU pre-accession funds, a total of EUR 506.2 million was allocated to Montenegro for the period 2007-20. The financing is aimed to assist the economy in improving its outcomes across the following areas: democracy and governance; rule of law and fundamental rights; environment and climate action; transport; competitiveness and innovation; education, employment and social policies; agriculture and rural development; and regional and territorial co-operation.

On 6 October 2020 the European Commission adopted the Economic and Investment Plan for the Western Balkans, which seeks to support the long-term economic recovery of the region, a green and digital transition and regional integration and convergence with the EU. The plan envisages the mobilisation of up to EUR 9 billion in investment in sustainable transport, human capital, competitiveness and inclusive growth.[11]

In addition to grant funding, the EU also provides important guarantees that support public and private investment by reducing the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade.[12]

The Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the Western Balkans Investment Framework, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment to support better connectivity in the WB region. It also represents the first step in implementing the flagship projects under the Economic and Investment Plan for the region.

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced Montenegro's Competitiveness Outlook Government and Statistical Office Co-ordinators[13] to the new digitalised assessment frameworks (see Assessment methodology and process chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital

solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, the Ministry of Economic Development disseminated the materials among all 16 Policy Dimension Co-ordinators and Statistical Office contact points in Montenegro. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All 16 Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from the Ministry of Economic Development, Policy Dimension Co-ordinators and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders (including chambers of commerce, academia and NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook Government Co-ordinator,[14] Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 17 December. The draft Competitiveness Outlook economy profile of Montenegro was made available to the Government of Montenegro for their review and feedback from mid-January to mid-February 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 23.3).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Assessment methodology and process chapter.

**Table 23.3. Competitiveness Outlook scoring system**

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

#### *Exceptions*

Unlike the other 15 policy dimensions, Competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score

reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

Montenegro's performance on the investment dimension has improved since the last assessment. The economy's score has increased from 2.6 in the 2018 Competitiveness Outlook (OECD, 2018[34]) to 3.2 in the 2021 assessment, with notable progress having been made on all sub-dimensions. Although the economy has significantly improved its institutional framework by creating a new investment promotion agency, the Montenegro Investment Agency (MIA), with an extended mandate and capacities, the MIA has just started its work and the new scores for investment promotion and facilitation do not yet reflect these improvements. Montenegro ranks second amongst the WB6 economies for economic performance. While Montenegro is among the top WB6 performers for its investment policy, its investment promotion and facilitation performance still lags behind its neighbours (Table 23.4).

### Table 23.4. Montenegro's scores for investment policy and promotion

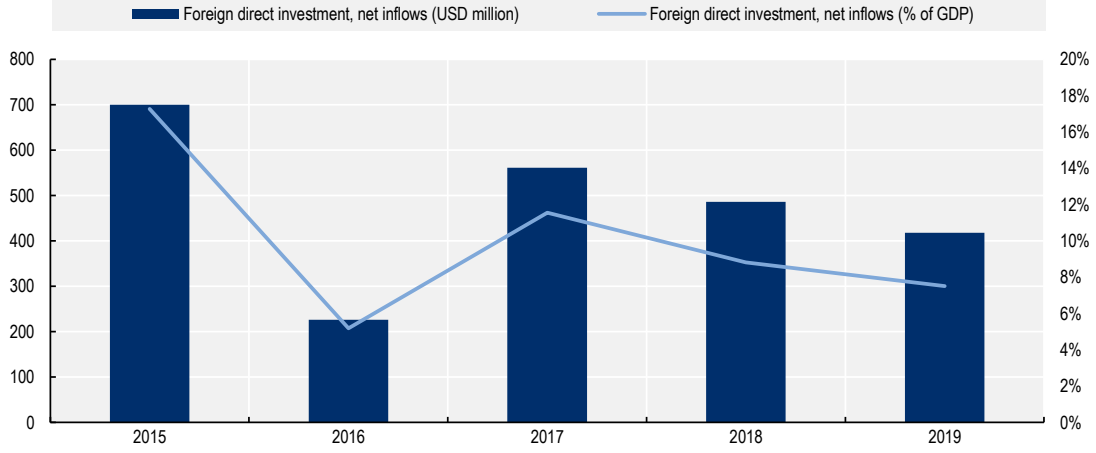
| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1: Investment policy framework | 3.6 | 3.2 |
| | Sub-dimension 1.2: Investment promotion and facilitation | 2.8 | 3.0 |
| | Sub-dimension 1.3: Investment for green growth | 3.0 | 2.0 |
| **Montenegro's overall score** | | **3.2** | **3.0** |

### *State of play and key developments*

Montenegro is the leading WB6 economy for attracting FDI. Net FDI inflows have averaged USD 487 million a year over the last five years (Figure 23.2). In 2019, the economy's net FDI inflows accounted for 8.4% of GDP. This figure is higher than neighbouring economies: 8.3% for Serbia, 7.8% for Albania, 3.8% for Kosovo and North Macedonia, and 1.9% for Bosnia and Herzegovina. It is also higher than the average for upper-middle income economies (1.6%) and OECD economies (1.5%).

FDI in Montenegro is mostly concentrated in the tourism, energy, telecommunications, banking and construction sectors. Its origins are diverse, with no single economy dominating. The most significant investments have originated from Hungary, Italy, Russia and Serbia, with new interest coming from Azerbaijan, China, Turkey, the United Arab Emirates and the United States.

### Figure 23.2. Net FDI inflows to Montenegro (2015-19)




Source: (World Bank, 2020[1]), *World Development Indicators*, https://datacatalog.worldbank.org/dataset/world-development-indicators.

StatLink https://doi.org/10.1787/888934255817

*Sub-dimension 1.1: Investment policy framework*

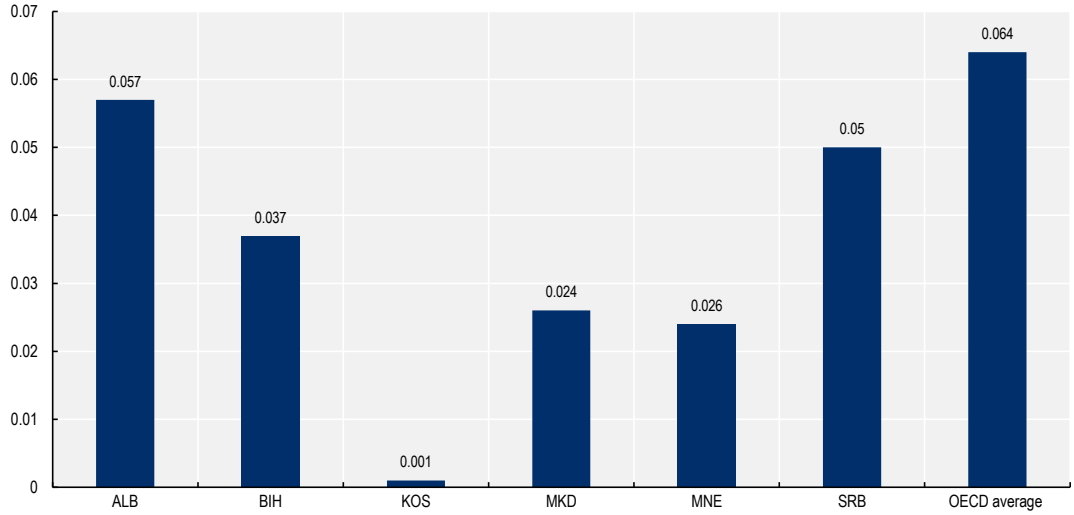
Overall, Montenegro has a clear and comprehensive **legal framework for investment** activities and conducting business. The main law governing investment activities is the Foreign Investment Law (FIL), adopted in 2014. The FIL provides investors with national treatment, makes no restrictions in terms of investment activities, foreign companies can own 100% of a domestic company, and profits and dividends can be repatriated without limitations or restrictions. Montenegro has enacted sectoral and business-related laws[15] outlining guarantees and safeguards for investors in accordance with EU standards. Recent positive developments reinforcing the investment framework include the adoption of a public-private partnership law as well a public procurement law at the end of 2019.

The government is endeavouring to ensure that the regulatory framework for investment is consistent, clear, transparent, readily accessible and does not impose undue burdens. In May 2019, the government adopted the Individual Reform Action Plan for implementing the Regional Investment Reform Agenda at the national level (IRAP), which represents a set of concrete reform actions in three areas of investment policy: investment entry and establishment, investment protection and retention, and investment attraction and promotion, all of which were completed in December 2020. The IRAP was adopted within the framework of the Investment Pillar of the Multi Annual Plan for Regional Economic Area (MAP REA) to continue the implementation of the commitments outlined under the investment pillar of the MAP REA 2017-2021. These efforts will continue through the Common Regional Market Plan 2012-2024.

The Ministry of Economy publishes the most important legislation concerning trade and investments on its website.[16] The development of laws, treaties and regulations involves stakeholder consultations and includes relevant ministries and other public bodies. Public participation in policy making and implementation is secured through the relevant decrees.[17] Nevertheless, NGOs – including business associations – have complained about recent policy-making and legislative processes that lacked public consultation and involvement of key stakeholders (EC, 2020[35]).

In Montenegro, the market is open and **exceptions to national treatment** are very limited. The economy's score in the OECD FDI Regulatory Restrictiveness Index (Figure 23.3),[18] which assesses and benchmarks market access and exceptions to national treatment, was 0.03 in 2018. This indicates that the economy maintains only a handful of restrictions (notably in the transport sector), making its FDI regime less restrictive than the average OECD economy (0.064) (World Bank, 2020[36]). This suggests that foreign investment rules do not constitute impediments to FDI. However, the economy does not have a negative list indicating the sectors where foreign investment is prohibited or conditioned and outlining which discriminatory conditions apply.

## Figure 23.3. FDI Regulatory Restrictiveness Index (2019)




Note: Restrictions are evaluated on a scale of 0 (open) to 1 (closed).
Source: (OECD, 2020[37]), *FDI Regulatory Restrictiveness Index (database)*, http://www.oecd.org/investment/fdiindex.htm.

**Investor protection against expropriation** without fair compensation is enshrined in the constitution and its modalities are defined in the Law on Expropriation. The law stipulates that expropriation measures are taken only in a non-discriminatory manner, for a public purpose, under due process of law, and with fair compensation. It does not however recognise the concept of indirect expropriation. The expropriation law clearly defines the procedures for calculating compensation fees, including that the expropriation fee is determined by a commission of five members, at least three of whom are forensic experts in the relevant profession.

Administrative-judicial protection from expropriation decisions is available for dissatisfied parties; it also determines the fee for expropriation. Thus, a party can file an appeal against an expropriation decision with the Ministry of Finance. If the party is not satisfied with the decision of the Ministry of Finance, it can initiate an administrative dispute against it in the Administrative Court of Montenegro. Dissatisfied parties also have the opportunity to initiate civil proceedings in regular courts.

Montenegro has signed a large number of bilateral investment treaties (BITs),[19] which constitute an additional layer of protection for foreign investors. The Government of Montenegro is currently in the process of reforming its existing network of BITs and defining a new BIT model that will balance investor protection provisions and national strategic interests, while fully complying with EU standards and good international practices.

Foreign investors have the same rights and remedies under the national court system as domestic investors when it comes to **dispute settlement**. The justice system is continuing its reform efforts under the 2019-2022 judicial reform strategy,[20] which focuses notably on the independence, efficiency and professionalisation of the judiciary. Overall, the judiciary system is independent but remains vulnerable to political interference. Its financial resources have been slowly but steadily increasing over 2016-2020 to reach EUR 39.1 million (EC, 2020[35]). However, according to similar EU reports, it remains lower than the judiciary budgets of other WB6 economies. Overall, the court system is functioning well, and investors can generally rely on it for a wide range of disputes. Montenegro has commercial courts which have first-instance jurisdiction in commercial matters. Judges are trained to hear complex commercial disputes and the backlog of cases is decreasing. Though the disposition time (the average time from filing to decision) for commercial cases increased from 107 days in 2018 to 116 days in 2019, it remains comparable to OECD economies.

Montenegro is stepping up its efforts to offer alternative dispute resolution mechanisms. It ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) in 2012 and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) in 2006. By virtue of their adherence to the New York Convention, foreign arbitral awards are recognised. Moreover, Montenegro signed the United Nations Singapore Convention on Mediation in 2019.

Montenegro also adopted the Arbitration Act in 2015 and is in the process of adopting the Law on Alternative Dispute Resolution (ADR),[21] which provides for compulsory recourse to ADR mechanisms for specific types of cases. According to the European Commission, Montenegro is recording a positive trend in alternative dispute resolution for which a programme and accompanying action plan for 2019-21 were adopted at the end of 2018. In 2019, 917 cases were referred for mediation, up from 629 cases in 2018 and 437 in 2017, while 403 cases were resolved through mediation in 2019, compared to 107 in 2018 (EC, 2020[35]).

Montenegro has sound **intellectual property (IP) rights laws**, which are harmonised with EU legislation and contain the minimum requirements of the World Trade Organization's (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Montenegro is a member of the World Intellectual Property Organization and adheres to the main international treaties and conventions on IP rights. The Ministry of Economic Development of Montenegro is the public authority in charge of registration, protection and enforcement of IP rights, and co-ordinates closely with other IP institutions, including customs. Since 2018, following a restructuring of the administration, the IP office is part of the Ministry of Economy. It should be noted that following these changes, the staffing of the office was reduced.

Montenegro is strengthening its **IPR enforcement** and implementation. It has reinforced the capacity of the intellectual property rights co-ordination team and the attached working group through regular training. The Ministry of Economic Development has strengthened its co-ordination with other IP-related institutions and boosted its efforts to sensitise businesses and the public and provide them with better access to information on IP rights. The Commercial Court of Montenegro, as a specialised court, has the exclusive jurisdiction for resolving disputes in the field of intellectual property. The Commercial Court has a Department for Disputes on the Protection of Copyright and Intellectual Property Rights, which has ten judges who are regularly trained professionally in this area.

The government has also reinforced its **IP rights awareness raising and access to information**. The Ministry of Economic Development has initiated measures such as seminars and campaigns to proactively raise awareness on IP, as well as capacity-building programmes on how to file for IP protection. In addition, relevant information about registered IP rights is available on the ministry's website,[22] as are patent registers and other databases on IP rights.

### *Sub-dimension 1.2: Investment promotion and facilitation*

Montenegro is currently modernising its **investment promotion agency structure and strategy.** The last Competitiveness Outlook reported that the Montenegrin Investment Promotion Agency (MIPA) was constantly short-staffed, had limited capacities and a mandate focused solely on investment promotion. Following the adoption of the new PPP law in October 2019, MIPA and the Secretariat for Development Projects have ceased to exist and the Montenegro Investment Agency (MIA) was established in 2020 with significantly more employees and a much broader set of responsibilities. By the end of 2020, the MIA had 27 employees compared to the 5 previously employed by MIPA. According to the organisation's Personnel Plan, it seeks to increase the total number of employees to 42 by 2021.

The establishment of the MIA is expected to reinforce Montenegro's **investment facilitation services and activities**. It has recently been put in charge of revamping administrative systems to speed up procedures and provide the conditions for efficient work, which requires close co-operation between the agency and relevant ministries. While the former agency MIPA was not involved in any business registration

procedures, the MIA provides investors with information on all the necessary steps for business registration, as well as on which institutions to reach out to in the process. The Government of Montenegro has also approved an action plan aimed at helping businesses by digitalising and cutting unnecessary procedures, including for company registrations, and establishing an e-cadastre.

Key recent progress on simplifying company registration include:

- Developing two rulebooks[23] which clarify the registration procedure, the single registration application of economic entities, and the content and manner of keeping the Central Registry of Economic Entities.
- Merging the 16 previous forms for registering a business into a single form, and progressing on electronic company registration through eFirma.
- Cutting various registration fees: for example the fee for establishing a joint stock company has been reduced from EUR 50 to EUR 40, and the minimum capital for electronic registration of a one-member limited liability company for resident founders has been reduced to EUR 1.

Following its establishment, the MIA has started developing **investor targeting** actions. It is trying to move from MIPA's reactive stance to a more proactive targeting of potential investors and countries. For instance, in 2020 the MIA embarked on an investor outreach campaign for the furniture manufacturing sector with financial and technical assistance from the World Bank. It has also defined target countries and started organising missions.

Montenegro has put a complex and multi-layered **investor incentive** scheme in place to attract investment. Incentives are provided by the state and include 1) subsidies (mostly through the Program for Improving Competitiveness, consisting of 10 programme lines to provide financial and non-financial support to potential and existing entrepreneurs, SMEs and large enterprises, as well as clusters); 2) tax relief (write-offs, deferrals of taxes and contributions); 3) loans with lower interest rates (through the Investment Development Fund's loans); and 4) guarantees. In addition, incentives and facilitation measures are provided to investors in Free Zones and Business Zones or by the Law for Specific Projects, while other incentives are provided by municipalities and for investing in least developed areas, primarily in the north (OECD, 2017[38]). However, the system could prove difficult to navigate for foreign investors due to lack of awareness and clarity on qualifications (EC, 2020[35]). On the control side, the government ensures the transparency of state aid in the annual report on granted state aid by the Agency for Protection of Competition, which is publicly available on its website.

The establishment of the MIA is also a positive step towards improving **aftercare services,** which requires strong co-operation with other institutions and regulatory bodies. Although the agency does not have a formal mandate to provide aftercare services, it still answers investors' enquiries on an ad hoc basis.

### *Sub-dimension 1.3: Investment for green growth*

Overall, Montenegro has started to develop a sound green **investment policy and promotion** strategy. Its national strategy, the Smart Specialisation Strategy of Montenegro (S3.me) 2019-2024, based on the EU's cohesion policy, promotes green growth and building a legal framework that encourages green investment (Ministry of Science of Montenegro, 2019[39]). This strategy paves the way for future green investment programmes as it defines the priorities and focal areas to be developed for sustainable and green growth. In addition, Montenegro has adopted two very key laws regulating green investments and innovation: the new Law on Innovation Activity and the Law on Incentives for the Development of Research and Innovation. These are accompanied by an implementing body, the Innovation Council, and an innovation fund that supports targeted projects.

Montenegro respects core investment principles such as investor protection, intellectual property rights protection and non-discrimination in areas inclined to attract green investment. In addition, the government has developed policies, laws, market-based instruments and regulations in the energy sector to encourage

private investment for green growth, while including sustainable development provisions in the new BIT model. Additional measures are also adopted at the local level to encourage private green initiatives. Several programmes have been developed with international organisations for achieving green investment, notably the Growing Green Business in Montenegro 2018-2021 project developed in co-operation with the United Nations Development Program (UNDP).

Montenegro has also developed a strong framework for **choosing public and private partnerships for green growth**. It has recently adopted a favourable regulatory framework through the new Law on Public-Private Partnerships in 2019 that reinforces its ability to mobilise and scale-up green investments by leveraging domestic and international public and private investments in large-scale projects, including infrastructure. The new PPP law was developed in co-operation with donors following good international practices. It includes financial sustainability, value for money and environmental performance as key elements of feasibility studies of proposed PPP projects. In addition, a risk-sharing principle is clearly stated in the PPP law. Finally, the new MIA will be in charge of facilitating, promoting and monitoring PPP projects, including those for green investment.

### *The way forward for investment policy*

Over the past decade, Montenegro has developed a solid track record in attracting and promoting investment, building on its openness and business-friendly environment. It has initiated important reforms, notably the establishment of a new institutional framework for investment promotion. It could further these efforts and remain an attractive investment destination through the following actions:

- **Improve the transparency and inclusiveness of policy making**. More open and inclusive policy-making processes help to ensure that policies will better match the needs and expectations of citizens and businesses. Improving the public consultation process and including foreign investors would lead to better targeted and more effective policies.
- **Continue efforts aimed at encouraging the use of alternative dispute mechanisms**. These mechanisms can help alleviate the pressure on the judiciary system, build trust and create a more business-friendly environment for conflict resolution. Conducting awareness-raising campaigns to increase the use of alternative dispute mechanisms will reassure prospective investors that fair resolution processes exist in the event of commercial disputes.
- **Accelerate the establishment of the MIA, clarify its aftercare mandate, and reinforce its capacity and resources** in order to improve its investment facilitation and aftercare services. Increased resources would help streamline the large mandate of MIA, while greater inter-institutional co-ordination would avoid repetitive and overlapping objectives. In addition, the government needs to clearly define the MIA's responsibilities for aftercare services, notably by expanding the agency's mandate and producing a clear system for enquiries.
- **Streamline the multiple investment incentives** and reinforce mechanisms for evaluating their cost and benefits, their appropriate duration, and their transparency. The government should increase the clarity and awareness of these incentives through greater transparency on their qualification criteria and by targeting foreign investors through awareness-raising campaigns.
- **Further reinforce the MIA's green investment promotion activities**. Montenegro should systematically consult with the private sector and other local stakeholders in the design and implementation of strategies and plans, policies and regulations that are relevant for green investment.

## Trade policy (Dimension 2)

### *Introduction*

Montenegro's performance on the trade policy dimension has improved since the last assessment. The economy's score has increased from 2.6 in the 2018 Competitiveness Outlook to 3.2 in the 2021 assessment (Figure 23.1), with notable progress on all sub-dimensions. Montenegro has improved inter-ministerial consultations on trade policy by establishing new bodies and adopting cross-sectoral strategies, including for implementing its WTO commitments. In addition, the economy has improved its regulatory framework for implementing public consultation standards through a new decree on state administration,[24] which aims to systematise the public consultation process and promote stakeholder participation in trade policy design.

As regards trade in services, Montenegro has put in place policies to liberalise its services markets. As a result, significant progress has been made in lowering non-tariff barriers that were restricting services. Efforts have been primarily regional, with the conclusion of the Central European Free Trade Agreement (CEFTA) Additional Protocol 6 in December 2019 and its ratification in June 2021. Montenegro continues to improve its trade policies. Some nodes still exist. The economy could focus on lifting and modifying some economy-wide restrictive measures affecting foreign entities from third countries wishing to invest and operate in Montenegro. The context of the COVID-19 pandemic has undermined the efforts of many states to lower barriers to trade. However, Montenegro is one of the few economies not to have introduced trade restrictions. This is particularly important in a context where recent OECD studies of member economies tend to show a growth in the number of trade-restricting regulations in 2020 (OECD, 2021[40]).

Finally, Montenegro is the regional leader in e-commerce trade flows in terms of increase in business-to-consumer (B2C) sites and trade flows made through the Internet, with a very low degree of trade restrictions in digitally enabled services. However, there have been no substantial changes to the e-commerce policy framework since 2018. Implementation efforts have not evolved fast enough, co-ordination mechanisms are absent and programme planning is insufficient, leading to inadequate monitoring and evaluation processes. These explain its below-average score on this sub-dimension (Table 23.5).

**Table 23.5. Montenegro's scores for trade policy**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 3.5 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 2.5 | 3.1 |
| **Montenegro's overall score** | | **3.2** | **3.4** |

### *State of play and key developments*

Montenegro's exports of goods and services have been growing steadily since 2015, though this growth has been affected by the COVID-19 pandemic. Foreign trade overall increased from 105.6% of GDP in 2017 to 108.5% in 2019 (in real terms), compared with 103% in 2015. In 2019, Montenegro's exports of goods and services represented 43.7% of GDP, while imports of goods and services were 64.8%.[25]

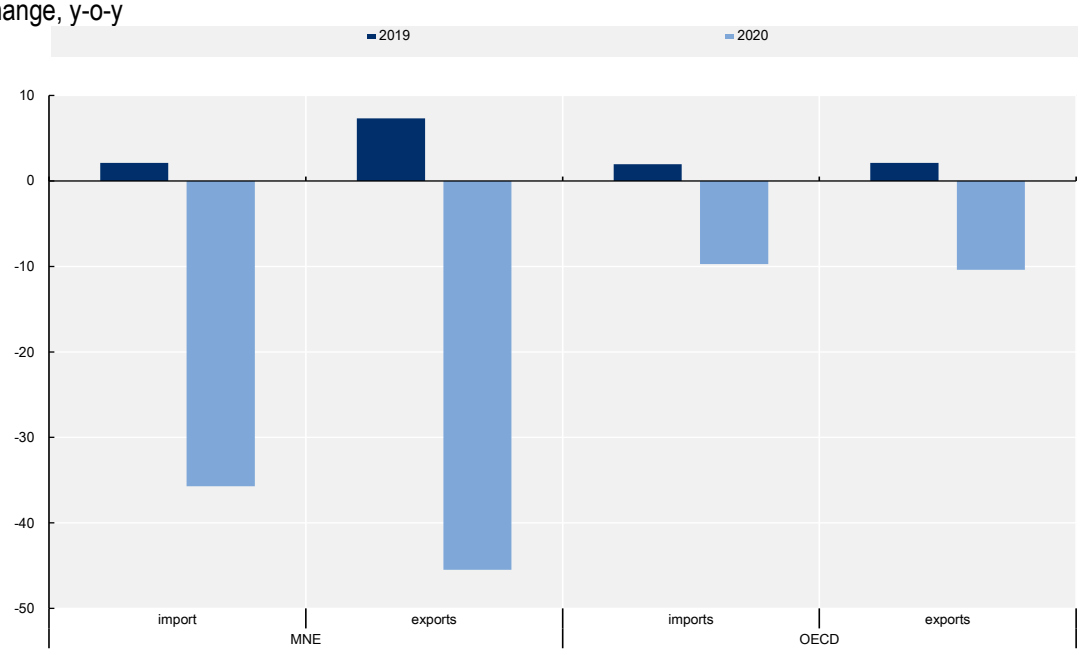
Exports of goods reached EUR 465.6 million in 2019, while imports reached EUR 2.5 billion. The external deficit in trade in goods and services accounted for 21.1% of GDP in 2019. Montenegro is a net exporter of commercial services, with commercial exports accounting for EUR 1.7 billion against EUR 677.6 million in imports.

Serbia is Montenegro's main trading partner, accounting for 23.6% of total exports in 2018, followed by Hungary (11.7%) and Bosnia and Herzegovina (7.8%). Montenegro's main supplier is also Serbia, with 19.3% of Montenegro's imports coming from Serbia, followed by China and Germany (10.1% and 9.2% respectively). As for the European Union, it accounted for 44% of Montenegro's exports and 48.5% of its imports in 2018.

Like all economies, Montenegro has been heavily affected by the COVID-19 pandemic. The pandemic-related export bans, restrictions on the movement of people and closures of shops and services led to a significant decline in imports and exports in Q2-Q3 2020 compared to 2019 (imports down 35% and exports 45%; Figure 23.4).

## Figure 23.4. Impact of COVID-19 on trade, Montenegro versus the OECD (2019-20)

% change, y-o-y




Note: y-o-y = year-on-year.

Source: (IMF, 2020[41]), *World Economic Outlook*, https://www.imf.org/en/Publications/WEO/weo-database/2020/October, (OECD, 2020[42]) *OECD Economic Outlook*, Volume 2020 Issue 1, https://dx.doi.org/10.1787/0d1d1e2e-en.

StatLink https://doi.org/10.1787/888934255836

The tourism sector, which accounts for 25% of the economy's GDP, is expected to contract by 12.4% in 2020. The tourism and travel industry has been hit hard by the movement-of-people restrictions imposed to limit the spread of COVID-19. The decrease in tourism has also affected other related industries, such as food, entertainment and retail, as well as tourism-related investment – see also Tourism policy (Dimension 15). In 2020, Montenegro's current account deficit (CAD) is projected to increase to 16.8% of GDP, making it the largest in the WB6 region (World Bank, 2019[43]).

The closure of EU borders to non-EU citizens, as well as other regulatory responses in the Western Balkans, have particularly affected freight transport services. The Western Balkan economies set up the CEFTA co-ordinating body to exchange information on trade in goods at the beginning of the pandemic. They also set up priority "green lanes" with the EU and "green corridors" within the WB6 to facilitate the free movement of essential goods through priority "green" border/customs crossings (within the WB6 and with the EU). At the peak of the crisis (April to May 2020), most road transport in WB6 economies passed through these green lanes and corridors, and they have helped to maintain a certain degree of international trade in goods in the region. Only about 20% of the goods that benefited from the green corridor regime (i.e. within the WB6) were basic necessities, the rest being regular trade. Such inclusive regional

co-operation has proven very efficient in mitigating the consequences of the COVID-19 pandemic and is helping economies to recover.

### *Sub-dimension 2.1: Trade policy framework*

A fundamental principle of regulatory transparency is that the regulatory development process is open to all relevant stakeholders through formal and informal consultations before and after adoption. These co-ordination and consultation mechanisms have a positive impact on the efficiency of economic activities and the level of market openness, as they can improve the quality and enforceability of regulations (OECD, 2019[44]). In addition to laws setting out consultation obligations, governments are also adopting secondary standards such as guidelines to better systematise the public-private consultation (PPC) process. These include clear and detailed directives for conducting the process in a consistent manner regardless of the institution carrying out the PPC.

Montenegro has a robust regulatory framework for **institutional co-ordination on trade policy formulation**. The Ministry of Economic Development, the main ministry in charge of designing trade policies, regularly involves other ministries[26] in the development of trade regulations at all stages of the policy-making process.

Progress has been made since the previous cycle of analysis, with new platforms for inter-institutional co-ordination being established in 2018. These include the Government Working Group for Trade Policy Review process (TRP),[27] and increased competencies for the National Trade Facilitation Committee (NTFC)[28] with the adoption of a new strategy for trade facilitation for 2018-2022.[29] These developments have allowed the Ministry of Economic Development to consult on trade with an increased number of agencies and institutions (e.g. ministries of economics, agriculture, infrastructure, industry, customs authority, national standardisation body).

Progress has been made on the regulatory framework for **public-private consultation** (PPC) standards. The new Decree on State Administration (2018)[30] introduces a mandatory consultation procedure in which the government must hold a public hearing when preparing laws and strategies. This is obligatory unless the changes concern “extraordinary, urgent or unpredictable circumstances”.[31] The use of simplified legislative procedures (thus bypassing the consultation process) that affect the business community is a real challenge in the region (OECD, 2019[44]). Montenegro has made efforts to address this problem and to subject the majority of its regulations, particularly those related to trade, to a normal legislative process. This positive trend was already apparent in the previous assessment cycle; around 10% of all laws in 2016-2018 were adopted without PPC (Montenegro Ministry of Public Administration, Digital Society and Media, 2020[45]) In addition, it is now mandatory for the government to invite those stakeholders it deems relevant to provide inputs and comment on draft laws.[32] The Decree on State Administration has also extended the scope of public consultations to include national strategies. An online participation platform has also been created to facilitate public consultations.[33] Following the consultations, the ministry responsible for the draft regulation publishes a report on the consultation process on its website and the e-government portal, and disseminates it to the entities that participated in the process.[34]

As far as monitoring is concerned, regulatory impact analysis (RIA) was formally introduced in 2012 and enhanced further in 2018. A mandatory RIA report must accompany each legislative proposal submitted to the government for approval. Montenegro has a well-developed procedure for RIA, and the Ministry of Finance – as the central RIA unit in Montenegro – conducts the evaluation process efficiently. Since the last assessment cycle, RIAs have been systematically produced, though their quality could be improved further. They do not always compare several policy options and lack other important elements, such as assessments of impacts on the stakeholders most affected. Their publication also has room for improvement. Only 51% of them, according to the most recent report available, were published within the deadlines imposed by the law.

The Ministry of Public Administration, Digital Society and Media produces statistics on the number of legislative projects that have been subject to PPCs; reports for 2018 and 2019 are available. The reports are comprehensive and detailed but still published on an ad hoc basis. There is an upward trend in the participation by interested members of public in the policy-making process, with an increase in the number of comments received compared to 2018. In addition, there is also a notable trend in the number of comments accepted. For comparison, in 2019 the percentage of accepted comments out of the total number of comments received was 77%, in contrast to 2018 when the percentage of accepted comments out of the total number of comments received was 51% (Montenegro Ministry of Public Administration, Digital Society and Media, 2020[45]).

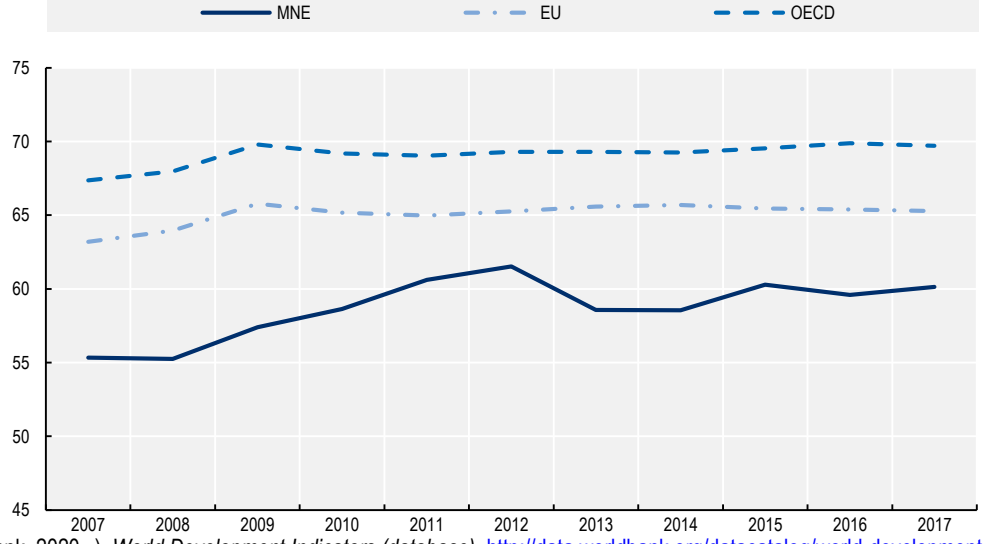
As regards bilateral and multilateral free trade agreements, Montenegro has not extended its **free trade agreement network** since the last cycle of analysis. The economy has been a member of the Central European Free Trade Agreement (CEFTA) since 2007 and entered the Stabilization and Association Agreement in 2010. Shortly after it joined the WTO in 2012, Montenegro concluded a Free Trade Agreement with Ukraine, liberalising the goods market for most agricultural and industrial products while opening the market for services linked to the transport of gas and fuel, as well as additional liberalisation of passenger, freight and ancillary services in road transport.

Recently, Montenegro strengthened its treaty network by signing the Additional Protocol 5 (on Trade Facilitation) to the CEFTA on 18 April 2018. Shortly afterwards, on 19 November 2018, Montenegro replaced Protocol II of the original (2010) Free Trade Agreement with Turkey in June 2019, redefining the term "originating products" and methods of administrative co-operation. Additionally, Protocol I was revised to include additional agricultural concessions, and a new Protocol III on trade in services was concluded in 2019. Montenegro is also currently amending its free trade agreements with CEFTA economies as regards rules of origin.

### *Sub-dimension 2.2: Services trade restrictiveness*

Services contribute close to two-thirds of GDP in the WB6, underlining how strongly economic growth, innovation and job creation depend on effective policies that promote open and competitive markets for services. Montenegro is particularly dependent on services as they contribute to more than half of its GDP (58.7% in 2017), and account for 72.9% of employment (Figure 23.5).

**Figure 23.5. Services, value added (% of GDP) - Montenegro (2007-17)**




Source: (World Bank, 2020[1]), *World Development Indicators (database)*, http://data.worldbank.org/datacatalog/world-development-indicators.

StatLink https://doi.org/10.1787/888934255855

The potential gains from liberalising services trade are significant because increased domestic and foreign competition, complemented by effective regulation, can enhance performance (OECD, 2018[34]) and lower trade costs related to regulatory barriers (Box 23.3).

### Box 23.3. The costs of regulatory barriers to trade in services

OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[46]). Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rule making. The costs resulting from barriers to trade in services are much higher than those from trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services. Even exporting to the most liberal countries still requires compliance with regulation at a cost that corresponds to around 30% of the export value in most sectors, and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are around 10% in most sectors and around 32% for financial services.

Source: (Benz and Jaax, 2020[47]), *The Costs of Regulatory Barriers to Trade in Services: New estimates of ad valorem tariff equivalents*, https://dx.doi.org/10.1787/bae97f98-en.

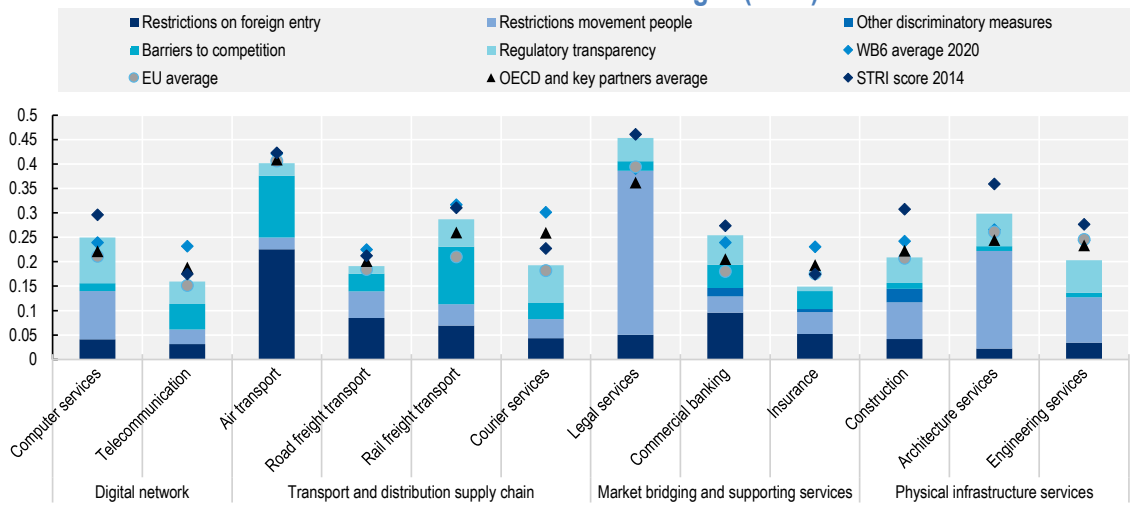
The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse barriers to trade for 12 services sectors** in Montenegro. The OECD STRI project is a unique, evidence-based diagnostic instrument that inventories trade restrictions in 48 economies,[35] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts. For this Competitiveness Outlook assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices compute restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[36]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[37] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any preferential regimes, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[48]).

Figure 23.6 shows the STRI indices for each of the sectors, as well as the average scores for the WB6, EU and OECD. Within the region, Montenegro scores below the WB6 average in 5 out of 12 sectors. Of these, telecommunications, insurance and engineering services are the three least restrictive compared to the WB6 average, while courier, legal and architecture services are the most restrictive sectors.

## Figure 23.6. Services trade restrictiveness index for Montenegro (2020)



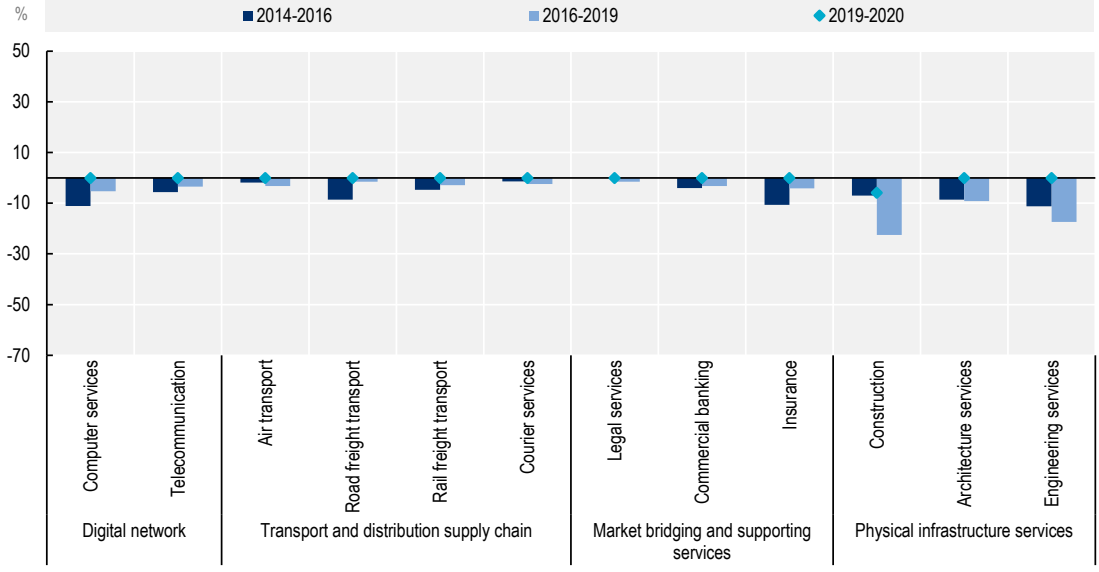

Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[49]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255874

Montenegro has progressively eased barriers to services trade over time, with the most pronounced reforms taking place between 2016-19 (Figure 23.7). The slowdown in reforms to open up services markets in 2019-20 is explained by the focus of all regulatory change in the economy on measures to safeguard public health and the economy in the context of the COVID-19 pandemic. It should be noted that there were no trends towards regulatory protectionism in the WB6 region, including Montenegro, in 2020. This is particularly important in a context where recent OECD studies of member states tend to show a growth in the number of regulations restricting services in 2020 (OECD, 2021[40]).

## Figure 23.7. Evolution of STRI scores by sector in Montenegro (2014-2020)

Percentage change over the periods 2014-2016, 2016-2019 and 2019-2020




Note: Negative values indicate a reduction in the restrictiveness of the economy's trade regulatory environment.
Source: (OECD, 2020[49]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255893

The following analysis starts with the horizontal measures that are included in all sectors and that hamper services trade in the economy as a whole – especially in the area of general business regulation, restrictions that affect the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. It then reviews each of the 12 sectors analysed, displaying the STRI scores, explaining what drives the results, and providing a brief description of the most common restrictions and good practices.

**Cumbersome horizontal business regulations affect firms' ability to operate**

In terms of g*eneral business regulations,* Montenegro has taken major steps towards harmonisation with EU standards in the area of company law; further harmonisation of regulations in this area is planned in the coming years. There are a number of areas in which Montenegro could focus its future regulation efforts. This is the case for the acquisition or use of land and real estate by foreigners, which is not fully liberalised. There are purchase restrictions for foreign nationals in some areas – such as natural monuments, land located less than one kilometre from the border, any island area and agricultural land.

Likewise, Montenegro maintains a minimum capital deposit requirement for the establishment of joint stock companies. This measure is present in the majority of EU Member States, but is nevertheless considered restrictive under the STRI as it constitutes an obstacle for foreign service providers' ability to operate.

*Restrictions on the movement of people* are also an issue in Montenegro. Although significant progress has been made in easing the conditions for the movement of people between the CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA agreement, people from economies outside CEFTA or the EU are subject to restrictive requirements. Montenegro, according to the Law on Foreigners,[38] applies quotas and labour market tests for work permits issued to third-country nationals, and although intra-corporate transferees (ICTs) are exempt from the quotas (which is beneficial for Montenegro's degree of openness), they are subject to labour market tests. Labour market tests are undertaken to determine whether suitably qualified local workers are available (or could easily be trained to do the work). They typically involve seeking advice from industry representatives and government agencies to determine current skill shortages. The length of stay for independent service suppliers, contractual service suppliers and ICTs in Montenegro is limited to 12 months. This duration is comparable with those EU Member States participating in the STRI project, but shorter than best practice elsewhere, which is more than 36 months (OECD, 2020[49]).

From the perspective of trade, *regulations for the cross-border transfer of personal data* are aligned with those of the EU. Transfers to non-EEA (European Economic Area) economies may take place where these ensure an adequate level of data protection or, failing that, where appropriate safeguards (e.g. binding corporate rules or standard data protection clauses) are in place.

Similarly, in this evaluation round, data based on World Bank Doing Business indicators showed that *business registration procedures* in Montenegro take up to 12 days and consist of 8 different procedures, while best practice examples indicate shorter and less cumbersome procedures (less than 9 days and up to 5 procedures) (World Bank, 2019[22]). However, in the third quarter of 2020, Montenegro implemented a series of regulations to simplify physical registration[39] and introduced an electronic registration procedure for companies. Similarly, the economy has also lowered the various fees related to the opening of a business[40] and facilitated payment procedures.[41] Although the benefits of these regulations will only be felt in 2021, and therefore reflected in the next round of STRI analysis, these regulatory efforts are positive.

In *public procurement* Montenegro does not impose domestic price preferences or conditions on foreign contractors to source personnel and products locally when selecting tenders and awarding contracts. The procurement process does not bias the conditions of competition in favour of local firms. Furthermore, the economy's public procurement regulation explicitly states that the contracting authority may not specify the conditions under which national or territorial conditions are exercised in the procurement process. The

process is determined by the estimated value of a procurement classified into three different threshold categories. There is no procurement regime applied to suppliers below the value thresholds.

Montenegro's laws do not contain any elements restricting trade in services in terms of investment screening. *Screening of foreign investments* refers to cases where laws or regulations enable governments or regulators to alter or prohibit foreign investment projects; the consideration of economic motives or economic interests is explicitly included in the criteria for approval. In Montenegro, regulations do not mandate that economic interests should be considered in the review of foreign investments. The conditions or criteria are vague and the consideration of economic motives are not ruled out. The economy does not set a threshold above which a foreign investment project is subject to screening.

A final horizontal element that affects some economies is the ability of foreigners from third countries to obtain the necessary business visas. Ease of business travel is an important complement to the cross-border offer and commercial presence in services. These are mainly measures affecting the duration of issuance and the cost of business visas. The Law on Foreigners stipulates that the procedure for obtaining a business visa in Montenegro should not take more than 10 days, with the possibility of extending the time for issuing a decision to 30 days if necessary. In practice, a period of 10-15 days is the norm. The cost of obtaining a visa is USD 147 and the applicant must submit 10 different documents. These procedures are all more burdensome and costly than the best practices identified by the OECD, but it is important to note that since 2016 Montenegro has brought its visa application procedure closer to the standards set in the EU visa code.

### How restrictive are individual services sectors?[42]

Beyond regulatory measures that affect Montenegro's trade in services across the board, a certain number of sector-specific restrictions are observed in the 12 sectors analysed.

**Air transport services** are defined as passenger and freight air transport, carried domestically or internationally (code 51 under the International Standard Industrial Classification – ISIC – Revision 4). In light of the range of air transport subsectors, the STRI project focuses on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant where regulations can affect the ability of foreign carriers to transport passengers and goods between points. The other aviation services are covered more fully in the STRI for logistics services. The STRI scores can range from 0 to 1, with 0 signalling a completely open sector, while 1 indicates a sector closed to foreign service suppliers. The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601, while the WB6 average is 0.421 which is roughly in line with EU (0.406) and OECD (0.409) averages. With a score of 0.401, Montenegro is the third least-restrictive of the WB6 economies (Figure 23.6).

*Restrictions on foreign entry* figure prominently in Montenegro's STRI results for air services. Like 40 other OECD and STRI key partners (OECD, 2020[50]), Montenegro limits the equity share that foreign natural or juridical persons can hold in an air transport services company to 49%. This restriction is, however, in line with European Union legislation. The leasing of foreign aircraft without crew (dry lease) and with crew (wet lease) are allowed, but subject to prior authorisation.

The other major category that influences the degree of restriction concerns *barriers to competition.* Like several economies, Montenegro maintains public ownership in the aviation sector through a national airline, Montenegro Airlines. However, the national air carrier does not provide cargo services.

Montenegro, airport slot allocation is aligned with EU regulations; slots are allocated in a fair and transparent manner. The general principle is that an air carrier having operated its particular slots for at least 80% during the summer/winter scheduling period is entitled to the same slots in the equivalent scheduling period of the following year (grandfather rights) which is very common across countries. To mitigate this restriction, Montenegro reallocates slots which are not sufficiently used by air carriers (the so

called "use it or lose it" rule), an effective competition protection measure in the sector. The STRI score is, however, limited by the economy prohibition of commercial exchange of slots, a practice which is more restrictive than the EU *acquis,* where slots can be freely transferred.[43]

**Road freight transport** (ISIC Rev 4 code 4293). The 2020 scores for all OECD member states and STRI partners in this sector range between a very low 0.124 and a high 0.624. The WB6 average is in the liberal bracket, with a score of 0.225, demonstrating the region's open approach to road freight transport services. With a score of 0.191, Montenegro is the third most open of the WB6 economies, performing better than the OECD average (0.201) but remaining more restrictive than the EU average (0.184). Unlike some OECD and STRI key partners, Montenegro does not impose many sector-specific regulations on this sector (Figure 23.6).

As regards *foreign entry restrictions*, Montenegro has a standing practice of limiting capacity in the domestic transport sector by instituting transport licenses or permits, with a fixed number of permits for a given time period.

In the area of *barriers to competition*, fees are set by the government for transportation management certification, issuing of licenses, license copy statements, licenses for international carriage of goods, and special permits for foreign carriers. But transport prices are set freely by the operators, which increases the competition in the sector.

**Rail freight transport** (ISIC code 4912) is provided over a dedicated network in which the market structure may take different forms. The two most common are: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between infrastructure management and operations (the case in Montenegro). Regardless of the market structure, there are well-established best practice regulations that also take into account competition from other modes of transport, particularly road transport. The 2020 scores for all OECD member states and STRI partners in this sector range between a very open 0.129 to a completely restricted score of 1. The WB6 average (0.316) is relatively low. Montenegro is the third most restrictive economy of the WB6 and its score (0.287) is higher than the EU (0.209) and the OECD (0.259) averages. It is also worth mentioning that the economy is more restrictive than the EU's worst performer (Poland) (OECD, 2020[51]) (Figure 23.6).

In terms of *foreign entry*, according to the railway law, non-resident foreign carriers can use the Montenegrin railroad under the conditions set by international agreements. Montenegro is only connected by railroad to Albania and Serbia. The bilateral agreement with Albania is only applicable for the railroad sector going from the border to the nearest stations in both economies: Bajza in Albania and Tuzi in Montenegro. Transit rights are not provided. The fact that licenses and certificates in railway traffic are required in order to enter the market has a negative effect on the STRI score.

As regards *restrictions on the movement of people*, licenses are required in order to practise. However, positively, there are laws in place which establish processes for recognising qualifications gained abroad, which mitigates this restriction.

*Barriers to competition* are an important contributor to Montenegro's STRI performance in rail transport services. Access fees are regulated and are calculated by the infrastructure manager according to certain pre-defined criteria. The fees must be approved by the government. Transfer and trading of infrastructure capacity are prohibited and there is a dominance on the infrastructure. The Montenegrin state owns the majority share capital of Montecargo, a major firm in the sector. This negatively affects competition, and consequently the STRI score in the sector.

**The courier services sector** (ISIC Rev 4 code 53) comprises postal and courier activities. While courier services have traditionally been an important means of communication, the rise of modern ICT has reduced its use for communication. The STRI for courier services covers regulations that have an impact on pick-up, transport, delivery (door-to-door delivery) services of letters, parcels, and express delivery services regardless of who provides the services. These services include both addressed and unaddressed items.

The 2020 scores for all OECD member states and STRI partners are between 0.106 and 0.881, while the WB6 average is 0.301. With a score of 0.193, Montenegro is one of the least-restrictive WB6 economies, still scoring higher than the EU (0.181) but lower than the OECD (0.259) averages (Figure 23.6).

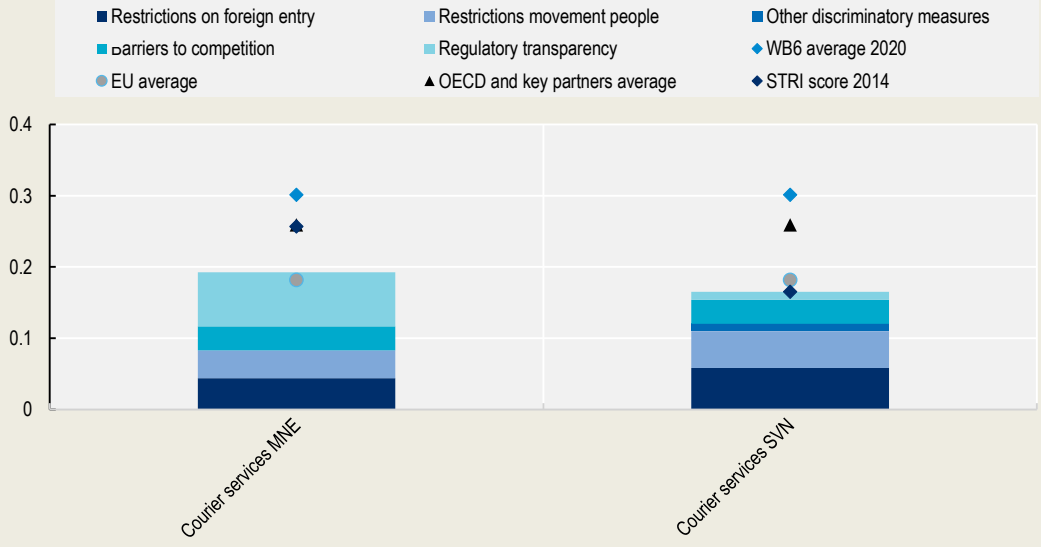
In terms of sector specific restrictions on the *movement of people*, legal and natural persons registered as providing transport of goods must file an application to the Montenegro Agency for Electronic Communications and Postal Services (AECPS) for providing commercial postal services. However, this is a very common measure in the postal sectors.

*Foreign entry* restrictions contribute significantly to the performance of many economies; Montenegro is no exception. Such restrictions are present in the form of a license needed in order to enter the market as prescribed by the Law on Postal Services.[44] Postal services are carried out under either a special licence, or a decision on the fulfilment of all conditions for carrying out postal services. Among the measures that have contributed most to the liberalisation of this sector, Montenegro has abolished all reserved services for the designated postal operator (DPO) in 2013, thus increasing its openness in this sector and bringing it closer to the best performers in the EU (Box 23.4).

## Box 23.4. Making the best of the STRI tools: Comparing courier services in Slovenia and Montenegro

The joint use of STRI tools helps identify the regulatory elements that weigh on the restrictiveness index and consequently on the degree of openness of a sector. A comparative study of the STRI 2020 indices of Slovenia and Montenegro (Figure 23.8) highlights certain elements.

### Figure 23.8. Comparing courier services restrictiveness in Montenegro and Slovenia




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; MNE=Montenegro; SVN=Slovenia
Source: OECD2020 STRI; CO2021 STRI

StatLink https://doi.org/10.1787/888934255912

Comparing both economies using the STRI Sector Brief 2020 and indices, Montenegro has a relatively low score in the courier services sector compared to other OECD STRI participants. Likewise, Slovenia has a very open and liberal courier services market, scoring amongst the lowest indices in this sector. The Postal Act of 1997 brought Slovenian legislation in the postal sector partially into line with the EU *acquis*. The complete liberalisation of postal services was achieved with the adoption the new Postal Services Act in April 2002 and secondary acts in 2003. Currently, courier services are Slovenia's least restrictive STRI sector. The economy maintains only a few sector-specific restrictions, notably the

existence of a state-owned designated postal operator and limits on the proportion of shares that can be acquired by foreign investors.

Comparing both economies using the STRI policy stimulator, it appears that only a limited number of regulatory measures dictates the weight difference between Slovenia and Montenegro's STRIs. This suggests that Montenegro could substantially reduce its restrictiveness index to the average levels found in the STRI by lifting specific restrictions:

- In the area of *restrictions on movement of people*, the scoring of both economies is largely driven by the quotas on foreign services suppliers. Additionally, both states allow only very short stays for foreign service providers. However, Slovenia has aligned its regulatory environment with international good practice on the length of stay of intra-corporate transferees. Overall, lifting limitations on movement of people based on the Slovenian example could decrease Montenegro's courier restrictiveness index value by 0.008. Going beyond Slovenia's reforms, lifting all restrictions on movement of people could decrease Montenegro's index by 0.052.
- In the *barriers to competition* category, unlike Montenegro Slovenia does not apply any preferential tax or subsidy treatment to the national DPO. Lifting this restriction could decrease Montenegro's courier index value by 0.011.

Source: (OECD, 2017[52]), *Services Trade Policies and the Global Economy*, https://doi.org/10.1787/9789264275232-en; (OECD, 2020[53]), *OECD Services Trade Restrictiveness Index (STRI) - STRI Sectoral Brief: Postal and Courier Services 2020*, https://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-sector-note-courier.pdf.

As regards *barriers to competition*, the universal service provider is the State-owned Post Office Montenegro d.o.o Podgorica, designated by the AECPS under a public tender procedure, which is in line with EU regulations. The Post Office Montenegro Podgorica is the only postal operator with the technical capacity to provide universal services across the entire territory of Montenegro. The DPO obtains preferential tax or subsidy treatment and is entitled to compensation if the operation of the universal postal service incurs a net cost that represents an unfair financial burden on the universal postal operator. Box 23.4 presents a detailed case study of how Montenegro could reduce the restrictions in this sector.

**Legal services** (ISIC Rev 4 code 691) cover advisory and representation services in domestic and international law, and where relevant, measures are compiled separately for each of them. International law includes advisory services in the home country law, third country law, international law, as well as a right to appear in international commercial arbitration. Domestic law extends to advising and representing clients before a court or judicial body in the law of the host country. The 2020 scores for all OECD member states and STRI partners in the legal services sector range between a very open 0.141 and a completely closed 1. With a score of 0.454, Montenegro is the fifth most-restrictive economy in the WB6, scoring just above the WB6 (0.391), EU (0.394) and OECD (0.382) averages (Box 23.6).

Though foreign equity limits are rarely used in legal services amongst OECD member states, most of those countries restrict the ownership of law firms to locally qualified lawyers, particularly in the area of domestic law. Ownership restrictions are often coupled with requirements that the majority of the board (or equity partners in the case of partnerships) and the manager of law firms be locally qualified (OECD, 2020[54]). This is not the case in Montenegro, which is competitive in this respect. Its result, which is in the median of the OECD, is due to *restrictions on movement of people*, such as the requirement to practice locally for at least one year, licensing and recognition procedures for foreign qualifications. These include nationality and residence requirements for practising, as well as the obligation to pass a local examination or to engage in local practice prior to recognition of the qualification.

Montenegro separates domestic lawyers (who practice national law) from foreign lawyers (who practice their national, international or European law). In both cases, a separate registration with the Bar Association exists.

Attorneys practising domestic Montenegrin law must be registered in the directory of attorneys regulated by the Bar Association. Only citizens of Montenegro (and EU citizens who have been practising law in Montenegro for at least three years and that have passed the Bar exam) can practise domestic law.

Since 2017, EU lawyers can advise on their home country law, the European Union law and the International law without being registered as a foreign lawyer. Third country nationals are bound by the obligation of being registered as foreign lawyers with the Bar Association. Once registered, third country nationals can represent their clients in front of Montenegrin jurisdictions but only jointly with a local attorney who has the right and duty to practise legal profession in Montenegro. Foreign attorneys are also limited in their interaction with the Bar Association as they cannot be elected to its bodies or employ a law trainee. It is only after three years of practice in Montenegro that an attorney entered in the directory of foreign lawyers, can be registered in the directory of foreign attorneys-at-law under the name “attorney” (i.e. full scope of legal practice).

There is no temporary licensing in place. Nevertheless, with the 2017 amendment, some activities may be performed by an attorney from an EU Member State who is not registered in the directory of foreign attorneys-at-law. An attorney from an EU Member State must submit a written notice to the Bar Association of their intention to perform activities and attach a proof of entry in the registry for practising law in their home country, as well as proof of professional liability insurance in the home country.

As regards *restrictions on foreign entry*, local presence is required for cross-border supply of legal services. In order to practise, licensed lawyers must declare an address or a representative who has an address in Montenegro for administrative purposes, especially for receiving correspondence. Commercial association is prohibited between lawyers and other professionals. It is important to note, however, that foreign lawyers who establish a limited liability company in Montenegro may provide consultancy services and they can co-operate with other professionals as they don’t have the status of law firms.

In the area of *barriers to competition*, the Bar Association of Montenegro regulates all attorneys’ tariffs, which is considered as a restriction to competition in the legal sector. Registered lawyers are forbidden to advertise – these restrictions further undermine the STRI score.

**Commercial banking** (ISIC divisions 64-66) is defined as deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of dynamic economies; they provide financing for investment and trade across productive activities, and thus underly all value chains.

The 2020 scores for all OECD member states and STRI partners in the commercial banking sector range between 0.131 and 0.517. The WB6 average is 0.239, above the EU (0.180) and OECD (0.205) averages. With a score of 0.254, Montenegro is the third least restrictive of the WB6 economies for this services sector (Box 23.6).

Montenegro applies restrictions on cross-border mergers and acquisitions. A legal person may not acquire a qualifying holding in a bank without the prior approval of the Central Bank. Those who hold a qualifying participation in a bank may not increase their participation in the capital or voting rights in the bank to reach over 20%, 33% or 50% of the voting rights or capital of the bank, without the prior approval of the Central Bank. A foreign bank may open a representative office in Montenegro but this office may not deal with the bank's affairs. Only a commercial presence has this capacity. The criteria to obtain a licence are more stringent for foreign companies. The foreign bank must provide numerous documents proving that they have a credit rating of at least an A and that the deposit protection system in the origin country has at least the same level of protection as the Montenegrin deposit protection system. The legislation does not state

that applicants must be informed of the reason for denial of licences, an omission which further damages the STRI score.

In the area of *barriers to competition,* Montenegro's risk-weighting methodology is still not fully aligned with Basel Committee on Banking Supervision (BCBS) standards. According to its 2020 policy, the Central Bank will adopt and monitor the implementation of a comprehensive set of secondary legislation enabling the application of the Law on Credit Institutions, aimed at full execution of Basel III requirements,[45] and recent amendments to relevant EU regulations (CRD V and CRR2). The law will enter into force in January 2022.[46] Contractual and default interest rates, as well as interest rates on deposits, are regulated. The bank is obliged to calculate and report active effective interest rates on loans and effective passive interest rates on deposits received and to inform clients and the public about the amount of effective interest rates in a format determined by a Central Bank regulation.

**Insurance services** (ISIC Rev 4 code 651 and 652) comprise life insurance, property and casualty insurance, reinsurance and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.104 and 0.565. With a score of 0.149, Montenegro is the second least restrictive of the WB6 economies for the insurance services sector, scoring below the EU (0.175), OECD (0.193) and WB6 (0.231) averages (Box 23.6).

Restrictions on the *movement of people* are applied through licence requirements. Criteria to obtain a licence are more stringent for foreign companies. Foreign affiliates are subject to a list of additional submissions including a report on the last three years of operations, audit reports on the financial statements for the previous business year, the opinion of the home country's supervisory authority on the applicant's business and approval to establish the affiliate in Montenegro, among others.

There are also *restrictions on foreign entry*. The regulatory body will reject the request from a foreign company if insurance companies based in Montenegro are prevented from performing insurance business under the same conditions as insurance companies in that state. Under the STRI guidelines, this measure is marked as reciprocity based and is therefore restrictive.

**Construction services** (ISIC Rev 4 codes 41 and 42) cover the construction of buildings (residential and non-residential) as well as construction work for civil engineering. **Architecture services** and related technical consultancy (ISIC Rev 4 code 711) constitute the backbone of the construction sector, with key roles in building design and urban planning. **Engineering services** (ISIC Rev 4 code 711) cover several related activities, such as engineering and integrated engineering services, and engineering related scientific and technical consulting services.

An important feature is the regulatory complementarity between architectural, engineering and construction services. Often, architectural and engineering activities are combined in projects proposed by a single firm, and are sometimes subsumed within the building and construction sector. The scope of the STRI definition for architectural services includes several related activities, such as architectural consulting and pre-design services, architectural design, contract administration services, and urban planning and landscape architecture services. Engineering services are the backbone of construction and procurement. Engineers are involved in the construction of key infrastructure, such as buildings and roads. They also play an important role in the development of production processes and the adoption of new technologies. Finally, construction services have historically played an important role in the functioning of economies, providing the infrastructure for other industries. These services account for a significant share of GDP and employment in most economies. Public works, such as roads and public buildings, account for about half of the construction services market. Therefore, the STRI for construction services covers detailed information on public procurement procedures.

The 2020 scores for construction services for all OECD member states and STRI partners range between 0.123 and 0.464, while the WB6 average is 0.242. Montenegro (0.209) is the third-least restrictive of the WB6 economies for the construction services sector, scoring lower than the OECD (0.222) and WB6 (0.242) averages, but higher than the EU average (0.207) (Box 23.6).

The 2020 scores for the architecture sector for all OECD member states and STRI partners range between 0.113 to 0.684. With a score of 0.298, Montenegro is the most restrictive of the WB6 economies in this sector. It is more restrictive than the EU (0.260), OECD (0.244) and WB6 (0.265) averages. Finally, the 2020 scores in engineering for all OECD member states and STRI partners range between 0.118 and 0.575. Montenegro (0.203) is the second-least restrictive of the WB6 economies in this sector, scoring below the EU (0.245), OECD (0.233) and WB6 (0.244) averages.

For all three sectors, *restrictions on the movement of people* are present in the form of licensing requirements which need to be respected in order to provide engineering services in Montenegro. Since 2017, a foreign entity from an EEA Member State in possession of an authorisation from its economy of origin can operate in Montenegro provided that the authorisation is related to the activity governed by the law. A foreign entity from a non-EEA Member State may also perform activities in compliance with the law governing the recognition of foreign qualifications under the principle of reciprocity. Foreign construction engineers are required to take a local examination. For architecture and engineering, a temporary licence can be issued for up to one year, which is a restrictive measure in this sector.

On the positive side, Montenegro has a procedure for recognising foreign qualifications. In the process of issuing a licence to a foreign certified engineer, foreign educational qualifications are checked according to the law on recognition of foreign qualifications.

**Computer services** (ISIC Rev 4 codes 62 and 63) include computer programming, consultancy and related activities, and information service activities. The 2020 scores for all OECD member states and STRI partners range between 0.123 and 0.448. With a score of 0.249, Montenegro is the third least restrictive of the WB6 economies, scoring above the EU (0.211), OECD (0.221) and WB6 (0.239) averages. This sector is very rarely regulated by sectoral legislation. Montenegro subjects computer services to general laws that apply to the economy as a whole. This is why restrictions on the movement of people account for one-third of the total scores in computer services (Box 23.6).

**Telecommunication services** (ISIC Rev 4 codes 611 and 612) cover all wired and wireless telecommunications activities. These services are at the core of the information society and provide the network over which other services including computer services, audio-visual services, professional services and many more are traded. The 2020 scores for all OECD member states and STRI partners range between 0.108 and 0.682. Montenegro is in the high bracket for the restrictiveness of its telecoms sector with a score of 0.159, which makes it the second-most restrictive of the WB6 economies. It scores above the EU average (0.151) but below the OECD (0.188) and WB6 (0.231) averages (Box 23.6).

The STRI participant economies' results in the telecommunications sector are usually driven by two policy areas: 1) restrictions on the entry of foreigners; and 2) barriers to competition. In all OECD member states, barriers to competition account for 30% of the total STRI scores in the sector. This reflects the particular characteristics of the sector as well as the policy environment in which it operates. It is a capital-intensive network industry and its strategic importance has led many economies to restrict foreign investment and activity in the sector.

In order to ensure fair competition in the telecommunications market, Montenegro has an independent telecommunications regulator, the Agency for Electronic Communications and Postal Services (EKIP), which is separate from stakeholders and the government and operates without state intervention. EKIP has sufficient regulatory powers to regulate the sector effectively through *ex ante* regulations applied in accordance with EU precepts. These ensure that no single operator with significant market power (SMP) in certain market segments (inevitable in certain cases) is bound by appropriate pro-competition

regulations. *Ex ante* regulations are based on regular market analysis and are readily available on the EKIP website. The government does not maintain any state-owned enterprise (SOE) in this sector. Montenegro applies a "use-it-or-lose-it" policy to frequency bands[47] - an important measure that prevents incumbent operators from monopolising valuable frequency licences, as well as free tradable spectrum and telecom services.

In absolute terms, the regulatory framework of Montenegro's telecommunications sector is competitive. It is only constrained by economy-wide measures, most notably on the movement of people. Although telecommunications lend themselves easily to cross-border trade from a technical point of view, restrictions on the movement of people account for a modest share of the total STRI score in this sector. Cumbersome procedures for obtaining visas and registering companies negatively affect the sector to some extent as well.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring about significant gains for businesses, driving firms' process innovation. In addition, it enlarges businesses' market scope, reduces operational costs at various stages of business activities and facilitates market access, thus intensifying competition (OECD, 2013[55]). E-commerce also benefits consumers by providing information on goods and services, helping consumers identify sellers and compare prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[55]).

In the context of the COVID-19 pandemic, e-commerce appears to have been essential for maintaining trade flows despite the restrictions put in place to preserve public health (OECD, 2020[56]). Buying online rather than in person also reduces the risk of infection. Being able to keep selling in locked-down economies preserves jobs despite social distancing and movement restrictions. Finally, e-commerce increases the acceptance of prolonged physical distancing among the population and allows them to maintain a certain level of consumption. It is sure that 2020 will be a turning point in electronic commerce. This digital transformation underlines the importance of adopting a more holistic approach to policies as well as increasing international co-operation (Ferencz, 2019[57]); (OECD, 2020[58]).

This sub-dimension assesses those policies which are implemented in parallel and in addition to those discussed under Digital society (Dimension 10). However, it is mainly focused on the trade in digitally enabled services given the rapid growth of trade in services in the region.

Modern e-commerce regulations should focus on a number of key elements, such as electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property regulations, and intermediary liability. On the other hand, an attractive regulatory environment should refrain from maintaining disproportionately restrictive measures, such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows.

Quantitative data show that e-commerce is developing rapidly in Montenegro. In 2019, 99.3% of Montenegro's businesses had access to the Internet; 83.6% of these connected enterprises had a business website. The Statistical Office of Montenegro (MONSTAT) reports that 26.9% of companies receive orders via the Internet and around 26.7% place their orders online (MONSTAT, 2019[59]). Montenegro is a regional leader in global competitiveness in the field of ICT; revenue in the e-commerce market is projected to grow in the coming years to achieve a peak annual growth rate of 13.7% by 2025.[48] However, the share of consumers buying online is still lower than in EU Member States. This gap is likely to narrow in the coming years as a result of the structural changes to the economy caused by the COVID-19 crisis. The majority of companies in Montenegro switched to electronic trade during the lockdown.

There have been no substantive changes to **the e-Commerce policy framework** since the last assessment cycle. Montenegro has an enabling regulatory environment for e-commerce. The Montenegrin Law on Electronic Commerce adopted in 2004 (with subsequent amendments in 2010, 2011 and 2013), regulates e-commerce services and provides legal certainty for businesses and consumers in this area. The law is largely aligned with EU *acquis* and the EU Directive on e-Commerce.[49] Regulations related to e-commerce fall under the competence of several institutions. The Ministry of Public Administration is responsible for adopting the law; the Ministry of Economic Development helps implement it in relevant areas of trading and business good practices; and its implementation is supervised by inspectors for information society services.

In practice, however, according to the authorities themselves, co-ordination mechanisms are lacking and programme planning is poor, leading to inadequate monitoring and evaluation for effective policy revision. To mitigate these issues, the Ministry for Public Administration will propose a new strategy for digital transformation for the period 2021-25. Relevant e-commerce indicators were identified in the Strategy for the Information Society Development for Digital Business 2020, which outlines strategic development tools with a view to reaching the EU standards set out in the Digital Agenda 2020 and the Digital Single Market Strategy.

The OECD digital STRI captures **the restrictiveness of digitally enabled services** by identifying cross-cutting barriers that inhibit or completely prevent firms from supplying services using digital networks, irrespective of the sector in which they operate. The regulatory data underlying the digital STRI were extracted from the OECD STRI database and from data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. Digital STRI scoring uses a binary system: scores are assigned a value of 0 when there are no trade restrictions and a value of 1 when full restrictions are in place. The rating takes into account the specific regulatory and market characteristics as well as the links and hierarchies among regulatory measures affecting digitally enabled services (Ferencz, 2019[57]); (OECD, 2020[58]).

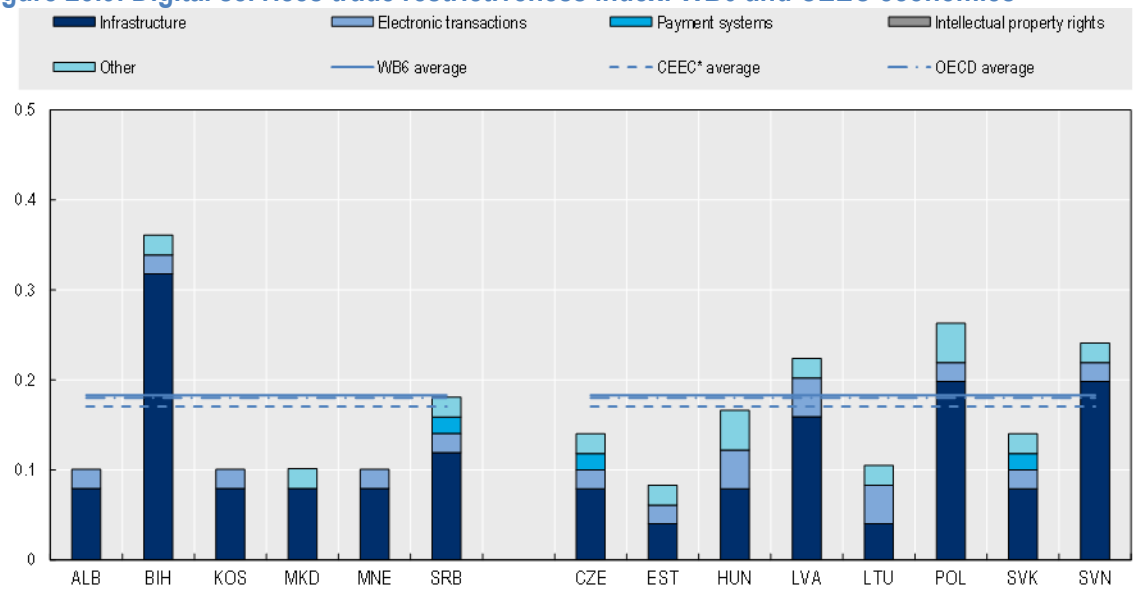
The 2020 digital STRI scores for all OECD and partner states in this sector are moderate to high, ranging from 0.043 to 0.488, and with an average of 0.183. Montenegro is in the lower bracket for the restrictiveness of its digital sector, with an overall score of 0.101. This reflects, among other things, the complete absence of restrictions in some of the categories analysed by the OECD Digital STRI as displayed in Figure 23.9.

The digital STRI scores across OECD countries are regularly driven by infrastructure and connectivity measures. This is usually the consequence of the lack of effective telecoms infrastructure regulations, especially in the area of interconnection. However, this is not a limitation in Montenegro, which benefits from regulations that are relatively well aligned with international good practice and are not excessively restrictive. Similarly, although Montenegro has stricter rules than the OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data (OECD, 2013[60]) in this area, it does not impose overly burdensome conditions on cross-border data flows, beyond those put in place to ensure the protection and security of personal data. However, like 11 other digital STRI economies, Montenegro requires some types of data to be stored locally, though this is mitigated by allowing the transfer of copies abroad as long as the Montenegrin authorities can have direct access to the data upon request.

No specific licences or authorisations for e-commerce activities are required, other than normal commercial licences. This eases the establishment of electronically enabled services and makes the economy all the more attractive to foreign suppliers. International standards for electronic contracts and key electronic authentication measures such as recognition of electronic signatures are generally in place.

Montenegro is open in the categories of intellectual property rights and payment systems from a regulatory point of view. The regulations in place do not treat foreigners less favourably than nationals in terms of intellectual property protection.

## Figure 23.9. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states nor OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[49]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934255931

### *The way forward for trade policy*

Despite some important steps taken to improve the trade policy framework, especially in the area of public consultations, the Government of Montenegro could improve its decision making further by paying attention to the following:

- **Adopt a system for evaluating regulatory frameworks by implementing public consultation standards.** A comprehensive system for review, based on both qualitative indicators (e.g. broadness of consultation, stakeholder satisfaction with their involvement) and quantitative indicators (e.g. frequency of consultations), would help to measure the success of reforms and allow for the adjustment of consultation frameworks where necessary.
- **Enforce the effective application of regulatory impact analysis.** Despite the existence of a well-developed procedure for RIA, its implementation can be improved. The analysis of the impact of legislative proposals could be more comprehensive. The government needs to build line ministries' capacity to undertake impact assessments and to evaluate the effects of legislative proposals, especially for trade-related matters.
- **Further enhance the existing process for evaluating the Public-Private Consultation frameworks**. There is a need to sustain and deepen the current process of regular review of consultation frameworks. The Ministry of Public Administration, Digital Society and Media already collects the necessary statistics on the established objectives of effectiveness, efficiency, inclusion and transparency. Its efforts should now be focused on harmonising and systematising evaluation as well as developing performance indicators that measure the degree of openness and transparency of consultations. In doing so, Montenegro can draw inspiration from the United Kingdom's guidelines on PPCs (Box 23.5). Ideally, a monitoring programme with an adequate budget and office independent from the government could be introduced to allow for systematic evaluations. In addition, training could be provided in the use of various quantitative and qualitative approaches to measure compliance with the minimum standards set by regulatory frameworks for

public consultations. Moreover, the increased participation of the business community in the consultation process demonstrates a potential to be exploited in Montenegro to improve the process. Montenegro should follow the example of the stakeholder involvement in the European Commission policy cycle (Box 23.6) to develop a feedback mechanism to improve its consultations.

- **Broaden trade in services efforts beyond regional trade agreements**. Significant improvements have been made among the WB economies to open services trade through the conclusion of CEFTA Additional Protocol 6 in December 2019. Nonetheless, the STRI analysis in this section has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness.
- **Lift some of the stringent restrictions on services in trade**:
  - **Ease conditions on the temporary movement of natural persons** by removing the remaining quotas and labour market tests which apply to foreign services suppliers. This would further encourage innovation and knowledge transfer, and contribute to economic growth.
  - **Reduce the remaining barriers to market entry and competition** in the courier sector (Box 23.4) as well as the legal and architecture services sectors, and make further efforts to increase competitiveness.
  - **Lift the requirement for third-country foreign architecture service providers to completely re-take their university degree.**
  - **Amend the preferential subsidy treatment** for the designated postal provider in the courier sector.
  - **Amend the prohibition of commercial association between lawyers and professionals**, along with the local presence requirement which states that licensed lawyers must declare an address or a representative who has an address in Montenegro in order to practise in the economy.
- **Strengthen the regulatory framework for e-commerce** by creating co-ordination mechanisms and strengthening programme planning in order to establish an effective monitoring and evaluation process to improve policy revision. A first step could be to review and assess the impact of previously implemented programmes on the digitisation of Montenegrin businesses in order to identify gaps in the design of regulatory measures governing e-commerce. A set of indicators for private sector ICT take-up, including e-commerce, should be developed and regularly monitored.

### Box 23.5. Consultation guidelines in the United Kingdom

The United Kingdom's 2008 Code of Practice is a good example of how a government can provide its civil servants with a powerful tool to improve the consultation process and its review, even though it is not legally binding and only applies to formal, written consultations. The 16-page Code of Practice is divided into 7 criteria, to be followed for every consultation:

- Criterion 1: When to consult. Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- Criterion 2: Duration of consultation exercises. Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- Criterion 3: Clarity of scope and impact. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- Criterion 4: Accessibility of consultation exercises. Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

- Criterion 5: The burden of consultation. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- Criterion 6: Responsiveness of consultation exercises. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- Criterion 7: Capacity to consult. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

The Code of Practice was replaced with the much shorter "Consultation Principles" in 2012. The Consultation Principles highlight the need to pay specific attention to proportionality (adjusting the type and scale of consultation to the potential impacts of the proposals or decision being taken) and to achieve real engagement rather than merely following a bureaucratic process.

Source: (UK Government, 2008[61]), *Code of practice on consultation*, www.bis.gov.uk/files/file47158.pdf; (UK Government, 2016[62]), *Consultation principles 2016*, www.gov.uk/government/uploads/system/uploads/attachment_data/file/492132/2 0160111_Consultation_principles_final.pdf.

### Box 23.6. Stakeholder engagement throughout the policy cycle at the European Commission

Following the adoption of the 2015 Better Regulation Guidelines, the European Commission has extended its range of consultation methods to enable stakeholders to express their views over the entire lifecycle of a policy. It uses a variety of different tools to engage with stakeholders at different points in the policy process. Feedback and consultation input is taken into account by the Commission when further developing the legislative proposal or delegated/implementing act, and when evaluating existing regulation.

At the initial stage of policy development, the public has the possibility to provide feedback on the Commission's policy plans through roadmaps and inception impact assessments (IIA), including data and information they may possess on all aspects of the intended initiative and impact assessment. Feedback is taken into account by the Commission services when further developing the policy proposal. The feedback period for roadmaps and IIAs is four weeks.

As a second step, a consultation strategy is prepared setting out consultation objectives, targeted stakeholders and the consultation activities for each initiative. For most major policy initiatives, a 12-week public consultation is conducted through the website "Your voice in Europe" and may be accompanied by other consultation methods. The consultation activities allow stakeholders to express their views on key aspects of the proposal and main elements of the impact assessment under preparation.

Stakeholders can provide feedback to the Commission on its proposals and their accompanying final impact assessments once they are adopted by the College. Stakeholder feedback is presented to the European Parliament and Council and aims to feed into the further legislative process. The consultation period for adopted proposals is eight weeks. Draft delegated acts and important implementing acts are also published for stakeholder feedback on the European Commission's website for a period of four weeks. At the end of the consultation, an overall synopsis report should be drawn up covering the results of the different consultation activities that took place.

Finally, the Commission also consults stakeholders as part of the *ex post* evaluation of existing EU regulation. This includes feedback on evaluation roadmaps to review existing initiatives, public

consultations on evaluations of individual regulations and “fitness checks” (i.e. comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose). In addition, stakeholders can provide their views on existing EU regulation at any time on the website “Lighten the load – Have your say”.

Source: (OECD, 2017[63]), *OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy* (draft), www.oecd.org/gov/regulatory-policy/public-consultation-best-practice-principles-on-stakeholder-engagement.htm; (OECD, 2016[64]), *Pilot database on stakeholder engagement practices in regulatory policy. Second set of practice examples*; (EC, 2015[65]), *Better Regulation Guidelines*, https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

## Access to finance (Dimension 3)

### *Introduction*

With an overall score of 2.7, Montenegro is the WB6's second-best performer (after Serbia) for access to finance (Table 23.6). Montenegro has increased its score by 0.5 since the previous assessment (Figure 23.1), reflecting changes in the legal framework.

**Table 23.6. Montenegro's scores for access to finance**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Access to finance dimension** | Sub-dimension 3.1: Access to bank finance | 3.1 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 2.1 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 3.5 | 2.8 |
| **Montenegro's overall score** | | **2.7** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

Montenegro's financial sector is bank-dominated, with the banking sector accounting for around 92% of total assets in the financial sector, followed by insurance companies (5%). Between 2010 and 2019, the cumulative market share of the top three banks dropped from 57% to 42%, reflecting an increase in competition in the banking sector. As of January 2020, six domestic and seven foreign banks were operating in the economy. In 2019, two domestic banks declared bankruptcy, initiated by the Central Bank of Montenegro. An external, independent review of the asset quality of all 13 banks started in February 2020, with a view to strengthening stability and confidence in the banking system. The review is expected to be concluded in 2021 (EC, 2020[66]).

Montenegro benefits from a well-established **legal and regulatory framework for the banking industry**. The banking law, most recently amended in November 2017, governs the foundation, management, operations and supervision of banks operating in Montenegro. Basel II[50] recommendations have been fully implemented. The law does not impose any barriers to the entry and operation of foreign banks. The conditions to obtain a licence from the Central Bank of Montenegro are the same for both domestic and foreign banks.

In December 2019, the law on the resolution of credit institutions and the law on credit institutions were finalised under the supervision of the Central Bank of Montenegro. By improving the minimum capital requirements, as well as the leverage and the liquidity coverage ratios for the banking industry, the laws aim to bring Montenegro's regulatory framework in line with Basel III core principles. Although they were planned to enter in force in January 2021, difficulties caused by COVID-19 has postponed implementation until January 2022 following the request of the Association of Montenegrin Banks.

The law on credit institutions applies uniformly to all credit institutions as recommended by the European Banking Authority,[51] and has the same approach regardless of the size of business. As Montenegro is a euroized economy, no special capital requirements exist for foreign exchange or for the mandatory disclosure of the risk of foreign exchange borrowing.

A functional **cadastre and registration system** is in place and the information is available on the Real Estate Administration's (REA) website. There are three types of cadastral records: 1) registry cadastre; 2) land cadastre; and 3) real estate cadastre. As in the previous assessment, the ownership of the pledges of registered assets (fixed and non-fixed) remains largely documented (75%) and covers 100% of the urban territory.

**Collateral requirements** remain strict and high, rendering access to bank loans challenging for businesses in Montenegro. Around 60% of loans require collateral in Montenegro, close to the OECD average (58%). However, 209% of the borrowed amount is required as collateral in Montenegro, compared to an average of 88% in the OECD economies (World Bank, 2019[20]). The Montenegrin legal framework allows secured creditors to create and enforce their rights over non-fixed assets such as securities, movable assets and stocks; however, real estate and land remain the most common collateral for loans. Moreover, there is no limitation in terms of threshold regulation under which collaterals are flexible for small business, and banks can adopt their own policies, potentially limiting smaller firms access to liquidity without immovable collaterals.

Montenegro lacks a national credit guarantee scheme for **credit enhancement and risk mitigation.** However, in March 2019 the Investment Development Fund (IDF) of Montenegro signed an agreement worth EUR 75 million with the European Investment Fund under the COSME Loan Guarantee Facility programme to improve the access to finance for micro and small enterprises. The programme aims to support entrepreneurs who are unable to provide adequate collateral. It foresees subsidising interest rates for SMEs with an average value of 3%, compared to the average 5% interest rates applied by commercial banks. SMEs have been able to benefit from the programme since mid-2020.

Moreover, to mitigate the effects of the COVID-19 pandemic, the government has created a new credit line under the IDF to improve the liquidity of SMEs up to a maximum amount of EUR 3 million per beneficiary. SMEs can apply through a simplified procedure with no approval fee and an interest rate of 1.5%. In addition, in January 2021 the government introduced an interest rate subsidy with a 12-month grace period for firms operating in the agriculture sector.

One public credit registry exists in Montenegro under the supervision of the Central Bank. It includes both positive and negative **credit information** on borrowers, and is accessible to financial institutions and the public upon motivated requests. In addition to daily updates on information collected by the credit registry for newly issued loans, coverage increased from 38.8% in 2018 to 41% of the adult population in 2019 (World Bank, 2019[22]). The law on data protection provides for comprehensive consumer rights on the use of personal data and allows users to correct mistakes in credit reports. However, the law does not stipulate a minimum time limit for data storage.

### *Sub-dimension 3.2: Access to alternative financing sources*

The legal and regulatory framework to support **factoring and leasing** is improving; however, the use of these options is very limited: their combined share in the total financial sector assets represents around 0.9%. According to the latest available data from the Central Bank, factoring volume decreased from EUR 3.3 million to EUR 1 million between 2011 and 2019. This is directly linked to the change of the law in 2018 (see below), which meant that only one company could obtain a work licene. By contrast, the volume of leasing increased from EUR 1.6 million to EUR 40.3 million between 2011 and 2019.

The Law on Financial Leasing, Factoring, Purchase of Receivables, Micro-credit and Credit-guarantee Operations took effect in May 2018. It provides the framework for factoring and leasing activities, and assigns the Central Bank the supervisory role. For the first time in Montenegro,[52] the law regulates factoring and purchase of receivables. Financial leasing was previously partially covered under the Law on Banks adopted in 2011 and now benefits from a more comprehensive dedicated regulation under the new law. Overall, the new law significantly improves these activities and aligns the regulatory framework with international standards (Rosca, 2017[67]). Another novelty is that following the recent extension to the regulatory framework, factoring and leasing are supervised by the Central Bank of Montenegro. Previously factoring companies were only obliged to report to the tax administration. Since Q1 2019, licensed firms have started to report to the central bank quarterly.

There is no clear definition of **venture capital** activities in Montenegro; however, the regulatory frameworks allow these activities to be established as specialised investment funds, regulated by the law on investment

funds adopted in 2018. The law contains basic provisions, such as rules on the method for determining net asset value, and detailed requirements for investors. However, the lack of a regulation covering seed and early investors limits the development of venture capital activities in Montenegro. According to a government statement, a law on alternative investment funds is planned to be drafted by the capital market authority. However, no clear timeline could be identified. The Enterprise Innovation Fund (ENIF), which is a stand-alone venture capital fund covering the Western Balkans region, has invested in two start-ups at the seed stage – Uhura (EUR 400 000) and Om3ga solutions (Daktilograf) (EUR 30 000) – since 2014.

**Business angel networks** have recently started operating in the economy; however, there is no legal definition. Montenegro recorded a total of 13 investments in 2018 and 2019 by one active network, with a respective value of EUR 1.5 million and EUR 2.1 million (EBAN, 2019[68]).

There is no dedicated law or body that governs **crowdfunding** activities**.** Crowdfunding is regulated by several laws;[53] however, none provide the mandatory form of the contract between parties, allowing it to be concluded at all parties' own risk. As a result, crowdfunding in Montenegro is based solely on the goodwill of donors without any obligation of the applicant towards the donors. In 2019 a total of EUR 300 000 was raised through crowdfunding, a substantial increase on 2017 when only EUR 4 000 was raised. This indicates a moderately increasing level of confidence on the part of investors in crowdfunding. According to the government, an action plan (CrowdStream) is planned under the Danube Transnational Programme to draft and implement a crowdfunding law by 2024. Box 23.7 illustrates how clear laws in Lithuania have helped boost the crowdfunding sector.

**Initial coin offering** (ICO) based on blockchain technology is in the incipient phases of development, while the use of cryptocurrencies is allowed in Montenegro. The Capital Market Authority (CMA) – a financial services commission and an independent regulatory agency – has organised several cycles of education on the use of blockchain technology in the financial market and in public administration in order to explore the possibilities of its applications in both sectors. In addition, the government has reported that the CMA is working on the regulatory framework for Securities Token Offerings,[54] but has not specified the timeline.

### Box 23.7. Lithuania's crowdfunding legislation

While Lithuania's crowdfunding market is smaller than other European fintech hubs, the economy is only one of 11 EU member states with dedicated national legislation for crowdfunding platforms and boasts a mature and comprehensive regulatory framework for crowdfunding. Although its crowdfunding is in its infancy, Lithuania currently has 15 registered crowdfunding platforms. There has been a positive increase in the total value of crowdfunding platform loan portfolios, from EUR 6.6 million in 2019 to EUR 9.13 million in the first half of 2020 (Bank of Lithuania, 2020).

Lithuania adopted its Law on Crowdfunding in 2016 with the aim of providing a hospitable, clear and transparent setting for cross-border crowdfunding platforms. The law adopted all aspects of the European Commission's Regulation for European Crowdfunding Service Providers, allowing for a seamless transition once the EU Directive comes into force (EC, 2018[69]). It was established through a multiple stakeholder consultation process and provides protection and guarantees for investors through information disclosure obligations, governance rules, risk management and a coherent supervision mechanism. The law covers equity, real-estate, and debt-based crowdfunding models, while donation and rewards models continue to fall under the Civil Code of the Republic of Lithuania.

Transparency regulations for crowdfunding platforms help mitigate misinformation and legal risk to better protect investors. Therefore, platforms must be included on the Public List of Crowdfunding Platform Operators, subject to an efficient reliability assessment conducted by the Bank of Lithuania's supervisory authority within 30 days. Platform operators, board members and significant stakeholders

also undergo a criminal record check, while platforms must instate measures to avoid, identify and address any conflicts of interest that would prejudicially benefit the funder or project owner.

In addition to the EUR 40 000 minimum capital requirement, platform owners are required to put up 10% of starting capital themselves. In the case of offerings between EUR 100 000 and EUR 5 million, platform operators are obligated to publish a light prospectus, while offerings over EUR 5 million require a full prospectus detailing the project and project owner characteristics, proportion of own funds used, details of the offering, security measures, and existence of secondary markets.

In all cases, Lithuania's crowdfunding regulations require platforms to publish wide-ranging information on their websites for investors including data on the company, risks associated with investment, project selection criteria, conditions and procedures for repayment of funds, disclaimers on tax and insurance information, as well as monthly and yearly progress reports.

Meanwhile, Lithuania is continuously improving its innovative business environment to give financial institutions and crowdfunding platforms more investment opportunities. In 2016, the economy began allowing the use of remote identity verification via qualified electronic signatures and video streaming/transmission and is harmonising itself with the EU regulation on electronic identification. Lithuania has also recently amended its Law on the Legal Status of Aliens to include an e-residency programme, allowing foreigners to set up companies, open bank accounts and declare taxes through digital identification, furthering financing opportunities for its fintech platforms.

Source: (EC, 2017[70]), *Final Report on Identifying market and regulatory obstacles to cross border development of crowdfunding in the EU*, https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf; (Bank of Lithuania, 2019[71]), *Consumer Credit Market Review*, URL; (Bank of Lithuania, 2020[72]), *List of Crowdfunding Platform Operators*, https://www.lb.lt/lt/finansu-rinku-dalyviai?list=36.

### *Sub-dimension 3.3: Mobilisation of long-term financing*

**Public-private partnerships** (PPPs) are regulated by the law on public-private partnership adopted in December 2019. The implementing regulations accompanying the law were prepared in co-operation with OECD SIGMA (Support for Improvement in Governance and Management) and for the first time will regulate the implementation of PPP projects. Previously, PPPs were regulated by several pieces of legislation. The legal framework regulates several factors of major importance for PPP projects:

- It identifies areas in which PPPs can be developed, as well as implementation models that fall under PPP structures, such as build-operate-transfer and design-build-operate models.
- It clearly describes investors' rights, such as the right to reimburse the invested funds, conditions of return of the invested capital to a private partner and settlements in case of disputes.

Between 2015 and 2020, several projects were implemented through PPPs, including two student dormitories in Podgorica and Nikšić, several infrastructure projects in the field of energy and two wind farm projects in Možura and Krnovo. The wind farm in Krnovo is the first large-scale PPP project for the production of electricity in Montenegro.

When it comes to capital markets, the Montenegro Stock Exchange (MNSE) located in Podgorica is the only stock exchange operating in Montenegro.[55] In September 2020, MNSE's total turnover was EUR 6 million, 89% lower than in September 2019. Overall, market capitalisation of MNSE remains illiquid, with a turnover ratio of 1% in 2019 against 3% in 2017. No initial public offering (IPOs) occurred between 2010-19, while five secondary public offerings were issued over the same period, for a total value of EUR 23.8 million.

Some progress has been made in the regulatory framework to facilitate **access to capital markets** since the last assessment. The law on investment and the law on voluntary pension funds, both amended in 2018, govern **institutional investors**. The CMA is the supervision authority, and acts as an independent

regulatory body accountable to the Parliament of Montenegro. The legal framework is moderately comprehensive and covers situations under which institutional investors should exercise their voting rights, prevention of conflict of interest and transparency of fees.

The CMA has adopted extensive secondary legislation related to the law on capital markets and the law on investment funds, which provide for partial alignment with the EU *acquis* concerning markets in financial instruments, securities, investment funds, prospectuses and capital markets (EC, 2019[73]). It also regulates insider trading and market manipulation. The law on capital markets details how listed companies should submit their financial reports to the CMA on a quarterly basis. All submitted reports are publicly available on the CMA website. Requirements for listing are also prescribed in article 50-93; however, as described above the stock market is static, with no IPOs.

In 2016, Montenegro applied to be part of the SEE Link project. This cross-border initiative aims to integrate regional equities markets without merger or corporate integration, using only technology that will enable participating stock exchanges to remain independent yet complementary and to allow investors an easier and more efficient approach to those markets through a local broker, for more information see Access to Finance (Dimension 3) regional chapter (SEE LINK, 2020[74]). However, as the potential benefits were not clear, the Stock Exchange has decided to stop the process of joining the SEE Link.

The main client categories of Montenegro's **asset management** industry are insurance companies, investment funds and pension funds. The top five asset management firms' total assets under management represented EUR 28.5 million in 2019. **Bond markets** are the main asset allocations preferred by pension funds; however, they are not fully developed yet. Government-issued bonds represent 0.35% of GDP in 2019, while private sector issued bonds were considerably lower (0.16% of GDP). The functioning of bond market is regulated by the capital market law under the supervision of the CMA. Information on the maturity, liquidation preferences, coupon rates and tax status is clearly indicated on Montenegro's stock exchange website.[56] The government does not provide any subsidies to increase the attraction of bond markets; nor does it apply specific rules to facilitate the use of corporate bond markets by smaller issuers.

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finance, policy makers should:

- **Continue efforts to align Montenegro's banking regulations with international standards**. The economic shock caused by the COVID-19 pandemic means the need for resilience in the banking sector to absorb shocks has become even more vital. Regularly monitoring regulations and revising them in line with internationally agreed norms would further enhance Montenegro's banking sector capacity.
- **Extend and simplify the provision of loan guarantees** to enable commercial banks to expand lending to SMEs. Credit guarantee schemes should be designed to ease liquidity constraints in the post-COVID period. While the introduction of loan subsidies under the Investment Development Fund has been an important step, it does not lower or ease collateral requirements that are limiting access to liquidity for SMEs. Ways forward could be to introduce fair pricing of the guarantees and to impose caps on the level of collateralisation for guaranteed loans, with longer repayment periods for sectors in difficulties.
- **Enhance credit information**. Montenegro should consider expanding the coverage and granularity of the credit information system by incorporating information from retailers and utilities. This will enable smaller companies without a decent credit history to access finance. Economies lacking a private credit information system typically tend to have lower coverage than those with private credit bureaus or hybrid systems. Creating a private credit information system in Montenegro would expand the coverage of the adult population.

- **Continue efforts to diversify financing sources**. Adopting dedicated legal frameworks supporting innovative businesses, such as Lithuania's crowdfunding law (Box 23.7), would increase the number of potential financing sources, especially for smaller companies.
- **Increase investor interest by conducting awareness campaigns on the existence of capital markets and the advantages they offer**. Although the capital markets tend to be viewed as a financing tool only for the largest companies, in fact capital market structure can help small and medium-sized companies raise debt and equity capital. Awareness and access could be raised by establishing programmes or digital platforms with informative and interactive tools for SMEs to promote and ease the process of capital market participation (Box 23.8).

### Box 23.8. Awareness-raising campaigns for capital market participation in OECD member states

Awareness-raising campaigns aim to share knowledge and information on the benefits of accessing capital markets for SMEs through informative platforms, public seminars, conferences, IPO summits, and workshops. Increasing awareness of the procedures and advantages of issuing financial products eases the process of issuing stocks or bonds for enterprises and increases the likelihood of SME participation in capital markets. Several OECD member states have already successfully launched initiatives to inform SMEs about the benefits of accessing the capital markets as a financing instrument for their growing businesses.

In 2012, under the National Plan for Financial Education, the Banco de Portugal, the Portuguese Securities Market Commission and the Insurance Institute of Portugal jointly launched the **Todos Contam Portal**, a platform aimed at promoting the financial education of the Portuguese population and new businesses. The portal specifically provides information on access to financing for SMEs through the capital market, highlighting the circumstances under which a new or growing company would benefit from capital market inclusion while informing SMEs of the risks associated with this type of financing.

**The Bolsa Mexicana de Valores** (BMV) has also launched a digital interactive tool to inform SMEs of the costs and benefits of going public by financing through the capital market, and guides businesses through the process of listing their company on the Mexican Stock Exchange. The platform provides information on available financing instruments and equips the user with registration forms, helps with implementing an effective corporate governance model and IFRS, guides businesses through working with brokerage and rating firms, and provides information on maximising sales, promotion of securities and securities maintenance.

Meanwhile, the Spanish National Strategy for Financial Education has established a dedicated website (**Finanzas para Todos)** providing educational tools to better equip entrepreneurs and SMEs with the financial literacy necessary to further their opportunities for growth. The initiative covers the advantages of using capital markets and stock exchanges as a source of financing from both investor and business perspectives. Additionally, the State Agency for SMEs (ENISA) in Spain regularly organises working seminars on the convenience of developing SME access to capital markets with multi-stakeholder participation, including members from academic, private and public sector institutions.

Source: (OECD, 2020[75]), *Capital Market Review of Italy 2020: Creating Growth Opportunities for Italian Companies and Savers*, https://www.oecd.org/corporate/ca/OECD-Capital-Market-Review-Italy.pdf; (OECD, 2020[76]), *OECD Capital Market Review of Portugal 2020: Mobilising Portuguese Capital Markets for Investment and Growth* https://portal.oecd.org/eshare/grs/pc/Deliverables/CO2021/Publication; (Banco de Portugal, 2016[77]), *National Plan for Financial Education*, https://www.todoscontam.pt/pt-pt.

- **Promote the use of infrastructure project bonds**. While PPPs are an efficient tool to finance infrastructure projects, promoting bonds can bring beneficial dynamics to capital markets and enable a more productive use of institutional funds for long-term investments. The government can promote the use of infrastructure project bonds through streamlining issuance and placement procedures, providing clear definitions of "infrastructure" project bonds as well as providing tax incentives (APEC/OECD, 2019[78]). Moreover, although local currency bonds, in particular in developing economies, are often characterised by lower liquidity due to heightened currency risk, Montenegro's euroisation could reverse this tendency.

## Tax policy (Dimension 4)

### *Introduction*

Table 23.7 compares Montenegro's scores on two tax policy sub-dimensions with the average for the WB6 economies. With regard to the first sub-dimension, which relates to the tax policy framework, Montenegro scores below the WB6 average because of its weak performance on the tax expenditure reporting indicator. However, on the second sub-dimension (tax administration), Montenegro scores close to the WB6 average.

**Table 23.7. Montenegro's scores for tax policy**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 2.0 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 3.4 | 3.3 |
| | Sub-dimension 4.3: International tax co-operation | n.a. | n.a. |
| **Montenegro's overall score** | | **2.8** | **3.0** |

Note: For comparability with the previous assessment, the new sub-dimension (4.3) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

**Tax revenues** as a share of the economy are relatively high in Montenegro. In 2019, the tax-to-GDP ratio was 35.7%, which is above both the WB6 (28.3% in 2019) and OECD (33.8% in 2019) averages (OECD, 2020[79]). The tax-to-GDP ratio in Montenegro has remained relatively stable in recent years, having slightly decreased from 36.2% in 2015. In line with other WB6 economies, Montenegro's tax mix relies heavily on taxes on goods and services and social security contributions (SSCs) (Table 23.8). In 2019, taxes on goods and services accounted for 55.8% of all tax revenues (second only to Kosovo in the WB6), which is somewhat higher than the WB6 average of 49.4% (in 2019) and substantially higher than the OECD average of 32.7% (in 2018). SSCs as a share of total tax revenues in Montenegro were 31.8% in 2019, which is in line with the regional average (32.0% in 2019) but above the OECD average (25.7% in 2018). Combined, SSCs and taxes on goods and services account for 87.6% of total tax revenues (OECD, 2020[79]).

Montenegro's reliance on these two taxes far exceeds levels found in OECD countries (58.4% on average in 2018). Consequently, other taxes play a smaller role in Montenegro. For example, **personal income tax (PIT) and corporate income tax (CIT)** combined account for slightly less than one-sixth of all tax revenues (14.5%), compared to about one-third (33.5%) in OECD countries. The reliance on SSCs may make the economy relatively vulnerable to a decline in formal employment or a rise in informal employment. One option could be to rebalance the taxation of labour income away from SSCs and towards PIT, which would increase equity and, if designed properly, efficiency by shifting the tax burden from low incomes to higher incomes. OECD research shows that a relatively higher taxation of PIT would allow for reductions in high employee SSCs and would encourage workers to register in the formal economy. With regards to taxes on goods and service, OECD research has found that consumption taxes and particularly VAT may be less distortive on the decisions of households and firms, and thus on GDP per capita, than income taxes (Johansson et al., 2008[80]).

### Table 23.8. Montenegro's tax revenues as a percentage of GDP

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| Montenegro | 1.5% | 2.6% | 11.3% | 19.9% | 35.7% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 10.9% | 33.8% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions.
Source: (OECD, 2020[81]), *OECD.stat*, https://stats.oecd.org/ (2019 for overall tax/GDP ratio, 2018 for specific tax/GDP ratio).

In terms of **SSCs and PIT rates**, Montenegro levies a 9% CIT rate (Table 23.8), which was the lowest rate of all WB6 economies in 2020 (where the average was 11.5%). The CIT rate is also substantially below the average rate in OECD countries (23.3% in 2020). The low CIT rate results, not surprisingly, in low CIT revenues. In 2019, CIT revenues as a share of GDP were 1.5% (Table 23.8), which is only slightly below the WB6 average (1.8% in 2019), but half the OECD average (3.1% in 2018). Montenegro is currently amending its Law on Corporate Taxation with the aim of strengthening existing anti-base erosion and profit shifting (BEPS) measures in terms of transfer pricing, and is in the process of implementing thin capitalisation rules. Dividend income is excluded from the CIT base, but when dividends are distributed to an individual shareholder, a 9% withholding tax is levied by the distributing company. Capital gains are included in the CIT base.

The PIT is a relatively small tax in Montenegro. It is levied at a flat 9% rate, the lowest PIT rate among WB6 economies. Despite this low rate, PIT revenues accounted for 2.6% of GDP in 2019, which is slightly above the regional average (2.2% for WB6 economies in 2019). However, PIT revenues remain significantly below OECD levels (8.1% of GDP in 2018). Unlike other WB6 economies, Montenegro does not have a basic tax allowance that exempts people with a low income from PIT. The absence of a basic tax allowance might explain Montenegro's above-average PIT revenues compared to WB6 economies despite its below average flat PIT rate. Montenegro carried out a **PIT reform** in 2019, which took effect in 2020. This reform abolished the so-called crisis rate.[57] With regard to the taxation of personal capital income, a 9% withholding tax is levied upon dividend distribution to resident shareholders. Resident individuals are liable for capital gains tax at a rate of 9%.

SSC revenues reached 11.3% of GDP in 2019, which is above the WB6 average (9.3% in 2019) and the OECD (9.0% in 2018). The sum of employee and employer SSC rates was 32.3% in 2020, which is above the OECD average rate (26.9% in 2020), and slightly above the average rate in WB6 (29.4% in 2020). Employees pay SSCs at a rate of 24%, while employers pay SSCs at a rate of 8.3%. These rates are similar to average rates in WB6 economies (19.9% and 9.5% respectively) but atypical by OECD standards. In the OECD, employer SSC rates are higher than employee SSC rates, possibly linked to the fact that PIT rates are higher in the OECD than in the WB6. Self-employed individuals are liable for SSCs at a rate of 34.3%, which is above the WB6 average (29.7% in 2020).

The high SSC rates in Montenegro create a high tax burden on labour income and reduce the incentives for workers to participate in the formal economy, especially low-income and low-skilled workers who earn a relatively low gross salary (OECD, 2018[34]). The high employee SSC rate could be reduced, while the PIT could be made more progressive through the introduction of a progressive PIT rate schedule. This would help to shift the labour income tax burden from low-income workers to those with higher incomes. This in turn would strengthen the tax system's equity and would also be efficient, as it would strengthen the formal labour market and labour supply. Such a reform would require accompanying measures to prevent, for instance, tax-induced incentives for the self-employed to incorporate and turn high-taxed labour income into low-taxed capital income.

In terms of the **design and functioning of VAT and environmentally related taxes**, Montenegro relies heavily on tax revenues from consumption. In 2019, taxes on goods and services as a share of GDP were 19.9%, which is the highest share among the WB6 economies (14% average in 2019). This level of reliance on taxes on goods and services exceeds the 10.9% OECD average (in 2018). With regards to VAT, the

standard rate is levied at 21%, following an increase from 19% in 2016. This rate, the highest of the WB6 economies in 2020, is above the average rate for WB6 (19% in 2020) and OECD (19.3% in 2020). The VAT registration threshold is EUR 18 000, which is lower than other WB6 economies. Montenegro has a reduced 7% rate that applies to specific goods and services, including basic products for human consumption (bread, flour, milk etc.), medicine supplies, public transport services and print media. While VAT is levied on imports at between 0% to 7%, a 0% rate applies to exports, as well as products that are used for offshore oil exploration. Montenegro could consider whether it could broaden its VAT base. As for other consumption taxes, Montenegro levies excise duties on mineral oils, their derivatives and substitutes, as well as on coal. Overall there is significant scope to levy environmental taxes.

Concerning taxation of international business income, Montenegro operates a worldwide taxation system whereby resident companies pay taxes on domestic and foreign-sourced income, and non-resident companies are liable only for taxes on income originating from Montenegro. A worldwide taxation system is currently adopted in all of the WB6 economies. However, such systems are increasingly less common among OECD countries, particularly small open economies.

### Table 23.9. Selected tax rates in Montenegro

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| Montenegro | 9.0% | 9.0% | 32.3% | 21.0% |
| WB6 | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions.
Source: (OECD, 2020[81]), *OECD.stat*, https://stats.oecd.org/ (2020 for CIT and VAT, 2019 for PIT and SSCs).

In terms of **investment tax incentives**, Montenegro operates a mix of both cost and profit-based tax incentives. Companies investing in so-called underdeveloped areas can benefit from profit-based tax incentives (which generally reduce the tax rate for taxable income). These companies are exempt from CIT for an eight-year period, provided the total amount of tax paid without the incentive would not exceed the EUR 200 000 threshold. This exemption also extends to the investors' PIT liability. Companies operating in the transport, agriculture, shipbuilding, steel and fishery sectors cannot benefit from this tax incentive. Similarly, companies investing in underdeveloped areas that are employing new workers for employment contracts of at least five years are exempt from calculating and withholding PIT for a four-year period. Montenegro also operates a few targeted cost-based tax incentives (which generally lower the cost of investments made). For example, expenses directed at environmental protection may be recognised as tax deductible business expenditure, lowering the taxable base up to a maximum of 3.5% of total income. Research shows that cost-based incentives are preferable to profit-based incentives, which risk leading to high redundancy of expenditure since the investment may have proceeded anyway (UNCTAD, 2015[82]). Given its low CIT rate, which already provides a significant investment incentive, Montenegro may wish to re-evaluate the merits of profit-based incentives.

**Tax expenditure reporting** in Montenegro could be strengthened. Currently, the annual tax expenditure report is prepared for internal government use only and is not made public. The measurement of tax expenditures is not disaggregated by item, reported in the budget or under a regular assessment. This prevents Montenegro from linking tax expenditures with other budgetary programmes. To support transparency and accountability, Montenegro should develop regular and systematic tax expenditure reporting. This will allow it to monitor the use and effectiveness of tax incentives along with the tax revenue forgone (OECD, 2010). Recently, other WB6 economies have been making good progress on tax expenditure reporting; Albania prepared a tax expenditure report in 2019, and North Macedonia and Kosovo are currently in the process of doing so.

Montenegro has an aggregated **forecasting model** based on macroeconomic data covering the main types of tax. The forecasting relies on relatively simple calculations, based on the previous year's revenues

adjusted for expected growth rates in certain economic indicators. Revenues are typically forecasted twice a year, with several new initiatives taken into account for the 2020-2021 models. A micro-simulation model has been developed for the PIT, in co-operation with the International Monetary Fund (IMF). It was used for the first time in 2019 for estimating effects of changes to the minimum wage.

### *Sub-dimension 4.2: Tax administration*

Concerning **tax administration functions and organisation**, Montenegro has a unified tax administration responsible for collecting all types of tax, with the exception of VAT on imports, for which the Customs Administration is responsible. The Montenegro Tax Administration (MTA) carries out all the traditional functions except tax fraud investigation, which is conducted by a Special State Prosecutor's office and the police directorate. Its internal organisation mostly involves a functional approach, though a 2016 reform created a Large Taxpayers Office following recommendations by the IMF. The MTA is controlled by the State Audit Institution (SAI) on an annual basis. The SAI produces public recommendations, which in the past have led to significant reforms, such as making the MTA an independent body. MTA agents participate in regular internal and external training, such as the EU programme Fiscalis 2020. The MTA is also part of the Intra-European Organisation of Tax Administration, which also provides regular training.

**Compliance assessment and risk management** are carried out by the Department for Operations in the Field of Inspection Control, assisted by its eight regional offices. The Audit Plan is defined following a risk approach of tax audits. In 2017, a law created the Division for Risk Analysis. Montenegro is currently in co-operation with the IMF to develop a plan for managing compliance with tax regulations, which will be implemented in 2023.

In terms of **independence and transparency**, Montenegro took a step forward in January 2019 as the MTA became an independent body (it was previously integrated in the Ministry of Finance). The head of the MTA is now nominated for a five-year period and reports to the Minister of Finance. Such long-term appointments comply with the policy objective of independence. Its budget is however still integrated within the Ministry of Finance. In 2019, the MTA created an advisory board for large taxpayers, composed of members of the public and private sector. Strict requirements and subsequent sanctions are imposed by the 2016 Code of Ethics on MTA's employees. While Montenegro's overall initiatives for independence and transparency are satisfactory, several areas could be improved. The MTA still lacks a real operational budget, independent of annual budgeting process, as well as procedural safeguards to guarantee its newly found independence.

Access to electronic **tax filing** is widespread and open for every major type of tax. It is mandatory for income taxes and optional for others, though the use of e-filing is widespread (77% of VAT tax returns were electronically filed in 2019). However, e-filing is only open to taxpayers who purchase a digital certificate, at a cost of EUR 110. Tax-filing procedures are regularly audited by the SAI and current rules were defined after a large audit in June 2015. Other audits targeted at effectiveness and efficiency are jointly carried out by both the SAI and the Internal Audit of the Ministry of Finance.

In terms of **taxpayer services**, the MTA offers online access to information, electronic communications and in-person inquiries. The usual response time is approximatively 30 days for written requests. Consultations with various institutions as well as taxpayers' surveys are regularly conducted to monitor these services.

### *Sub-dimension 4.3: International tax co-operation*

Montenegro has become increasingly involved in the **international tax environment**. It became a member of the BEPS Inclusive Framework in December 2019 and is in the process of implementing BEPS minimum standards. It has also made improvements in the field of exchange of information. The OECD Global Forum has started a peer review assessment of Montenegro's readiness to exchange information on request

(EOIR). Montenegro could begin the automatic exchange of information (AEOI) in 2023. The economy also signed the Convention on Mutual Administrative Assistance in Tax Matters in October 2019 and is in the process of updating its transfer pricing rules via a reform of the Law on Corporate Profit Tax (discussed above).

Montenegro is engaged in several initiatives for **digital taxation**. While it has not yet implemented the international VAT/GST guidelines, the place of taxation for cross-border digital services is where the service is supplied, rather than where the service provider is established. This approach to cross-border VAT on electronic services resembles the "destination principle", the cornerstone of international VAT/GST guidelines. Furthermore, revenues accruing from digital platforms are included in the PIT base and taxed at a 9% rate. Montenegro has not participated in the discussion on Pillar 1 and 2 of the OECD/Tax Challenges Arising from Digitalisation project as part of the BEPS framework. The digital taxation discussions might have a great impact on how Montenegro would want to reform its CIT. Pillar 2 of the project proposes introducing a global minimum tax on corporate profits. Montenegro's low CIT rate will very likely be below the minimum rate that will be set. If consensus can be found amongst Inclusive Framework members, Montenegro will face the choice of either raising its rate to the minimum rate or foregoing tax revenues to foreign tax jurisdictions. The GLOBE proposal, an OECD project to globally introduce income inclusion and undertaxed payment rules as well as tax treaty provisions, might also restrict Montenegro's use of cost-based and profit-based tax incentives. The introduction of a minimum CIT might bring to an end the fierce tax competition and race to the bottom that the WB6 region is engaged in. It would allow Montenegro to rebalance its tax mix away from high taxes on labour income towards more taxes on capital income. Montenegro should follow the ongoing international tax discussions and prepare itself for swift action if an international consensus is reached.

**Regional co-operation** in tax matters is a key challenge for the WB6 economies; it would allow them to benefit from more effective tax enforcement and lower overall tax avoidance and evasion. Montenegro does collaborate with other WB6 economies, but it could be strengthened further. The economy joined the Centre of Excellence in Finance in 2015, an organisation which supports capacity development for finance officials in South East Europe. In 2016, six Western Balkan economies planned to sign a memorandum on the establishment of a regional organisation – the so-called B-6 – to strengthen co-operation on administrative tax matters. However, due to legal obstacles in some economies, this memorandum has not yet been signed. Montenegro has started exchanging information within the WB region following a multi-lateral administrative agreement that the MTA has signed with Bosnia and Herzegovina, Bulgaria, North Macedonia and Serbia.

### *The way forward for tax policy*

To enhance the tax policy framework and achieve their objectives, policy makers may wish to:

- **Continue to support the economy in light of COVID-19**. Montenegro has implemented a comprehensive set of measures to mitigate the effects of COVID-19 on its economy and citizens. The economy may wish to continue its efforts, while focusing on measures that could spark an economic recovery.
- **Diversify the tax mix by strengthening the role of the CIT and PIT, recurrent taxes on immovable property and environmentally related taxes**. Montenegro's tax revenues rely heavily on SSCs and taxes on goods and services. There is scope to diversify the tax mix in a way that stimulates growth and makes the tax system more progressive.
- **Avoid the use of profit-based tax incentives given the low CIT rate**. The tax revenue foregone as a result of tax incentives needs to be measured as part of the annual tax expenditure report. This information would be the starting point of a cost-benefit analysis of all tax incentives.
- **Continue to implement anti-BEPS measures to protect the domestic tax base and to avoid international tax avoidance and evasion**. The economy is currently amending its CIT law to

implement anti-BEPS measures in the area of transfer pricing and thin capitalisation rules; these reforms could be extended to other CIT areas.

- **Develop an action plan in case members of the OECD/G20 Inclusive Framework on BEPS reach a consensus on Pillar's 2 global minimum tax**. A global minimum tax will very likely be higher than the current statutory CIT rate and would imply that foreign jurisdictions would tax profits sourced in Montenegro. This will create an incentive for Montenegro and other WB economies to increase their CIT rates and to stop their current race to the bottom in tax competition.
- **Carry out a cost-benefit analysis on the merits of a worldwide taxation system for resident corporations**. For small open economies such as Montenegro, worldwide taxation may entail high administrative costs without raising significant revenues.
- **Replace part of the high employee SSCs with a progressive PIT rate schedule**. This reform would increase the labour market participation of low-income and low-skilled workers in the formal labour market and make tax more progressive. The reform would have to be accompanied by other measures to prevent tax-induced incentives for self-employed entrepreneurs to incorporate their business. This could include an increase in the taxes on personal capital income.
- **Explore the scope to broaden the VAT base by reducing the lists of goods and services taxed at the reduced VAT rate**. Reduced VAT rates are an ineffective way to support people on low incomes, as those with higher incomes benefit more from the reduced rate. Targeted cash support, reduced employee SSC rates and progressive PIT rates are a better tool to support low-income households and make the tax system more progressive.
- **Prepare an annual tax expenditure report as part of the annual budget cycle and make it publicly available**. It should include a list of all tax expenditures, revenue foregone on an item-by-item basis and the assessment methodology used.
- **Expand the use of micro-simulation models to analyse the impact of the tax system and simulate impacts of tax reforms. Improve the methods applied to forecast tax revenues**. Montenegro's new PIT micro-simulation model can be used to assess other reforms, including the introduction of a progressive PIT rate schedule.
- **Implement strong procedural safeguards to protect the newly established independence of the tax administration**. For example, the economy could create an independent management board for the tax administration.
- **Continue to engage in international tax dialogue**. While Montenegro has strengthened its active involvement in the area of exchange of financial account information for tax information, ample scope exists to deepen the dialogue on other international tax fronts.
- **Foster regional co-operation and co-ordination on common issues for WB6 economies**. This would enable Montenegro to benefit from more effective tax enforcement and lower overall tax avoidance and evasion. Enhanced tax policy dialogue on CIT incentives could help create a more attractive investment climate across the region.

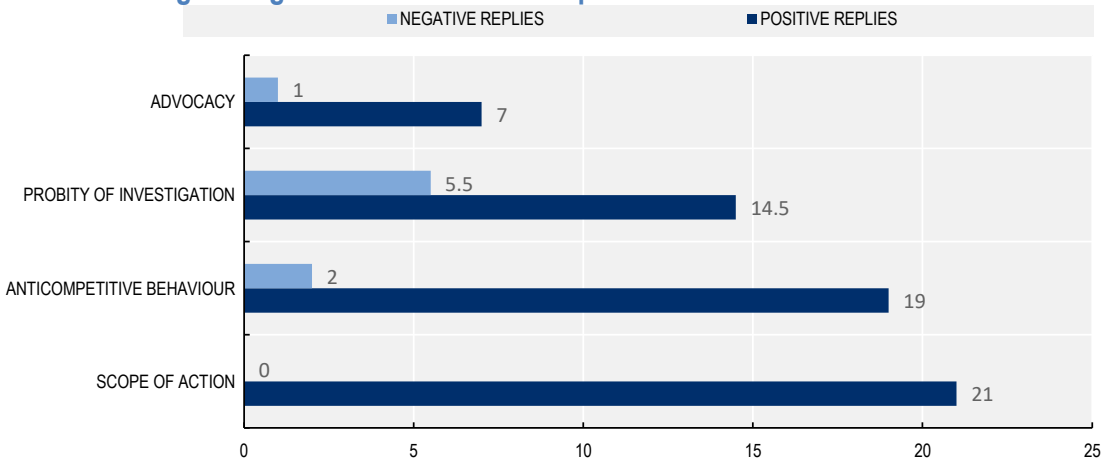
## Competition policy (Dimension 5)

### *Introduction*

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas ( scope of action, anti-competitive behaviour, probity of investigation and advocacy, plus a new area: implementation). Scoring is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administered by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy areas has a different number of possible criteria that can be stated as having been adopted. Each policy area is assessed through data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

The dark blue bars in Figure 23.10 represent the number of positive answers (alignment with good practices), while the pale blue represent the negative replies.

**Figure 23.10. Montenegro's legal and institutional competition framework**




Source: Based on the OECD assessment.

### *State of play and key developments*

#### *Sub-dimension 5.1: Scope of action*

The Law on Protection of Competition of Montenegro does not require substantial amendment, since it is largely aligned with the EU rules on restrictive agreements (Art. 101 Treaty on the Functioning of the European Union, TFEU) and on abuses of dominant position (Art. 102 TFEU). The law also provides for *ex ante* control of mergers above certain turnover thresholds, in line with the principles of the EU Merger Regulation.

The Agency for Protection of Competition (APC) is the body responsible for implementing the Law on the Protection of Competition in Montenegro. It is an operationally independent authority and its powers are broadly comparable to those of the European Commission in the area of competition. In 2018, state aid control was included within the remit of the APC.

Nevertheless, despite the addition of a sphere of competence, the financial and human resources of the APC have not been substantially increased and are still insufficient to ensure it can function optimally. In fact, competition enforcement and advocacy still need to be developed and expanded.

In terms of competencies, the ACP has the power to adopt enforcement decisions against anti-competitive practices and to review mergers, as well as to advocate competition principles to national policy makers. In 2018, the Law on State Aid Control transferred the competence on state aid affairs from the Commission for the Control of State Aid to the ACP.

Following the adoption of the Law on State Aid Control, the Council of the APC includes the President, the Member of the Council for Competition and the Member of the Council for State Aid. They are appointed by the Government of Montenegro following proposals by the Ministry of Economic Development (for the President and the Member for Competition) and by the Ministry of Finance (for the Member for State Aid). The APC is managed by a director, in turn assisted by a deputy director, also appointed by the Government of Montenegro. The duration of all these mandates is four years.

APC's staff numbers have been steadily increasing, from 13 employees in 2015 to 29 in 2019. Nevertheless, only nine employees focus on competition. This figure is low compared with other OECD and non-OECD countries, such as those listed in the OECD CompStats database.[58] For example, in 2019 the average total staff of the 15 competition authorities in small economies (with a population lower than 7.5 million) was 114, of whom 43 were working on competition.

The annual budget of the APC has grown from EUR 305 000 in 2015 to EUR 820 000 in 2020. However, the most significant increase (from EUR 435 000 to 733 000) occurred between 2017 and 2018, following the assignment to the APC of the new competence on state aid control.

The Montenegrin Law on the Protection of Competition ensures competitive neutrality, insofar as it also applies to state and local administration bodies that engage in an economic activity directly or indirectly and participate in the trade of goods or services.

The APC has appropriate powers to investigate and powers to sanction possible anti-trust infringements, i.e. restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms. It can impose cease and desist orders, as well as behavioural and structural remedies, on firms that have committed anti-trust infringements. It can also adopt interim measures if the alleged competition breach poses a risk of irreparable damages. In addition, it can accept commitments offered by the parties to remove the competition concerns and close the investigation.

The APC can compel investigated firms and third parties to provide relevant information and can perform unannounced inspections on parties' premises. The assessment of alleged anti-competitive conduct follows thorough scrutiny of the evidence, which can include an economic analysis of the competitive effects of vertical agreements or possible exclusionary conduct.

In terms of power to sanction, the agency has no power to impose fines directly: the imposition of fines is the competence of the Misdemeanour Courts, which can conduct the relevant procedure and determine the amount of the fines. The amount can range from 1% to 10% of the aggregate annual turnover of the undertaking in the financial year preceding the year in which the misdemeanour was committed.

The Law on Competition also contemplates a leniency programme, in that it ensures total or partial immunity from sanctions to firms involved in unlawful agreements that report to the agency the existence of the agreement and submit evidence that allows the APC to adopt an infringement decision. In particular, with respect to these firms the APC cannot submit a request for the initiation of misdemeanour proceedings or must withdraw an already submitted request or propose a milder punishment to the court. Such provisions do not apply to firms that initiated or organised the cartel. The agency can propose to the party to the agreement that they conclude it on admission of guilt.

The Law on Protection of Competition provides for *ex ante* control of mergers, following the principles of the EU Merger Regulation. The APC can compel merging firms and third parties to provide relevant information and can perform unannounced inspections of parties' premises (one was carried out in 2017).

The assessment of notified mergers must follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration.

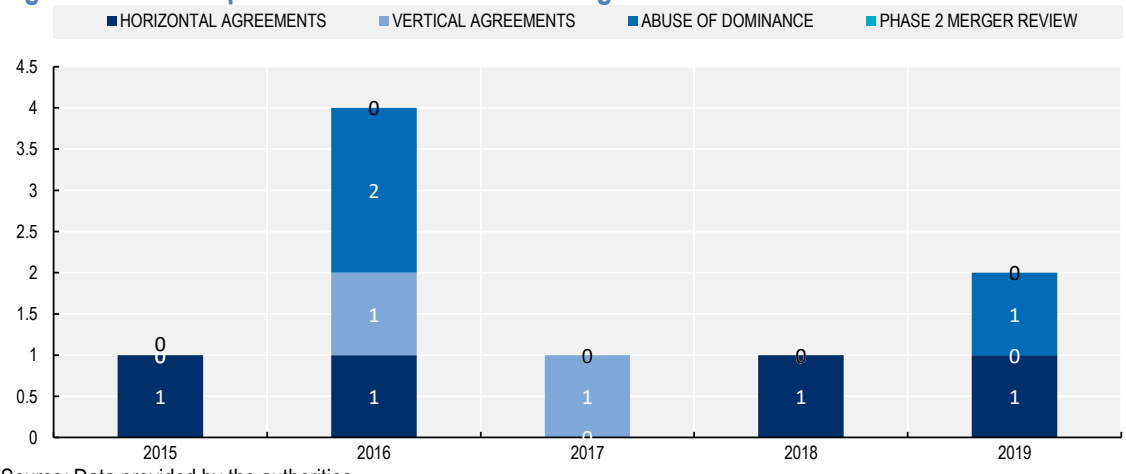
In case of significant restriction, distortion or prevention of competition in the relevant markets, the APC can prohibit the transaction. The merging parties can submit their observations and propose measures to prevent the alleged competition distortion. If the agency establishes that the proposed measures are adequate, it adopts the decision approving concentration and orders the implementation of the measures.

Regarding private enforcement, individuals, firms and consumers – either collectively or through consumer associations – can bring a legal action to seek damages from firms that have committed antitrust infringements.

*Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. Despite an appreciable legal and institutional competition framework, the actual enforcement of competition rules is still limited (Figure 23.11).

**Figure 23.11. Competition decisions in Montenegro**




Source: Data provided by the authorities.

Between 2015 and 2019, the APC took only four cartel decisions (one every year except 2017), two decisions on agreements with a vertical element (in 2016 and 2017) and three decisions on abuse of dominance (two in 2016 and one in 2019). In 2019, the APC opened two vertical investigations concerning resale price maintenance (RPM) violations, a hard-core restriction in Montenegrin competition law. The agency has never received a leniency application.

Importantly, in 2019 the APC carried out unannounced inspections in the two anti-trust proceedings on RPM opened in that year. The agency had already performed one dawn raid in 2017, but in a merger case. The total amount of fines imposed in 2019 by the Misdemeanour Courts was particularly low (less than EUR 3 000). Between 2015 and 2019, the annual fines never reached EUR 100 000. Furthermore, the highest fines were not imposed in cartel cases, but for abuse of dominance.

Again, these data can be appreciated by comparing them to the 15 competition authorities in smaller jurisdictions that participated in the CompStats database. Focusing on cartel enforcement, it is telling that in those jurisdictions the average annual number of cartel cases between 2015 and 2019 was 3.2, while the average annual fines resulting from cartel investigations were EUR 2.7 million.

Cartels are the most clear-cut and undisputedly harmful competition infringements. They affect every economy. The limited number of current cases seems insufficient to deliver a strong message that firms that engage in collusion risk being severely punished. Furthermore, fines are very low. Unlike in most jurisdictions, they cannot be imposed by the APC but by a decision of the Misdemeanour Courts. Consistent with the changes introduced in other jurisdictions in the WB region, the APC could be empowered to impose fines directly. Indeed, fines act as a deterrent because the possibility of a fine enters into the decision-making process of managers and undertakings in their consideration of whether or not to violate the law. If the amount of fines sufficiently exceeds illicit gains, offences can be deterred even when the probability of incurring a fine is low. Concern about fines is also a key driver of leniency applications, thus fostering the effectiveness of the leniency programme – which has been unproductive in Montenegro so far – and further boosting detection.

In 2019, the APC rendered 65 merger decisions, which represents a sharp increase over 53 decisions in 2018 and 35 decisions in 2017. All 2019 merger decisions were unconditionally cleared in Phase I (i.e., without the need for an in-depth investigation). Many of the notified transactions concerned extraterritorial transactions, with little or no impact on the Montenegrin economy. This is due to the low merger filing thresholds applied in Montenegro, which often catch transactions with modest local nexus, i.e. hardly capable of distorting competition within the national territory of Montenegro.

For comparison, from 2015-19, the 15 competition authorities in smaller jurisdictions that participate in the cited OECD CompStats database carried out 4.2 in-depth merger investigations per year on average, out of 36 notifications.

### *Sub-dimension 5.3 Probity of investigation*

The APC was established as a functionally independent entity in February 2013. Previously, competition law and policy fell within the remit of the Ministry of Economic Development. The agency must submit an annual report on its activity to the Montenegro Government and Parliament for approval.

In terms of procedural fairness, the decisions to open formal proceedings and the final decision finding competition infringements, as well as decisions regarding mergers, are published. However, only the decision part is made public, not the reasoning.

The APC's decisions can be appealed before the Administrative Court and the Supreme Court. Appeals regarding fines can be submitted to the Misdemeanour Court and Higher Misdemeanour Court.

During the course of the proceedings, the parties under investigation for an anti-trust infringement may consult with the APC with regard to significant legal, factual or procedural issues and have the right to be heard.

Prior to the adoption of a final anti-trust decision, the APC must inform the party of the relevant facts, evidence and other elements on which the decision is based, and enable the party to submit defences. Likewise, if the APC intends to prohibit a merger transaction it must inform the merging parties about the evidence and conclusions on which the decision would be based and enable them to submit their remarks and possible remedies.

The APC has issued explanatory notices on the procedure for submitting requests for confidentiality and for submitting information on alleged violations of competition law. These are available on the APC website. However, it has not issued guidelines for the assessment of horizontal and vertical agreements nor for abuses of dominance.

### *Sub-dimension 5.4: Advocacy*

The ACP can formulate opinions on national or local laws or regulations that affect, or might affect, competition. The agency has issued a limited number of opinions over the last five years. The main

interventions concerned the Law on Public Procurement (in 2011), the Law on Free Access to Information (in 2016) and the Draft Law on Audio-visual Services (in 2019). In the latter, the APC clarified to the Agency for Electronic Media and Postal Services the differences between the criteria provided in the draft law for defining markets and identifying operators with significant market power and those typically used in competition enforcement.

All opinions on draft laws and regulations have been delivered on the agency's initiative, with the exception of the request submitted by the Agency for Electronic Media and Postal Services. APC's recommendations on public procurement and on free access to information have led to pro-competitive changes.

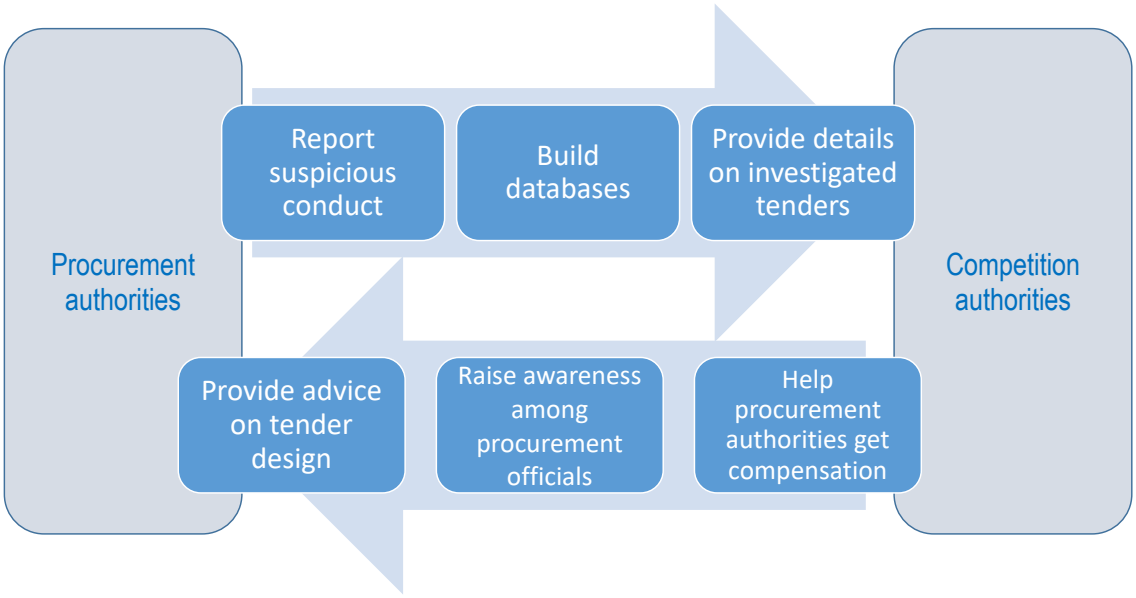
The APC has not conducted any market studies. These are a key tool to gain an in-depth understanding of restrictions to competition in crucial sectors.

Finally, over the last five years the APC has performed some activities aimed at developing a competition culture, including eight seminars for members of the Chamber of Commerce, four seminars for the judiciary and two seminars for the media and general public.

### *The way forward for competition policy*

- **Expand APC's enforcement capacity and increase its enforcement efforts** with a view to increasing the number of decisions on cartels and abuses of dominant position, as well as the fines. The two recent on-site inspections seem to indicate the APC's determination to step up competition enforcement, but the APC needs to make full use of its powers and promote the use of its leniency policy to uncover cartels.
- **Provide the APC with adequate financial and human resources**. Despite an increase over the last few years, a more substantive growth in the budget is needed to extend the APC's activity on competition. More financial resources would enable the agency to recruit additional competition officials with appropriate skills and thus develop the APC's potential for competition enforcement and advocacy (see Box 23.9 for an example from Italy).
- **Give priority to boosting cartel enforcement and imposing high fines. To this end, the APC could be empowered to impose fines directly**. The APC should also expand its detection skills, for example by focusing on bid rigging (see next point on public procurement).
- **Pay specific attention to public procurement, particularly during the Covid-19 crisis**. The APC should explore ways to enhance cartel detection and prevent bid rigging through better tender design by procurement officials. Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm to public budget and taxpayers, dampening innovation and causing inefficiencies. Figure 23.12 shows how co-operation between competition and procurement authorities can help detect and avoid bid rigging. The APC signed a co-operation agreement with the Public Procurement Administration in 2015. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012[83]) calls for governments to assess their public procurement laws and practices at all levels of government in order to promote more effective procurement and reduce the risk of bid rigging in public tenders. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[84]), which form a part of the recommendation, are designed to reduce the risks of bid rigging through careful design of the procurement process and to detect bid-rigging conspiracies during the procurement process. The OECD can also provide assistance through a project aimed at assessing the main rules governing procurement of public works as well as procurement practices of major public buyers. It provides recommendations to design competitive procurement and fight bid rigging in accordance with international good practice. It can also offer training for both competition and public procurement officials, based on the Guidelines on Fighting Bid Rigging in Public Procurement.

Figure 23.12. Example of co-operation between competition and procurement authorities




Source: OECD elaboration.

- **Raise the APC's voice regularly to oppose laws and regulations that restrict competition and promote competition culture.** Competition authorities can help governments to eliminate barriers to competition by identifying unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives. The OECD's Competition Assessment Toolkit is a practical methodology that supports competition authorities in this task. Where a detrimental impact is discovered, the toolkit helps to develop alternative ways to achieve the same objectives, with minimal harm to competition. In the past, OECD country projects have proved to be very helpful in boosting competition advocacy and competition assessment in several jurisdictions, including in Eastern Europe. On top of establishing a competition culture in national stakeholders, competition advocacy would strengthen the APC's standing and reputation when it acts against anti-competitive restrictions by private firms.
- **Increase the APC's engagement in advocacy initiatives to promote competitive neutrality**. In particular, the COVID-19 crisis could further increase the relevance of SOEs, as a result of state interventions to support the economy and stimulate growth. The APC could contribute to a quick economic recovery by the country by ensuring competitive neutrality. The authority can advocate for industrial policies that focus on pro-competitive alternatives and ensure that state aid is provided in a transparent way and for a limited period.
- **Perform market studies.** Market studies are used to assess how competition in a sector or industry is functioning, detect the source of any competition problems, and identify potential solutions. Competition problems that can be uncovered in market studies include regulatory barriers to competition and demand-side factors that impair market functioning. Because market studies are a versatile tool, and they allow the examination of a broader set of issues than competition enforcement, their use is growing. International organisations, notably the OECD and the International Competition Network (ICN), have developed a wide range of documents on market studies, including the OECD Market Studies Guide for Competition Authorities (OECD, 2018[85]). The OECD Competition Division can also assist competition authorities, regulators, ministries and other policy makers with market study projects.
- **Expand international co-operation and training.** With the increasing complexity of anti-trust issues and the frequent cross-border nature of competition infringements, international organisations like the OECD, the ICN and UNCTAD offer valuable opportunities for sharing

experience and policy discussions. The OECD-GVH Regional Centre for Competition in Budapest also provides an ideal forum for capacity building and sharing of good practices with colleagues from other jurisdictions, focusing on the specific challenges of Eastern European and Central Asian countries. The management and the staff of the APC are already actively involved in these co-operation initiatives and can benefit from engaging more actively.

### Box 23.9. Financial independence for the Italian Competition Authority

Until 2012, the financing of the Italian Competition Authority (AGCM) was based on two main sources: annual funding from the state and fees paid by companies subject to merger notification requirements.

Legislative Decree no. 1/2012 modified the AGCM's funding system, which is now based on mandatory contributions imposed on companies incorporated in Italy whose turnover exceeds a threshold of EUR 50 million. The revenues from these contributions replace all previous forms of funding. The level of contribution, originally fixed at 0.06 per thousand, has been gradually lowered by the AGCM to 0.055 per thousand. The authority's financial statements have to be approved by 30 April of the following year, and are subject to auditing by the Court of Auditors.

This funding system can be regarded as an indirect recognition of the positive role played by AGCM in supporting a healthy and level competition field, which justifies the imposition of a small contribution on the largest businesses incorporated in Italy.

Importantly, the previous funding system entailed the risk of possible fluctuations in the amount of the annual budget, due to unpredictability in the number of notified mergers and levels of state funding. The new system shelters the AGCM from that risk, thus allowing for more stable and forward-looking recruitment planning.

Source: (OECD, 2016[86]), Independence of competition authorities: from designs to practices, https://one.oecd.org/document/DAF/COMP/GF(2016)5/en/pdf.

## State-owned enterprises (Dimension 6)

### *Introduction*

Montenegro's SOE landscape has the peculiarity of including a high proportion of private shareholders, in many cases resulting from stalled privatisation efforts. Since the beginning of the privatisation process, which started in 1999, more than 90% of the country's state-owned enterprises have been privatised. However, some of the country's most important enterprises still remain state-owned, including Montenegro Airlines, Montenegro Railways and several companies in the tourism and energy sectors. State ownership responsibilities for Montenegro's SOEs are exercised directly by the government, by a variety of line ministries and a number of state funds.

Montenegro's performance on the state-owned enterprises policy dimension has not changed since the 2018 Competitiveness Outlook (Figure 23.1). Nevertheless, certain improvements to the framework for business have been made recently, especially taking into account the adoption of the new Law on Business Organisations. This is one of the key measures for the closure of negotiations on Chapter 6 (Company Law) in the context of Montenegro's membership negotiations with the European Union. The new law can be expected to affect the legislative framework for SOEs, for instance by further professionalising boards and strengthening their operational autonomy. Eventually, it should positively affect the economy's score on this indicator.

Table 23.10 provides an overview of Montenegro's scores for the state-owned enterprises dimension. This dimension considers three broad sub-dimensions which are based on elements in the SOE Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) (OECD, 2015[87]). Montenegro achieves a relatively low score in the efficiency and governance sub-dimension, reflecting its lack of an ownership policy and insufficiently harmonised ownership practices. Montenegrin SOEs are subject to sound financial disclosure and auditing requirements, resulting in an average score for the transparency sub-dimension. Montenegro also achieves an average score for ensuring a level-playing field between state-owned and private companies, owing to the fact that SOEs mostly operate according to the general company law (the Law on Business Organisations).

**Table 23.10. Montenegro's scores for state-owned enterprises**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 2.3 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 3.0 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 3.0 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising state-owned enterprises | n.a. | n.a. |
| **Montenegro's overall score** | | **2.7** | **2.6** |

Note: For comparability with the previous assessment, sub-dimension 6.4 (reforming and privatising state-owned enterprises) has not been scored but is discussed in the text below.

### *State of play and key developments*

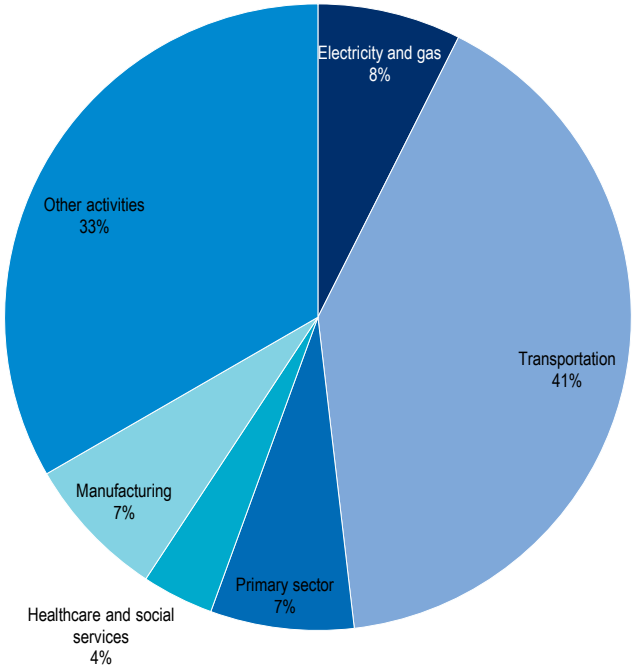
#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

According to the Central Depository Agency, the Montenegro state is the majority or full owner of 32 companies (this number also includes companies undergoing bankruptcy procedures). The state also owns several SOEs that operate under the separate legal form of "public enterprise": those which provide "public" goods and are mainly established by the local municipalities. However, data on these enterprises were not available for this assessment.[59] In addition, the state holds minority shareholdings (over 10%) in

21 companies operating in a range of sectors, including sea transport, manufacturing, construction, accommodation (hotels) and retail. The large number of companies in which the state still maintains minority shares often reflects privatisation attempts that were not completed.

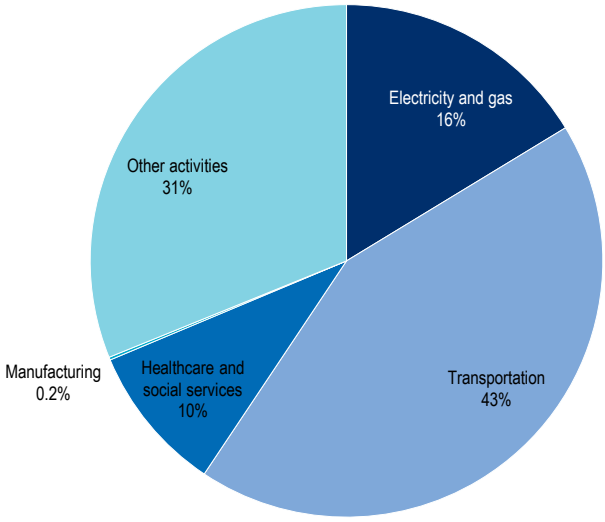
Montenegro's 32 SOEs are present in structurally important sectors such as electricity and gas, the postal services, railway and air transport (Figure 23.13). While these 32 state-owned companies do not include the aforementioned public-service SOEs that were excluded from reporting/data, most of these SOEs are reportedly owned by municipalities rather than the central government. Figure 23.13 shows how employment is allocated across sectoral SOEs. Montenegro's largest state-owned companies by employment are *Electroprivreda Crne Gore* (975 employees), *Pošta Crne Gore* (952), *Aerodromi Crne Gore* (894), *Željeznička Infrastructura Crne Gore A.D.* (789), *Institut Za Fiz. Med. Reh. I Reum. Simo Milošević* (731) (Table 23.11). According to available data, state-owned companies in Montenegro employ almost 8 000 people, accounting for an estimated 3.3% of national employment.[60] This compares with an OECD average of approximately 2-3% and puts Montenegro in the lower tier of the ten largest OECD-area SOE sectors as measured by SOE's share of national employment, ranging from 2.9% in Sweden to 9.6% in Norway.[61]

### Figure 23.13. Sectoral distribution of Montenegro's SOEs




Source: Calculations based on information provided by the authorities of Montenegro (for 27 SOEs).

## Figure 23.14. Sectoral contribution of fully corporatised SOEs to SOE employment




Note: Employment figures were not provided for seven SOEs, including two operating in the primary sector. The total number of reported SOEs is based on data provided by the Central Depository Agency in the context of this assessment, whereas sectoral figures are based on reporting by the National Statistical Office, which arrived at a slightly different classification of companies as SOEs or minority-owned companies (27 SOEs and 24 state minority-owned companies, perhaps reflecting a different classification of enterprises undergoing bankruptcy proceedings).
Source: Calculations based on information provided by the authorities of Montenegro.

## Table 23.11. The five largest employers in Montenegro's SOE sector, 2019

| Rank | Company name | Percentage of state ownership | Sector | Number of employees |
|---|---|---|---|---|
| 1 | Electroprivreda Crne Gore A.D Nikšić (Eng. Montenegrin Electric Enterprise AD Niksic, EPCG) | 88.7% | Production of electricity | 975 |
| 2 | Pošta Crne Gore (Eng. Montenegro Post) | 100% | Postal activities | 952 |
| 3 | Aerodromi Crne Gore (Eng. Airports of Montenegro) | 100% | Service activities in air transport | 894 |
| 4 | Željeznička Infrastructura Crne Gore A.D. (Eng. Railway Infrastructure of Montenegro, ZICG) | 76.6% | Passenger rail transport, interurban | 789 |
| 5 | Institut za fizikalnu medicinu, rehabilitaciju i reumatologiju Simo Milošević (Eng. Institute for Physical Medicine, Rehabilitatiton and Rheumatology "Dr Simo Milosevic" JSC Igalo) | 56% | Hospital activities | 731 |

Source: Based on data provided by the Montenegro authorities.

It is difficult to draw a general conclusion about the efficiency and performance of Montenegro's SOEs. The limited data on their performance points to inefficiencies and low overall returns to the state's investments in these companies. Five majority-owned companies are currently undergoing bankruptcy procedures. As mentioned earlier, the state also holds minority shares in 21 enterprises. A 2020 study by the European Bank on Reconstruction and Development (EBRD) found that SOEs in Montenegro had posted overall negative returns on equity from 2014 to 2016, including inefficiencies and/or uncompensated non-commercial objectives (EBRD, 2020[88]). SOEs had particularly high employment costs relative to their revenues compared to other surveyed economies (40%, compared with 12% in Latvia). Also, according to stakeholders interviewed for this assessment, 9 out of 21 SOEs for which data are available on the Tax Administration portal operated with a loss in 2018, totalling over EUR 8 million.

The main legal document that regulates business organisations in Montenegro is the Law on Business Organisations adopted in June 2020. The law is applicable to most enterprises – state and private companies – that operate in Montenegro, including SOEs incorporated as either joint-stock or limited-liability companies. The main public sector bodies responsible for exercising state ownership rights in the case of joint-stock and limited liability companies are the state (the government and various line ministries)

and several state funds (namely the Fund for Pension and Disability Insurance, the Employment Office of Montenegro, the Compensation Fund, the Investment Development Fund of Montenegro and the Health Fund). Additionally, the Ministry of Economic Development plays an advisory role on behalf of the government for certain decisions that explicitly require government consent in fully- owned SOEs.[62] The fact that the ownership of many SOEs is exercised jointly by state funds introduces some elements of a centralised ownership model, wherein ownership rights are not exercised predominantly by regulatory authorities (e.g. line ministries).

Regarding the **clarification of ownership policy and rationales**, Montenegro has not developed an overarching ownership policy that states why the government owns companies and how it expects them to create value. The authorities do take steps to establish clear objectives for individual SOEs, for example within shareholder agreements or other contractual arrangements between the state and other shareholders. A range of line ministries are also responsible for monitoring individual companies, setting stimulative measures and defining support programmes. The role and power of these various government bodies are primarily related to defining goals and priorities at the sectoral level. Although individual SOEs may have performance targets, the government as a whole does not have an overview of performance objectives or how well the SOE portfolio is performing overall.

In most cases, ownership rationales can be determined through some policies and strategic decisions. They have been developed by the government based on priority sectors that possess high potential for growth with high value added and comparative advantages. As part of this assessment, the authorities cited the following as the key rationales for state ownership: 1) supporting national economic and strategic interest; and 2) supporting specific goods or services (after ensuring the market cannot supply them).

Montenegro has not established a central co-ordinating or oversight unit to **professionalise state ownership** practices and ensure a whole-of-government approach. In many cases, the exercise of ownership rights falls to the various relevant sectoral government institutions as well as the jurisdiction of the certain institutions. In principle, different line ministries, depending on the topic and their concrete field of act, are in charge of monitoring, setting stimulative measures and defining some support programmes.

Regarding SOE **board nomination procedures**, there is currently no common or transparent approach across Montenegrin SOEs. As most SOE board members are civil servants, SOE boards may not have an adequate mix of competencies, including private-sector expertise. The board nominations are not clearly framed by the Law on Business Organisations and not subject to well-defined criteria developed across government. In practice, board members are generally elected by the relevant line ministries or state funds and are in some cases vetted by the government. In June 2020, the government adopted the new Law on Business Organisations that improves clarity of the procedure for board nomination in companies. The amendments to the company law can be expected to improve SOE governance, notably by requiring independent directors on company boards, including some SOEs. Introducing independent directors on boards can help reduce conflicts of interest (because the independent members have no business relationship with management) and as a result help ensure that decisions are taken in the interest of the company and its shareholders. Special provisions in the Law on Prevention of Corruption ban government ministers and vice-ministers from serving on SOE boards (vice-ministers are banned when the ministry where he/she works is supervising the respective SOE). Public officials may not be a president or member of the management body or supervisory board, executive director, or member of management of public companies, public institutions, or other legal persons.[63] Nevertheless, there is still limited evidence that the whole nomination process relies on transparent and merit-based appointment criteria, leading to a high risk of political influence in appointing board positions. The risk is that corporate decisions could be politically motivated, rather than in the interest of corporate performance. There is some evidence that political affiliation has been known to play a role in job placement in Montenegrin SOEs (US Department of State, 2020[89]). Likewise, according to stakeholders interviewed for this assessment, SOE boards of directors and governing bodies are mostly made up of politicians.

In addition to ensuring basic legal requirements concerning board members' fiduciary duties – i.e. to act in good faith in the interest of the companies that they serve – Montenegro has recently taken steps to **promote independent and professional boards** in companies, including SOEs. The main step taken is to require that the boards of companies include a minimum one-third proportion of independent directors. Recent amendments also make boards of directors liable for any damages they cause to the company(ies) they serve, other than implementing decisions made by the general meeting of shareholders. According to the Law on Business Organisations, the board of directors should be a collective body whose activities are directed by its chairman. The number of board members is established by the charter of each company, but the typical size of an SOE board is five members. The legal framework states that the board of directors should also have an odd number of members, and not less than three. The law establishes that board members must act in good faith for the benefit of the company as a whole, taking into account government strategic priorities. Recent amendments to the Law on Business Organisations adopted by Parliament introduce requirements for company boards to include independent directors. In practice, the absence of independent directors can limit the extent to which enterprise management decisions are subject to external professional scrutiny. The amendments establish that 1) at least one-third of all company boards must be independent directors, and the boards of public joint stock companies must comprise at least two-fifths independent directors; and 2) a person cannot be considered independent if he/she has a kinship relationship with another member of the company's managing body(ies) or a significant shareholder or received fees from the company or was a significant shareholder of the company or related companies in the preceding two years. These amendments can be expected to improve the independence of state-owned companies' boards.

In terms of gender balance on corporate boards, the authorities report that the government follows national and international standards as well as guidance regarding gender diversity on SOE boards.

### *Sub-dimension 6.2: Transparency and accountability practices*

According to the Law on Accounting, **financial and non-financial reports** are obligatory for all SOEs. SOEs which are not listed on the stock exchange are obliged to prepare and submit financial reports to the Tax Office of Montenegro. The reports must include a brief description of the business activities and organisational structure of the legal entity, analysis of its financial position and performance, information on the members of the governing and supervisory bodies, information on environmental investments and planned future development, and data on R&D activities, among others. However, there is an overarching concern over SOEs' weak compliance with reporting requirements. According to monitoring by the Securities Commission, only an estimated half of state-owned joint-stock companies respect these disclosure requirements.[64] Weaknesses in SOE compliance with reporting requirements are quite common across the region, and the fact that half of SOEs do comply with applicable disclosure requirements can be considered an achievement.

Concerning disclosure by the state, information on the aggregate performance of SOEs is not compiled into a single report. The legislative framework also does not establish comprehensive requirements for the disclosure of companies' non-financial information, and, in practice, these disclosures are generally limited. In addition, monitoring of the Capital Market Authority (CMA) does not include elements on environmental and social performance. According to the Law on Accounting, SOEs should compile financial statements following internationally recognised standards such as the International Accountant Standards (IAS) or the International Reporting Standards (IFRS). In line with the existing legislative framework for business organisations, there are no differences in accounting requirements for SOEs and private companies. According to stakeholders interviewed for this assessment, when it comes to key reporting to the Tax Administration, SOEs report fairly regularly, and transparently. It may sometimes happen that, within the report itself, certain SOEs do not provide complete information (e.g. the average number of employees, the average net salary) which means that the net result is not clearly shown. However, the fact is that they report regularly, on an annual basis, to the Tax Administration.

Montenegro has established sound basic legislation to ensure quality **auditing practices** among SOEs, but a fully informed assessment of this would require a qualitative review of how this legislation is implemented in practice. According to the Law on Audit, SOEs are subject to the same external audit requirements of their financial statements as stock-exchange listed companies. The audit should be performed by an independent auditor elected by the general meeting of shareholders for a term specified in the SOE charter, but not exceeding one year. In general, most SOEs incorporated as joint-stock companies follow this practice. In addition, the State Audit Institution is responsible for conducting audit practices of legal entities owned by state or state bodies. Although there are no rules on the frequency of SOE audits by this institution, many SOEs have been subject to an audit since the State Audit Institution was established.

Minority shareholders' rights are of paramount importance in the context of SOE governance in Montenegro since the majority of SOEs include private shareholders. Some basic elements of a sound legal framework are in place to **protect minority shareholders'** rights. However, external assessments point out that there is room to improve these legal protections in Montenegro. Notably, the World Bank's Doing Business report underlines persistent shortcomings in minority shareholder rights and accords Montenegro an average score of only 3.0 out of 6.0 for the extent of shareholder rights (World Bank, 2019[22]). The authorities expect to improve their score under the new Law on Business Organisations.

In essence, minority shareholders' rights are regulated by the Law on Business Organisations, which has been harmonised with EU Directives in this field. Generally, minority shareholders' rights are defined based on shares and for the same type of shares there are no differences in shareholders rights. Shareholders whose shares represent at least 5% of the share capital are entitled to convene a general shareholders' meeting, to add items to the agenda and to nominate board members. In practice, however, there have been "reported" instances of minority shareholders not being consulted. There is also some evidence suggesting that often minority shareholders are not aware of their rights.

The rights of shareholders have been regulated under the new law in more detailed terms, such as the right to hire experts, to ask questions relating to materials and proposals of decisions to be considered at the General Meeting, to expand the agenda, to nominate candidates for the members of the board of directors and supervisory board, and to nominate candidates for the company's auditor. Nevertheless, progress in this area will depend on effective implementation.

### *Sub-dimension 6.3: Ensuring a level playing field*

The vast majority of SOEs in Montenegro are incorporated according to company law (the Law on Business Organisations). Thus, the foundational elements of SOEs' **legal and regulatory treatment** are broadly in line with those of private competitors. According to the Law on Business Organisations, there are no differences in the legal and regulatory framework for privately owned and state-owned enterprises that carry out economic activities. The authorities assert that SOEs are subject to the same regulatory treatment regardless of shares in ownership structure and commercial orientation. SOEs – incorporated as joint-stock or limited liability companies, including municipal SOEs – are not formally exempt from the application of general laws, tax codes and regulations (including any special legal privileges neither benefit from competition and environmental/zoning regulations). In addition, the legislative framework does not distinguish between SOEs and private companies in implementing insolvency and bankruptcy procedures. Companies in which bankruptcy procedures are initiated are restructured in accordance with the Law on Insolvency.[65] The government is currently preparing amendments to the Law on Insolvency that aim to improve the rationality and efficiency of bankruptcy procedures. The fact that most commercially oriented SOEs are subject to the same legislative framework as private companies provides a sound foundation for ensuring a level playing field.

Concerning **access to finance**, the government can provide state guarantees for SOEs and other regulated companies which are regulated mainly by government support programmes and the Law on

State Aid Control. Each decision concerning financial guarantees is discussed, defined, and made by the government on a case-by-case basis. Although this might give SOEs a more favourable position, the authorities note that the government can give guarantees to private companies based on the same criteria. According to external assessment, although Montenegro has EU-based state-aid regulations in the form of guarantees, there is some evidence of gaps in implementation (World Bank, 2019[43]). For instance, the recent government decision to support the national carrier Montenegro Airlines from bankruptcy or closure has been widely criticised (BalkanInsight, 2019[90]).[66] Even though Montenegro is subject to state-aid rules to ensure fair competition, this recent example of support to their national airline highlights complexities in implementing the rules.

As a consequence of COVID-19, many state-owned enterprises have accumulated additional losses. For instance, Montenegro Airlines has posted losses of several million euros since halting its operations in mid-March 2020. The government has adopted a series of business support measures in the context of the COVID-19 crisis, issuing three packages worth over EUR 1.5 billion (more than 30% of GDP) to maintain the liquidity of companies, save jobs and support vulnerable groups.

### *Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

A significant proportion of SOEs' capital began to be privatised from the 1990s onwards. In some cases this occurred through full privatisation of the firms, while in others it involved partial privatisation, where the state maintained majority or minority shares. Many of the remaining enterprises in which the state maintains majority or full ownership are of strategic importance to the Montenegrin economy and operate in such areas as energy, transport and tourism. Table 23.12 outlines the number of SOEs privatised between 2010 and 2014.

Privatisations in Montenegro are conducted in accordance with a clearly defined legislative framework, based on the Law on Privatisation of Economy, the Law on Ownership and Management Transformation, Law on Foreign Investments, and other by-laws and regulations. An annual privatisation plan is adopted by the government in accordance with the Law on Privatisation of Economy and contains basic data on companies that are subject to privatisation that year, as well as the means and methods of the privatisation.[67] In recent years, the privatisation plans have mainly envisaged the sale of the remaining state capital in some of the national enterprises. The process is managed, controlled and implemented by the Privatisation and Capital Projects Council. The authorities report that the main objectives of privatisation are to 1) increase companies' competitiveness and efficiency; 2) encourage foreign investment and entrepreneurship in all areas; and 3) increase employment and improve standards of living.

Table 23.13 presents privatisation revenues and the main types of procedure in Montenegro for the period 2010-2019. The most common methods of privatisation in these years were 1) sale of shares and property through a public tender; 2) sale of shares on the stock exchange; and 3) sale of shares and property through a public auction. Although most Montenegrin SOEs have been sold, the state has still majority of ownership in 32 companies. The fact that some state-owned companies were continuously demanding help from the state has urged the authorities to accelerate their privatisation (IMF, 2018[91]). In 2019, for instance, negotiations to sell the health institute in Igalo were initiated but ultimately cancelled and restructuring of the hotel group *Budvanska Rivijera* has been completed. The calls for privatisation have also been published for another two companies from the 2019 privatisation plan. Six state-owned companies were scheduled for privatisation in 2020 through stock-exchange sales.

### Table 23.12. Montenegrin SOEs privatised between 2010 and 2014

| Year | Name of the company | Percentage of privatised shares | Sector |
|---|---|---|---|
| 2010 | Marina Bar AD Bar | 54% | Port traffic |
| | Lovcen osiguranje AD – Podgorica | 41% | Insurance |
| 2011 | 0 | 0 | |
| 2012 | Mljekara Zora Berane | 99% | Milk production |
| 2013 | Kontejnerski terminal I generalni tereti Bar | 62% | Maritime transport |
| 2014 | Gornji Ibar – sale of property | .. | Wood industry |
| | Montenegro defence industry d.o.o Podgorica | 100% | Defence industry |
| | Poliex AD – Berane | 51% | Chemical industry |
| | Hotel Park Bijela – sale of state property | .. | Hotel |

Source: Data provided by the Montenegro authorities.

### Table 23.13. Privatisation revenues (EUR) in Montenegro (2010-2019)

| Type of procedure | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Tender | 8.2 million | 0,00 | 250 thousand | 8.1 million | 0,00 | 3.5 million | 0,00 | 0,00 | 0,00 | 0,00 |
| Stock | 0,00 | 0,00 | 0,00 | 1260 thousand | 0,00 | 0,00 | 52 thousand | 20 thousand | 0,00 | 0,00 |
| Auction | 3.9 million | 0,00 | 4 million | 300 thousand | 0.5 million | 0,00 | 0,00 | 0,00 | 0,00 | 200 thousand |
| **Total** | **12.1 million** | **0,00** | **4.2 million** | **8.4 million** | **0.5 million** | **3.5 million** | **52 thousand** | **20 thousand** | **0,00** | **200 thousand** |

| Number of SOEs privatised (by tender) | |
|---|---|
| 2010 | 2 |
| 2011 | 0 |
| 2012 | 1 |
| 2013 | 1 |
| 2014 | 4 |

Source: Data provided by the Montenegro authorities.

### *The way forward for state-owned enterprises*

SOEs operate at the nexus of the public and private sector; as such, their operations are affected by both the quality of public governance and the prevailing corporate and boardroom culture. Choosing the appropriate sequencing of reforms is just as important as their content, and depends in large part on the national political climate and current reform priorities. The OECD Guidelines on Corporate Governance of State-Owned Enterprises provide signposting for reforms that the authorities can use to inform their policy efforts in this domain. Based on the state of play of SOE policy development in Montenegro, the following priority reform areas – which are in line with the OECD SOE Guidelines – could offer a basis for discussions with the authorities. Because the vast majority of Montenegro's SOEs have non-state shareholders, as the state implements its ownership responsibilities in line with the recommendations below, it will be important to ensure that non-state shareholders' interests are considered – and their rights respected – to maintain an attractive environment for private investors:

- **Develop a state ownership policy and review the effectiveness of current state ownership arrangements.** In Montenegro, ownership rights in SOEs are exercised by the government, state institutions (state funds) and (in some cases) line ministries, which is different from the somewhat common model of decentralisation under line ministries. The authorities should ensure that these state actors operate under a unified ownership policy. Since reviewing the effectiveness of the current ownership arrangements goes beyond the scope of this assessment, the authorities could for instance

undertake an in-depth review of the efficiency of current ownership arrangements with a view to improving them.

- **Improve the process for setting objectives and monitoring their fulfilment.** There is scope for strengthening the state's role in setting performance targets for SOEs and monitoring their achievement. The state should also produce an aggregate report presenting information on the performance of the state's portfolio.
- **Ensure that the SOE board nomination process is merit-based and transparent.** The state should ensure that SOE boards are equipped with qualified professionals and should minimise the risk of political board nominations. Recent updates to the company law requiring independent directors on (some) SOE boards can be expected to reduce conflicts of interest and further professionalise SOE boards. Nonetheless, company law provisions on board nominating procedures cannot be considered to constitute a robust SOE board nomination framework on their own. The authorities should establish SOE-specific board nomination procedures to ensure that SOE boards of directors are equipped with a sufficient diversity of expertise, as well as independence from both political influence and corporate management, to oversee corporate decision making in the interest of the SOEs and their shareholders.
- **Ensure that SOEs create value for all shareholders, including the state and minority non-state owners.** The role of minority shareholders in SOE decision making should be enhanced. Since the authorities have chosen to prioritise private investments in their SOE sector, they need to ensure that private capital holders' interests are taken into account. In addition, in the companies in which the state is itself a minority shareholder, the authorities should review the need to continue holding minority shares in them. Box 23.10 describes how Poland has worked towards a positive and value-creating relationship between the state and private investors.

### Box 23.10. Broadening the ownership of SOEs in Poland

Privatisation through the stock exchange has been one of the key elements in the Polish economy's transition from command to free-market economy. Share offerings of SOEs have been used as a means to develop Poland's capital markets, to strengthen Warsaw's role as a regional financial centre, to maximise revenues from privatisation through the capital markets, and to attract financial resources for the companies themselves.

In general, the Polish Government considers that listing has been a key factor in contributing to improvements in overall company performance and governance standards. This is due to a number of factors, including more effective and better qualified management teams, which are able to introduce operational efficiencies after listing (e.g. cost reductions); increased disclosure and reporting requirements following listing; and the presence of larger more active institutional investors, which helps to bring about increased diligence and focus on company performance.

In companies where the state remains the majority shareholder, the state has the power and duty (through its seats on the supervisory board) to:

- appoint, dismiss and suspend board members
- recommend a remuneration policy for the management board
- access company financial statements
- approve annual financial plans and long-term strategic goals
- monitor and control decisions which are material to the company
- approve investment/divestment decision above certain limits
- select company auditors and monitor the audit process
- assure continuous monitoring of performance and ability of the company to meet its financial and long-term strategic goals.

The Treasury considers equal shareholder rights to be of paramount importance, which is enshrined in the Commercial Companies Code and supported by codes of best practice. The code specifically states that each share carries one vote. However certain exceptions apply, such as: share with preferential voting rights, but not more than two votes per share; limitation in the exercise of voting rights by shareholders representing more than one-fifth of the total number of votes; and personal rights for individual shareholders, such as the right to appoint or remove members of the management and/or supervisory board. Shareholders representing at least one-tenth of the company's share capital may request an extraordinary general meeting to be convened, and can also place matters of particular interest on the agenda of annual general meetings. Depending on the company, some rights may be granted to shareholders representing a smaller minority of the company's share capital. Representatives of the Treasury on the supervisory boards of companies in which the state is a minority shareholder have a number of rights including: informing the appropriate supervisory units of any violation of the laws committed by company management or of any activities which may be harmful to the Treasury's interests; applying statutory provisions appropriately to secure the Treasury's best interests; and initiating reporting and disclosure obligations by the company's board members.

Source: extracted from (OECD, 2016[92]), *Broadening the Ownership of State-Owned Enterprises. A comparison of Governance Practices*, https://www.oecd.org/fr/publications/broadening-the-ownership-of-state-owned-enterprises-9789264244603-en.htm.

## Education policy (Dimension 7)

### *Introduction*

Overall, Montenegro has one of the best performing education systems in the Western Balkans. Participation in primary education is now on a par with EU and OECD levels, and student learning outcomes – as measured by the Programme for International Student Assessment (PISA) – have seen important progress. Notably, Montenegro's mean score for student performance in mathematics increased by around 12 points between the 2015 and 2018 PISA cycles; compared to an average of 2 points in OECD countries (OECD, 2020[18]). In the last two years, the government has started implementing significant policy reforms, such as curriculum guidelines to ensure continuity in children's transition from early childhood education to primary education, and free tuition for students at public higher education institutions. These efforts have led to increases in Montenegro's education scores since the CO 2018 (for those indicators which allow for comparisons (Figure 23.1). Montenegro is also slightly above the WB6 overall average for this dimension (Table 23.14). However, a large share of students are still not mastering basic competencies.

**Table 23.14. Montenegro's scores for education policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 3.2 | 3.0 |
| | Sub-dimension 7.2: Teachers | 3.3 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 3.5 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 2.8 | 2.8 |
| | Cross-cutting dimension: System governance | 3.5 | 3.3 |
| **Montenegro's overall score** | | **3.2** | **3.0** |

### *State of play and key developments*

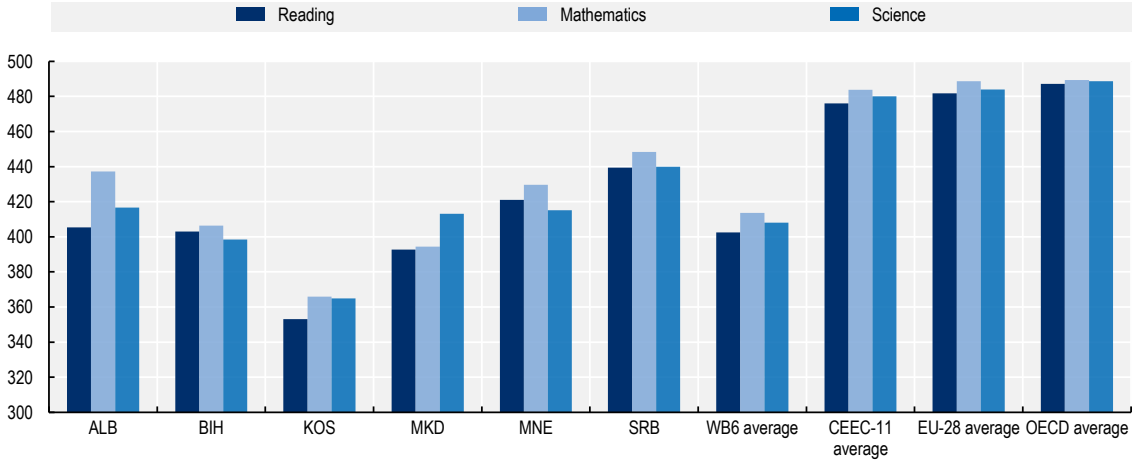
#### *Sub-dimension 7.1: Early childhood and school education*

Montenegro's score in this sub-dimension is slightly above the WB6 average. Since the last CO assessment, Montenegro has made strong progress in improving access and raising the quality of early childhood education. It has also taken steps to support implementation of its new curricula for the pre-university school system. As of 2019, net enrolment in Montenegro was universal for primary education (99.9%), but slightly lower for lower secondary (92.3%) (UIS, 2020[93]). Net enrolment in upper secondary (89%) has gradually increased and is on track to meet OECD (92.5%) and EU (93%) averages in the coming years. Moreover, Montenegro has some of the lowest early school-leaving rates in the region, on a par with European and OECD countries such as Ireland, Poland and Switzerland (Eurostat, 2019[94]).

In terms of learning outcomes, Montenegro's average scores in PISA have increased over time and are above the Western Balkan average. However, average performance across subjects remains below the EU and OECD averages (Figure 23.15). While Montenegro has a smaller share of low-performing students than most economies in the region, the share of students who lack baseline levels of proficiency in reading (44.4%) and mathematics (46.2%) is still much higher than the OECD average (around 23% and 22% respectively) (OECD, 2020[18]). This has implications for Montenegro's long-term economic development, as students without basic skills are less likely to attain well-paid and rewarding jobs.

## Figure 23.15. Performance in reading, mathematics and science in Western Balkan six education systems, 2018

PISA mean scores




Note: CEEC - Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
Source: (OECD, 2020[18]), *PISA 2018 Database*, Tables I.B1.4, I.B1.5 and I.B1.6, www.oecd.org/pisa/data/ PISA database.

StatLink https://doi.org/10.1787/888934255950

There are also signs of educational inequities in the education system. Students from Roma and Egyptian Balkan communities and students with disabilities are more likely to face barriers in accessing high-quality early childhood education (ECE) and school education (UNICEF, 2013[95]). Moreover, data from the 2018 PISA reading assessment reveal a performance gap of 66 points between students who receive instruction in Montenegrin and those who are taught in Albanian (OECD, 2020[18]). While it is positive that Montenegro has strategies to support inclusive education and offers mother-tongue instruction in areas where there is a significant presence of minority language groups, there is a need to analyse disaggregated data on the education system to better understand and address disparities.

Montenegro's performance in **early childhood education** is slightly above the regional average. The Strategy of Early and Preschool Education in Montenegro 2016-2020 (UNICEF Montenegro, Ministry of Education of Montenegro, 2016[96]) establishes clear goals, notably to increase ECE coverage and improve the quality of services. Facilitated by the construction of new facilities, Montenegro's gross enrolment ratio in pre-primary education increased from around 31% in 2010 to 74% in 2019 (UIS, 2020[93]). This rate is now above the 2018 WB6 average (71%) but lower than the OECD and EU averages (around 94%) (UIS, 2020[93]). While participation in pre-primary education is not compulsory in Montenegro, there are several measures to reduce barriers to access, including free provision for socio-economically disadvantaged children and those with disabilities. The Ministry of Education and international partners have also organised outreach efforts to encourage families and communities to enrol their children in ECE. In terms of quality, Montenegro has clear educational requirements for ECE staff and there are curriculum guidelines to ensure continuity in children's transition from ECE to primary education. However, the latter do not include clear development and learning goals that children should achieve by each age group. Finally, donor-led initiatives continue to play an important role in implementing policy initiatives and monitoring and supporting the ECE sector in Montenegro.

While Montenegro performs relatively well compared to most Western Balkan economies in PISA, the **instructional system**[68] scores below the regional average for this indicator. This is primarily because the economy lacks an overarching strategy that establishes a coherent vision for the school system (see the Cross-cutting dimension: System governance). Instead, Montenegro has multiple strategies which cover different time periods, topics and levels of education. For example, there are separate strategies for general and vocational education at the secondary level, both of which cover 2015-20, in addition to strategies on inclusive education (2019-25) and supporting talented students (2020-22). Despite Montenegro's rather

fragmented approach to the strategic development of the pre-university education sector, administrative laws establish clear regulations for curricula, assessments and evaluations.

A major curricular reform was introduced in 2017. Its main goal is to shorten the primary school curriculum by 10% to create more space for the development of cognitive skills and reaffirm the educational role of the school. This reform is being supported by the Bureau for Education Services,[69] which is developing a manual that will set out learning outcomes for students and how their achievement should be measured by subject and grade. While the manual's finalisation has been delayed because of COVID-19, its implementation will serve as an important reference for Montenegro's Examination Centre, which is responsible for Montenegro's two national examinations. Currently, Montenegro's exams respectively certify the completion of primary education (in grade 9) and upper-secondary education (in grade 12). The Examination Centre is also responsible for managing Montenegro's participation in international assessments, like PISA, which provide valuable information to monitor and compare the quality of instruction.

Similar to many European education systems, Montenegro has a set of school quality standards that cover teaching and learning, in addition to more compliance-based requirements. These standards are accompanied by a rulebook on the content, form and manner of external and internal evaluations of schools to ensure the quality of their educational work. According to the General Law on Education and the rulebook on the content, form and manner of determining the quality of educational work in institutions, schools in Montenegro must conduct annual self-evaluations in specific areas, as well as comprehensive biannual self-evaluations. The Department for Determining the Quality of Educational Work of Schools, a body independent of the Ministry of Education, is responsible for conducting external school evaluations.

The **early school leaving** rate in Montenegro has generally declined over the last decade. It had fallen to 5% in 2019, well below the EU target of less than 10% of early school leavers by 2020 (Eurostat, 2019[94]). While there is no specific strategy for early school leaving, several policies and initiatives tackle the issue, often by targeting students at risk of leaving school early. For example, the Ministry of Education employed 21 Roma mediators in 2019-20 to help increase enrolment and reduce the dropout rates for students from Roma and Egyptian communities (EC, 2020[35]). Montenegro also benefits from IPA[70] funding to help marginalised students who are at risk of dropping out or leaving to prevent them leaving or return them to the system. Career guidance and a dual education programme in Montenegro further help connect students with an educational pathway that fits their interests and abilities. Other key policies, such as the multidisciplinary Protocol on the Procedure and Prevention of Early School Leaving and refined indicators in the Ministry of Education's information system have also contributed to Montenegro's low early school leaving rate by collecting a range of data and drawing on a variety of competent institutions and actors to monitor and tackle the issue. To further improve in this sub-dimension, Montenegro should evaluate and adjust its strategies and policies relevant to early school leaving.

### *Sub-dimension 7.2: Teachers*

Montenegro's score on the teacher sub-dimension is above the WB average, largely because the Teacher Education Strategy in Montenegro (2017-2024) offers a set of policy actions to improve initial teacher education and their professional development and management. Montenegro also has clear regulations and rulebooks that shape teacher policy. For example, all school teachers are required to have at least a higher education degree. National data received for this assessment reveal that as of 2019, most teachers (77.5%) had achieved at least a Bachelor's degree or equivalent. While the average gross salaries of teachers in Montenegro are lower than other European countries, they are similar to or slightly lower than the mean earnings of workers in Montenegro with similar levels of education. For example, the actual salaries of lower secondary teachers in 2014-15 were around 75% of the mean earnings of workers with a short-cycle tertiary education or a Bachelor's degree. This situation is similar to European countries like Hungary, the Czech Republic and Greece (EC/EACEA/Eurydice, 2019[97]).

Montenegro accredits **initial teacher education (ITE)** programmes based on professional teacher standards. This means that ITE providers must demonstrate how their programmes help candidates develop the specific competencies needed to teach by offering relevant courses and dedicating 25% of learning time to a teaching practicum. The latter consists of a one-year teaching internship under supervision of a trained mentor. After completing the internship, candidates must pass a professional examination before they can start working in schools as a licensed teacher. While these are positive practices found in many European countries, Montenegro does not have minimum entry requirements for candidates in ITE because higher education institutions have full autonomy to determine these criteria. To raise the profession's competitiveness and attract the most motivated and qualified candidates into ITE, Montenegro reports having made improvements to teachers' working conditions and increasing salaries. However, there are no targeted efforts to recruit teachers with specific profiles and there are no alternative pathways into the profession, which leads to imbalances in the teaching workforce.

There is a clear regulatory framework around the **professional development and management** of teachers in Montenegro. Funding for professional development comes from the Ministry of Education, schools, international projects and teachers' personal budgets. In some cases, funds are transferred directly to schools, especially in the case of international projects. Teachers must renew their teaching licences every five years and there is a progressive career structure linked to financial incentives that helps encourage continuous professional development. Montenegro has four categories of teachers (mentor, advisor, senior advisory and teacher researcher) that align with years of work experience, professional development requirements and an appraisal process based on teacher professional standards (Republic of Montenegro, 2009[98]). These types of performance-based career structures can help motivate teachers to improve their practice. However, Montenegro's professional teacher standards are not differentiated by category of teacher, meaning that the expectations for teachers do not evolve or become specialised to reflect experience or the subjects or grade levels taught.

### *Sub-dimension 7.3: Vocational education and training*

Montenegro's score in the sub-dimension on vocational education and training (VET) is slightly above the WB average (Table 23.14). Professionally oriented education can start at lower-secondary level, when students attend a single school with peers following a general curriculum; or in upper secondary, when students are allocated into either a general (gymnasium) or a 3-4 year vocational or professional school (Eurostat, 2020[99]). As of 2018, some 33% of secondary students in Montenegro were enrolled in VET programmes, above the WB (29%), EU (27%) and OECD (23.5%) averages (UIS, 2020[93]). Similar to other economies, data from PISA 2018 find that students in Montenegro's vocational programmes are more likely to be low performers[71] than their peers in general education. However, the share of low-performing VET students in Montenegro (55%) is one of the lowest in the Western Balkans, second to Serbia (47%) (OECD, 2020[18]). Nevertheless, some evidence suggests that VET students continue to lack the skills required by the labour market (EC, 2020[35]).

A range of public bodies are responsible for the **governance of VET** in Montenegro, which is guided by the new Strategy for the Development of Vocational Education (2020-2024). Key institutions include the Ministry of Education; the Centre for Vocational Education;[72] the Examinations Centre, which among other responsibilities manages vocational examinations to ensure that VET qualifications are rigorous, transferable and understood by the public; and the Bureau for Education Services.[73] Policy coherence is ensured by good co-operation amongst these institutions. For example, these is a co-ordination body responsible for monitoring and implementing the strategy, allowing various actors to participate in decision-making processes. Industries and social partners also engage in the sector's development by helping shape occupational standards for educational programmes and hosting and assessing students in dual education programmes. Montenegro has clear processes for accrediting VET programmes and providers must undergo an external evaluation at least once every four years, in addition to biannual self-evaluations. Reports on the findings from these evaluations are publicly available.

The Strategy for the Development of VET in Montenegro recognises the importance of **work-based learning** to improve the relevance of VET programmes for individuals, the labour market and society. Notably, Montenegro is the first economy in the Western Balkans to roll out a dual VET system nationally (ILO, 2020[100]). The relationships between the scope and duration of theoretical and practical classes are clearly defined[74] and the government plans to further improve the quality of dual education by developing a certification system for companies that wish to train students, improving training for teachers and in-company tutors, improving monitoring and evaluation instruments, and strengthening final examination processes. Montenegro collects a range of information on VET, often in partnership with Employment Services, to help inform the design of policies and programmes. However, there is no information on the earnings of VET graduates nor the location and type of work-based learning (WBL) opportunities, completion rates from WBL programmes or the duration of these programmes. Nevertheless, there are broad public awareness campaigns and presentations to social partners and companies to help match learners with WBL places. While Montenegro does not currently offer financial incentives for employers to provide WBL places, there are plans to create a Fund for Dual Education which will pay employers to host students during part of their study programme (see also Box 23.13 later in this report).

### *Sub-dimension 7.4: Tertiary education*

Montenegro's score in the tertiary education sub-dimension is on a par with the Western Balkan average. School life expectancy (from primary education through tertiary education) has increased in recent decades and was similar to the WB average (nearly 15 years) in 2018, but still lower than the average in the EU (16.6 years) and OECD (17 years) (UIS, 2020[93]). The share of the labour force (aged 15+) who have attained some form of tertiary education (ISCED 5-8) increased slightly between 2018 and 2019 to 29%, the highest share among the WB economies (ETF, 2020[101]). However, gross enrolments in tertiary education have decreased by 4 percentage points since 2017 (UIS, 2020[93]) and the share of youth who are not in employment, education or training (NEET) increased slightly between 2018 and 2019 (from 16.2% to 17.3%) (ETF, 2020[101]). A new higher education strategy in Montenegro (2020-2025) is currently being developed in consultation with the public; however, its finalisation may be delayed by the COVID-19 pandemic. The sector is regulated by legal frameworks, notably the 2014 Law on Higher Education, but there have also been several national reforms in the last two years. In particular, Montenegro has aligned its study model for higher education with the European Higher Education Area (a 3+2+3 year model), and since 2017 undergraduate studies at public higher education institutions are tuition free.[75]

Montenegro has established transparent processes for selection into higher education[76] and there are affirmative action policies for people with disabilities who wish to pursue higher education studies. The Ministry of Education awards students with loans and scholarships based on their results of academic competitions, which helps pay for living and other associated costs. However, these are the only financial support mechanisms available to students since undergraduate tuition is now free. While tuition-free policies are intended to facilitate more **equitable access to higher education** it is likely they will benefit advantaged students who were already on track to attend higher education programmes, rather than create more equal opportunities to support marginalised students who may face greater barriers in accessing and completing higher education. This concern is exacerbated by the limited amount of data available to monitor equity in tertiary education in Montenegro. While the Statistical Office of Montenegro (MONSTAT) reports collecting gender data on enrolment rates, there have been no studies on associations between individual factors, such as socio-economic or minority background, and participation in higher education. Without more disaggregated data and analysis, Montenegro may struggle to identify and tackle equity issues in the tertiary sector.

An important goal of Montenegro's previous Higher Education Development Strategy (2016-2020) was to harmonise education with the needs of the labour market by modernising study programmes, introducing new learning methods (e.g. ICT), promoting entrepreneurial learning and teaching English. There are several initiatives to support the internationalisation of higher education in Montenegro both at the central

government level, such as participation in the EU Erasmus Plus programme, and by individual higher education institutions (HEIs).[77] Data on the **labour market relevance and outcomes** of higher education are mainly under the responsibility of Montenegro's Employment Service Bureau, which collects labour market information using employer surveys, quantitative forecasting models and sectoral studies. Individual HEIs also collect their own data on student outcomes across study programmes, but it seems they are not aggregated centrally. An important development in Montenegro since 2017 is the establishment of the Agency for Control and Quality Assurance of Higher Education. It started working at full capacity in 2018 to conduct research on the higher education system and to co-operate with international institutions in the field of quality assurance in higher education (AKOVO, 2020[102]). This change has helped align Montenegro's quality assurance mechanisms with those of the EU.

### *Cross-cutting dimension: System governance*

Montenegro's score for this cross-cutting dimension is similar to the WB average, as some **system governance** features align with the policies and practices found in European and OECD education systems. For example, Montenegro's National Qualifications Framework was aligned with European Qualifications in 2014 and covers eight levels of qualifications. The Ministry of Education, Science, Culture and Sports also manages the Montenegrin Education Information System (MEIS), which stores a range of information about the education system and helps monitor performance through a set of key indicators. These include student learning outcomes, which are generated through the economy's regular participation in international assessments since Montenegro does not have a national assessment system.

Despite these positive features of system governance, a notable difference between Montenegro and other WB6 economies, EU member states and OECD countries is the lack of a comprehensive national education strategy that sets out a clear vision and goals for the entire sector. Instead, Montenegro has several individual strategies that cover different levels of education and topics, such as the Strategy for General Secondary Education (2015-20) and the new Strategy on Support for Talented Students (2020-22). Taken alone, these strategies have clear and measurable targets, allocate responsibilities and provide timelines for implementation. However, it is unclear how the various strategies relate to one another and many are set to expire in 2020, without a clear indication on whether they will be extended or revised. A positive feature of Montenegro's strategic governance system is that there are evaluations of individual education strategies and on thematic topics, such as VET. Monitoring activities are carried out by co-ordination bodies who usually meet quarterly to analyse the implementation of planned activities. However, many of these evaluation efforts are supported by donor agencies and Montenegro does not produce its own reports on the performance of the education system as a whole.

Similar to governments around the world, Montenegro was faced with a rapid shift from classroom to remote learning in 2020 to help slow the spread of COVID-19. Working with donor agencies, the Ministry of Education introduced a variety of distance learning opportunities for the different education levels. These included a portal, "Školskiportal", for teacher-student communication with classes divided by years and subjects; a dedicated YouTube channel for recorded classes; and another portal, "UčiDoma", centralising recordings and schedules of classes.

To support the inclusion of children from marginalised social or ethnic groups, the ministry, in co-operation with the HELP organisation and Telekom Crne Gore provided a small number (100) of smartphones with free three-month subscriptions to students in need. While in-class teaching is now possible once again, policy measures are in place to provide paid leave for parents of children under the age of eleven and children with special educational needs if the country should move towards online learning again.

In the tertiary sector, the University of Montenegro, as well as private educational institutions, have created an online teaching plan and encouraged the use of online platforms such as Moodle for learning management and Zoom for online classes. Furthermore, the Ministry's Bureau of Education issued

recommendations on how to best organise distance learning, covering fields such as teaching planning and organisation, teacher-student communication, student assessment and inclusive education.

### *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education can help Montenegro increase its competitiveness and create opportunities for more individuals to develop the competencies needed for sustainable development and social cohesion. Montenegrin officials will need to reflect on the economy's political, social and fiscal environment to determine how best to achieve their education goals. The following considerations can provide insights for discussions on the way forward for enhancing education:

- **Develop a new and comprehensive education strategy with a clear set of priorities and a strong monitoring framework.** Rather than continuing to develop ad hoc strategies on various education priorities, such as inclusive education or support for talented students, Montenegro should develop a comprehensive education strategy that provides a vision and clear set of priorities for directing the education sector towards supporting more students to achieve good and excellent outcomes. This education strategy should align with Montenegro's overall development strategy as it will cover a critical period of potential accession to the EU. It will be important to focus on priorities that are clear and measurable to help mobilise stakeholders across the system and serve as a key reference for other strategic education documents that focus on specific levels or thematic areas. These priorities should be translated into financially viable implementation plans that can be measured through a monitoring framework.
- **Strengthen evaluation and assessment policies across the system.** Montenegro already has an Education Management Information System, but there are several areas where additional disaggregated data would help support education policy reforms and inform decision making. For example, data on educational participation, attainment and learning outcomes according to linguistic, socio-economic and immigrant background could help monitor and advance Montenegro's inclusive education goals. It is also important to analyse and review education data and policy initiatives. In particular, Montenegro should consider producing a regular analytical report on system-wide progress that pulls together individual work programmes and various education strategies into a prominent state of education report. The Czech Republic and Portugal provide similar reports for their education systems (Box 23.11).
- **Finalise the development of the national assessment and set targets for improving student learning outcomes.** Many Western Balkan education systems have – or are developing – national standardised assessment systems to help monitor the implementation of curricula and focus actors across the system on improving student learning outcomes. Developing a national assessment instrument would allow Montenegro to collect valuable information to monitor national education goals.

### Box 23.11. Annual analytical reports on the education system in the Czech Republic and Portugal

In the Czech Republic, the Ministry of Education, Youth and Sports produces an annual report on its evaluation of the country's education system (the Status Report on the Development of the Education System in the Czech Republic). This report relies on a set of indicators designed to assess progress towards the country's long-term policy objectives. The document summarises the main organisational and legislative changes that have occurred during the year and presents statistical indicators describing the situation and development in pre-primary, basic, secondary and tertiary education. The report also contains information on educational staff in the system, the funding of schools and the labour market situation of school leavers. These data constitute a basis for the development of education policies. Furthermore, the report typically includes an area of specific focus. For example, the 2017 annual report includes a section on the country's results in the 2016 Progress in International Reading Literacy Study (PIRLS). Individual regions within the Czech Republic also produce their own reports to assess progress towards long-term policy objectives.

In Portugal, the National Education Council, an independent advisory body to the Ministry of Education, has published the annual State of Education report since 2010, which provides an analysis of key data on the education system. The first issue, the State of Education 2010 – School Paths, offered a detailed investigation of student pathways in the education system. The latest issue, The State of Education 2017, published in 2018, contains a section dedicated to the state of education in Portugal's countryside and the role of education in promoting territorial cohesion. The report also offers policy advice on how to improve the quality of pre-primary, basic, secondary and tertiary education. It also evaluates policy initiatives, such as changes to school evaluation, human and financial resources and policies to increase educational equity.

Source: (Santiago et al., 2012[103]), *OECD Reviews of Evaluation and Assessment in Education*, https://doi.org/10.1787/9789264117020-en; (Santiago et al., 2012[104]), *OECD Reviews of Evaluation and Assessment in Education: Czech Republic 2012*, https://doi.org/10.1787/9789264116788-1-en; (CNE, 2018[105]), *Estado da Educação 2017*, http://www.cnedu.pt.

## Employment policy (Dimension 8)

### *Introduction*

Since the last Competitiveness Outlook assessment, Montenegro has made efforts to align its labour legislation with the EU *acquis*. New legislation has aimed at increasing flexibility on the one hand, and better working conditions on the other. Improvements have been made to the capacities of labour inspectors and inspectorates. However, no progress has been made to analyse the volume and structure of informal employment or to analyse the impact of tax wedges and the low level of the social protection benefits on informal employment. Inter-institutional co-operation to reduce informal employment has been improved. With the support of the International Labour Organization (ILO), there are concrete plans to strengthen the role of social partners and collective bargaining. Important improvements have been made in skills mismatch analysis, co-operation between actors, setting up a dual education scheme and increasing the quality and image of VET, and building an adult education system. Although some improvements have been made in the territorial coverage of PES offices and tools for PES counsellors (profiling, setting up of individual action plans), no sizeable improvements have been made to the number of PES counsellors or budgets. Targeting of the most vulnerable unemployed and inactive groups is still weak, although relevant programmes have been set in place (however, with low budgets).

Figure 23.1 in the key findings shows the improvement of Montenegro's performance, as its overall score increased from 2.1 in 2018 to 3.0 in 2021. All four sub-dimension scores are higher than the WB6 average (Table 23.15), and its overall score is second only to North Macedonia.

**Table 23.15. Montenegro's scores for employment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 3.0 | 2.6 |
| | Sub-dimension 8.2: Skills | 3.0 | 2.2 |
| | Sub-dimension 8.3: Job quality | 2.5 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 3.3 | 2.9 |
| **Montenegro's overall score** | | **3.0** | **2.6** |

### *State of play and key developments*

**Table 23.16. Key labour market indicators for Montenegro (2015 and 2019)**

| | Montenegro | | WB6 average | EU average |
|---|---|---|---|---|
| | 2015 | 2019 | 2019 | 2019 |
| **Activity rate (15-64)** | 62.6% | 66.2% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 51.4% | 56.0% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 17.8% | 15.4% | 16.3% | 6.4% |

Note: WB6 average rates are based on author's own calculations using simple averages.
Source: (Eurostat, n.d.[106]), Labour Force Survey database, https://ec.europa.eu/eurostat/web/main/data/database.

As shown in Table 23.16, the activity rate of the population aged 15-64 increased by 3.6 percentage points from 2015 to 2019 reaching 66.2%, the fourth highest in the region. However, it was still 7.9 percentage points below the EU average, as well as below the 11 new EU member states (73.7%). Over the same period the number of employed increased constantly (+11%). Between 2015 and 2019 the employment rate of people aged 15-64 rose to 56.0% (Eurostat, 2020[107]), the third highest rate in the region after Serbia and Albania, though still largely below the EU average (Eurostat, 2021[108]). There was a very strong increase in the employment rate of older workers, from 32.3% to 44.6%, and of youth (14-24 years old), from 17.7% to 25.7%.[78] The latter was well above the WB6 average, but markedly below the EU average. Employment growth in 2018 and 2019 was linked to the favourable economic climate (Government of

Montenegro, 2020[109]) and driven mainly by decreasing inactivity and to a lesser extent falling unemployment (one-quarter of employment growth reflects falling unemployment between 2015 and Q2 2019, according to Labour Force Survey data). The unemployment rate (amongst the 15-64 age group) fell by more than 2 percentage points from 2015 to 15.4% in 2019, and the youth unemployment rate nearly halved (25.2% in 2019, according to Labour Force Survey data). The decrease in the unemployment rate was less steep than the WB6 average, however. In 2019, the unemployment rate was below the region's average (16.3%), but largely above the EU average (6.4%). Unemployment has risen again in 2020 as a consequence of the COVID-19 pandemic. In Q2 2020, the employment rate was 5.7 percentage points lower than in the same quarter the previous year, a lower decrease than in North Macedonia, but higher than in Serbia and the EU[79] (-1.6 percentage points) (Eurostat, 2021[108]) where short-term work schemes have been in place (Duell, 2020[110]).

As a result of the COVID-19 pandemic, on 30 September 2020 the number of registered unemployed was 28.8% higher (+9 700) than in September 2019. Unemployment rose for all qualification levels, with a relatively stronger increase among the highly educated and medium-educated groups. Young people were more strongly affected by unemployment than older workers. Between January and September 2020, the number of registered job vacancies fell by 32.2% and the number of work permits issued fell by 40.3%.[80] The Employment Agency of Montenegro has continued to implement active employment policy programmes for the unemployed. These include direct job creation and public works; training measures in co-operation with employers; and the programme "stop the grey economy" that provides training and employment for young highly educated unemployed people for a period of seven months. Newly registered unemployed recent graduates are offered workshop activities through the Zoom platform. The delivery of these kinds of digital services to the unemployed is a novelty in Montenegro. To cope with social distancing rules, digitalisation and provision of remote services for the unemployed has also strongly expanded in EU countries (Duell, 2020[110]).

### *Sub-dimension 8.1: Labour market governance*

The pillars of the **regulatory framework** setting minimum employment standards consist of a new Labour Law adopted in December 2019, which entered into force in January 2020; the General Collective Agreement of 2014 with latest amendments made in 2019; and the Law on Occupational Health and Safety of 2014, with latest amendments made in 2018. The latest changes in the legislation were made to align with EU standards[81] by improving labour market flexibility and labour standards for workers in certain areas. The new labour law is harmonised with 14 EU directives. The work on alignment with the *acquis* will be continued.[82] Improvements made include the areas of (Karanovic and Partners, 2020[111]):

- transparent working conditions
- part-time work and temporary agency work (strengthening the protection and rights of temporary agency workers and lengthening the use of temporary agency workers to 36 instead of 24 months, excluding internship)
- work-life balance, i.e. working from home
- aligning overtime hours with EU standards (average working time should not exceed 48 hours per week, within a period of 4 months)
- take-up of annual leave
- improved protection of pregnant workers and workers on parental leave.

In the case of collective layoff procedures, the new law prescribes mandatory consultations with the employees' labour union (or their representatives) and to notify the Employment Bureau of the consultations; previously only employees and their representatives were notified (Karanovic and Partners, 2020[111]). An employer cannot employ another person in a position deemed redundant for a period of six months.

Certain non-standard forms of employment are covered by the social protection framework, such as temporary employed and self-employed workers. There is no regulation in place clarifying labour standards and employment protection for gig workers.

Some of the key priorities of **labour inspections** are to combat informal work and supervise the implementation of regulations on occupational health and safety, temporary agency work, and labour standards in general.[83] The bulk of inspections are carried out during the summer tourist season, which is characterised by a high incidence of undeclared work (70% compared to the rest of the year). Enhanced supervision is also carried out in the construction and transportation sectors. A rotating system of labour inspectors across cities has been implemented to increase the effectiveness of their work. Undeclared work cases are processed through preventive and repressive measures, controlling for registration of business and of payments, and disciplining employers for breaching labour regulations. Infractions of the law are monitored and sanctioned. Inspections are carried out through regular visits or following notification by the people employed or formerly employed, various associations and citizens. Some forms of undeclared work are particularly difficult to detect, e.g. envelope wages (where only one part of the wages is declared). In cases of breaches, inspectors first issue the employer with a "warning" and give them a deadline for correcting the breach.

There is a co-ordination mechanism in place bringing together other units with inspection facilities, such as the tax authority, police administration (border police and sector for foreigners), and local municipality institutions (communal inspection and police). The labour inspectorates share relevant data with these institutions/units, while also implementing joint inspections. Labour inspectorates are part of intergovernmental work groups for drafting laws and bylaws such as the Labour Law, the Law on Occupational Safety and Health and its bylaws. Labour inspection outcomes are monitored through indicators in the information system of the labour inspectorates, established in 2016 (Administration for Inspection Affairs, 2019[112]).

While implementing preventive measures is highly relevant, it would also be useful to conduct an assessment of the institutional capacities of labour inspectorates to fulfill their tasks. Labour inspectorates' human and technical resources are inadequate and more frequent inspections are necessary. In 2020, there were 42 labour inspectors, up from 33 in 2017. There are around 5 800 workers for each inspector, which is a better ratio than in Albania, North Macedonia, Serbia and Kosovo.[84] Capacity is however lower than in a country like Germany, where the same inspector-worker ratio would apply solely to the detection of informal employment, with additional staff in charge of occupational health and safety. Most inspectors in Montenegro are lawyers (32), who carry out employment and labour law inspections. The remainder are graduate engineers of various technical and technological professions, who carry out health and safety inspections. They receive training in legal issues and attend seminars on topics like informal employment, health and safety at work, gender equality, discrimination, employment of persons with disabilities, human trafficking and corruption. Inspectorates in the field of occupational health and safety are also constantly involved in organising and delivering various training and awareness-raising events, which are attended by representatives of employers and workers in the companies.

During 2019 the Labour Inspectorate performed a total of 11 430 inspections (8 128 in the field of labour relations and employment and 3 302 in the field of occupational health and safety), in which it identified a total of 6 548 irregularities (Ministry of Public Administration of Montenegro, 2020[113]).

There is a basic labour market information system in place. The statistical office MONSTAT and the Employment Agency of Montenegro (EAM) are the primary sources for a wide array of indicators. MONSTAT provides data on temporary employment (fixed-contract) and part-time work. There are some ad hoc data on informal employment, but they date back to 2014. A question on informal employment has been introduced in the Labour Force Survey instead. It would be advisable to analyse these data and assess their quality. Progress has also been made with publication of the first results of the household survey aligned with European Union Statistics on Income and Living Conditions (EU-SILC); however more

indicators on social protection and inclusion would be needed (EC, 2019[23]). Key monitoring reports include the Report on Implementation of the Action Plan for Employment and Human Resources Development 2019 (Government of Montenegro, 2020[114]), Report on the Work of the Employment Agency of Montenegro (Employment Agency of Montenegro, n.d.[115]) and the Report on the Work of the Ministry of Labour and Social Welfare for 2019 (Ministry of Labour and Social Welfare of Montenegro, 2020[116]). There are no studies assessing the effects of current labour regulations on social protection coverage, health and participation in employment or on the recruitment behaviour of companies. Nevertheless, project-based evaluations are carried out in certain areas. While improvements have been made, efforts need to be continued to make systematic evidence-based policy making. This would include conducting thorough evaluations of measures and programmes, as well as assessing the institutional capacities of key actors, in particular labour inspectorates (the last assessment, done by the ILO, dates back to 2006).

According to the UNICEF Multiple Indicator Cluster Surveys (MICS) in 2018, 12% of children aged 5-17 were involved in child labour and 5% of children aged 5-17 worked in dangerous conditions (UNICEF, 2018[117]). In comparison, the results of the 2018 survey of North Macedonia show that 5% of children aged 5-17 years were involved in child labour and 3% worked in dangerous conditions. Although institutional mechanisms for the enforcement of laws and regulations on child labour are in place, there is room for improvement in the operations of the agencies responsible for child labour law enforcement (ILO, 2019[118]). Montenegro could take action by improving the capacities of the labour inspectorates in detecting child labour and by constantly tracking and publishing information about children involved in the worst forms of child labour.

The National Strategy for Employment and Human Resources Development 2016-2020, and its annual action plans, set the **employment policy framework.** The strategy includes four priority goals: increasing employment and reducing the rate of unemployment; achieving the efficient functioning of the labour market; adjusting qualifications and competencies to labour market needs; and promoting social inclusion and reducing poverty. A new strategy for 2021-24 aims to improve monitoring and evaluation of results and to align with the European pillar of social rights; however, it has not been adopted yet (Government of Montenegro, 2020[109]). Other relevant documents include the Economic Reform Programme for Montenegro 2020-2022, which aims to increase the labour market participation by vulnerable groups and to create and adopt the new Employment Strategy 2021-2024. Other policy documents, such as the Montenegro Development Directions 2018-2021 and multi-year sectoral programmes,[85] focus on employment, covering measures to increase the labour market inclusion of specific disadvantaged groups, such as people with disabilities, as well as active labour market programmes. Activities to improve the labour market integration of vulnerable groups are carried out by projects financed by international donors/organisations. The challenge is to make these approaches sustainable by introducing them into mainstream policy.

The policy framework also includes the Strategy for Promotion of Occupational Safety and Health in Montenegro 2016-2020 and related action plans. These target improving working conditions and preventing work-related injuries and professional diseases. Objectives also include adapting the regulatory framework to EU and ILO regulations, raising awareness, promoting a prevention culture and improving collection of data in a database.[86] All these objectives are highly relevant.

**Social dialogue and tripartism** play a role in defining some concrete labour standards, such as wages and the wage grid, and social partners[87] are involved in consultation processes on issues concerning employment conditions. There is a legislative framework for social dialogue in place (Labour Law, Law of Social Council, Law on Peaceful Labour Disputes Resolution, Law on the Representativeness of Trade Unions). There is uncertainty about trade union density:[88] assessments vary between 26% and 41% (ILO, 2019[16]). Employers organised in employers' organisations employ 51% of the employed workforce (ILO, 2019[16]). While union density is relatively high compared to other economies in the region, unions lack resources to adequately complete their tasks, according to the ILO assessment. Trade unions in multinational companies have most power to conduct collective bargaining and ensure that the labour

legislation is implemented, as they get support from the sister unions of other economies.[89] Collective agreements can be concluded by social partners as general agreements, at branch level and with the employer. In 2018 there were 21 collective agreements for certain sectors or professions, 8 of them targeting the public sector (ILO, 2019[16]).

The General Collective Agreement was concluded in 2014, and extended in 2018 and 2019. It defines the minimum coefficients for each level of education, based on which the salaries are calculated. The minimum wage is defined by the law. The branch agreements define additional requirements within the branch, which may be higher but not lower than those defined by the general collective agreement.[90] The General Collective Agreement applies to all employees and employers if no branch-level collective agreement has been concluded. There is no estimate of how many employees are covered by the collective agreements. It would be important to get an overview of collective bargaining coverage and to understand the respective role of the General Collective Agreement and branch-level collective agreements. In many EU Member States branch-level agreements are an important instrument for defining the specific minimum labour standards in this sector. The Social Council (see details below) plays a crucial role in fixing labour standards through the General Agreement, thus involving tripartism. Worker representation committees represent the interests of workers at the workplace level; however, there is no assessment of how many companies have an active committee in place. According to the new Labour Law, collective agreements must be registered with the Ministry of Labour and published. There is a conflict resolution system in place (lasting several months).

The Social Council, in which social partners participate, meets usually six times a year (except in 2020 due to the COVID-19 pandemic). It has local branches and must be systematically consulted on labour-related legislation and strategic policies. It covers a wide range of issues such as social security, health care and pensions, wages, prices and taxes, industrial relations, collective bargaining and labour relations. It was involved in the COVID-19 impact assessment of employees and enterprises conducted jointly by the ILO/ EBRD and was consulted for the programme for providing support to the economy and employees in order to mitigate the negative effects the pandemic. Nevertheless, overall involvement of the Social Council in preparing key policy documents is often limited (EC, 2019[23]). One of the challenges it faces is the lack of participation by key ministries, while others are the lack of administrative, financial, technical, and professional support and insufficient funding (ILO, 2019[16]). Through the ILO Decent Country Work Programme 2019-2021,[91] the government and social partners have committed to giving the Social Council greater relevance as a dialogue platform, stronger organisation of employers and workers and new labour legislation aligning with international and EU standards.

### *Sub-dimension 8.2: Skills*

Montenegro has a framework for **skills mismatch analysis** in place. The EAM prepares an annual analysis of the labour market situation which includes supply and demand for all qualification levels and all municipalities (Box 23.12). The Chamber of Commerce and the Montenegrin Employers Federation conduct various analyses and provide the education sector with recommendations for future qualifications needs. In addition, various ministries prepare strategies for their specific sectors, such as the Strategy for Development of Tourism, the Strategy for Development of Construction, the Strategy for Regional Development, etc. Some municipalities prepare strategic documents for sectors of activity which are priorities for them. Based on these data, Sector Commissions prepare sector profiles, and identify the need for new qualifications. They include representatives of relevant ministries, employers' unions, chambers of commerce, trade unions, and education and tertiary institutions.

### Box 23.12. Skills mismatch analysis

The employment agency EAM conducts detailed annual supply and demand analysis, covering all levels, sectors and municipalities. Based on this analysis, the EAM provides recommendations to the education sector for determining the enrolment policy for secondary and tertiary education institutions. Relevant data include vacancies by qualification, the length of time seeking employment, people without work experience by sector, the number of pupils and students finalising secondary and tertiary education, the number of registered unemployed with no qualifications, the duration of unemployment, etc. In 2018, an advanced skills mismatch analysis was made using Labour Force Survey data, with support by the European Training Foundation (ETF). Labour market data prepared by EAM is available on its website and is updated regularly (as well as MONSTAT data).

Apart from EAM labour market analysis, sector commissions and certain units of the Ministry of Education also conduct analysis. The Ministry of Education established the Department for Qualifications in order to conduct systematic analyses of the labour market situation, skills gaps and qualifications required. In the forthcoming period, a tracing system of graduates from secondary schools will be needed, using the results to adapt the education system with the goal of improving the employability of the graduates. The Chamber of Commerce and the Montenegrin employers' federation periodically conduct research on education and labour market needs, business barriers and conduct open questions regarding hiring and seasonal employment. This kind of research is also used by the education sector.

Source: Information provided by the government for the Competitiveness Outlook assessment.

In principle, all relevant actors – social partners, relevant ministries, chambers, education institutions, Sector Commissions – are involved in the decision-making process for developing specific qualifications and their content. Sector Commissions are formed by the Council for Qualifications and are tasked with analysing developments in the labour market, and make proposals for revising/adopting new qualifications to overcome skills gaps. These commissions propose to the Council for Qualifications the adoption of occupational standards and qualifications, while the council itself adopts and classifies qualifications within the Qualifications Framework (EC, n.d.[119]). Occupational and qualification standards are adopted at the national level.

Despite a well-developed framework for skills needs and skills mismatch analysis, and good horizontal and vertical co-ordination, skills mismatches remain an issue. Nevertheless, improvements have been made in reducing the NEET rate (share of young people aged 15-24 not in employment, education or training) from 19.1% in 2015 to 16.2% in Q2 2019 (World Bank and WIIW, 2020[120]). In 2018, the NEET rate in Montenegro was lower than the WB6 average but substantially above the NEET rate in the EU-28 and the 11 new EU Member States (10.1% in both cases, in 2019). Vertical skills mismatches,[92] with 70% of young people enrolling in higher education, may add to the high (youth) unemployment rate. Nevertheless, the unemployment rate among highly educated people (9.6%) was lower than for medium (14.9%) and less-educated people (24.6%) in Q2 2019. While the unemployment rate has decreased since 2015 for the highly educated and in particular medium-educated people, it has remained constant for the less educated (World Bank and WIIW, 2020[120]). A skills mismatch analysis indicated that in 2017, 10.9% of employed people (aged 15-64) with a tertiary degree were overqualified for their job as they were working in semi-skilled occupations. However, this has declined since 2015. This mismatch affected more men than women. The percentage of people who have completed upper secondary education working in elementary occupations was 8.2% in 2017, up from 2015, and affected more women than men (ETF, 2019[21]).

Three-year VET programmes may not be very attractive to young people. Employers believe that there is a mismatch between the skills and knowledge that students acquire in the education system and the skills

and knowledge demanded by the labour market. There are also vertical skills mismatches and skills gaps in the application of new technologies. A desire to tackle these has led to the launch of a new dual VET education scheme (Box 23.13; and see also Education policy, Dimension 7). In addition, the Ministry of Education provides annual scholarships for professions lacking workers with the right skills as a way to encourage enrolment in three-year VET programmes. The Chamber of Commerce also provides a certain number of scholarships. The importance of successful VET programmes is highlighted further by the higher demand for medium-level skills, as shown by recent market labour developments. Employment of medium-educated people grew more strongly than for both the less and more highly educated between 2015 and 2019 (World Bank and WIIW, 2020[120]).

### Box 23.13. Dual education in Montenegro

The school year 2017/18 saw the launch of a new concept of practical education in the workplace (dual education). Dual education programmes last for three years. They are based on occupational standards and qualifications standards prepared by the Centre for Vocational Education, with active involvement of employers and their associations. The content of standards is approved by Sector Commissions and adopted by the Council for Qualifications. The business community was involved in preparing the regulations and also supported this arrangement. In accordance with the provisions of the Law on Vocational Education, the pay for students in the first and second grades acquiring practical education with employers are provided from the budget, while pay for third grade students is the employers' responsibility. First grade students spend one day, second grade students two days and third grade students three days with employers (Government of Montenegro, 2020[109]). The capacity of employers for providing practical training is being explored for deciding which training can be implemented in a dual manner.

In its first year, 277 students went through practical education programmes with 101 employers. In the school year 2019/20, the number of students rose to 800, involving 270 employers (Eurydice, 2021[121]). Initial results show that around 60% of students who finished third grade through dual education in June 2019 were employed by the same employer (ILO, 2020[100]). These results are promising, although the share is lower than in economies with long established dual VET systems such as Germany, where the corresponding share was 71% (Federal Ministry of Economic Affairs and Energy of Germany, n.d.[122]).

Source: Information provided by the government as well as (Government of Montenegro, 2020[109]), *Montenegro Economic Reform Programme 2020-2022*, https://www.gov.me/ResourceManager/FileDownload.aspx?rId=396260&rType=2; (Eurydice, 2021[121]), *Montenegro: Organization of secondary vocational education*, https://eacea.ec.europa.eu/national-policies/eurydice/content/organisation-vocational-upper-secondary-education-32_me; (ILO, 2020[100]), *Making Dual VET work: Lessons learnt from Montenegro*, https://www.ilo.org/budapest/whats-new/WCMS_740890/lang--en/index.htm; (Federal Ministry of Economic Affairs and Energy of Germany, n.d.[122]), *Dual training as a successful model*, https://www.bmwi.de/Redaktion/DE/Dossier/ausbildung-und-beruf.html.

The Strategy for the Development of Vocational Education in Montenegro (2020-2024), along with its action plans for 2020/21, outline measures for overcoming workforce skills shortages and to improve the efficiency and the effectiveness of the VET system and lifelong learning. The planned measures aim to create flexible modularised and credit-based educational programmes, based on learning outcomes with vocational and key competences; adapt educational programmes to aid people with special education needs and talented students; promote work-based learning; and upskill VET teachers. The strategy also covers career guidance and counselling in schools. Montenegro is on the right track and should continue its efforts to develop vocational guidance, improve the quality of VET education and close skills gaps according to current and future demand for skills and employers' needs and promote good-quality work-based learning.

While VET and tertiary education should provide the workforce with a solid skills basis, adult learning is essential for upskilling low-skilled adults as well as adapting the skills of workers of all educational levels

to technological change and economic restructuring (OECD, 2019[123]) (OECD, 2019[124]). Montenegro's legislative framework for **adult education**[93] is guided by the Adult Education Strategy 2015-2025, its key policy framework. A budget is foreseen for specific activities, although there is still no specific Ministry of Education budget line for adult learning. Montenegro has made progress in raising awareness about adult education, including organising the Adult Education and Learning Day Conference, and publishing relevant material, such as guides and flyers and a guide to the system of non-formal education. One challenge is to better connect all the players involved: the policy makers, ministries of other departments, local governments, social partners, employers, media representatives and NGOs.[94]

Human resource management within the public sector foresees a budget for continuous training. In addition, the Chamber and the Employer's Federation have small budgets earmarked for adult learning for their members. However, there is no strategy or measures to set financial incentives for participating in continuous training. According to Labour Force Survey data, in 2017 only 2.8% of adults (aged 25-64) participated in learning; the percentage was higher for males (3.3%) than for females (2.7%) (Kaluđerović and Golubović, 2019[125]).

A system for validating and certifying skills, including skills acquired through non-formal learning, is in place and new regulations on the verification of knowledge, skills and competencies were adopted in 2019. A remaining challenge consists of providing adequate continuous training to teachers (professional skills, adult learning pedagogy, and providing vocational rehabilitation). The Adult Education Plan 2019-2022, another key strategic document for adult education in Montenegro, lists the improvement of employees' competencies as one of its priority areas.

### *Sub-dimension 8.3: Job quality*

In terms of **quality of earnings**, minimum wages are fixed through tripartite dialogue in Montenegro. The level of the minimum wage is determined annually by the Government of Montenegro on the proposal of the Social Council of Montenegro, based on indicators such as the general level of wages in the economy, the costs of living and changes to them, economic development and the level of productivity. By law, the minimum wage must not be lower than 30% of the average wage in the preceding semester, which seems to be a moderate level. In 2018, the minimum wage amounted to 40% of the average gross wage, which was low compared to other economies in the region (Kaluđerović and Golubović, 2019[125]). In 2019 the net minimum wage amounted to EUR 222 in Montenegro, 43% of the average net wage, which was EUR 515 according to MONSTAT. Recent increases in the minimum wage have reduced the gender wage gap.[95]

According to MONSAT, the poverty rate in Montenegro was 21.9% in 2018. The in-work poverty rate in 2017 was lower than the EU average (5.9% and 6.4% respectively) and this also holds true for the in-work poverty rate of the self-employed (19.8% compared to 22.7% in the EU). However, in-work poverty for the self-employed increased between 2013 and 2017 (Kaluđerović and Golubović, 2019[125]). In-work poverty was higher for those working in the public sector than in the private sector. Personal earnings are taxed at a rate of 9%, while gross earnings that exceed EUR 720 a month are taxed at 11%. Thus, although the taxation rate is lower than in many EU countries, there is no reduced tax rate or tax exemption for low earners (those on minimum wages). Overall there is lack of regular monitoring and analysis of the structure of wages and wage distribution, as well as of the coverage and impact of the minimum wage. For more details on tax rates, refer to Tax policy (Dimension 4).

**Women's** activity and employment rates improved between 2015 and 2019 (from 56.9% to 59.1% and from 46.9% to 49.7% respectively). Nevertheless, women's activity rates are still 14.5 percentage points below men's in Montenegro, a larger gap than the EU average (10.7 percentage points for EU-28) (Eurostat, 2020[99]). In 2019, women's unemployment rates were only 0.9 percentage points higher than men's. Research commissioned by the Ministry of Labour and Social Policy in 2017 reveals the strong prevalence of gender stereotypes, a patriarchal way of thinking and a lack of openness to diversity in

Montenegro.[96] The 2018 report Women and Men in Montenegro also points to occupational segregation (MONSTAT, 2018[126]). Additional research is planned by the government on citizens' perceptions in order to assess discriminatory patterns and stereotypes and the influence of the media, as well as the level of citizens' awareness of the legislative and institutional framework for preventing discrimination.

In 2017, the Ministry for Human and Minority Rights launched the Action Plan for Achieving Gender Equality 2017-2021 and related implementation plans. Policy measures of a range of ministries focus on developing female entrepreneurship.[97] Women are the focus of active labour market programmes (ALMPs) run by the EAM, and they represent more than half the participants. The EAM has implemented measures to activate women who were entitled to a lifelong benefit deriving from the Law on Social and Child Protection, and who thus left the labour market prematurely (there was a strong incentive to do so in the previous scheme). Another new measure was the Pilot Programme "Empower me and I will succeed", launched in 2018. This programme aimed to support and activate hard-to-employ people. The project was primarily focused on women who benefited from pensions for mothers with three or more children and family material support. The programme reached 925 hard-to-employ people, 96% of whom were women (Ministry of Human and Minority Rights of Montenegro, 2019[127]).[98] As the placement rate was very low, the programme was discontinued. The reasons for the low placement rates should be evaluated and integration strategies improved.

Improvements need to be made to include gender sensitiveness in career counselling in order to reduce gender segregation. At present, there is no strategy to expand the career choices of young women or to encourage enrolment in non-traditional vocational programmes and university studies, nor are there any specific guidelines for women returning to the labour market after childcare breaks, or programmes to empower young women to climb the career ladder. Lack of childcare is hindering women's employment prospects. The employment rate for women with children younger than six was 46.5% in 2019, below the average for all women (49.7% in 2019) (Eurostat, 2021[128]). The employment rate of women with young children is significantly below the EU average (66.8% in 2019) (Eurostat, n.d.[129]). And while the EU average increased by 2 percentage points between 2015 and 2019, no progress was made in Montenegro.

### *Sub-dimension 8.4: Activation policies*

In 2019, the Law on Employment Mediation and Rights during Unemployment was adopted and a number of new rules introduced or amended. This should help to improve the services provided by the **public employment service (PES**) in Montenegro, which is essentially the EAM (Government of Montenegro, 2020[109]). The EAM budget is financed from both assigned and budget funds.[99] In order to implement the new regulations, capacities will be expanded and two new regional units created in the municipalities in the north of Montenegro. In 2019, the caseload of counsellors (number of registered unemployed per counsellor) was around 556,[100] which is higher than the caseloads in EU countries with well-developed PESs. In France and Germany for example, the caseload for hard-to-place jobseekers is around 70 jobseekers per employment counsellor. Caseloads may vary in these countries between 100 and 350, depending on how many jobseekers need individual guidance and how autonomous they are in using self-help guidance tools (OECD, 2020[130]) (Manoudi et al., 2014[131]) (Pôle emploi France, n.d.[132]). As is done in EU Member States with well-developed PESs, Montenegro also segments jobseekers into different groups.

According to Labour Force Survey data, the share of long-term unemployed in Montenegro was 79.3% in Q2 2019, an increase since 2015. It was well above the WB6 (66.6%) and EU averages (32.2%[101]) in Q2 2019 (World Bank and WIIW, 2020[120]) (Eurostat, 2020[133]). This is an extremely large share of unemployed people who would need intense guidance and counselling to overcome employment barriers, including motivational ones.

While the number of counsellors has remained constant, the number of registered unemployed has decreased (although less sharply than the number of LFS unemployed) (MONSTAT, 2020[134]). The vast

majority (85%) of unemployed (according to Labour Force Survey Data) were registered at the EAM. The decreasing number of registered unemployed is in contrast with the decreasing number of registered vacancies. In 2019, 32 344 job vacancies were published through 16 934 vacancy applications, an increase since 2018, but a decline since 2015, pointing to the need for continued efforts in vacancy collection and the provision of employer services.[102] A comparison of the profiles of collected vacancies and the registered unemployed would help to render employer services, vacancy collection, and placement and activation measures more effective. EAM provides statistical reports monthly, semi-annually and annually. Where such evaluations exist, results have helped to improve ALMPs.

New rulebooks have improved the implementation of EAM's activation policies. These include rules on active job search, profiling, counselling and establishing an individual employment plan. One novelty is the introduction of statistical profiling. Implementation of this model is expected soon, assisted by ILO experts. Rules for mediation services address not only the provision of information and publication of vacancies but also the pre-selection of jobseekers for referral to employers, as well as employment mediation abroad and provision of information on employment conditions abroad. Since 2011, EAM has been implementing career orientation in primary and secondary schools in co-operation with the Ministry of Education and the University of Montenegro. Note that for vocational rehabilitation several rulebooks were established in 2011, 2014 and 2017.

The new Labour Law[103] and the Law on Mediation in Employment and Rights during Unemployment, has introduced the obligation for employers to report vacancies to the EAM, and the EAM publishes vacancies only at the request of the employer (Karanovic and Partners, 2020[111]). Experience from other countries indicates that obligations to report vacancies are often not implemented effectively. Instead, EU countries have in general developed the quality of services provided to employers, have taken a proactive stance to approach employers and are collecting vacancies through other means, e.g. in partnership with private employment agencies and web scraping.

The Law on Employment Mediation and Rights during Unemployment regulates unemployment benefits for employees and other groups (e.g. entrepreneurs[104]) with at least nine months of employment over the past 18 months, under the condition that they became unemployed without their fault or their consent. The same goes for self-employed who have the corresponding insurance history and whose activity ceased without their fault. There are no specific rules for gig/platform workers. Unemployment benefits should amount to 120% of the calculated value of the coefficient, which is determined by the General Collective Agreement, and was fixed at EUR 90 at the time of writing. This compensation level is low and may not be effective as it offers no incentive for taking up formal employment as it is not linked to earnings. Unemployment benefit recipients need to register within 30 days at EAM, which is longer than OECD good practice. For example, in Germany jobseekers need to register as soon as they receive their dismissal notification and three months before a temporary work contract runs out (Federal Employment Agency of Germany, n.d.[135]). In Switzerland, people need to register on the first day of unemployment. Early intervention in the unemployment period is generally perceived as important. As part of a **mutual obligation** approach, recipients of unemployment benefit, like any other jobseeker, have to actively search for work otherwise they are sanctioned. The number of unemployment benefit recipients was 12 372 in 2019, a strong increase from 2015 (7 352). Coverage is nevertheless still low, since only 27.9% of the unemployed get unemployment benefits.[105]

There is an agreement in place between EAM and the Social Centres for activating social assistance recipients. File transfer is mainly done electronically, but data are extrapolated from different databases. File sharing is monitored through reports (from EAM, Social Centres and the Ministry of Labour), although improvements still need to be made. Social assistance recipients participate in ALMPs, however less often than the other unemployed. During the first nine months of 2019, only 58 working-age beneficiaries receiving family financial support were employed; 129 were included in an active employment policy programme, and 9 were in professional rehabilitation measures (Government of Montenegro, 2020[109]). It

would be advisable to analyse the barriers to employment faced by family financial support recipients, as well as by the long-term unemployed not receiving any benefits.

EAM implements **active labour market programmes (ALMPs)** such as programmes to support self-employment, public works programmes, adult education and training programmes, entrepreneurship training and vocational rehabilitation. Expenditures on ALMPs fell from 0.1% to 0.05% of GDP between 2015 and 2017, but increased to 0.7% in 2018.[106] They then fell by one-third in 2019. The share of funds for financing adult education and training programmes, training for independent work, training for work with the employer and the "Stop the Grey Economy" programme represented 71.1% of all funds spent on ALMPs.

In terms of ALMPs' target groups, during the first 11 months of 2019, 55.4% of participants were women, 37.7% were young people, 35.7% were long-term unemployed (less than their share among all unemployed) and 53.7% were from the northern regions (Government of Montenegro, 2020[109]). The number of participants was rather low, amounting to 2 037 unemployed people in 2019, out of 37 000 registered unemployed and more than 100 000 unemployed according to LFS data. More than half participated in vocational rehabilitation measures.

People with disabilities are another target group for ALMPs. There are quotas for employing people with disabilities. When companies do not comply with the quota, they have to pay a special contribution to the vocational rehabilitation fund, administered by EAM. However, according to the audit report of the fund of 2014, the use of these financial resources could be significantly higher (Kaluđerović and Golubović, 2019[125]). Activities planned in 2020 to increase labour market participation, particularly by sensitive groups of unemployed persons, focus on education and skilling programmes for adults, employment incentives, direct opening of jobs and incentives for entrepreneurship (Government of Montenegro, 2020[109]).

Another target group for public work programmes are vulnerable groups such as the Roma and Egyptian populations. Although there is a Strategy for Social Inclusion of Roma and Egyptians (2016-2020) in place, it does not explicitly include an employment dimension. Eight projects to increase training and employment of the Roma and Egyptian population in bottleneck occupations have started. It would be advisable to scrutinise the implementation and outcomes of these projects to learn more about employment barriers, scale up activities to promote employment and skills, address discriminatory behaviour by employers and identify potential employers.

The Grant Programme for Self-Employment project, targeted at young people, women and the long-term unemployed, is mainly EU-financed. The sustainability of the programme may be an issue. It would be advisable to include entrepreneurship counselling to render the measure more effective.

EAM has implemented a special programme for young highly educated unemployed people called Stop the Grey Economy. Training is provided in technical support and assistance to officials of bodies and administrations in their fight against informal business. The programme for training university graduates was introduced in 2012, substituting an earlier measure which provided wage subsidies for young graduates. All faculty graduates without prior work experience can apply for the programme and get employment in their specific field of study for a period of nine months. During this period they receive 50% of the average net wage. Graduates are expected to gain knowledge and skills during the programme that will help them find employment after completing the programme.[107] The number of participants amounts to 3 000 to 4 000 young university graduates annually.

The Employment Agency of Montenegro is one of the agencies implementing the project Further Development of Local Employment Initiatives in Montenegro is funded by EU-IPA. Its overall goal is to encourage the development of employment initiatives at the local level, and will last for 18 months (August 2019 to February 2021). An analysis of local labour markets in Montenegro was prepared as part of the project and local employment strategies are currently being prepared.

### *Cross-cutting policy areas: Informality*

The contribution of the informal economy to total GDP is estimated at around 28% to 33%, while over 20% of work is informal (EC, 2019[23]). Weaknesses in the institutional and regulatory environment, corruption and high tolerance of tax non-compliance are the key issues contributing to the large informal economy in Montenegro. The latest survey on informal employment dates back to 2014.[108] At that time, unregistered self-employed people made up almost 70% of the total number of undeclared employed people, 42.4% belonging to the age group of 46-64. The highest percentage of informally employed were in agriculture, forestry and fisheries; household services; and the construction industry. It would be useful to conduct a new survey in order to take stock of recent trends.

The term "informal employment" is not defined in any legislation. Nevertheless, there are policies in place. The Action Plan for Combating the Grey Economy in the Labour Market, adopted by the Government of Montenegro in 2017, contains preventive, restrictive and stimulative measures. Preventive measures deal with issues such as business barriers caused by tax evasion, disloyal and unequal competition. Restrictive measures cover various repressive measures designed to detect and penalise informal employment, with planned goals, deadlines and competent authorities, including Labour Inspectorates, the Administration for Inspection Affairs and the Tax Authority. Stimulative measures aim to lower the fiscal deficit and include measures for transitioning from an informal to a formal economy. However, as stated above, Labour Inspectorates do not have enough capacity to implement their work effectively.

In 2013, the Ministry of Finance conducted an analysis of the effects of progressive taxation on individuals' income, profit of legal entities and real estate.[109] A study on the link between the tax wedge for low wage earners and its impact on informality and reforming the tax system should be carried out, using results of previous relevant studies. There is also no research on the link between the low level of social protection (e.g. level and coverage of unemployment benefits, level of pensions) and the incentive to be formally employed.

The Parliament of Montenegro recently adopted the law on Fiscalisation in the Trade of Goods and Services; it entered into force in January 2020. Montenegro is the first economy in the region to introduce fiscalisation in non-cash transactions, i.e. business-to-consumer (B2C) and business-to-business (B2B) transactions. The Tax Administration of Montenegro will have an insight into each fiscal invoice issued that is paid in cash or by cashless transfer, in real time, via a permanent Internet connection through which the taxpayer is connected to the Tax Administration (Government of Montenegro, 2020[109]). Eventually, these developments may lead to the reduction of the informal economy, including undeclared work. Thus, it would be useful to assess implementation and impact of the new law on informal employment (in particular regarding unregistered businesses and self-employed).

### *Cross-cutting policy areas: Brain drain*

While migration into Montenegro is registered, there are no official data available on the number of people leaving Montenegro temporarily or permanently to work abroad, nor is there a thorough analysis of brain drain. The number of emigrants amounts to 20% of the resident population and this share has not declined since 2010; many of them are young and well educated (ILO, 2019[16]). Data collection on the patterns of recent emigration trends would be essential to understand whether there is a risk of brain drain and to formulate policies to tackle it.

Skills governance, i.e. planning the number of places for enrolment in VET and education, is not determined by demand abroad. However, the compatibility of qualifications acquired in Montenegro is being closely monitored in order to facilitate recognition or professional development for those who wish to continue their education or search for employment elsewhere. Currently, Montenegro is part of the dialogue on mutual recognition of vocational qualifications across the Western Balkans. Montenegro has adopted the Law on Recognition of Professional Qualifications for Regulated Professions. This law refers

to mutual recognition of professional qualifications with the EU, European Economic Area and Switzerland. It will enter into force if Montenegro joins the EU.

The Government of Montenegro has adopted the Strategy for Integrated Migration Management in Montenegro for the period 2017-2020. However, the strategy does not include any measure to contain brain drain or favour brain circulation.

### *The way forward for employment policy*

- **Continue to improve working conditions, aligning with EU *acquis* and ILO standards.** Labour inspectors should play a preventive role in addition to controlling implementation of the law. Continue to strengthen social dialogue both at government level as well as at branch level, as foreseen in the Decent Work programme. Good working conditions in formal employment also help to increase its attractiveness vis à vis informal employment and increase labour productivity.
- **Continue to increase the capacities of Labour Inspectorates in terms of number of staff, training and equipment.** Greater capacity will allow them to make on-the-spot visits and to monitor and follow-up infringements of employment legislation and occupational health and safety regulations. Establish guidelines on how to prevent diseases and accidents at work.
- **Implement the activities planned to upskill adult learning and introduce incentives for employers and workers to participate in continuous training.** Adult learning should be perceived as a medium to long-term challenge. This should also include upskilling the low-skilled. Guidance on lifelong learning should be developed, as is done in Portugal through the Qualifica Centres (OECD, 2019[124]). Introduce financial incentives for employers to offer these schemes, such as subsidies in Finland (Box 23.14), Belgium, Portugal and Germany; as well as incentives for employees and jobseekers (tax credits, individual learning accounts, e.g. in France) or training leave (e.g. in France and Austria) (OECD, 2019[136]). Link recognition and validation of skills from prior learning to upskilling activities. This increases the quality and the acceptance of the recognition and validation of skills, as suggested by experience in Portugal (Düll et al., 2018[137]).
- **Use the skills anticipation system for guiding young people, adult workers and the unemployed in retraining and upskilling activities.** Use the information on skills in demand and tracer studies to adapt the curricula of VET and university programmes as well as of adult education programmes. Train the trainers in the area of adult education and vocational rehabilitation in skills in demand as well as in adult learning pedagogy.
- **Make a thorough analysis of wage development and the wage structure as well as of non-wage labour costs.** Assess the impact of minimum wages on reduction of poverty and informal employment.
- **Update the assessment of the scope, structure and reasons for informality.** Continue planned activities to combat informality. Explore how taxes could be adapted to aid the transition from informal employment to formal employment. The OECD Jobs Strategy recommends reducing non-wage labour costs, especially for low-wage earners (OECD, 2018[138]). Explore the options for supporting the transition to formal employment and formalising enterprises through subsidising social security contributions, as recommended by the OECD and ILO (OECD/ILO, 2019[139]).
- **Reduce labour market barriers for women.** Reduce gender stereotypes beginning from early childhood education right through education and working life, in order to increase female employment. Promote access to childcare and out of school care for school children, and part-time and flexible working to ease the reconciliation of family and working life.[110] Make vocational guidance in primary and secondary schools more gender sensitive and widen occupational choices for both men and women. Continue to develop and improve access for women to credit, financial support and entrepreneurship learning. Continue efforts to strengthen the labour market activation

of women receiving welfare benefits and analyse the employment barriers for family financial support recipients.

- **Increase efforts to bring vulnerable groups, e.g. Roma and Egyptian communities, into education, training and work.** Combatting discrimination needs to be addressed in a wider way. It would be advisable to analyse the reasons for the low performance of the "Empower me" programme and to investigate how approaches to integrate vulnerable groups could be improved, e.g. by better integrating the various social and employment services and ALMPs. More emphasis should also be placed on implementing vocational rehabilitation and placing people with disabilities.
- **Assess the volume of seasonal, temporary and permanent emigration to the EU and other regions, and develop strategies to mitigate the negative effects of migration and to consolidate the benefits.** It would also be useful to analyse the employment effect of remittances, the activities of the temporary migrants returning to Montenegro and labour shortages in specific professions and sectors caused by emigration. To reap the benefits of migration, encourage investments of remittances in Montenegro. It is also recommended to take advantage of migrant experiences and help workers who have gained experience abroad to find good living and working conditions when returning.

### Box 23.14. Financial incentives and support to companies for continuous training in Finland

Finland offers a financial incentive that goes hand-in-hand with building the capacity of companies to identify their training needs and deliver training. The Joint Purchase Training (*Yhteishankintakoulutus*) supports employers who want to retrain existing staff or set-up training programmes for newly recruited staff. Offered by the PES, it supports employers to define their training needs, select the appropriate candidates for training and find an education provider to deliver the tailored training. The PES also part-finances the training (ranging from 30-80% of the expenses for the training). Types of training that can be developed include: 1) tailored training for employers who want to retrain their staff due to technological or other changes in the sector (minimum training duration of 10 days); 2) recruitment training for employers who cannot find employees with the skills needed and want to hire, then train new staff (training duration of 3-9 months); and 3) change training for employers who have staff who have become redundant to help them transition to other job opportunities (training duration of 10 days to 2 years).

Source: (OECD, 2019[124]), *Getting Skills Right: Engaging low-skilled adults in learning*, www.oecd.org/employment/emp/adult-learning-systems-2019.pdf.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Montenegro has continued to introduce reforms to develop a business environment conducive to innovation, research and development. It has improved its overall score in STI from 1.84 in 2018 to 2.4 in 2021 (Figure 23.1). Progress has been made in a number of areas since the previous assessment and Montenegro continues to perform better than most Western Balkan economies (Table 23.17), with only Serbia achieving a higher score and North Macedonia scoring at par. However, overall performance in this dimension remains below the economy's potential.

**Table 23.17. Montenegro's scores for science, technology and innovation**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| Science, technology and innovation dimension | Sub-dimension 9.1: STI system | 2.9 | 2.4 |
| | Sub-dimension 9.2: Public research system | 2.3 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 2.0 | 1.6 |
| **Montenegro's overall score** | | **2.4** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 9.1: STI system*

Montenegro has significantly advanced its **STI policy framework** since the last assessment. In late 2017, the government adopted the Strategy for Scientific Research Activities (2017-2021), which complements the recently expired Strategy on Innovation (2016-2020). Montenegro developed a set of guidelines for smart specialisation in 2018, and is the first WB6 economy to adopt a smart specialisation strategy (covering 2019-2024). Action plans are in place to support implementation of the strategic framework, and budget allocations have increased in recent years. However, full implementation is behind schedule due to a lack of resources within the administration and limited long-term funding security.

The new strategic framework envisages a strengthened **institutional framework** for STI policy. In 2019, the Council for Innovation and Smart Specialisation was set up to oversee the design and implementation of STI policies. Through its permanent Secretariat, funded partially by the Government of Montenegro as well as the UNDP, it acts as a co-ordination body across ministries and gives support to the Ministry of Science, the body formally in charge of STI policy making. The council became operational in early 2020, and is mandated to advise on the governance of the STI framework and oversee all funding for STI-related policy measures. Montenegro is also in the process of setting up a dedicated Innovation Fund, expected to be established by the middle of 2021. The Council for Innovation and Smart Specialisation has been leading this process, and discussions are ongoing with the World Bank to provide its expertise in setting up the fund. If designed well, the Innovation Fund, together with the Council of Innovation and Smart Specialisation, are expected to significantly accelerate implementation of the STI strategic framework in the coming years.

The **regulatory framework** has been expanded and aligned with EU standards. In July 2020, the Government of Montenegro adopted the new Law on Incentive Measures for Research and Innovation Development and a revised Law on Innovation Activity. The revised framework will regulate the STI system and incentives for innovation activity, and aims at creating an innovation-conducive environment incentivising innovation and R&D, including through the Innovation Fund. A legal framework for intellectual property (IP) is in place and largely aligned with the EU *acquis*, though it does not include specific provisions to encourage commercialisation of IP or collaboration between researchers and the private sector. Montenegro's track record of enforcing IP legislation remains poor, though the capacity of the IP

office has increased in recent years and efforts have been made to intensify co-operate with the research community.

**International collaboration,** especially within the European Research Area**,** is recognised as key for developing Montenegro's STI framework. Support is made available through an annual Call for Co-financing of Research and Innovation Activities, which aims to facilitate access to international STI programmes and networks, in particular Horizon 2020.[111] Despite increasing efforts, however, Montenegro's success in the Horizon 2020 framework remains below potential. By the end of 2019, the economy had only participated in 30 Horizon 2020-funded projects, most of which received only small-scale funding (EC, 2020[140]). However, as project submissions have become better aligned with EU priorities in recent years, an increase in successful proposals is becoming evident. Montenegro has also maintained active engagement with international bodies and networks, such as Eureka[112], European Cooperation in Science and Technology (COST)[113] and the European Organization for Nuclear Research (CERN), and it is a shareholder in the Western Balkans Enterprise Development and Innovation Facility (WB EDIF), whose Enterprise Innovation Fund has invested in two Montenegrin start-ups to date. Another mechanism to promote international collaboration is the active inclusion of the Montenegrin diaspora in scientific research activities through visiting fellowships, evaluation of project applications and including them in research programmes.

**Alignment with EU STI policy** standards remains a priority. Montenegro is committed to the priorities of the European Research Area and actively participates in the European Strategy Forum on Research Infrastructures (ESFRI). In 2019, it revised its roadmap for research infrastructure to identify impediments to advancing research and development. It also became a member of the European Societal Survey of the European Research Infrastructure Consortium (ESS-ERIC) in 2018. Within the framework of Montenegro's participation in the EURAXESS initiative[114], the University of Montenegro has adopted a human resources strategy for researchers (HRS4R) aimed at harmonising human resources policy with the principles determined by the Charter and Code for Researchers, for which it was awarded the HR Excellence in Research Award by the European Commission. National open science and open access initiatives are well underway and aligned with EU standards. Finally, Montenegro is expected to participate in the European Innovation Scoreboard in 2020 for the very first time, which is likely to enable more analysis and monitoring of the STI system in the future.

### *Sub-dimension 9.2: Public research system*

Montenegro has completed a large-scale World Bank-funded programme during the assessment period. The Higher Education and Research for Innovation and Competitiveness (HERIC), implemented between 2013 and 2019, aimed to strengthen the quality and relevance of higher education and research in Montenegro by reforming the higher education finance and quality assurance systems and by strengthening research capacity. Within this framework, and underpinned by Montenegro's new STI framework, some efforts have been made to expand the **institutional structure of the public research system**. Most notably, in May 2018, the Centre of Excellence for Research and Innovation was established at the University of Montenegro as a successor to the pilot Centre of Excellence in Bioinformatics – BIO-ICT, which was established in 2014 under the HERIC project. In addition, two centres of excellence projects are currently underway, focusing on food safety and biomedical science respectively. The total value of the projects is EUR 2.5 million, of which the state will co-finance EUR 1.8 million over three years.

The higher education institutions (HEI) sector is governed by the Law on Higher Education, but the role of the Ministry of Science as the gatekeeper of the STI policy framework in the governance of the HEI and Research and Development Institutes (RDI) sectors remains unclear. While all HEIs conduct a mandatory annual self-evaluation, independent performance assessments remain ad hoc and primarily project-linked. In March 2019, a Law on Academic Integrity was adopted aiming to promoting academic integrity and tackle plagiarism.

State budget allocations for **public research funding** and innovation have more than doubled in recent years, although from low levels. Public scientific research remains predominantly dependent on institutional funding, which is largely geared towards education and not subject to regular performance reviews. However, in line with the revised legal framework, a new performance-based financial contracting model was adopted for the University of Montenegro in 2018 aimed at improving the quality of public funding. As a result, more competitive project-based funding schemes have been introduced, and as the new Council on Research and Innovation and the Innovation Fund launch operations, more funding is expected be made available on a competitive basis, and following international best practice evaluation methodologies.

The number of active researchers in Montenegro remains low, at around 460 in 2018. With 734 researchers per million inhabitants, Montenegro performs below some of the regional peers, such as North Macedonia and Serbia, and remains far behind the EU average of around 4 000 researchers (UIS, 2021[141]). The development of **human resources for research and innovation** has become a priority aspect of Montenegro's STI framework. Since the previous assessment, Montenegro has launched a dedicated programme to strengthen human resources and human research capability in Montenegrin research institutes. This was implemented between 2018 and 2020 and aimed to create more attractive employment prospects within academia. The programme envisaged a more favourable environment for research and overall promotion of scientific research as a profession, and included a variety of measures such as scholarships for doctoral students, and support for international mobility, training and participation in international networks. Other measures included training on proposal writing, project management and applying for international research tenders. In addition, the Law on Incentive Measures for Research and Innovation envisages tax incentives for scientific research and innovation projects that employ qualified researchers.

### *Sub-dimension 9.3: Business-academia collaboration*

Overall investment in research and development, of almost 0.37% of GDP in 2018, remains low compared to the EU average of 1.69%, while only a fraction of this investment is funded by the private sector. While the **collaboration promotion framework** is well embedded in the STI framework, only a few targeted policy measures have been implemented to date. Some awareness-raising activities are being implemented to promote the benefits and opportunities of academia-business co-operation, and the increased focus on building an institutional support structure is a welcome step in the right direction.

Montenegro has made some progress in introducing small-scale **financial incentives** to stimulate research institutes and the private sector, though these remain largely focused on fostering innovation in the private sector more broadly. Based on the positive experience of a pilot co-operation grant scheme under HERIC in 2013/14, a new Innovation Programme for Grants and Innovative Projects was launched in 2018 for a period of two years, providing competitive co-operation grants to companies to develop innovative market-oriented products, services and technologies and supporting the transfer of innovative ideas from scientific research institutions to the market. In 2018, over EUR 730 000 were awarded to ten successful projects, three of which were proposed by RDIs. In 2019, eight more innovative projects were awarded, with co-financing by the Ministry of Science amounting to EUR 615 000, and a successor programme is being considered. In addition, grants for scientific research projects are available for RDIs to co-finance investments and foster research excellence. However, a pilot voucher scheme, designed with OECD support, was discontinued in 2015 and there are no fiscal incentives for academia-business collaboration. Equally, **non-financial incentives** are also limited. Doctoral research scholarships specifically encourage a mandatory mobility placement of Montenegro PhD candidates in foreign academic institutions or in business entities in Montenegro and abroad. In reality, however, only a few scholars take up the opportunity to spend their mobility period in business entities. Montenegro also does not actively participate in the Marie Sklodowska-Curie actions, and evaluations of researcher performance continue to be primarily based on traditional criteria, thereby providing little incentive to engage with the private sector.

Similarly, the IP framework does not include specific provisions to support such collaboration, as IP rights are usually defined in employment contracts. The Ministry of Economic Development, however, offers small-scale technical assistance in the form of advising on patenting, and plans are underway to develop a booklet for innovation protection to act as a guidance for innovators and researchers.

Some progress has been made in strengthening **institutional support for business-academia collaboration**. Identified as a priority in the Smart Specialisation Strategy, the expansion of a network of Centres of Excellence is currently underway, as discussed above. This will contribute to fostering co-operation between academia and the private sector in the medium-term. In addition, an office for technology transfer has been established within the Centre of Excellence for Research and Innovation at the University of Montenegro. Furthermore, significant efforts have been made to build the country's first Science and Technology Park, which envisages a networked structure with a central base in Podgorica and three decentralised impulse centres in Nikšić, Bar and Pljevlja. Following the launch of the Innovation and Entrepreneurship Centre Tehnopolis in Nikšić, construction of the central unit of the Science and Technology Park of Montenegro in Podgorica is well underway, and is expected to be fully completed in 2021. Montenegro has also been the key driver of the creation of the South East European International Institute for Sustainable Technologies (SEEIIST), which is expected to deepen regional scientific research co-operation (Box 23.15).

### Box 23.15. Building a regional research infrastructure: The South East European International Institute for Sustainable Technologies

For the small and open economics of the Western Balkans, the availability of state-of-the-art, regional research infrastructure plays a fundamental role in developing STI.

In 2017, the South East European International Institute for Sustainable Technologies (SEEIIST), was initiated by the Government of Montenegro and supported by the governments of the Republic of Albania, Bosnia and Herzegovina, Republic of Bulgaria, Kosovo, North Macedonia, Montenegro, Republic of Serbia and Republic of Slovenia. The institute focuses on the development of pioneer high technologies used for tumour therapy and biomedical research. With funding from the European Commission and extensive capacity building provided by renowned international research institutes, including CERN, the institute is expected to become a key player within the European research spectrum on medical science and an access point for international researchers.

The institute will offer numerous opportunities for technology transfer to the region and is expected to give a boost to local industry. Moreover, the establishment of the institute could trigger spin-offs and complementary technologies, and spur on digital transformation.

Source: (SEEIIST, 2020[142]), *The South East European International Institute for Sustainable Technologies (SEEIIST)*, https://seeiist.eu/; (Ministry of Science of Montenegro, 2019[143]), *Revised Roadmap for Research Infrastructure of Montenegro (2019-2020)*, https://www.esfri.eu/sites/default/files/RI%20Roadmap%20Montenegro%20revised%20(2019-2020)%20ENG.pdf.

## *The way forward for science, technology and innovation*

Montenegro has made good progress in advancing its STI policy framework. Efforts made in recent years have strengthened the institutional framework, and initial steps have been taken to introduce financial support schemes and build an STI-supportive infrastructure. Going forward, the focus should be on fully implementing and expanding these measures. Specifically, Montenegro should prioritise the following:

- **Ensure swift operationalisation of the new Innovation Fund**. The focus should be placed both on building the fund's internal capacity as well as ensuring sufficient funding availability.

- **Invest in the scientific research system**. More comprehensive measures should be put in place to build human resource capacity in priority STI areas and increase the attractiveness of research as a profession. An evaluation of the HERIC Programme may identify key obstacles to overcome. Montenegro should explore ways to more actively participate in the Marie Slodowska-Curie actions.
- **Continue increasing Montenegro's participation in international research programmes such as Horizon 2020**. Concrete measures should be put in place to encourage private sector businesses to invest in research and development and intensify co-operation with RDIs. Financial programmes should be designed with the clear objective of stimulating academia-business co-operation, which should be reflected in the eligibility criteria and evaluation methodology.
- **Continue building a national and regional research infrastructure**. Timely completion of the STP in Podgorica and affiliated impulse centres, coupled with sustained funding, will improve integration between academia and the private sector. Efforts should also be made to operationalise the pilot technology transfer office at the Centre of Excellence at the University of Montenegro.

## Digital society (Dimension 10)

### *Introduction*

Montenegro has recognised the potential of entrepreneurship and innovation for driving smart growth, especially in the ICT sector. This is reflected in the economy's Smart Specialisation Strategy, which considers ICT as a cross-cutting enabler and Digital Montenegro as its flagship initiative. As shown in the Table 23.18, the economy achieved the second highest overall score in digital society among the Western Balkan six. However, the Montenegrin ICT industry is not yet strong enough to support digital transformation across all sectors, and support to the digital transformation of MSMEs has not been enough to allow it to accelerate. Although 99.5% of the enterprises in Montenegro have access to the Internet and 84.5% of them have a website, e-commerce is lagging behind the EU average. The economy is making steady progress on broadband development, reflected in above average score in access sub-dimension - it has aligned its respective framework with the EU *acquis* and has secured financing to support private sector investments in rural network infrastructure development. Montenegro is also moving forward to reach its vision for the digital transformation of its public administration, turning it into a digital service for citizens and businesses. Even so, the public sector is not fully aligned with international practices on privacy protections and free access to information in the digital age, and the economy scores slightly above average in the trust sub-dimension. Raising public awareness and building human capacities in the public sector on these issues needs to receive higher priority to help change mindsets and instil a culture of trust, transparency and data openness.

**Table 23.18. Montenegro's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 3.2 | 2.9 |
| | Sub-dimension 10.2: Use | 3.0 | 2.4 |
| | Sub-dimension 10.3: Jobs | 2.5 | 2.3 |
| | Sub-dimension 10.4: Society | 2.0 | 2.1 |
| | Sub-dimension 10.5: Trust | 2.3 | 2.2 |
| **Montenegro's overall score** | | **2.7** | **2.4** |

### *State of play and key developments*

#### *Sub-dimension 10.1: Access*

Montenegro has continued to improve its **broadband infrastructure** and although positive progress has been made towards the strategic targets of the Strategy for the Information Society 2020, some of them remain unattainable, particularly those for increasing broadband penetration in sub-urban and rural areas (e.g. the target for broadband penetration to reach 100% of population by 2020). In 2019, next generation access (NGA) coverage was 80.3% (the target for 2020 was 100%), fixed broadband penetration was 90.3% (the 2020 target was 100%), the share of fast broadband connections was 75.1% (the 2020 target was 70%), but ultrafast broadband penetration was 14.2% (the 2020 target was 50%) (EKIP, 2019[144]) The Ministry of Economic Development[115] has just started implementing two major projects on broadband infrastructure development:

1. The Regional Broadband Infrastructure Development in Montenegro[116] project is financed under the Western Balkan Investment Framework (WBIF). Its ultimate objective is to support the construction of adequate infrastructure (mostly in rural areas) for fast and secure Internet to all households (increase from 70% to 95%), businesses, educational and health institutions in order to support the digital transformation of society and the economy. A National Broadband Development Plan (NBDP) will be developed, based on which a secured loan of EUR 15.9 million

from the European Bank for Reconstruction and Development (EBRD) will finance broadband development plans for underserved areas.

2. The Western Balkan Digital Highway Initiative, supported by the World Bank.[117] Montenegro is co-operating with the other WB economies on this project, which aims to investigate regional interconnectivity improvements through infrastructure sharing of the optical fibre ground-wire installed over the years by local energy utilities. Comprehensive broadband infrastructure mapping[118] has been conducted in the past three years by the Agency for Electronic Communications and Postal Services (EKIP). The draft law on the use of physical infrastructure for the setting up of high-speed electronic communication networks, which transposes the EU's Broadband Cost Reduction Directive (2014/61/EU), is expected to be proposed for adoption in the second quarter of 2021. The law completes an adequate ICT policy investment framework for broadband infrastructure investments that enables strategic public spending to resolve bottlenecks to private operations without creating excessive crowding-out effects. This framework will support the implementation of the two major broadband infrastructure projects under implementation.

Montenegro's **ICT policy regulatory framework** is fully aligned with the EU 2009 Regulatory Framework and international connectivity agendas, such as the agenda for the Western Balkans, promoting quality infrastructure investment in the electronic communications sector. Montenegro also signed the Regional Roaming Agreement with WB economies in April 2019. The framework is based on the Law on Electronic Communications. This was amended in 2017 to eliminate issues that compromised the independence of the Regulatory Agency: 1) the provision to transfer budget surpluses of the regulatory body to the state budget; and 2) the provision that permitted the National Assembly to dismiss the Regulatory Agency's President and Council members if the agency's annual financial report is not accepted. As a result of these amendments, the agency now enjoys full operational and financial independence and its budget is provided from fees paid to the agency by network operators. The agency is well staffed and has the resources to perform its responsibilities, including market monitoring, publishing data on the development of the market, and maintaining a database of relevant indicators. In 2020 it also adopted a new plan for the use of the radio frequency spectrum (amending the 2017 plan), in order to implement the decisions of the World Radio Communication conference (WRC-19). Improvements to the regulatory framework are continuously being made.[119] The agency implements legal obligations and procedures for conducting public hearings, providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals in the ICT field. Regulatory impact assessments (RIA) are also conducted in the early stages of the policy-making process, and the analysis is published on the website of the relevant ministry and the e-government portal at the beginning of the public consultation period.

Since 2018, Montenegro has made significant steps in developing its **data accessibility** framework and aligning it with international practices. Data accessibility based on the principles of transparency and openness are covered by a number of policy documents, including the Information Society Development 2020, the Public Administration Reform Strategy 2016-2020, and the Open Government Partnership (OGP) Action Plan. The most important development in 2019 was the adoption of the National Interoperability Framework, which is in line with the European Interoperability Framework (EIF 2.0), and will serve as a solid basis for data exchange among public sector bodies. Amendments to the Law on Free Access to Information were made in 2017, following OGP recommendations, creating the conditions for re-use of information, and obliging each institution (data owner) to maintain and publish the information for reuse in a manner that makes it searchable, in an open and machine-readable format, on the Open Data portal.[120] The portal publishes open data sets for commercial and non-commercial purposes via a shared metadata catalogue, and serves as a foundation for setting standards in public data management and data re-use for added value creation. The portal included 106 data sets from 18 state institutions by mid-2020. A new draft of the Law on Free Access to Information was prepared in 2019, but was still pending adoption in 2020. The engagement of the private sector in open data re-use initiatives is still at an early stage of development and no public-private partnership data-sharing platforms (data PPPs) with certification

systems have been created yet. On the upside, the Ministry of Public Administration and the Chamber of Commerce of Montenegro organised an Open Data Hackathon[121] during the Infofest 2019 Conference to stimulate data innovation initiatives.

### *Sub-dimension 10.2: Use*

Montenegro has demonstrated a long-term commitment to transforming its public administration to a new public service, however progress on e-government development over the last two years (2018-2020) has been slower than in other United Nations (UN) countries. As a result, Montenegro's ranking fell from 59 (2018) to 75 out of 193 countries in the UN 2020 e-Government Survey (United Nations, 2020[145]; United Nations, 2018[146]). The **digital government** policy framework is made up of the Information Society 2020 Strategy and the Public Administration Reform Strategy (PARS) and its action plan for 2018-2020, which is also aligned with the economy's Open Government Partnership commitments. The PARS promotes e-government development and the creation of efficient electronic services for citizens and businesses in Montenegro. It also seeks to ensure interoperability of registers and user availability of data from registers. The legal framework is primarily based on the new Law on e-Government (electronic Public Administration), which was adopted in 2020[122] to replace the law from 2014. The new law establishes the Council for e-Government for the improved cross-cutting co-ordination of digital government development across the public sector. It aims to ensure an increasing number of user-oriented and business-oriented e-services are developed around the fundamental "only once" principle (i.e. a citizen submits certain data only once, and this data is then propagated for provision of any relevant public service). The legal framework is also complete, with a number of acts adopted in 2019 to eliminate obstacles to the development and use of e-government services.[123] The Law on Electronic Identification and Electronic Signature was also amended in 2019 to harmonise the framework with the new law on identity cards, to align with the eIDAS Regulation (EU 910/2014). Montenegro is also preparing a new Strategy for Digital Transformation in Montenegro 2021-2025, which is pending adoption in 2021. The new strategy aims to promote the digital economy and digital transformation in Montenegro.

The Ministry of Public Administration, Digital Society and Media has introduced the Unified Information System for Electronic Data Exchange (JISERP) to exchange data among public administration bodies and other entities. JISERP allows data from a number of e-registers and information systems to be accessed, including the Central Population Register (CRS), the Education Register, the IS Social Card and Central TAX and Insured Persons Register (CROO) and the information system of the Health Insurance Fund. The e-government portal, the eUprava portal,[124] is the point of access for all electronic public services (e-services) offered by state administration bodies, local self-government bodies and local government bodies. It was launched in April 2011 and initially provided 12 services, all in the Montenegrin language. By 2020, the portal was offering 598 electronic services under the competence of 52 institutions (EC, 2020[66]). The portal also includes an e-Participation module for public hearings, contributions to legislative proposals, participation in working groups and e-consultations. It also provides access to several e-health services.[125] Notably, according to eUprava survey statistics, there is a positive trend in public service satisfaction, as 52% of eUprava users were completely or mostly satisfied with services in 2019, an improvement on 30% in 2018. Additionally, 82.7% of survey participants believe that the procedure for requesting a particular document has been simplified (Ministry of Public Administration, 2020[147]).

The policy framework for **private sector ICT adoption** is based on the Strategy for the Development of MSMEs, with an action plan for 2018-2022. It aims to improve SMEs' competitiveness through the use of ICT, digital business transformation and promotion of e-commerce. The multi-annual action plan implementing the Industrial Policy 2020 also covers aspects of ICT adoption by companies. These policies include support measures for the purchase of ICT equipment and software, for hiring consulting services to modernise and digitalise business processes and for innovating business processes and products. They also promote modernisation and greater effectiveness of e-services for businesses. Along the same lines, the Programme for Improving the Competitiveness of the Economy, designed and approved on an annual

basis, also supports private sector ICT adoption. As part of this programme, a special programme line for business digitalisation was designed for 2020.[126] Unfortunately, due to the COVID-19 pandemic, its launch was delayed and the first call for applicants was announced in August 2020. The total annual budget for the implementation of the Digitalisation Support Programme Line is EUR 200 000 and each company can be reimbursed for 50% of eligible costs (excl. VAT) for a maximum amount of EUR 3 500.[127] The expected impact of this programme is limited, since this funding can support no more than 60 companies. Results from similar programmes in previous periods also indicate very low rates of SME participation (e.g. only 10 companies applied in 2018 for a similar digitalisation programme according to the ministry's annual report[128]), which has been attributed to the heavy administrative burden on SMEs when applying and implementing these projects. Government-funded capacity-building activities to support ICT adoption have not been prioritised.

On a positive note, the legal framework for e-business and e-commerce has been recently updated, providing an enabling environment for doing business online. According to a 2020 survey on ICT usage by enterprises conducted by MONSTAT, 99.5% of the surveyed enterprises have access to the Internet, 84.5% of these enterprises have a business website, 45.5% of them use connection speeds of 30Mbps or lower while another 29.7% use speeds of between 30 Mbps and 100 Mbps (MONSTAT, 2020[148]). According to Eurostat, 12% of small businesses made e-commerce sales during 2019, compared to an EU average of 17%.[129]

### *Sub-dimension 10.3: Jobs*

The **digital skills for students** policy framework is based on a new digital competence framework that came into force in September 2020. The policy framework also includes a national curriculum that incorporates digital skills into compulsory subjects in primary and secondary education,[130] and a Higher Education Strategy for 2020-2024 that promotes the adoption of e-learning platforms and learning management systems. The higher education strategy was pending adoption in late 2020. Progression of digital skills and competences between primary, secondary and higher education curricula is coherent and quality assurance (QA) processes are in place, but indicators on digital skills are not included in QA reports.

Digital skills for students are assessed through regular student assessment procedures. Competent bodies claim that several international good practices in school curricula and teaching methods have been reviewed or even transferred, particularly from the UK and Finland. Every school in Montenegro has access to the Internet, although with varying speeds and availability in the classrooms, especially in suburban and rural areas. Efforts are made to bring Internet connectivity and equipment to every classroom at higher speeds and greater quality. Network infrastructure and speed will be improved through the Regional Broadband Infrastructure Development project launched by the Ministry of Economic Development during 2020. Software and digital tools for collaboration are also gradually being adopted in classrooms and into the teaching and learning process. The COVID-19 pandemic has expedited this process.

By the end of 2020, the targeted computer-student ratio was 1:10, which is the highest in the region. Montenegro has created a regional good practice through the appointment of an ICT co-ordinator in every school. The initiative for designating an ICT co-ordinator in schools started in 2006; since then every school in Montenegro has adopted the practice. This co-ordinator is responsible for the school's overall ICT management (including system maintenance, reporting failures, monitoring antivirus protection, etc.) and for encouraging and assisting staff with the application of ICT in teaching, training them to use ICT, and supporting them with the use of electronic didactic materials. However, data on digital skills for students, as well as on teachers' digital literacy, continue to be scarce. UNICEF Montenegro has supported the Ministry of Education in surveying aspects of children's and teachers' Internet use, online safety and digital literacy, introducing the Global Kids Online research toolkit[131] and supporting the development of digital literacy education in schools.

During 2018, the University of Montenegro started a process of digitalisation. New servers were installed in the Information System Centre and the academic network, EDUROAM, was introduced in all organisational units with network speeds up to 1Gbps. The development of an e-index and e-services is on the way, as well as the establishment of a new e-learning system that enables online teaching and collaboration with students at all higher education institutions. The Ministry of Education, Science, Culture and Sports is also actively participating in international co-operation projects, such as the IPA-funded project on Improving Key Competencies in the Education System of Montenegro. Although the Institute for Education and the National Examination Centre conduct external evaluations of the teaching process and the progress of developing digital skills, and co-ordinate follow-up activities (including teacher training, modernisation of equipment and methods, preparation of digital textbooks, etc.), evaluation reports are not publicly available. In general, monitoring of students' digital skills is weak and data are not regularly published by the relevant institutions.

The framework for **digital skills for adults** is based on the Strategy for the Development of Vocational Education in Montenegro and Action Plan for 2020-2021, and the Adult Education Plan (2019-2022), which aim to prepare a skilled workforce through the application of the European e-skills framework. These policies make clear reference to the development of digital competencies through lifelong learning and formal and non-formal education systems, and envisage co-operation with the labour market to identify training needs and design curricula. Approximately EUR 8 million have been allocated to implement the actions for the new Strategy for Vocational Education,[132] spread over three years up until 2022. However, reports on the funds allocated and implementation progress so far are not publicly available.

Digital skills for adults are developed through programmes promoted by the Centre for Vocational Education in various educational forms. The centre is also responsible for quality assessments of these programmes. Despite the industry being consulted during curricula design, the number of people trained and the quality of the training do not always meet market needs for skilled ICT professionals. Donor or private sector funded programmes offer non-formal adult learning opportunities, including several teacher training courses in digital skills, which have had a positive impact. For example, the Ministry of Education, Science, Culture and Sports co-operated with the British Council on the 21st Century Schools project, which trains primary school teachers[133] in critical thinking, problem solving and coding with micro:bit devices. The project has trained 537 primary school teachers from 95 primary schools since 2019, and is set to train a total of 800 teachers by the time it ends in 2022. In addition, 252 teacher training courses on the basics of programming and databases were also held during 2018 and 2019 in co-operation with the Oracle Academy.

According to the regulations, professional qualifications acquired through non-formal education systems can be recognised under the national professional qualifications framework, aligned with the EU Qualifications Framework since 2014. The Employment Agency also offers opportunities for IT skill development to unemployed people and other underprivileged groups; however, data on the impact of these programmes are not publicly available. The National Education Council consults the Employment Service, the Chamber of Commerce and the Union of Employers prior to adopting a digital skills programme. External evaluations took place during 2018/19 of each education provider and the reports were published on the Centre for Vocational Education's website.[134] However, no reports have been published since at least 2017 on internal evaluations or on the implementation of the new strategy.

Montenegro partly covers **ICT sector promotion** in policy documents that foster digitalisation and innovation through ICTs. The Strategy for the Development of the Information Society (IS) by 2020 and the Smart Specialisation Strategy (S3) 2019-2024, which is an overarching national strategy, are the main policy documents to support the development of the ICT sector. The IS strategy together with the announced Strategy for Digital Transformation 2021-2025 highlight broadband infrastructure development as one of their main objectives, which directly supports the growth of the communications sub-sector. On the other hand, the Smart Specialisation Strategy, adopted by the Ministry of Education, Science, Culture

and Sports, highlights ICT as a cross-cutting priority and includes the flagship initiative Digital Montenegro, aimed at promoting the digitalisation of businesses and ICT-related innovation in existing or emerging technologies. By promoting these, the S3 indirectly affects the ICT sector by boosting growth in all sectors of the economy through the use of ICT; however, it doesn't support ICT industry growth directly. The IT sub-sector companies (e.g. software development and information systems) may exploit the opportunities created across industries by the S3 to develop innovative products based on emerging technologies for the domestic and the international market. The Digital Montenegro initiative plans for IT awareness raising to enable dynamic and proactive access to new and innovative technologies; once again, however, the focus of these activities is cross-cutting rather than ICT sector targeted. The Ministry of Science is already supporting some activities to raise awareness of ICT technologies and innovation, notably among the youth, such as the annual IT fair Knowledge Factory within the Open Science Days Festival. It also introduced a new instrument in 2019 that co-finances (EUR 15 000 a year) activities intended to encourage a culture of innovation, such as hackathons, intense training camps, or similar. However, the impact of these initiatives on ICT sector promotion is limited, since they are focused on fostering ICT as an enabling technology, rather than on promoting the growth of the sector itself.

No internal assessments or external evaluations have been conducted on the impact on the ICT sector of the implementation of the IS 2020 Strategy or other policies, such as the Strategy for the Development of MSMEs. The ICT Association at the Chamber of Commerce points to the fact that the ICT sector does not have a national umbrella institution, since three ministries implement relevant polices (Economic Development, Public Administration and Education), all of which consider a well-developed ICT sector important for achieving their goals. However, the IT sub-sector of the industry cannot be considered as well developed. There is a lack of trained professionals, which is attributed to education system shortcomings. The ICT Association emphasises the need for a dedicated ICT sector promotion policy or programme that fosters measures to strengthen the ICT industry through internationalisation, promotion of exports, improved access to capital and favourable tax and staff social security regimes to enable investments.

### *Sub-dimension 10.4: Society*

The Strategy for Information Society Development 2020 and the new Law on e-Government, enacted in 2020, cover the basic principles of a **digital inclusion framework.** They promote the use of digital technologies among marginalised groups and equality across society regardless of age, geographic location, gender, education level, ethnicity or ability. The new Rulebook on e-Accessibility standards, adopted in late 2020, is aligned with international standards for websites, e-documents, e-services and procurement of ICT products and services. This rulebook complements the new Law on e-Government, and updates the existing framework through obligatory guidelines for all public sector websites in Montenegro. Guidelines had already been adopted for e-accessibility on public sector websites (since 2014) and for the creation of e-documents (since 2017), as prescribed by the Strategy for the Information Society 2020, but monitoring and enforcement was weak (OGP, 2018[149]). Some training for public officials and portal administrators has been organised, as well as a few awareness-raising and capacity-building activities for marginalised groups. The Ministry of Public Administration along with Montenegrin network operators and associations have organised free training for various population groups, equipment donations for schools in rural areas, training and certification testing for the Roma population, campaigns for people with disabilities, and ICT training workshops. However, low prioritisation and resource allocation for digital inclusion measures are aggravated by the lack of a central body tasked to oversee and co-ordinate digital inclusion activities by the various line ministries. Data on digital inclusion indicators are not regularly collected, which hinders informed policy and programme design.

*Sub-dimension 10.5: Trust*

The Law on Personal Data Protection (PDP) provides a basic framework for digital **privacy protections**. However, the current PDP framework is not fully aligned with the EU's General Data Protection Regulation (GDPR) (EU) 2016/679 and is outdated, with the law on PDP having been enacted in 2008 and last amended in April 2017. The Ministry of Interior formed a working group in 2020 to prepare a new PDP Law, but preparations are still at an early stage and there is no announced schedule for the adoption of the new law. Montenegro has not yet signed or ratified the Council of Europe 2018 Protocol amending the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data. The Agency for Personal Data Protection and Free Access to Information is the competent, independent enforcement authority. It undertakes inspections of PDP compliance and although it organises training for public sector officials and public awareness-raising workshops, capacity-building activities on PDP are weak. The agency has insufficient resources to implement its tasks. It is also evident that a culture of data privacy and access to public information is yet to be instilled in the public sector and across all levels of the government. Without such a culture, implementing the framework is difficult. Public institutions often deny access to public information requests by not answering or by declaring requested documents to be classified (EC, 2019[73]). The COVID-19 crisis has further exposed the challenges of limited awareness of PDP rights and obligations, with authorities struggling to find the right balance between protecting the health of the nation while respecting the confidentiality of personal health data and citizens' right to a private life[135] (EC, 2020[66]). Personal data disclosure measures taken by public institutions to address the COVID-19 pandemic in 2020 have raised questions on disproportionality by civil society organisations (AZLP, 2020[150]). On a positive note, in 2018 the agency completed a successful EU-funded twinning project Strengthening the Capacity of the Agency for Personal Data Protection and Free Access to Information with its partner agency in Croatia. It used training to improve staff capacity in the application of the law on free access to information. The aim of the project was to reduce the number of cases of administrative silence by first instance bodies and the number of agency decisions annulled by the administrative courts (AZLP, 2018[151]).

The framework for **consumer protection in e-commerce** is defined by the National Consumer Protection Programme 2019-2021 and its annual action plans, as well as the Law on Consumer Protection, amended in December 2019 to transpose the EU Directive on consumer rights (2011/83/EU). The new law improves consumer protection in e-commerce and introduces many new protection mechanisms for distance contracts. The Ministry of Economic Development is working on subsequent secondary legislation to regulate consumer protection in e-commerce. During 2020 two regulations were adopted, both regarding unilateral termination of consumer contracts concluded online. A law on alternative dispute resolution was also adopted in 2019 and subsequent by-laws are under preparation. The Commission for the Implementation of the National Consumer Protection Program is an inter-sectoral body, established by the Ministry of Economic Development to co-ordinate and report on the implementation of the programme. The law enforcement authority for consumer protection in e-commerce, the Directorate for Inspection Affairs,[136] is in charge of inspections of information society services and also collects data on consumer complaints, surveys and other trend data that allow for comprehensive monitoring of consumer protection. However, in its 2019 annual report, the directorate doesn't mention any activities related to consumer protection in e-commerce, suggesting that the implementation of the e-commerce consumer protection framework and its monitoring are still weak. Although consumer education and information are part of the mission of the Consumer Protection Programme, activities to raise public awareness around e-commerce are also insufficient. Ministries and other agencies, as well as the NGO CEZAP (Centre for Consumer Protection), have the role of informing or educating consumers, but again e-commerce activities have not been prioritised. Indicators on e-commerce and consumer protection in e-commerce are not regularly collected and published.

The Cyber Security Strategy of Montenegro 2018-2021 draws on international instruments to promote **digital security risk management** and cybercrime mitigation and encourages in-service risk management

training and awareness raising across the population through education programmes. Since 2018, there is clear evidence of active policy implementation. The Information Security Council was established in 2019 to co-ordinate implementation of the strategy in accordance with the EU Directive on security of network and information systems (NIS Directive EU 2016/1148) (EC, 2020[66]). The Critical Information Infrastructure for Montenegro has been defined in eight critical sectors. Also, the operational capacity of the national computer incident response team CIRT.ME has been strengthened with six additional staff members, and other public and private computer security incident response teams (CSIRTs) are gradually being created. Despite the staff increases for the CIRT.ME, additional technical and financial resources are still needed both for the CIRT.ME and the police department in charge of the fight against cybercrime, which, with only two employees, is seriously understaffed. The Law on Information Security and the Law on Classified Information are in place, but further harmonisation is needed and additional regulations are pending to complete the legal framework on information security and to align further with the NIS Directive.

### *The way forward for digital society*

Despite some important steps taken to improve the digital society policy framework, the government of Montenegro should pay more attention to the following aspects:

- **Invest in activities that promote the re-use of open data and stimulate the creation of public-private partnerships on data innovation.** Activities to promote the re-use of open data include organising open data hackathons, like the one organised in 2019; supporting business start-ups that create new value from open data sets; and open data partnering events that bring together public institutions (data owners) and private sector companies to stimulate the creation of open data PPPs focused on data innovation. Raising public awareness on data openness can be achieved by co-operating with civil society organisations and allocating sufficient resources to build the capacities of public officials.
- **Develop support programmes for SMEs to boost the adoption of e-business and e-commerce.** Review and evaluate the impact of previous programmes on digitalisation of SMEs and collaborate closely with industry stakeholders to identify shortcomings in the design of support measures. Adapt the approach and types of financial support to the needs of the market and allocate sufficient resources for co-financing tools for training SME staff in ICT. A set of indicators for private sector ICT adoption, including e-commerce, should be developed and regularly monitored.
- **Develop a common digital competence framework for ICT professionals to meet the needs of the labour market.** Despite the proliferation of ICT-related subjects and IT training programmes, their poor quality and lack of relevance to industry needs is widening the gap between the skills available and those sought by ICT sector companies. Increased co-operation between ICT training providers and the industry should be systematised following EU and international good practice. State institutions should strengthen the monitoring of digital skills indicators and regularly assess the relevance of acquired IT skills to market needs.
- **Adopt an ICT sector promotion policy or programme to strengthen the domestic industry so that it can act as an enabler of economic growth**. Although ICT is identified as a horizontal tool for growth across industries in the Smart Specialisation Strategy, the domestic IT industry has not received the necessary support to grow, increase exports or attract investments. Specific measures are needed to support the ICT sector in financing growth, internationalising products and services and retaining talent.
- **Establish or appoint a state body to oversee and co-ordinate digital inclusion activities and institutions implementing digital society policies.** Enable this body to co-ordinate activities at the highest level of the government, across ministries, agencies and institutions, to prioritise digital inclusion measures and ensure the sufficient allocation of resources to activities. This body would

need to facilitate collaboration with the private sector and donors to avoid duplicated effort and wasted resources, and to promote ICT capacity building for underprivileged groups. It could also be tasked with monitoring the implementation of e-accessibility regulations and regularly collecting data on a complete set of indicators for digital inclusion to enable data-driven policy making.

- **Accelerate the adoption of a new Law on Personal Data Protection to transpose the GDPR into national legislation.** Strengthen the Agency for Personal Data Protection and Free Access to Information with financial and human resources so it can perform its tasks effectively, particularly in view of the implementation of the new law. Intensify in-service training across the public sector to ensure that public officials understand and respect the principles of data privacy and the right to free access to public information.

## Transport policy (Dimension 11)

### *Introduction*

Since the last CO assessment, the main improvements made by Montenegro concern transport project selection, and implementation and procurement. The slowest progress has been in asset management. Montenegro's performance on the transport dimension is slightly above the WB6 regional average (Table 23.19), but further efforts are still needed to reach the EU's level of performance.

**Table 23.19. Montenegro's scores for transport**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 1.9 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 3.3 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 1.5 | 1.3 |
| **Montenegro's overall score** | | **2.1** | **2.0** |

### *State of play and key developments*

#### *Sub-dimension 11.1: Planning*

Improvements in Montenegro's **transport vision** since the last CO assessment include its new Transport Development Strategy (TDSM) for 2019-2035. It covers all transport modes; contains clear and measurable objectives, budgets per measures, roles and responsibilities for implementation; and is supported by a detailed action plan for 2019/20 (the 2021/22 action plan is being developed). Another improvement is the new Strategy for the Development of the Maritime Economy 2020-2030 and its 2020/21 action plan (adopted in August 2020). This comprehensive TDSM represents a solid basis for contributing to Montenegro's economic development, as well as to an open and competitive regional transport market. The TDSM's implementation plan is divided into two periods, 2019-2027 and 2028-2035, while action plans are adopted for two-year periods. Both of these strategies were developed through a consultation process involving a wide range of stakeholders, including the non-government organisation (NGO) sector. A transport model was used to develop the strategy, but it is not clear why the ranking of the measures was not assessed through this transport model – instead they were taken from the single project pipeline (SPP).[137]

The impact of the TDSM on tourism has not been assessed, showing a lack of coherence in policy making. However, there is a separate Tourism Development Strategy to 2020, which sets transport infrastructure and accessibility improvement throughout Montenegro as one strategic goal. Achieving this would not only benefit tourism, but also other branches of the economy. Once the upgraded transport and tourism policies and relevant infrastructure are fully integrated and jointly implemented, the attractiveness of Montenegro and the region will be improved and the relevant markets will become more competitive.

Monitoring of the TDSM will be done through the co-ordination body of the Ministry of Transport and Maritime Affairs (MTMA), as prescribed in the TDSM. The ultimate goal of the government should be to update the vision/strategy systematically based on the monitoring reports and impact assessments. National transport legislation is amended based on the regular monitoring results of the EU accession process; the last monitoring report was issued in the first quarter of 2020.[138] Up until 2019, transport-related strategic documents were always aligned with the European Commission Staff Working Documents (CSWDs)[139] on EU Enlargement Policy; as the new CSWD was issued in October 2020 it is expected that the TDSM will be aligned further if needed.

Investment in road and maritime infrastructure has fallen since the last CO assessment, but has increased for rail infrastructure. The same trend applies to spending on road and rail maintenance, while data for maintenance in maritime transport are not available.

Montenegro has co-operated with other WB6 economies to exchange experiences, as recommended in the last CO, especially through the Transport Community Permanent Secretariat (TCPS) cross-border co-operation programmes.[140] Projects include transport facilitation at the border crossing points (BCPs) with Albania, Bosnia and Herzegovina, and Serbia; co-operation for developing the Bar-Boljare motorway and railway line along Route 4; and co-operation with Albania and Croatia on realising the Adriatic-Ionian highway. Such regional co-operation and exchange of good practices needs to be enhanced on a regular basis and intensified, as the proper development of a single and competitive transport market can only be achieved through regular regional discussions on transport vision and planning. Montenegro participates actively in the EU Strategy for the Development of the Danube Region (EUSDR), aiming to help create a more competitive region through improved mobility and intermodality, as well as the use of more sustainable energy and better environmental protection. Montenegro also participates in the EU strategy for the Adriatic and Ionian Region (EUSAIR), which promotes economic and social prosperity and growth in the region by improving its attractiveness, competitiveness and connectivity.

The government has enough human and financial capacity to execute its tasks linked to the TDSM and related policy. The level of policy implementation to date is not known. Some legislation has been adopted since the last CO assessment linked to previous and current national transport strategies (presented below for each transport mode) but the level of harmonisation with the Transport Community Treaty (TCT), which aims to create a transport community between the EU and WB6 economies, is not clear.

Montenegro has made significant progress since the last assessment in developing legislation to improve **transport project selection** and project implementation. The Decision on the Preparation of the Capital Budget and Specification of Evaluation Criteria for the Selection of Capital Projects is a new prioritisation tool.[141] The process takes account of intermodality; accessibility; impact on the environment, society and economy; and cross-border and regional impact, etc. It is used only for projects to be financed through the WBIF; projects funded through national budgets and small-scale projects are not considered. Cost-benefit analysis (CBA) is only used for capital projects proposed for financing from the capital budget (projects over EUR 5 million) and projects listed in the SPP. Therefore, the return on investment is not known for projects financed through the national budget. There are no national guidelines for CBA so international practices and guidelines are used. Environmental impact assessment is conducted according to national legislation,[142] while social impact assessment is conducted using International Financial Institution (IFI) procedures. The government has enough human and financial capacity to execute the transport project selection process. However, *ex post* monitoring of the methodology and prioritisation processes is needed and should be applied annually in order to adjust the prioritisation framework.

Since the last CO assessment, new legislation has been adopted for **implementation and procurement processes** (the Concession Law, Public Procurement Law, PPP Law, and the Law on the Prevention of Corruption).[143] The PPP and concession laws allow transport infrastructure to be developed using alternative models to the traditional public procurement approach. While a procurement process is applied to all transport projects funded by the state budget, if the project is funded by IFI funds, an alternative procurement process is allowed, following IFI procedures. There are no transport PPP projects implemented in Montenegro yet (though the prequalification process started in 2019 for the concession for the Montenegrin airports). The Law on PPPs and Law on Concessions have been adopted recently, and the Investment Agency will have an oversight role in the procurement and monitoring of PPPs. For procuring goods or services of a very low value,[144] each institution defines the framework by adopting the Rulebook for conducting small value procurement, which is based on the Public Procurement Law.

*Ex post* evaluation of procurement and implementation processes does not exist and it is therefore not known if the implementation and procurement processes have achieved their objectives and, if not, why.

While the roles and responsibilities of the government bodies are defined, human and financial capacity are not adequate for the tasks assigned, especially for PPP projects, according to information provided by the government. Co-operation with the other WB6 economies has been established in the implementation and procurement sector, and best practices are shared and applied where possible. Examples include the development of a one-stop shop[145] (OSS) at the railway BCP with Serbia, and a one-stop shop at the railway and road BCPs with Albania, which minimise the crossing time and make transport corridors more competitive.

An **asset management system**[146] for transport modes has yet to be developed, and there is not yet a national inventory system of all state-owned (public) assets. As a good starting point for the road and railway sectors, the Technical Assistance to Connectivity in the Western Balkans (CONNECTA) study on Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6 (2018) could be used (CONNECTA, 2018[152]).

The state road network (1 853 kms) has been digitalised and road data collected through the Road Safety Assessment Project.[147] As per the newly adopted Law on Roads (2020), a medium-term state programme for roads has been adopted. It prescribes the development of maintenance plans which need to be implemented and developed to justify the maintenance budgets by directing funds to those areas where the return on investment will be greatest. This system should be considered as an integral component of planning, identification, prioritisation, implementation and monitoring processes for all transport modes.

Investment in road infrastructure is considerably higher in this assessment period than for other transport modes (Table 23.20) due to the ongoing construction of the Bar-Boljare motorway (part of the road and rail Route 4 – an important regional link, connecting the WB6 region to one of the biggest ports in the region). The planned investment in all transport infrastructure for the period 2020-22 is 25-30% lower annually than in 2019. Investment in rail infrastructure needs to be multiplied to achieve a similar level of investment as in the EU rail infrastructure market. The government's current plan for the period 2020-22 is to invest 50-100% more every year than in 2019. Investment in maritime port infrastructure is above the EU but below the OECD averages. Maintenance of road and rail infrastructure is slightly below the EU and OECD average (Table 23.20), but the government plans to invest 20-32% more annually over 2020-22 in the road sector and 45% annually in the rail sector.

### Table 23.20. Trends in transport infrastructure investments and maintenance, Montenegro (2017-19)

| | Investment costs | | | | | Maintenance costs | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Change over 2017-19 (%) | 2019 (mil EUR) | Share of GDP (2019) (%) | Share of GDP OECD average (2018) | Share of GDP EU average (2018) | Change over 2017-19 (%) | 2019 (mil EUR) | Share of GDP (2019) (%) | Share of GDP OECD average (2018) | Share of GDP EU average (2018) |
| **Road infrastructure** | -6.5 | 202 | 3.7 | 0.46 | 0.38 | -3.6 | 8.29 | 0.15 | 0.18 | 0.15 |
| **Rail infrastructure** | +1.5 | 6.9 | 0.12 | 0.17 | 0.31 | +1.5 | 6.9 | 0.12 | 0.16 | 0.16 |
| **Maritime infrastructure** | -68 | 1.8 | 0.03 | 0.05 | 0.02 | - | - | - | 0.05 | 0.01 |

Note: OECD and EU average represents the average value for the countries with available data.
Source: (ITF, 2019[153]), *Transport infrastructure investment and maintenance spending*, https://stats.oecd.org/Index.aspx?DataSetCode=ITF_INV-MTN_DATA; (IMF, 2019[154]), *IMF Country Profile - Montenegro,* data, https://www.imf.org/en/Countries/MNE; (World Bank, 2018[155]), GDP (current US$), https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&start=2018.

*Sub-dimension 11.2: Governance and regulation*

Since the last CO assessment, reforms have continued in the field of **aviation regulation**. The Law on Air Transport of Montenegro provides the legal basis for the adoption of by-laws that fully transpose the EU *acquis* and the TCT. The Single European Sky (SES) I and II packages had been fully transposed by 2013, while the Civil Aviation Authority (CAA) of Montenegro, with the consent of the MTMA, is fully committed to the further implementation of the Implementing Regulations and Community Specification, bringing Montenegro significantly closer to the EU *acquis*.

Safety Culture,[148] a programme covering important standards for safety risk assessment and safety assurance, has been adopted. The National Aviation Safety Plan for 2019-2023 was adopted in 2019. The National Supervision Authority's (NSA) tasks are performed by the Air Navigation Safety Division of the CAA. The CAA of Montenegro has developed training programmes for its staff and an Annual Training Plan is developed and approved each year covering fields related to safety, cost-efficiency and environmental issues.

Montenegro does not have its own Air Traffic Management (ATM) Plan; instead it relies on the European ATM Master Plan developed by the EU. A national ATM plan needs to be developed to provide a roadmap for the development and deployment of the strategic and operational concepts for optimising airspace management, enhancing safety and reducing emissions. The air traffic management plan in use was developed and monitored regularly through the Local Single Sky Implementation (LSSIP) monitoring[149] (EUROCONTROL, 2019[156]).

The Airport Charges Directive has not been transposed or implemented yet. This is an important piece of EU legislation stating that the charges have to be set and monitored based on the non-discrimination and transparency principles defined by the EU, including quality standards related to the service level agreement of the services provided at the airports. The market is monitored by the CAA (in 2015 and 2019 so far), which needs to provide the economic framework for air transport in granting and overseeing the operating licences of air carriers, market access, airport registration and leasing, public service obligations, traffic distribution between airports, and pricing.

Montenegro is not a member of any Functional Airspace Block (FAB), but has the very same form of FAB through Serbia and Montenegro Air Traffic Services (SMATSA), which aims to avoid national fragmentation and its impacts on safety, capacity, and above all, costs.

Air traffic in Montenegro is growing. The total number of passengers transported at all airports increased in the period 2017-19 by approximately 21.5%, amounting to 2.65 million passengers in 2019. This is a significant increase compared to the world average, which was 11.7% (IATA, 2020[157]) over the same period. The new airport passenger terminal in Tivat (which is the only coastal airport) was completed in 2018 to deal with the strong passenger growth and capacity constraints, and to provide welfare benefits for passengers at the terminal, better safety and security procedures, a higher quality of service and better working conditions for employees. Given the significant growth of this transport mode and its projected importance for the economy, it is important that Montenegro continues regulatory reforms to bring the governance of the aviation sector closer to European standards and international best practice.

Some positive efforts are visible in the **railway regulation** sector in Montenegro since the last CO assessment, but significantly more efforts are needed to align legislation with the EU *acquis* and the TCT and thus achieve a fully open rail market and safer and interoperable railway infrastructure. Structural reforms have been adopted and vertical separation has been implemented based on the 2005 Law on Railways. While the network monopoly is unbundled, the market is only officially liberalised for national companies. However, it should be fully open to and non-discriminatory for foreign firms too. There is only one national private undertaking for goods transport.

Established in 2019, the Railways Directorate is an independent administrative state authority, acting as a regulatory body and the National Safety Authority (NSA). It regularly monitors the implementation of

activities, with the latest report issued in 2019. The new Law on Railways will induce a full reorganisation of the Railways Directorate to become an independent administrative state authority performing the tasks of an oversight body. Railway Directorate operations are funded by the MTMA. Oversight activities are also conducted by the Directorate for Railway Transport in the MTMA. Network statements for infrastructure and services facilities are regularly issued, ensuring transparency and non-discriminatory access to rail infrastructure, and to services in service facilities.

Montenegro has advanced bilateral co-operation in the railway sector, signing border crossing operation agreements with Albania and Serbia to improve trade facilitation, shorten driving times and simplify border procedures. An agreement was signed in 2012 with Albania for a one-stop shop at BCP Tuzi. This OSS is now functioning well, while another agreement has been signed in 2018 with Serbia for installing an OSS at Bijelo Polje – this is still being implemented.

A National Register of Railway Vehicles has been established and will be transformed as per Commission Implementing Decision 2018/1614 by 2024 into a centralised European Vehicle Register. Staff are in the final phase of training in data processing. The EU Interoperability Directive 2016/797, important for developing and facilitating international railway transport, will be prepared for implementation during 2021. The following Technical Specifications for Interoperability (TSI) have been published on subsystem energy, on safety in railway tunnels, on subsystem control and signalling, and on infrastructure.

The mode share[150] of intercity rail passenger transport fell in the period 2017-19 by 4.3% to 11.4% (2019) of total transported passengers, while in the same period freight's mode share dropped by 14.5% to become 56.1% of the total transported freight. This freight mode share is good compared to the EU average in 2018, where road share accounted for 75.3%, rail share for 18.3% and inland waterways for 6% (Eurostat, 2020[158]).

### Table 23.21. Trends in transport of passengers and goods in Montenegro

| Rail network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of track) | +11.06 | 0.20 | 9.25 |
| Freight (tonnes*km/km of track) | -22.84 | 0.40 | 20.65 |

Source: (Eurostat, 2020[159]), *Eurostat transport statistics database*, https://ec.europa.eu/eurostat/web/transport/data/database; (MONSTAT, 2020[160]), *MONSTAT database*, https://www.monstat.org/cg/page.php?id=36&pageid=36.

Even though the share of rail freight is high, there is still potential to increase this share once the rehabilitation of railway Route 4 (Bar-Belgrade section) is completed. This is expected to increase both speed and reliability, easing access from the WB6 and Eastern Europe to the Mediterranean. There is still much to be done to achieve the EU average level of rail network utilisation (e.g. full opening of the market, incentives for shifting freight from road to rail, development of rail freight corridors, development of multimodal facilities but this will lead to much greater cost-effectiveness of transport infrastructure assets.

The current predominance of investment in road transport, shown in Table 23.20, indicates that more investment is needed in the railway sector to increase the quality of the network. This will lead to an increase in demand by passengers and shippers. If Montenegro succeeds in keeping its high rail freight share and increasing its rail passenger share this will indicate sustainable growth in demand. Such a growing and open market would lead to more efficient operation and could also help to lower prices for the users of the systems.

Very good progress has been made on **road market regulation** and in dealing with the impact of COVID-19. Since the last CO assessment, the Law on Road Transport (2019) and the Law on Working Hours and Pauses during Working Hours of Mobile Workers and Devices for Registration in Road Transport (2019) have both been adopted to harmonise legislation with the TCT. Therefore, local legislation is now fully

aligned with some key EU regulations. The legislation has been amended based on regular monitoring prepared on a quarterly basis as part of the EU accession process. The last monitoring report was issued in the first quarter of 2020.[151] The Law on Road Transport sets the deadline of December 2020 for all companies, managers and drivers to harmonise their businesses with this law. The government has prepared rulebooks related to the forms of permits, licences, etc. required. However, secondary legislation still needs to be harmonised for social provisions, tachographs, and enforcement of social legislation. This will require harmonising the following draft rulebooks: the Rulebooks on Tachograph Workshops, and the Rulebook on technical and performance requirements for tachographs, tachographs, and memory cards.

Montenegro participates in the European Conference of Ministers of Transport's (OECD-ITF, 2014[161]) multilateral quota system, which enables hauliers to undertake an unlimited number of multilateral freight operations in the 43 European member countries participating in the system.

Road network performance is measured occasionally and only for some indicators.[152] There is still scope to significantly improve the measurement of other indicators to monitor the road sector market. Doing so would help to allocate funds to areas that could generate the greatest benefits.

The mode share of road transport (88.6%) is significantly higher than for rail transport (11.4%), and higher than the EU average, whose road share accounted for 75.3%, rail share for 18.3% and inland waterways for 6% in 2018 (Eurostat, 2020[158]). Even though road network use is far below the EU average (Table 23.22), the road freight share is still high, with negative impacts on air pollution and climate change. Therefore, EU strategies for shifting freight from road to intermodal transport should be followed, accompanied by incentives. This could have a positive influence on air pollution and climate change, as well as on reliability, given the increasingly congested roads in the region and across Europe.

### Table 23.22. Trends in road transport in Montenegro

| Road network utilisation | Change over 2017-2019 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of road) | +0.02 | 0.013 | 1.26 |
| Freight (tonnes*km/km of road) | -21.75% | 0.009 | 2.27 |

Source: (Eurostat, 2020[159]), *Eurostat transport statistics database*, https://ec.europa.eu/eurostat/web/transport/data/database; (MONSTAT, 2020[160]), *MONSTAT database*, https://www.monstat.org/cg/page.php?id=36&pageid=36.

The COVID-19 outbreak is affecting the entire transport and mobility market the world over; the WB6 economies have not escaped its impacts. In the second quarter of 2020 Montenegro introduced measures at border and customs control to ease the provision of essential goods and medical equipment, aiming to keep low the number of infected individuals. Montenegro also introduced the Green Lane measure on major corridors for the transport of emergency goods, which requires that freight vehicles and drivers should be treated in a non-discriminatory manner and procedures should be minimised and streamlined. The time involved in passing through these green lane border crossings (including any checks and screenings) should not exceed 15 minutes (see also the Trade dimension). The implementation of these measures could have a direct impact on how the region's border crossings could be treated in the future. In addition to this, the regional measures underway to minimise crossing times could also have positive impacts, such as the OSS at the road BCP Preševo/Tabanovce between Serbia and North Macedonia; automation of customs procedures; and traffic management measures which transfer physical queues into virtual queues through an electronic queuing management system (e-QMS), inspired by the one installed in the Baltic countries (TCPS, 2020[162]) (TCPS, 2020[163]) (Government of Serbia, 2019[164]) (GoSwift, Estonian Border, 2020[165]).

In 2015, the Study on Inland Waterways in Montenegro was published to develop the non-existent **inland waterway (IWW)** transport legislation. Based on this study, the new Law on IWW is planned to be adopted by the end of 2021, transposing relevant EU legislation.[153]

Unlike for inland waterways, many EU Directives and Regulations have been transposed in the **maritime transport** market. Even so, many areas still need to be harmonised with the EU *acquis* and the TCT. These include maritime policy, market access, international relations and agreements, accident investigation, international safety management code, etc.

In April 2019 the Government of Montenegro adopted the Rulebook on Internal Organisation and Systematisation of the MTMA, establishing the Directorate for Maritime Transport and Inland Navigation comprising the Directorate for the Application of Standards to Protect the Sea from Pollution and Inland Waterways. There are still no specific incentives prescribed for shifting freight from road to maritime transport, which is flexible in terms of the size of the shipment, offers the foremost competitive freight cost especially over long distances, is the least environmentally damaging form of commercial transport, and is suitable for hazardous goods. Indicators to measure the performance of maritime transport have not been established yet. The total turnover of goods in ports decreased by 2% in the period 2017-19.

Indicators to monitor and assess the performance of all transport modes are either non-existent or not properly established (some missing indicators include average user costs, travel time satisfaction levels/reliability, value of assets, market research and customer feedback, quality of user information, audit programmes, etc.). Regular data surveys are not planned soundly – they need a clear purpose, a decision on the level of data needed, and an allocated budget. They are also not conducted regularly, and are conducted only for specific projects rather than as part of regular transport infrastructure assessment and planning. Therefore, Montenegro lacks the basis for a quality assessment of the transport network's performance.

### *Sub-dimension 11.3: Sustainability*

Further efforts are required to improve **road safety** in Montenegro. The Strategy for Improving Road Safety 2010-2019 (SIRS) was approved in 2009 after public consultations with all relevant government institutions (MTMA, Ministry of Interior, Police Administration, Ministry of Health, and Ministry of Education), municipal government units, NGOs, Insurance Supervision Agency, and the public. The SIRS was further upgraded through the Road Traffic Safety Improvement Program (RTSIP) for the period 2020-2022, and its action plan 2020-2022. The SIRS envisages that the Coordinating Body for Road Traffic Safety (CBRTS), whose task is to co-ordinate the activities of competent bodies and organisations in the field of road traffic safety, should monitor SIRS implementation. The government adopts the CBRTS annual reports, including those monitoring implementation of the previous year's action plan, and also adopts the action plan for the coming year. The most recent annual report only presents activities for 2019, therefore it is not easy to conclude the level of SIRS implementation. However, the 2019 report shows that 28% of operation goals have been fully realised, 36% are partially realised and 36% have not been realised. The RTSIP aligns the safety framework with the EU *acquis*,[154] as well as with the White Paper for Safe Roads in 2050.[155] It contains measures and actions, and assigns the bodies responsible for implementation, timelines, and budgets. Both staff and financial capacity are sufficient for implementing the strategy.

The Regional Road Safety Action Plan[156] was endorsed by the Council of Ministers of the TCPS in October 2020. Montenegro needs to align its national plans mentioned above with the goals set in this plan. The goal of the EU Policy Orientation on Road Safety 2011-2020 is to reduce road fatalities by 50% between 2010 and 2020 (the Decade of Action for Road Safety is 2011-2020, as proclaimed by the UN General Assembly in March 2010). SIRS is aligned with this document. This goal has already been achieved by Montenegro, as shown in Table 23.23. However, these good achievements need to be continued to secure the newly defined goal in the European "Vision Zero"[157] strategy to 2050, which also sets an intermediate goal for a 50% decrease in road fatalities in the decade 2021-2030. The basis for this good achievement lies with the RTSIP, whose goal is to reduce the number of road fatalities by 10% from 2018 figures and the number of persons with serious bodily injuries by 5% by the end of 2022. It is also necessary to

strengthen public-awareness and education activities, as well as promote innovative funding ideas in the road safety sector (Box 23.16).

### Box 23.16. Innovations in road safety: Road safety social impact bonds

The United Nations Development Program (UNDP) in Montenegro, in co-operation with the key national players in road safety, came up with the idea for road safety social impact bonds in 2018 as an innovative and alternative performance-based public financial instrument which shifts the policy framework from inputs and outputs to outcomes and value for money. This idea involves encouraging the private sector to invest in road safety improvements together with the public sector, with the aim of strengthening sustainability. The public partner commits to paying the outcome payments to the investor if and only if the predefined and measurable social goals are met. This idea has great potential to help other economies in the region (and beyond) to replicate and scale-up the model.

Source: (UNDP Montenegro, 2020[166]), *Project Summary, Rethinking road safety in Montenegro*, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

The main sources of information on road accidents in Montenegro are the Traffic Police (for data collected in the field) and the Ministry of Health (for information on injured persons). The actual road accident data system is updated quarterly, and the data are available on the MONSAT website.[158]

While these figures are positive (with Montenegro showing one of the two greatest achievements in the region in terms of reducing fatalities over the period 2010-2020), they are not completely stable, bearing in mind their fluctuations throughout the entire previous decade. Much greater efforts are needed, not only in harmonising the legislation with the TCT, but also in the areas of education, awareness campaigns, enforcement, etc.

### Table 23.23. Road safety trends in Montenegro

| Road safety trends | 2010-2020 (% change) | 2020 |
|---|---|---|
| Number of fatalities (Montenegro) | -49.5 | - |
| Number of fatalities (EU-27) | -23 | - |
| Number of fatalities per million inhabitants (Montenegro) | - | 77.2 |
| Number of fatalities per million inhabitants (EU-27) | - | 51 |

Source: (EC, 2020[167]), *2019 Road Safety Statistics: What is behind the figures?*, https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004. (MONSTAT, 2020[160]), *MONSTAT database*, https://www.monstat.org/cg/page.php?id=36&pageid=36.

There is no **environmental sustainability strategy,** though some environmental sustainability parameters related to the transport sector are partly covered in the National Strategy for Sustainable Development until 2030 and National Climate Change Strategy. The National Strategy for Sustainable Development (NSSD) has two main objectives: 1) enhancing the prosperity of citizens; and 2) promoting sustainable development. These strategies set a range of objectives and measures[159] for environmental sustainability in the transport sector. All these objectives and measures need to be linked with the national transport framework, and clear and measurable indicators need to be defined with timelines, budgets, and responsible bodies for implementation.

**Combined transport**[160] is the most cost-efficient transport mode, reducing environmental pollution, and increasing co-operation between the freight forwarding network companies. Achieving well-functioning logistical chains and establishing an international corridor approach and intermodal solutions could promote a high level of competitiveness in Montenegro's transport market. The legal and regulatory

framework for combined transport has been defined in Montenegro but not implemented, even though the TDSM does set some priority actions. Co-modality is proposed through the TDSM, including use of road freight transport for supporting intermodal terminals where it is impossible to achieve intermodality by other modes of transport; an increase of intermodal transport volume; an increase of intermodal transport agreements; development of intermodal stations in Podgorica and Bijelo Polje, etc. Although there is no separate strategy for logistics and co-modal solutions, the Law on Combined Transport (2014) introduced several incentives for users of combined transport (e.g. exemptions from road user tax and from permit fees to transport goods. It also required the locations for intermodal terminals and transhipment locations to be defined.

The World Bank's Logistics Performance Index (LPI) ranks Montenegro 77 out of 160 ranked countries, with an LPI score of 2.75. This is slightly below the world average (2.85) but far below the EU average (3.52). The best score achieved by Montenegro is for the timeliness indicator[161] (ranked at 63) while the worst is for tracking and tracing[162] (ranked at 105).

Improving data collection, which is currently very weak, needs to be one of the key actions for assessing performance on all sustainability areas. A strategy for data collection needs to be established as the basis for assessing the transport sector, as it could also directly influence the prioritisation processes within transport policy in general.

### *The way forward for transport policy*

Montenegro has taken some important steps towards developing a competitive transport sector, but special attention should be paid to the following challenges:

- **Develop and tailor the national cost-benefit analysis guidelines specifically to Montenegro.** It is very important for each economy to develop its own cost-benefits analysis guidelines with accompanying national technical instructions. The guidance needs to be updated often, at least every two years**.** A good example is the United Kingdom's Transport Analysis Guidance (UK, 2019[168]), which provides information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure consistency amongst the discount rates used for similar projects in the same economy, it is necessary to develop an economy-specific benchmark for all technical and economic parameters, including the financial and economic discount rate in the national guidance documents, and then to apply it consistently in project appraisal at the national level. Empirical research needs to be conducted at the national level to generate input data for calculating externalities.
- **Ensure transport facilitation remains a key priority.** More one-stop shops are needed to simplify border crossing procedures and to shorten crossing times, as well other measures in the newly endorsed regional Action Plan for Transport Facilitation (TCPS, 2020[163]). These include improving and upgrading existing ICT infrastructure, constructing or modernising infrastructure and building capacity to improve performance efficiency, etc. Implementing these measures will be a key trigger for integrating the Montenegrin transport market into the regional transport market, increasing the competitiveness and connectivity of the WB region, and further deepening integration with the broader European transport market. This will improve the transport of important goods that depend on quick, cost-effective and timely delivery, and will also boost investment in transport infrastructure.
- **Develop a combined transport strategy to promote sustainable transport.** This is of high importance given Montenegro's geographical location and the untapped potential of its existing seaports. With Rail and Road Route 4 currently being constructed/modernised, the timely development of a combined transport framework in Montenegro could generate substantial benefits for the economy and leave more time and resources for shipping companies to do new business. Therefore, incentives are needed for shifting freight to combined transport modes.

Additionally, lowering the cost of access to regional and international markets will boost the competitiveness of local companies.

- **Develop sound asset management practices that are in line with the national inventory system.** Sound asset management practices include regular monitoring of the condition of infrastructure, assessing the value of assets versus costs of unmaintained assets, adopting asset management strategies, being consistent in identifying the mix and timing of asset operation and construction strategies, etc. These enable economies to collect data and to manage and analyse conditions across all transport modes so as to optimise transport sector maintenance strategies and justify maintenance budgets, directing limited funds to those areas with the greatest return on investment. Performance-based maintenance contracts are already implemented in some WB6 economies such as Albania, Bosnia and Herzegovina, and Serbia,[163] though not extensively, and they could be used in Montenegro too. They are an essential component of the road asset management system and if well-developed ensure good road conditions at relatively low cost. The quality of transport infrastructure affects an economy's investment attractiveness, marking out the economy's territory as good for foreign direct investment.
- **Develop an Integrated Environmental and Transport Action plan** and a framework for environmental sustainability for the sector. This plan needs to integrate existing indicators and to include new ones in the framework for environmental sustainability. A good model to follow is the Transport and Environment Reporting Mechanism[164] developed by the European Environmental Agency, which prescribes indicators for tracking transport and environmental performance in the EU. Existing measures and indicators should be applied in the relevant strategies, including the new transport strategy.

## Energy policy (Dimension 12)

### *Introduction*

Overall, Montenegro has made substantial progress on this dimension since the last CO, with its overall score rising from 2.2 to 3.0 (Table 23.24). The most significant progress is in the energy markets sub-dimension, driven by finalising the unbundling of the sector's transmission and distribution system operators and implementing third-party access, as well as deregulation, liberalising energy markets and deploying a power exchange. However, there is still room for improvement, especially in completing the transposition of the EU's Third Energy Package (Box 23.17) and in the security of supply sub-dimension (mainly renewable energy and energy efficiency).

### Table 23.24. Montenegro's scores for energy policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Energy policy dimension** | Sub-dimension 12.1: Governance and regulation | 3.2 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 2.6 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 3.2 | 3.0 |
| **Montenegro's overall score** | | **3.0** | **3.0** |

### Box 23.17. The EU's Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Cooperation of Energy Regulators – ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies as members of the Energy Community, whose *acquis* reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude,

the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

## *State of play and key developments*

### *Sub-dimension 12.1: Governance and regulation*

Montenegro's **energy policy, legal and institutional framework**[165] encompasses an extensive array of documents (Energy Policy of Montenegro until 2030, Energy Development Strategy of Montenegro until 2030 and action plan for its implementation 2016-2020, National Renewable Energy Action Plan to 2020, and the first to fourth National Energy Efficiency Action Plans), legislation, and associated regulations. Together they provide comprehensive policy guidance for the sector. Essentially, the policy framework highlights three main priorities: 1) security in the energy supply; 2) development of a competitive energy market; and 3) sustainable energy development. These main priorities are supplemented by 20 key strategic commitments (Ministry of Economy, 2011[169]).

However, there are some limitations. For one, the government reports that only 25% of the projects stipulated in the strategies are or have been implemented to schedule. Secondly, only 75% of the Third Energy Package has reportedly been transposed into the national policy framework, with a key gap being network codes (Energy Community Secretariat, 2020[170]).[166]

Montenegro is also well advanced in following and implementing international best practice when it comes to **the regulator** sub-dimension. The Energy Community asserts that Montenegro's regulator, the Energy and Water Regulatory Authority of Montenegro (REGAGEN), is highly competent in executing its functions and roles and that it is one of the top two WB regulators (Energy Community Secretariat, 2020[170]). Resolving two outstanding issues would further the regulator's position as a strong, independent regulator: 1) ensuring it conforms with the EU Third Energy Package regulator roles, responsibilities and rights; and 2) enshrining and defining the independence of the regulator, as set out in Chapter IX of EU Directive 2009/72/EC, into Montenegro's primary energy legislation.

There are also two areas in which the regulator's functioning could be improved:

- Avoiding politicisation or political influence. According to the Energy Law, the government has the final decision in shortlisting their preferred candidate for the regulatory board to parliament.[167] This implies that there could be political influence on the regulator - although this is not in violation of EU Third Energy Package compliance and has not been raised as a major obstacle to regulator independence by the Energy Community (Energy Community Secretariat, 2020[170]). Moreover, recent changes to the Energy Law removed the requirement for government consent for the statute of the regulator, which is a step towards reducing the risk of political influence and reaffirms the independence of the regulator.
- The sanctioning powers of the regulator. Article 48 of the Energy Law requires the regulator to raise issues of non-compliance with the relevant national bodies rather than taking decisions and imposing sanctions themselves. It would strengthen the regulator's role as market enforcer if it had direct sanctioning power. However, it needs to be stressed that the current approach is not in opposition of what is permitted under the Third Energy Package. Meanwhile, the changes to the Energy Law mentioned above also fixed the former problem of fines being perceived as too low

and insufficiently dissuasive, by aligning the imposition of penalties with Articles 37 and 41 of EU Directives 2009/72/EC and 2009/73/EC.[168]

Progress on **managing energy infrastructure** has been a bit more muted than on energy policy and the regulator. While the sector is guided by the extensive strategy and the recently adopted Ten Year Network Development Plan, the new Infrastructure Law is yet to be adopted. Adopting it would make Montenegro compliant with the EU Third Energy Package. It also seems that Montenegro lacks a comprehensive approach to infrastructure incentives and an asset management system.

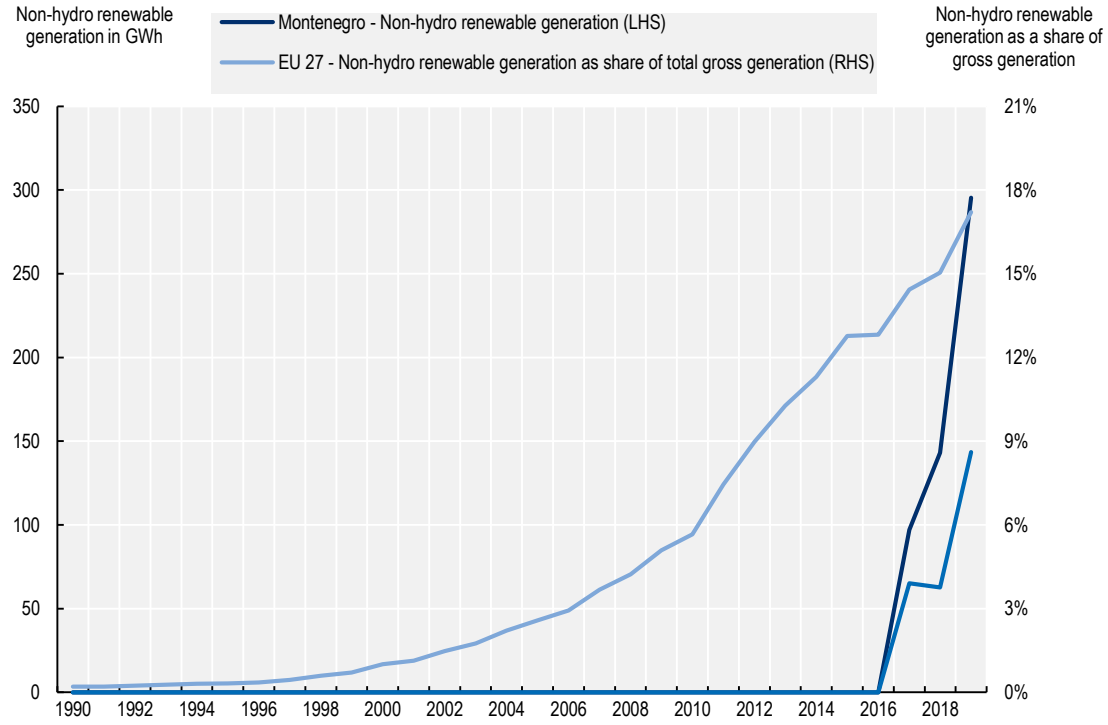
### *Sub-dimension 12.2: Security of energy supply*

When considering **natural gas supply** security, the main issue for Montenegro is the lack of a natural gas market. Although a significant share of the EU Third Energy Package has been transposed, significant gaps remain. For example, key secondary acts still to be adopted include supplier switching rules, various tariff and associated methodologies, connection rules, grid codes, balancing rules, metering rules, market rules, vulnerable customer rules, gas quality rules, and various strategic plans (including network development plans by either the distribution or transmission system operators). The failure to adopt most of these acts is due to the absence of a natural gas market; once the market has been established these should follow naturally. Moreover, without a natural gas market no judgement can be made on implementation.

Montenegro is looking to establish a natural gas market as part of its involvement in the Ionian Adriatic Pipeline (IAP). This natural gas supply would be the first step towards establishing a natural gas market as lack of supply is a key barrier.

The National Energy Development Strategy provides a clear policy and guidance for the **electricity supply framework.** Nevertheless, Montenegro continues to rely mainly on a single fuel – coal – which is used in two coal-fired thermal power plants: Pljevlja I and II. Montenegro plans to supply most of its expected demand growth by expanding the Pljevlja coal-fired thermal power plant complex. However, based on information provided by the government, it appears as if these plans, the expansion and continued reliance on coal fired generation, might no longer materialise or be pursued.

## Figure 23.16. Montenegro's non-hydro renewable energy generation (1990-2019)




Note: GWh: gigawatt-hours

Source: (Eurostat, 2021[171]), *Gross and net production of electricity and derived heat by type of plant and operator [nrg_ind_peh]* – Database accessed 26th June 2020, https://ec.europa.eu/eurostat/web/energy/data/database.

StatLink https://doi.org/10.1787/888934255969

The Energy Policy of Montenegro until 2030 does foresee some increase in **renewable energy**.[169] Montenegro currently generates around 2.1 terawatt-hours (TWh) or 55% of its power via hydro generation - a well-established source in Montenegro (Eurostat, 2021[171]). To take full advantage of renewable energy, a diversified renewable generation mix should be achieved. Montenegro is at the beginning of its renewable energy journey, with its non-hydro renewable generation only beginning in 2017. In 2018 only 143 GWh or 4% came from non-hydro renewable sources, namely wind energy, which rose to 295 GWh or 9% in 2019 (Figure 23.16). This is equivalent to the EU's non-hydro renewable share in 2007 – today its share is around 16% (Eurostat, 2021[171]).

However, hurdles need to be overcome in order to attract investors. First and foremost, the legislative framework needs to be finalised. The recent adoption of amendments to the Law on Energy nearly completes the transposition of the European Union Directive 2009/28/EC which "establishes an overall policy for the production and promotion of energy from renewable sources in the EU". The focus should now switch to implementation, including the adoption of secondary acts. Associated with this issue is also the competitive auctioning of renewable energy projects. While Montenegro has completed the first two state land locational auctions, the formal rules and regulations that create the standard approach for such auctions have not been adopted yet, which creates uncertainty around the timing and nature of future auctions.

Montenegro continues to use feed-in-tariffs, setting the price at the beginning of each year. While the tariff was increased recently, thus boosting the attractiveness of renewable energy projects, Montenegro should consider shifting to an alternative support system, such as feed-in-premiums. Feed-in-tariffs have fallen out of favour in most countries as they disconnect renewable generators from the realities of the market (Box 23.18). In addition, the priority integration and dispatching of renewable energy, while enshrined in law, is not adequately implemented in practice. Lack of resources means that connection to the grid can

take a while, and tends to be done by the renewable energy project developers and then sold to the transmission system operator (TSO) via a long-term contract. To provide optimal support and encouragement for renewable investment, Montenegro should expedite connections and TSOs should pay for and implement the connection to the grid. This in turn would lower the project capital expenditure hurdle and asset risks for investors.

Renewable energy generators are exempt from balancing responsibility (see Sub-dimension 12.3, energy markets), which is not in line with international good practice as it socialises the cost associated with renewable energy imbalances and minimises investors' responsibility to forecast their generation accurately.

Montenegro also needs to implement a framework for self-consumption of distributed renewable energy with regard to grid connection, and to promote its deployment in line with the energy efficiency and energy laws. The promotion of small-scale renewable energy producers for self-consumption ("prosumers") could increase consumer power and reboot consumer interest in energy efficiency.[170] The result would be an increase in renewable energy share, energy diversification and supply security.

Finally, on a positive note, Montenegro has transposed the relevant legislation to allow it to share its excess renewable energy with its neighbours, helping them to meet their national targets. This increases the value of renewable energy projects in Montenegro, even without a fully operational Guarantee of Origin system.[171] However, although Guarantee of Origin legislation is in place, the implementation of the scheme could be improved. The role of issuing the Guarantees of Origin has been shifted away from the regulator to the electricity market operator, which is currently working on deploying it but has not yet completed the electronic system for issuing, transferring or cancelling the Guarantee of Origin. It is worth mentioning that Montenegro has applied to become a full member of the Association of Issuing Bodies - a body that establishes a common approach to issuing and facilitates the transfer and cancellation of Guarantees of Origin in Europe.

**Energy efficiency** in Montenegro is guided by the advanced transposition of the relevant EU Third Energy Package. Even so, further transposition is needed to fully implement the Third Energy Package, in particular on energy performance of buildings and energy labelling. While most of the energy performance of building legislation is in place[172] and has been implemented - including mandatory energy performance audits and certification of buildings - gaps remain. These include near zero-energy building definitions as well as targets and strategies to achieve them, a comprehensive building inventory, and the software and analysis for calculating the cost-optimality of the current energy performance requirement. Moreover, there is no long-term vision for deploying energy efficiency in buildings - particularly outside the public building sector.

Another key energy efficiency issue relates to the energy service companies (ESCO) market.[173] This is a market in which energy service companies carry "out energy performance improvement at the contractor's site, while guaranteeing energy savings and/or the provision of the same level of energy service at a lower cost. The remuneration of ESCOs is directly tied to the energy savings achieved. The ESCOs can finance, or assist in arranging financing for the project, but this is not a prerequisite" (Boza-Kiss, Bertoldi and Panev, 2015, p. 445[172]). Although a first framework has been established in Montenegro, including standard contracts, the widespread use of ESCO markets is lacking.

Transparency is another factor weighing on Montenegro's energy efficiency performance. Montenegro has missed annual reporting deadlines to the Energy Community on its progress to implement the National Energy Efficiency Action Plan, in violation of treaty requirements. It missed the submission deadline for the third and fourth annual implementation reports. Although government sources suggest that the reports were eventually submitted, the Energy Community website does not list them as submitted.[174]

Finally, there are some concerns that the human resources dedicated by public entities to energy efficiency are not adequate. This is best demonstrated by the recent move by the Ministry of Economic Development to merge the Energy Efficiency Directorate into the Energy Directorate.

### *Sub-dimension 12.3: Energy markets*

Both the **electricity wholesale and retail market** are deregulated and are not subject to price regulation - apart from vulnerable customers and natural monopolies – and consumers are free to choose and switch suppliers. Currently, there are 39 participants in the wholesale market, and 6 in the retail market.

However, there are some limitations. First, while the power exchange has been established, it is not currently operational and thus Montenegro does not have an operational day-ahead market. The benefit of the day-ahead market lies in the automatic matching - based on algorithms - of supply and demand in a competitive manner to reach a price-based equilibrium. In its absence, the optimal distribution of economic rent remains out of reach in Montenegro. Second, while the retail market is deregulated and subject to free price formation and consumer switching, competition and market liquidity are so limited that consumers are in fact tied to a single supplier. This was highlighted by the government, which suggested that some consumer groups (households and small consumers) are dependent on a single supplier and/or are under a *de facto* forced price regulation regime. Despite this limitation to the quality of the market in Montenegro, the government does not appear to have plans to tackle the situation in the near term.

The balancing market is operating, with stakeholders being imbalance-responsible in a non-discriminatory manner.[175] However, there is a lack of competition as balancing reserves are offered by only two stakeholders: the incumbent generator, Elektroprivreda Crne Gore (EPCG), and an industrial consumer. Given the lack of reserves, the national balancing reserve capacity still falls under price regulation. However, the balancing price itself is not regulated and supplemented by the cross-border market-based exchange of balancing energy which supports the competitive price formation by increasing the liquidity. Nonetheless, Montenegro should design and implement policy to increase domestic balancing capacity and in turn deregulate balancing reserve capacity price.

One area where Montenegro has made significant progress is in **unbundling and third-party access**. The unbundling concept, which complies with the EU's Third Energy Package, is enshrined within Article 135-139 of the Energy Law. To that end the Transmission System Operator, Crnogorski elektroprenosni sistem (CGES), and the Distribution System Operator, Crnogorski elektrodistributivni sistem (CEDIS), have been certified as unbundled since April 2018 and June 2016 respectively.

In the case of the TSO, certification depended on the introduction of legislation or regulations for a compliance officer. The required legislative changes were made recently as part of the adoption of amendments to the Energy Law in July 2020. To this end, the Energy Community rates Montenegro's implementation of unbundling as 100% complete (Energy Community Secretariat, 2020[170]).

Articles 133 and 134 of Montenegro's Energy Law enshrine the concept of non-discriminatory third-party access to the transmission and distribution system, in line with the EU Third Energy Package - specifically EU Directive 2009/72/EC. Evidence that non-discriminatory third-party access is the operational norm in Montenegro can be seen in its publication of transparent tariffs, including for connections to the system. Other evidence includes the transposition of the Connection Network Codes and adoption of the Decree on requirements for connection of electricity generators to the transmission and distribution networks.

Moreover, access to the interconnector capacity with Albania and Bosnia and Herzegovina is assigned using the Coordinated Auction Office in South East Europe through competitive auctions for yearly, monthly, and daily products. In addition, the capacity of the interconnector with Serbia is based on specific rules that allocate capacity using split auctions for yearly, monthly, daily and intraday products.

As **regional integration** is a fundamental element of the national strategy, it is guided by a coherent central policy. Montenegro participates in various international bodies and working groups that aim to promote

regional integration and market coupling, including membership of the European Network of Transmission System Operators for Electricity (ENTSO-E), the Mediterranean Transmission System Operators (MEDTSO-E), the market coupling working group with Albania, Italy and Serbia (the AIMS project) and the Know-how Exchange Programme project (KEP). This is further supplemented by Montenegro's participation in various other projects aiming to promote regional integration and market coupling, including the Crossbow[176] and Trinity[177] projects within the context of EU Horizon 2020.[178]

However, despite these positive steps, there remains significant room for improvement. The Capacity Allocation and Congestion Management Network Code is currently being drafted and so has not yet been adopted. This code harmonises the method and rules for allocating cross border capacity and facilitating their use in a safe and competitive manner (i.e. promoting regional integration through the standardised and optimised use of interconnectors).[179] Additionally, market coupling is far from complete, despite Montenegro being part of various projects to that end. The lack of an operational day-ahead market is a key obstacle to progress. Finally, from the perspective of balancing reserves, Montenegro is still activating reserves on a manual bilateral basis with Serbia and Bosnia and Herzegovina. In other words, there is no regional balancing co-operation, including imbalance netting.

*Cross-cutting policy area: Energy incentives - direct and indirect subsidies in the energy sector*

Without a doubt there are direct and indirect subsidies present in Montenegro's energy sector. Although the information available within the public sphere is limited, there are strong indications that Montenegro provided subsides to the coal sector and to thermal power plants amounting to around EUR 2.9 million between 2015 and 2017 (Miljević, Mumović and Kopač, 2019[173]), (Mumović, 2019[174]). These are limited when compared to other Western Balkan economies, however.

### *The way forward for energy policy*

While Montenegro has made tremendous progress, some key challenges still need to be tackled:

- **Complete the transposition of the Third Energy Package.** This is essential as it will assure that Montenegro has a full and comprehensive legislative and policy framework for the sector. The Third Energy Package, despite being replaced by the Clean Energy Package in the EU, still reflects in many ways international good practice in establishing and stimulating a competitive energy market.
- **Finalise the operational deployment of the power exchange.** The main benefit of a competitive market comes from the efficient matching of supply and demand. This is the goal of the power exchange, which can facilitate competitive price development and achieve best value for money. The key next steps will be for the power exchange to undertake a dry run that eventually leads to the first trades.
- **Promote competition in the market so as to harness competitive forces and provide the best value to the economy.** This will come from increased interconnection and market coupling as trade flows will add liquidity and thus competition to the market.
- **Design and implement a decarbonisation strategy and phase out coal.** To widen acceptance of the coal phase out, the strategy should identify support for regions/municipalities that currently rely on the coal windfall to help them reorient their economies to new activities. International best practice shows that long-run sustainability and climate resilience in the power sector rely on decarbonisation. Moreover, with the EU contemplating introducing a carbon power border tax,[180] decarbonisation is merely a question of where the windfalls of carbon pricing will land. Thus decarbonisation could be the key to supporting the long-term competitiveness of Montenegro's exports to the EU.

- **Take steps to encourage the development and growth of renewables.** Diversification is necessary to harness the wider benefits of renewable energy while increasing supply security and decreasing risks associated with single sources of electricity. With Montenegro at the beginning of renewable deployment it needs to take steps to promote investment. These include finalising the legislative framework, establishing a project pipeline based on competitive assignment mechanisms and employing the latest best practice for subsidisation - including Guarantees of Origin (Box 23.18). Moreover, Montenegro needs to improve capacity to connect renewable projects to the transmission and distribution system so as to lower the investment hurdle for project developers.
- **Focus on energy efficiency, including developing a long-term vision and financial support mechanisms – especially outside the public building sector.** Energy efficiency is a central tool for managing demand. On the one hand it is used to make demand more cost effective in the use of energy, while on the other it contributes to the long-run sustainability of the energy market by easing demand for energy growth.

### Box 23.18. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated independent of the electricity market price (Banja et al., 2017, p. 15[175]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (CEER, 2018, p. 12[176]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (EC, 2013, pp. 12-13[177]). The latter has been a problem especially as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (EC, 2013[177]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (EC, 2013, p. 8[177]).

The European Commission suggests using a feed-in premium scheme in combination with the following good practice recommendations (EC, 2013[177]):

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable project and associated premiums using competitive allocation mechanisms such as auctions.

- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

However, the Council of European Energy Regulators reports that in 2016/17, 17 of the 27 European Union member countries still used some form of feed-in tariff, although mainly for small projects, while around 16 used feed-in premiums, including to complement feed-in tariffs (EUR-Lex, 2014[178]).

For further and more detailed exploration of renewable energy subsidies and best practice please see the sources below. Meanwhile, for more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.

Source: (Banja et al., 2017[175]), *Renewables in the EU*, https://e3p.jrc.ec.europa.eu/sites/default/files/documents/publications/kjna29100enn.pdf; (CEER, 2018[176]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (EC, 2013[177]; EC, 2013[177]), *European Commission guidance for the design of renewable support schemes*, https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (EUR-Lex, 2014[178]), *Guidelines on State Aid for Environmental Protection and Energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Environment policy (Dimension 13)

### *Introduction*

Montenegro has improved its performance in the environment policy dimension. The economy's score has increased from 1.8 in the 2018 Competitiveness Outlook to 2.4 in the 2021 assessment, with notable progress in enhancing the biodiversity and air quality policy frameworks. Montenegro is the best-performing economy in the Western Balkan region for environmental policy (Table 23.25).

**Table 23.25. Montenegro's scores for environment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 13.1: Resource productivity | 2.3 | 2.0 |
| | Sub-dimension 13.2: Natural asset base | 2.0 | 2.1 |
| | Sub-dimension 13.3: Environmental quality of life | 2.8 | 2.3 |
| **Montenegro's overall score** | | **2.4** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 13.1: Resource productivity*

As a Non-Annex-I signatory to the United Nations Framework Convention on Climate Change (UNFCCC) and its Paris Agreement, and a party to the Kyoto Protocol,[181] Montenegro has joined international climate change efforts and is committed to reducing greenhouse gas (GHG) emissions and limiting global warming to a maximum of 2°C by the end of this century. However, despite some efforts, carbon productivity has not improved since the last assessment. The economic output per unit of carbon dioxide ($CO_2$) emitted is still low (Environment Protection Agency, 2020[28]). More than two-thirds of Montenegro's total $CO_2$ emissions come from electricity generation and heat production (61.4% in 2018, highlighting its fossil-fuel based energy production), followed by transport, which accounts for a little over 20% (Ministry of Sustainable Development and Tourism, 2020[29]).

**Climate change mitigation and adaptation** policies in Montenegro have advanced slightly since the last assessment. The new Law on Protection against Adverse Impacts of Climate Change was adopted in 2019, in accordance with which the government adopted the Decree on activities or operations that emit greenhouse gases. This requires industries emitting GHGs to obtain a permit. Activities to align the legislation with the EU *acquis* have been undertaken and the Third Biennial Update Report (2020) to the UNFCCC introduces the main monitoring, reporting and verification mechanisms, including a GHG inventory (Ministry of Sustainable Development and Tourism, 2020[29]). The Law on Protection against Adverse Impacts of Climate Change and the Law on Environment oblige Montenegro to develop a Low-Carbon Development Strategy and an action plan. Developing this strategy is a priority for the coming period, but delays have occurred due to changes in government. Currently, there are three main strategies that address climate change in Montenegro:[182]

1. The National Climate Change Strategy to 2030, which is the main strategic document and has an advanced implementation track.
2. The National Energy and Climate Plan (NECP), which aims at aligning the main energy policy objectives and climate change mitigation actions.
3. The National Strategy and Action Plan for Transposition, Implementation and Enforcement of the EU *acquis* in the Field of Environment and Climate Change 2016-2020, which refers to harmonisation with the EU *acquis* in this area. A final report on its implementation was produced at the end of 2020.

Although a strategic framework for tackling climate change is in place, Montenegro needs to intensify its work to ensure consistency with the EU 2030 climate and energy policy framework and make sure that its strategies are integrated into all relevant sectoral policies and strategies (EC, 2020[66]).

When it comes to climate change adaptation, the Directorate for Emergency Situations of the Ministry of the Interior has started to prepare a disaster risk assessment, which will cover major climate change-related risks. Some flood-risk management measures have been implemented since the last assessment through the regional project, Adaptation to Climate Change through Transboundary Flood Risk Management in the Western Balkans (2016-2020). The project focuses on integrated water resource management and adaptation strategies in the Drin River Basin, which covers Albania, Kosovo, North Macedonia and Montenegro. Its main objective is to mitigate the impacts of climate change by focusing on flooding and drought risk management, as well as strengthening regional co-operation for managing water resources. The project has strengthened cross-border co-operation for flood warnings and established a cross-border warning system through the exchange of hydro-meteorological real-time data. Flood risk management plans have also been drawn up for the participating municipalities on Montenegro's side of the Drin River Basin, and their implementation capacity built through regular training. Furthermore, precipitation and stream-gauging networks have been extended to measure real-time data for transboundary flood forecasting, through upgrading or renovating a total of 10 stations. This now enables floods to be predicted and the population in the relevant areas receive early warnings. Local stakeholders have however reported that risk prevention analysis is insufficient and that projected measures focus on areas that have already been affected by floods and do not predict potentially new areas.[183]

Very little has been done to develop **a circular economy framework** in Montenegro since the last assessment. The main measures that relate to a circular economy are contained in the National Strategy for Sustainable Development until 2030 (NSSD, adopted in July 2016), with its first implementation report being finalised at the time of drafting. However, the timeframe of these measures is quite broad as they are spread up until 2030; no concrete activities have been undertaken so far. Recycling rates are very low (around 5% of municipal waste in 2018 compared to the EU-28 average of 47%) which means that 95% of municipal waste is landfilled (Eurostat, 2020[179]). There are centres for primary recycling in two Montenegrin municipalities, where certain types of waste are selected and prepared for export and further processing – and smaller lines in Kotor (including the first composting plant). Moreover, preparations are underway to construct new recycling yards and sorting plants.[184] There are no waste incineration plants in Montenegro.

With a municipal waste generation rate of 531.7 kg per capita, Montenegro's waste generation rate is higher than the EU average of 492 kg per capita (in 2018), and has seen a constant increase since 2014 (Eurostat, 2020[180]; Ministry of Sustainable Development and Tourism of Montenegro, 2019[181]). Despite this trend, no measures have been undertaken to decrease the amount of waste created. Since 2017, there have been no major changes in the legislative **framework for municipal waste management**. The new Law on Waste was being prepared at the time of drafting. There are two main strategy documents: the National Waste Management Plan 2015-2020 (the new plan is still being drafted and is expected to be adopted in 2022) and the National Waste Management Plan until 2030. However, their implementation is limited, with the exception of the rehabilitation of the four large unregulated landfills that was completed in 2017. The changing priorities and decreasing government revenues as a result of the COVID-19 pandemic are expected to slow implementation down still further. Although monitoring mechanisms were envisaged in the form of annual reports on the implementation of the National Waste Management Plan, they are mostly missing.

Waste collection and treatment infrastructure is financed mainly through the state budget, while waste collection and treatment services are funded from the local municipalities' budgets.[185] There have been no changes to waste tariffs since 2017. Waste separation at source has been introduced since the last assessment in certain municipalities: in 2020, the municipalities of Podgorica, Herceg Novi, Bijelo Polje, Pljevlja and Bar provided containers for selective waste collection. Although the awareness-raising project

Separate Waste Collection is my Decision continued to be implemented in co-operation with local self-governments throughout the assessment period,[186] primary selection of waste has been reported to be low despite infrastructure installed for this purpose. The situation might improve when the new law on waste is in place. No measures to combat unregulated burning or illegal dumping of waste have been undertaken, despite the fact that this practice continues to pose problems in Montenegro. Local stakeholders have been working on mapping the illegal dumps across the economy since 2015,[187] and sanctions for unregulated burning and illegal dumping of waste are envisaged by the law, but implementation has been weak due to the lack of capacity among the local municipalities responsible.

### *Sub-dimension 13.2: Natural asset base*

According to the Water Competition Index,[188] 30 425 m³/year of water[189] are available to each citizen of Montenegro, which makes Montenegro one of the wealthiest economies in Europe for water (EEA, 2015[182]). Despite the apparent abundance of water, around 35% of Montenegro's territory suffers from a chronic lack of water, while around 10% of the territory has a problem with seasonal surplus water. As a consequence of climatic conditions, the uncontrolled use of water, huge losses in the water supply system and inadequate infrastructure, water consumption per capita is double that of Western Europe (EEA, 2015[182]). Furthermore, during the tourist season, there is insufficient provision of drinking water in the coastal region. The following sectors place a high demand on water in Montenegro: agriculture, industry (primarily food, as well as SMEs), transport and road construction works (Ministry of Sustainable Development and Tourism of Montenegro, 2019). In 2018, households accounted for the main freshwater withdrawals (60%) in Montenegro, followed by industry (39%), with only 1% of abstractions coming from agriculture (World Bank, 2020[183]). In addition to the pressures on water, another major issue for freshwater is pollution, stemming from insufficiently treated industrial and municipal wastewater (see section below on Environmental quality of life).

The legislative and policy framework for **freshwater management** is in place and there have been no major changes since the last assessment.[190] Implementation has been rather limited, except for the new EU-IPA project on Support to the implementation and monitoring of water management in Montenegro, signed in December 2019, to improve overall water management in Montenegro. Monitoring and evaluation mechanisms are also lacking. According to the Government of Montenegro, prevention of pollution at source, emissions control and water quality standards are part of the legislation, as well as the prevention of and protection against flood risks.[191] Investments in hydropower currently do not always comply with national and international nature protection and water management obligations, such as the EU Water Framework Directive (2000/60/EC). In this regard, Montenegro should ensure public participation and consultation, and guarantee high-quality environmental impact assessment (EIA) reports that include cumulative impacts on nature and biodiversity (EC, 2020[35]).

As noted in the previous assessment, there are no data or projections on water demand from agriculture, industry (including energy) or households, despite regular requests from local NGOs. Decisions are therefore not guided by evidence on competing uses now and in the future. Water risk management data exist – mainly meteorological data (including rainfall) and historical data on water disasters – but not all are publicly available or communicated to citizens to increase awareness of water-related risks.

Montenegro hosts rich biological diversity. Forests make up 61.5% of its total land area – the greatest share in the Western Balkans region (where the average is 42%) (World Bank, 2020[183]). However, human pressures represent major risks when it comes to protecting biodiversity and maintaining forestry resources – including illegal tree logging, tourism, urbanisation and road construction, mini hydro power plants, pollution, illegal waste dumps, as well as forest fires, climate change and invasive alien species (Ministry of Sustainable Development and Tourism of Montenegro, 2019[181]). Therefore, strong **biodiversity and forestry frameworks** are key to overcoming these challenges and conserving ecosystems. Montenegro is party to the Convention on Biological Diversity, which comprises 20 Aichi Biodiversity Targets.[192]

Although certain activities have been implemented to meet these targets in Montenegro, progress is insufficient. For example, terrestrial protected areas increased from 6.5% in 2018 to 13.5% in 2020 (whereas the Aichi Target 11 aims for 17% coverage by 2020). Montenegro is actually regressing on some targets (e.g. Achieving sustainable tourism and Reducing pressures on biodiversity from transport, energy and infrastructure) (Ministry of Sustainable Development and Tourism, 2018[184]). Further progress is also needed to designate marine protected areas[193] and to establish a comprehensive system of strict species protection to be applied, among others, for seismic surveys, hydropower and touristic developments.

Biodiversity is monitored annually, through direct co-operation between institutions responsible for various thematic areas as prescribed by the Law on Nature Protection. There is a system to collect information on biodiversity (including conservation status of threatened species and habitats), but according to the government, the extent of the monitoring programme is not sufficient for an overall assessment of the conservation status of threatened species and habitats. The Nature and Environmental Protection Agency is in charge of these areas, but lacks the human and financial resources (mostly government-funded) for carrying out its main responsibilities.

A national forest inventory system exists in Montenegro and the Forest Management Programme was adopted in 2019, which defines annual forest management measures by volume, type and time of execution in order to ensure the sustainable management of forest resources. Fire prevention is an integral part of forest management plans. A co-ordination team for the suppression of illegal activities in forestry was formed in April 2019 to detect illegal forest activities, including deforestation. The Forestry Inspection, together with the Police Directorate and the Forest Directorate, carry out controls and inspections. Clear sanctions for illegal tree logging are in place and there are regular reports on the effectiveness of these measures.

**Land-use management** in Montenegro is under-developed. There is a legislative framework,[194] but it remains largely unchanged since the last assessment. Little progress has been achieved on policy. The National Plan for Desertification (2015-2018), the main policy document related to land-use management, has now expired and has not been updated. A National Drought Management plan is however being drafted that will cover national desertification (planned to be completed by October 2021). No new strategic documents have been produced since the last assessment, except for the new Spatial Plan of Montenegro (2020-2040) adopted in 2020, which will indirectly regulate land use. There is growing pressure on land and soil resources in Montenegro, especially in the context of a pronounced decrease in agricultural land, from 38% in 2012 to 18.6% in 2019 (comparatively lower agricultural land share than its regional peers) (MONSTAT, 2020[185]). According to the government, monitoring of potential soil contamination is hampered by the lack of an adequate legal framework. Although agricultural land is regulated by law, the legal framework does not prescribe the maximum concentrations of hazardous and harmful substances allowed on other types of land (industrial land, playgrounds, parks or residential areas).

### *Sub-dimension 13.3: Environmental quality of life*

Air quality in Montenegro remains a concern, with the population exposed to air pollution levels of $PM_{2.5}$ that are twice the recommended limits set by the World Health Organization[195] (World Bank, 2017[25]). The main polluters in Montenegro are public electricity, heat production and residential stationary combustion. Other key sources of pollution are agricultural processing and transport (IAMAT, 2020[27]). Levels of air pollution in the winter increase due to heating by solid fuels. The pollution levels in Pljevlja, where the thermal power plant is situated, regularly exceed the annual mean $PM_{10}$ concentration limits (EC, 2020[35]). Air pollution is recognised as a very serious environmental health risk and as such is managed through Montenegro's well-developed legislative and policy **air quality framework**. The legislative framework is almost fully aligned with the EU *acquis,*[196] while the policy framework, most notably the objectives of the National Strategy for Air Quality Management (2017-2020), are aligned with related policy areas including climate change, energy, agriculture and forestry.[197] In March 2020, Montenegro re-established reporting

on air pollution emissions and provided missing data for the period 2011-2018, which will help measure the effect of air quality measures on emissions levels given that the baseline values are now available.

Some of the key events since the last assessment relate to the extension of the air pollution emission monitoring network in 2019, from 7 to 10 automatic stations, and a slight decrease in annual mean population exposure to $PM_{2.5}$ air pollution. Immediate action is ensured if the recommended pollution limits are exceeded, particularly for pollutants such as sulphur oxides ($SO_x$) and nitrogen oxides ($NO_x$), in which case an emergency plan is prepared and prompt action taken. For example, in January 2019, following a high air pollution event, the government formed an ad hoc commission which came up with a set of urgent measures in two days. These included informing the population of pollution levels and providing advice, and cleaning streets to remove dust deposited on road surfaces. Montenegro provides data on air quality to the public almost in real time (hourly averaged) on the National Environmental Protection Agency (NEPA) website using a colour scheme to show air pollution levels. This is identical to the European air quality index. However, monitoring systems are not present in all municipalities. Since the last Competitiveness Outlook assessment NEPA has also started delivering short bulletins on air quality in the national media, as part of the weather forecast.

A high-quality **water supply and sanitation system** is also important for public health. Montenegro is a freshwater-rich territory (see the freshwater management section above), but has rising pollution problems, mostly as a consequence of untreated industrial and municipal wastewater. A significant cause of surface and underground water pollution is the inadequate condition of sewage infrastructure, including the inadequate collection and treatment of wastewater. Montenegro's legislative framework for wastewater management is almost fully aligned (95%) with the EU *acquis*. A new Municipal Wastewater Management Plan (2020-2035) was being prepared at the time of writing. The Ministry of Sustainable Development and Tourism, the Ministry of Agriculture and Rural Development, Directorate for Water, the Montenegrin Enterprise for Regional Water Supply and local enterprises established by municipalities are the key bodies responsible for wastewater management in Montenegro. However, the administration is of the view that financial and human resources are not sufficient to undertake their assigned responsibilities and there are no regular activities aimed at building their capacities. The lack of mechanisms for horizontal or vertical co-ordination impedes their effective implementation of the measures envisaged.[198]

In 2019, 58.4% of the population was connected to urban wastewater collecting systems in Montenegro – the highest share in the Western Balkans, but still lower than the EU average of 79.9% (Ministry of Sustainable Development and Tourism, 2020[186]) (Eurostat, 2020[187]). Some of the key measures in the draft Municipal Wastewater Management Plan (2020-2035) relate to investments in the water supply and sanitation system, such as the new sewage network and several major outfalls in the coastal region. There are currently ten wastewater treatment plants in operation or trial operation, half of which provide a secondary level of treatment.[199] Additional investments in wastewater treatment plants are also planned, but there is no evidence that new challenges, such as the need to treat contaminants of emerging concern,[200] are taken into consideration when upgrading the facilities, nor is there a plan to do so. Water supply and sanitation infrastructure projects are still largely dependent on donor funding and there is no particular methodology for calculating the service fees required. Current water service fees remain too low to cover or even complement the infrastructural investments required, as well as the water supply and services (the latter being complemented by subsidies from the municipalities). Various NGOs are also involved in implementing water sanitation projects; however; stakeholders noted that harmonisation was lacking among different actors. Although no measures have been taken to address water losses from the system since the last assessment, they have been recognised as a problem and there is a plan to reduce them in the strategic document Projection of Water Supply of Montenegro until 2040 (Ministry of Sustainable Development and Tourism, 2017[188]).

The **industrial waste management** situation has moderately improved since the last assessment. The legislative framework is now partially aligned with the EU *acquis*, including on environmental liability and industrial risks and accidents (Seveso III Directive 2012/18/EU). The preparation of a new Law on Waste

Management is in progress, which will regulate the management of industrial waste. Regarding key strategic documents, the National Waste Management Plan 2015-2020 has expired (although there is a plan to adopt a new one promptly) and the National Waste Management Strategy is valid until 2030, but its implementation record is weak. In terms of chemicals, the National Chemical Management Strategy (2019-2022) has introduced classification, packaging and labelling rules for chemicals. An inventory of chemical products is kept internally by the Nature and Environmental Protection Agency. While it is not connected to other information systems, NEPA is working on establishing an integrated electronic chemical and biocidal product register, which should use the software application IUCLID (International Uniform Chemical Information Database). The Pollutant Release and Transfer Register (PRTR) protocol was ratified in 2017 – however, the register has not been set up yet. Data on hazardous waste are scarce and, as no domestic hazardous waste disposal facilities exist, waste must be exported for treatment.

Some positive developments have been recorded for soil protection and provisions for identifying and managing contaminated sites, although the policy and legislative basis for soil protection is still non-existent. In 2014, the Government of Montenegro obtained a EUR 50 million loan from the World Bank for the Industrial Waste Management and Clean-up Project (IWMCP) to remediate four industrial waste disposal sites, and to manage the disposal of industrial hazardous waste, with NEPA being responsible for project implementation. The completion of the project was projected for July 2020, but has been delayed due to the COVID-19 pandemic. Moreover, the Global Environment Facility project, Environmentally sound management of PCBs,[201] intends to provide the necessary technical and financial assistance to ensure that all remaining PCBs are identified and disposed of (more than 900 tonnes of PCB contaminated equipment, waste and soil are estimated in Montenegro). The project will also ensure enough future capacity for the sound management of PCBs.

### *The way forward for environment policy*

Despite some important steps to improve the overall environment, especially in the areas of biodiversity, forestry and air pollution, the Government of Montenegro should pay more attention to the following aspects:

- **Ensure that measures for municipal waste management are accompanied by appropriate educational activities, and step up actions to raise awareness of waste prevention, waste separation, waste reduction and recycling**. Waste separation at source is envisaged in certain municipalities of Montenegro, with key infrastructure for this purpose installed. However, according to the government, implementation has been rather weak, as citizens do not separate waste. This behaviour stems from a lack of awareness of the importance of waste separation due to the limited educational activities on the topic. It is therefore important to tackle these issues through targeted campaigns and awareness-raising activities. Good practice from OECD countries might serve as inspiration (Box 23.19).

### Box 23.19. Public information and awareness raising for municipal waste management in the OECD

Public awareness and support are key factors in changing behaviour and thus for the success of waste policies. Educating young people can be a key approach. Several OECD countries have established environmental education initiatives. For example, Colombia's Communication and Environmental Agenda (2010-14) fostered educational projects on the environment across all levels of schools. Israel has a Green Education Project and also provides grants for "green schools", that promote resource efficiency and the separate collection of waste streams. Korea's Environmental Education Master Plan has created a network of environmental education centres.

Poland's "Don't Litter Your Conscience" campaign run by the national Ministry of Environment uses the character of a priest to tell parishioners to separate recyclable waste and not burn household waste in their gardens or dump it illegally. Another campaign encouraged the reuse of toys to encourage resource efficiency. Campaigns and activities to address illegal dumping are carried out in Hungary, where the Ministry for Agriculture supports the "TsSzedd!" ("Pick up!") Campaign to raise awareness about sound waste management practices.

Civil society organisations can also play an important role in promoting public awareness. "Let's do it! My Estonia" is an independently organised annual day of community activities, including litter clean-up. In Slovenia, about 200 000 volunteers worked together in 2010 for "Let's clean Slovenia in one day", a similar independently organised day to clean up litter and illegal waste sites, accompanied by environmental education activities.

Some OECD countries work through local government. In Israel, for example, the Ministry of Environmental Protection funds municipal activities for environmental education and awareness raising, and the country's 2010 Recycling Action Plan acknowledges the need for further action to raise public awareness and change behaviour towards separate collection.

Working with business, including producer responsibility organisations (PROs), can play an important role in fostering public awareness of recycling. In Korea, voluntary agreements with business include activities to raise public awareness on topics such as waste reduction and recycling; the country's PROs spend between 1% and 5% of their profits on information and awareness campaigns. In Poland, PROs are required to allocate 5% of their profits each year to public awareness.

Source: (OECD, 2019[189]), *Waste Management and the Circular Economy in Selected OECD Countries: Evidence from Environmental Performance Reviews*, https://doi.org/10.1787/9789264309395-en.

- **Direct more investment into improving wastewater systems and treating more wastewater.** Although Montenegro has taken some action to renovate and update its water supply and sanitation system, the activities are limited in scope and decisions on where to invest have not always been supported with concrete data. It is therefore important to conduct a clear mapping of the situation and identify key investment priorities. The government should try to finance these projects as much as possible from the domestic budget and higher water tariffs (at rates that take into account the needs of poor and vulnerable groups in the population). Where support from donor funds is provided, the government should make sure these finances flow regularly to ensure the sustainable maintenance of the water supply and sanitation system.
- **Introduce a comprehensive policy framework for identifying, characterising and remediating contaminated sites**. The policy and legislative basis for soil protection is still lacking and the process remains ad hoc. Given the importance of this element for Montenegro's environment, the next step will be to set a clear policy framework for cleaning up contaminated land as well as concrete guidelines to facilitate the process of identifying land that needs

decontaminating. A good practice example on how Israel approached this is presented in Box 23.20.

### Box 23.20. Cleaning up contaminated sites in Israel

Contaminated land has been discovered in hundreds of industrial, commercial and agricultural areas in Israel. These areas include several sites where hazardous waste was buried before the hazardous waste management site at Ramat Hovav was established. Such sites affect soil and water, with groundwater contamination found at 30% of sites.

Steps have been taken to develop a comprehensive framework for the identification, characterisation and remediation of contaminated sites. In 2000, the MoEP formulated a policy for cleaning up contaminated land and prepared several guidelines to facilitate the process. These documents included preliminary clean-up targets for 100 pollutants to serve as a basis for land remediation and guidelines on planning and implementing soil site characterisation, as well as guidelines for remediating contaminated soil at petrol stations. In 2009, the MoEP identified the 20 most severely polluted sites and began remediation measures. For example, EUR 42 million was allocated for remediating the hazardous waste treatment site at Ramat Hovav, which included a closed landfill, sedimentation and evaporation ponds, and temporary storage areas.

Since addressing past pollution will probably take decades, immediate actions focused on immediate risks, such as at Ramat Hovav, and monitoring other sites for potential contamination. Swift adoption of the Law on the Prevention of Land Contamination and the Remediation of Contaminated Land helped to create a comprehensive framework for rehabilitation efforts. This framework included instruments to carry out soil surveys on land suspected to be polluted (within the framework of building permits and real estate transactions, and state-owned land leasing agreements), with contamination and clean-up status recorded in the land registry. A database of contaminated and potentially contaminated sites (which includes state-owned land, such as army bases, defence industry sites, government-owned companies, as well as privately owned contaminated areas) helps the law to be implemented successfully. A risk-based methodology for soil and groundwater, approved in 2011, has enabled better risk assessment procedures.

Source: (OECD, 2011[190]), *Environmental Performance Reviews, Israel*, https://www.oecd-ilibrary.org/environment/oecd-environmental-performance-reviews-israel-2011_9789264117563-en;jsessionid=oCtpEfRgJ0rQSOhCxMWLZCll.ip-10-240-5-190; (Siegel, 2015[191]), *Let There Be Water*.

## Agriculture policy (Dimension 14)

### *Introduction*

Montenegro has significantly improved its performance in the agriculture dimension. The economy's score has increased from 2.4 in 2018 to 3.4 in the 2021 Competitiveness Outlook assessment, with notable progress in enhancing its agriculture support system policies (Table 23.26).

**Table 23.26. Montenegro's scores for agriculture policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 3.3 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 3.5 | 2.9 |
| | Sub-dimension 14.3: Agriculture support system | 3.5 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 3.0 | 2.6 |
| **Montenegro's overall score** | | **3.4** | **2.7** |

### *State of play and key developments*

The contribution of agriculture, forestry and fishing to GDP decreased from 6.7% in 2018 to 6.4% in 2019 (MONSTAT, 2020[192]). In 2018, agricultural products made up 18.8% of Montenegro's total exports and 21.5% of its imports (WTO, 2020[193]). While agriculture is a significant sector for Montenegro, its importance varies depending on the region and the climate, which shifts from Mediterranean to sub-continental over a very short distance due to the influence of the Adriatic Sea and local relief. Montenegro's landscape is characterised by substantial hilly and mountainous areas, with only a few level areas suitable for agriculture. Montenegro's entire territory is 13 812 km$^2$, of which 18.6% (257 469 ha) was used for agriculture in 2019, an increase of 0.3% compared to the previous year. Perennial meadows and pastures make up the largest share, at 94.3% (242 717 ha), while arable land represents only 2.8% (7 205 ha), permanent crops 2.1% (5 538 ha) and kitchen gardens 0.8% (2 010 ha) (MONSTAT, 2020[194]). The rural population in Montenegro is 33.2% of the entire population, and according to the Employment Agency, the agriculture sector employs 7.1% of the economy's workforce (Table 23.27), around 17 400 workers, all of whom receive social benefits.[202]

**Table 23.27. Employment by sector and sex, Montenegro (2019)**

| | 1000 | | | % | | |
|---|---|---|---|---|---|---|
| | Total | Men | Women | Total | Men | Women |
| **Total** | 243.8 | 136.3 | 107.5 | 100.0 | 100.0 | 100.0 |
| **Agriculture**[1] | 17.4 | (10.3) | (7.1) | 7.1 | (7.6) | (6.6) |
| **Industry** | 47.3 | 38.8 | 8.5 | 19.4 | 28.5 | 7.9 |
| **Services** | 179.1 | 87.2 | 91.9 | 73.4 | 63.9 | 85.5 |

1: Agriculture includes forestry and fishing.
Source: (MONSTAT, 2019[195]), *Labour Force Survey - Releases 2019*, https://www.monstat.org/eng/page.php?id=1543&pageid=22.

Fruit and vegetables are the most significant agricultural production sub-sector in Montenegro, while commercial crop production (cereals, maize, sugar beet, oilseeds) remains small scale. Regarding farm crops, potatoes accounted for the largest amount of arable land in 2019, covering 1 624 ha and accounting for 28.1% of crop production. This was an increase of 0.13% of arable land and 1.76% (26 557 tonnes) of production compared to 2018. Regarding fruit, citrus and olive production, plums made up the largest share at 43.5% in 2019, down 18.6% from 2018. Other fruit – including apples, pears, peaches and mandarins – accounted for over 54% of production in 2019, while olives accounted for 2.5%, up 10.1% from 2018. Meanwhile, grape production has been declining annually. In 2019 total production was 21 865 tonnes, 15.2% less than in 2018, and 27.5% less than in 2016.

Livestock breeding is the most significant agriculture sub-sector in Montenegro, both in terms of production quantity and value. The breeding of cattle and sheep, which make up the majority of the livestock sector (Table 23.28), uses land not suitable for arable production, such as the permanent grassland which accounts for a large portion of the total agriculture land in Montenegro.

### Table 23.28. Livestock and poultry numbers in Montenegro (2016-19)

| | 2016 | 2017 | 2018 | 2019 | Indices 2019/2018 |
|---|---|---|---|---|---|
| Cattle | 89 269 | 86 649 | 83 264 | 81 432 | 97.8 |
| Sheep | 191 992 | 189 008 | 187 021 | 182 127 | 97.4 |
| Goats | 31 458 | 29 595 | 29 040 | 28 754 | 99.0 |
| Pigs | 55 841 | 25 043 | 23 651 | 23 089 | 97.6 |
| Poultry | 835 705 | 788 309 | 666 339 | 635 882 | 95.4 |
| Horses | 3 947 | 4 071 | 4 005 | 4 008 | 100.1 |

Source: (MONSTAT, 2019[196]), *Livestock production - data*, https://monstat.org/eng/page.php?id=1583&pageid=61.

As of 2019, the Montenegrin fishing fleet consisted of 244 vessels, most of them old and with a very limited range due to safety concerns and operational limitations.

The agriculture sector has faced significant challenges due to the COVID-19 pandemic, including limitations on the movement of people, market closures, decreased demand, and difficulties in logistics. As the sector is closely linked to tourism in Montenegro, it particularly underperformed during the summer of 2020. The agriculture, forestry and fishery sector saw the number of employees decrease by 21.3% in the first nine months of 2020 compared to the same period in 2019 (MONSTAT, 2020[197]). This is a much larger fall than for the economy as a whole (11.3%). According to Erste Group, the second leading bank in Montenegro (SEE News, 2020[198]), unemployment will rise to 17% by the end of 2020, from 14.9% in 2019. The average gross wage decrease was 1.4%, but in the agriculture sector wages have fallen by 7.6%.

In April 2020, the Montenegro Government decided that, in addition to the full implementation of all measures envisaged in the year's substantial agricultural budget, it would add additional support for agriculture through a special programme worth over EUR 17 million. This includes the following measures:

- Market interventions to maintain market stability, price stability and producers' incomes. This involves the purchase and storage of surplus agricultural products, assistance in marketing or buy-out by the state institutions. The planned funds for this measure amount to EUR 3 million.
- Support for the purchase of domestic products. State budget consumers (state and public institutions) will give priority to procuring domestic products, as the use of shorter supply chains involving faster transportation becomes mandatory.
- Ensuring domestic producers receive support payments for products within 15 days. In order to shorten payment deadlines, the government will mandate the Investment Development Fund (IRF) to provide credit support to retail chains, with an obligation to pay domestic producers within a period not exceeding 15 days.
- Favourable loans for the supply of working capital to registered agricultural producers, processors, and fishermen. These loans will be approved up to a maximum amount of EUR 20 000, with an interest rate of 1.5%, a repayment period of up to two years and a grace period of up to one year. The government will pay the interest during the grace period, for which about EUR 150 000 are provided. The planned funds for this measure amount to EUR 10 million.
- Support for social contributions to employees in the agriculture sector. This support will cover 529 registered farmers for a period of six months. The financial resources for this measure amount to EUR 100 000.

- One-off support of EUR 64 for 3 200 people retiring from farming. EUR 225 000 are committed to this measure.
- One-off assistance for 184 fishermen with a valid license, for which EUR 200 000 are allocated.
- Advance payment of 80% of premiums on livestock and per hectare of arable land, based on data from the previous year. On this basis, producers will be paid a total of around EUR 3.5 million in the first half of May 2020.

In September 2020, MONSAT noted a decrease in agriculture sales of 5.1% cumulative since March 2020. The total export of goods for the period January-September 2020 decreased by 15.3%. The impacts on the livestock sector were variable. Live animal exports increased by almost 18%, while dairy product exports decreased by 22%.

Although the Government of Montenegro has reduced the negative impacts of COVID-19 on the agriculture sector, the consequences for the organisation of value chains, decreased market penetration and reduced income need to be addressed further in order to rebuild the broken links in the sector. Market support measures, cheap financial products to support agricultural households' cash flow and reinforcing one-off contracted payments are needed to ensure stability for farmers and the rural population.

### *Sub-dimension 14.1: Agro-food system capacity*

While rural infrastructure policy in Montenegro has made progress in increasing rural development expenditures and water-supply projects, Internet connectivity in rural areas remains weak and local agriculture budgets are underfunded. The responsibility for rural infrastructure policy is shared by the Ministry of Agriculture and Rural Development (MARD), Ministry of Transport and Maritime Affairs, the Transport Directorate, Government Regional Development Office, Ministry of Economic Development, and the municipalities.

The **rural infrastructure policy framework** is based on the Strategy for the Development of Agriculture and Rural Areas 2015-2020, which aims to enhance living standards and quality of life in rural areas, provide conditions for the growth of agriculture, and diversify economic activities on both agricultural holdings and in rural areas in general. Based on this strategy, the Programme for Development of Agriculture and Rural Areas in Montenegro has been established under IPARD II 2014-2020 (as described in Sub-dimension 14.3: Agricultural support system). Amongst its goals are revitalising and developing rural areas and building infrastructure on the basis of co-financing of projects by the applicant and the state, including local roads, water management and facilities of common importance.[203]

Investment in rural infrastructure development for 2014-2020 is supported by both the Agro-Budget and IPARD funds. The Agro-Budget for 2020 is EUR 60.7 million (compared to EUR 52.4 million in 2019), EUR 2.5 million of which has been allocated for developing village and rural infrastructure (EUR 0.7 million from the national budget and EUR 1.8 million from donations and credits), a 14.1% increase in expenditure over 2019 (MARD, 2020[199]).

As agriculture is defined as an area for strategic development in the majority of municipalities in the north and central regions, all local self-governments have agriculture units. Municipal budgets for agricultural development are predominantly intended for infrastructure, and to a lesser extent for other support measures. However, while all municipalities have agriculture units, few have their own funds for agriculture, impeding effective implementation of rural infrastructure policy.

Fixed broadband services, in particular the optical fibre sector, have shown strong growth, albeit mainly in large towns. In the first nine months of 2019, the number of fibre connections increased by 24% across the entire economy, totalling 34% of all fixed broadband connections. However, Internet connection in rural areas remains slow with low coverage. Additionally, development of telecommunication networks largely relies on the private sector as no government initiatives have been implemented.

Montenegro participates in constructing rural water supply systems through annual water management projects. In 2019, with a budget of EUR 970 000, the projects included constructing 31 water supply networks to create better living and working conditions in rural areas, as well as the further development of agriculture. Priority was given to rural water supply networks which were financed in the previous period, as well as new requests for water supply submitted by municipalities.

Montenegro has the highest level of water sediment in Europe, and due to an adverse water balance (which means that the inputs of water are lower than the outputs), almost 35% of Montenegro's territory suffers from water shortages (see also Sub-dimension 13.2: Natural asset base). However, the high amount of annual rainfall means that Montenegro, with the exception of distinct karst areas, is rich in natural springs, offering ample opportunities for irrigation.

Irrigation infrastructure falls under the auspices of the Ministry of Agriculture and Rural Development and the Directorate for Water Management within MARD. The Directorate for Water Management carries out the tasks of the ministry related to policies in the field of water management, proposing system solutions for the supply and use of water and implementing regulations on water and watercourses. While the **irrigation policy framework** is primarily based on the 2007 Law on Water, MARD adopted the National Strategy for Water Management in 2017, on the basis of which it is currently drafting a plan for irrigation development.

Irrigation infrastructure in Montenegro is underused, so there are significant water losses from irrigation systems. According to the National Strategy for Water Management, the irrigation system consists of both operating and abandoned systems, together occupying a total area of 18 310 hectares. The Agriculture and Rural Development Strategy 2015-2020 points out that some 51 000 hectares of land are suitable for irrigation, but only 15-17% of it is currently irrigated. As a consequence, 19% of water was lost from the irrigation system in 2018. The total number of irrigated agricultural holdings is 12 518, with an average area irrigated per agricultural holding of 0.42 ha (MARD, 2015[200]). The irrigation systems in Montenegro cover the areas of Ulcinjsko Polje (100 ha), Mrčevo Polje (220 ha), Sutorina (120 ha) and Bjelopavlićka ravnica (840 ha), as well as working open drainage systems in Crmničko Polje, Tivatsko Polje, Lješko poljski lug and parts of Bjelopavlička ravnica.

According to the Strategy for the Development of Agriculture and Rural Areas 2015-2020, the major part of Montenegro's development potential is located in its least developed rural areas. The strategy identifies as a priority improving the standard and quality of higher education to meet the needs and requirements of the market. It also prioritises developing and strengthening entrepreneurial skills in young people to meet minimum national standards. Montenegro's **agricultural education system** is under the authority of the Ministry of Education and Science and covers specialised secondary education in agriculture as well as tertiary education. Agricultural education is partially funded from the Agro-Budget, which includes a measure for improving producers' knowledge. This measure includes support for educating permanent employees on farms, organising study visits for farmers, organising a Winter School for farmers, as well as support for participation in regional and international fairs and exhibitions. Montenegro has established the Strategy for Development of Higher Education in Montenegro (2016-2020), and the Strategy for the Development of Vocational Education in Montenegro (2020-2024) with an action plan (2020-2022), all of which cover agricultural education (MARD, 2015[200]).

There are five high schools (secondary education, 15-18 years) for agriculture, food processing and veterinary, mostly mixed schools that provide education for agriculture technicians in all domains.[204] Only one of the schools is vocational.[205] While there is an on-going reform of high school education to develop new curricula that respond to emerging labour market needs and increase students' interest, the number of students enrolled in these schools is declining (Table 23.29).

### Table 23.29. Agriculture enrolments in first year of high school (2016-20)

| School year | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| Total number enrolled | 7 650 | 7 655 | 7 213 | 6 759 |
| Agriculture, forestry, fishery and veterinary enrolments (number) | 122 | 151 | 103 | 75 |
| Share of total | 1.59% | 1.97% | 1.43% | 1.11% |

Source: Strategy for the Development of Vocational Education in Montenegro (2020-2024) with the Action Plan (2020-2022).

Tertiary agriculture education is available at the Biotechnical Faculty of the University of Montenegro in Podgorica and at the Faculty of Food Technology, Food Safety and Ecology at the private University of Donja Gorica. Since 2005/06, the Biotechnical Faculty has included both a plant production and livestock production/cattle breeding division. The Biotechnology Faculty has departments and laboratories situated in Podgorica, Bar and Bijelo Polje, as well as experimental plots for students' professional practice.

The Faculty for Food Technology, Food Safety and Ecology (FFTFSE) has been in operation since 2012 as a department at the University of Donja Gorica. FFTFSE offers courses in technological engineering, sanitary engineering, environmental engineering and hotels, restaurants and catering (HoReCa) system engineering at an undergraduate level. FFTFSE has also established good links with industry by organising professional practice sessions and exercises for students in the field, at private laboratories, and through work on joint projects. FFTFSE has formed partnerships with various companies in the agriculture and food-processing sector as well as with national and international universities, faculties and research institutions.

#### *Sub-dimension 14.2: Agro-food system regulation*

**Natural resources regulations** in Montenegro have been improved and partially harmonised with the EU regulations; however, land consolidation remains limited and the water management system is weak. Regulations for natural resources fall under the auspices of the Ministry of Agriculture and Rural Development and are set out in the Law on Agricultural Land, the Environmental Law and the Law on Water.[206] The legislation defines the inter-sectoral co-operation between the various departments responsible for land, water and environment. However, there is no formal mechanism for co-ordination or information sharing. The Environmental Law defines the sustainable use of natural resources and sets the basis for agri-environmental measures.

Montenegro's Law on Agricultural Land regulates the use of agricultural land in the context of environmental and natural balance. An update of the law began in 2018 and is still on-going. Its main purpose is to include the necessary EU provisions for natural resources management, especially establishing and implementing a Land Parcel Identification System (LPIS). At present, Montenegro has implemented an LPIS partially in one specific region, supported by the EU IPA project Strengthening the Montenegrin Agriculture with establishing of Land Parcel Identification System (LPIS). The full implementation of the LPIS will enable digitalised maps of all agriculture parcels in the economy to be produced, creating a complete overview of data on type, area and volume of production. In addition, it will provide information for an integrated rural development approach and serve as a basis for the land consolidation process.

Agricultural land is very fragmented in Montenegro. This weakness is being addressed through the Law on Agricultural Land. Pursuant to this law, agricultural land consolidation is considered of general interest and land plots will therefore be grouped into larger and more regular parcels that can be used more rationally. This consolidation process remains very slow, however.

The Strategy of Water Management of Montenegro, last updated in 2017, defines the model for strategic water management planning, noting that water management should be based on the principle of preserving water as a resource. The concept of water as a natural public good means that it can only be used only in

a way that does not endanger its substance and does not exclude its natural role. The current water management system still faces a number of challenges due to a lack of investment in the maintenance of the existing network, limited wastewater treatment and lack of implementation of management plans for natural resources, including river basins (see also Sub-dimension 13.2: Natural asset base).

Several **regulations on agriculture products** have been updated in 2019 to further harmonise them with EU regulations. The legislation on seeds and planting materials is based on the Law on Plant Protection Products and the Law on Plant Nutrition Products, as well as accompanying by-laws. A range of rules has been established to systematise good agricultural practices, integrated pest management, sustainable use of natural resources, and the whole process for the registration, use and control of seeds and planting materials, as well as fertilisers and plant safety materials.

The regulations are continuously being improved through by-laws and rulebooks based on EU Directives. Over the last two years, the regulations on plant protection products have improved by adopting the 2019 Rulebook conditions for the treatment of stocks[207] and the updated Rulebook on maximum residue levels of plant protection products[208] the same year. In 2020, the Rulebook on conditions regarding professional personnel[209] has strengthened the regulatory framework.

The Laboratory for Seeds operates under the Biotechnical Faculty at the University of Montenegro. It is authorised by the Administration for Food Safety, Veterinary and Phytosanitary Affairs in accordance with the Law on Agricultural Plant Seed Material to undertake examinations of seed material quality, technical and professional affairs (for example, the university's Centre for Crop, Vegetable and Forage Growing, authorised by the Phytosanitary Administration, performs certifications of agricultural plants seed material). The procedures of the laboratory in this area are fully harmonised and accredited by the EU.

The review, amendments and establishment of new legislation in this field are structured through a participatory process, involving all stakeholders. The legal provisions relating to the preparation of a new regulation oblige the state institutions to organise a public stakeholder dialogue before entering into the process of parliamentary adoption. Every year, the MARD adopts the Programme of Phytosanitary Measures, whose main overall objective is to maintain the health status of plants on the territory of Montenegro. It does so by preventing the introduction of organisms harmful to plants, as well as their timely detection, control of occurrence and control of spread, and eradication. The programme also defines measurement inputs, aims, a body for implementation, and financial resources based on annual budgets. Programme input and output monitoring activities are conducted regularly according to the action plan approved at the beginning of the year.

### *Sub-dimension 14.3: Agricultural support system*

Montenegro's **agricultural policy framework** is comprehensive and well monitored by several directorates within the Ministry of Agriculture and Rural Development (MARD). Agricultural policy is under the auspices of the MARD, which prepares and proposes programme measures to the government, along with a series of other documents, acts and regulations necessary for the harmonised functioning of agriculture in Montenegro. Agrarian policies are based on the Law on Agriculture and Rural Development which regulates the development of agriculture and rural areas, agricultural support eligibility criteria for measures, usage, and the organisation of producers. EUR 20.8 million of the Agro-Budget for 2020 has been allocated to agricultural, rural and fishery development, a 13.76% increase over 2019 (MARD, 2020[199]).

In 2015, the MARD adopted the Strategy for the Development of Agriculture and Rural Areas in Montenegro 2015-2020. It was developed to define the future reform process in the sector, respond to changes in the environment caused by both external and internal factors, and prepare the groundwork for meeting any forthcoming challenges on Montenegro's path to EU accession and the application of the Common Agricultural Policy (CAP). The strategy is financed by the Agro-Budget, as well as rural development measures and direct support for some product groups.

In addition, the Fisheries Strategy of Montenegro for 2015-2020, and its action plan for transposition, implementation and enforcement of the EU *acquis*, was adopted by the Government of Montenegro in 2015. The strategy provides a general strategic framework, and identifies the key steps that Montenegro intends to take to prepare for fulfilling all of its commitments arising from the EU Common Fisheries Policy (CFP) (Institute of Marine Biology, 2019[201]).

The harmonisation of Montenegro's rural development policy with the EU is based on the Programme for the Development of Agriculture and Rural Areas in Montenegro under IPARD II 2014-2020, adopted in 2015. Amongst the most important components of the programme are the provision of investment support for primary agriculture (Sub-dimension 14.1: Agro-food system capacity) and the processing industry, and support for diversification in rural areas. MARD's Directorate for Rural Development, along with the Legal Affairs Department, develop and prepare the IPARD II programme for Montenegro. The Directorate for Rural Development is also responsible for monitoring the progress and impact of all rural development programmes, including IPARD, and preparing monitoring and evaluation reports. It is also responsible for reporting on IPARD implementation through annual and final implementation reports.

IPARD funds and payments are regulated and monitored by the Directorate for Payments under the regulations of the new Rulebook on the internal organisation and systematisation of the Ministry of Agriculture and Rural Development, adopted in 2019. This rulebook has seen the number of systematised jobs in the Directorate for Payments increase in accordance with the requirements and recommendations of the EC, and a new organisational unit (Direction for Regional Co-ordination) has been established to co-ordinate the regional offices of the future Agency for Payments. Additionally, MARD's Internal Audit Division is fully operational and autonomous for auditing programme implementation.

All stakeholders are active in the process of drawing up strategic documents (NGOs, producer associations as well as individual farmers). MARD publishes public calls for all stakeholders to be given the opportunity to contribute their feedback and suggestions. As part of the EU integration process and alignment with the EU *acquis*, the ministry annually prepares and presents reports to the government and the European Commission.

**Domestic producer support instruments** fall under the auspices of MARD and are based on the Strategy for Agriculture and Rural Development 2015-2020, which is supported by the Agro-Budget. The Agro-Budget defines the criteria, procedures, type of measures, sources of financing and implementation dynamics on an annual basis and covers national funding, donations (including IPARD) and credit lines. The Agro-Budget for 2020 is almost EUR 9 million higher than in 2019 (EUR 52.3 million). The budget structure in 2019 was made up of 42.7% from the national budget, 43.8% from EU funds and 13.5% from credit lines.

The producer support measures in the Agro-Budget cover 1) market pricing policy measures;[210] 2) rural development measures;[211] 3) agriculture services support measures;[212] 4) food safety and phytosanitary measures; and 5) fishery and aquaculture support. Agriculture service measures offer support for education, extension services, quality control, food safety standardisation, promotion, fairs and exhibitions, as well as support for the institutional framework to enhance national capacities for managing EU funds.

The total support for the first four measures focusing on agriculture is around 95% of the total Agro-Budget. The remaining 5% are for support and maintenance of fishery, aquaculture and other operational programmes aimed at enhancing the capacity of institutions in the area of food safety, phytosanitary operations and veterinary. While the use of the Agro-Budget is high, there is a difference in the criteria for the allocation of direct support measures (national budget) and the rural development measures (EU funding).

On the Common Market Organization (CMO), Montenegro launched a pilot school programme for fruit, vegetables and dairy products for the school year 2019/20. New steps to comply with the CMO have been implemented for the wine and olive oil sectors and for producer organisations. The programme inputs and

outputs have been monitored as part of the action plan and are reported to the government once a year. However, producers still lack adequate information to improve their market penetration, especially on diversified market linkages.

Montenegro's **agricultural trade policy** includes several bilateral and multilateral free trade agreements (FTAs). Foreign trade is regulated by the Law on Foreign Trade, the Treaty on Accession to the World Trade Organization (WTO), the Implementing Regulation Law on Foreign Trade, and the Law on Customs Tariff. Montenegro is a member of the Central European Free Trade Agreement (CEFTA), (Stabilisation and Association Agreement (SAA), and European Free Trade Agreement (EFTA), and also has free trade agreements with the Russian Federation, Republic of Turkey and Ukraine.

The economy remains committed to further aligning its trade regime with WTO and EU regulations. Montenegro has been a full member of the WTO since 2012. It follows the WTO mechanisms for the liberalisation of international trade in all product categories, and harmonises its legal and institutional structure with all the basic principles and rules of international trade. In accordance with the WTO Accession Schedules, Montenegro has a ten-year transition period to reduce import tariff duties to a level agreed upon by the WTO, which expires in 2022.

Regarding trade with the EU and the Republic of Turkey, Montenegro has agreed on a number of products for preferential tariff quotas. The allocation and administration of these quotas are done by the Customs Administration, on a first come first served system.

In order to create a framework for the full implementation of the EU *acquis*, Montenegro will have to conduct activities agreed upon by the EU that will ensure the full implementation of EU international trade by the time of accession. Co-operation with the Customs Administration and the prospective Payment Agency is essential to this process.

While in general Montenegro does not have import and export permits, or export refunds on agricultural goods, certain agriculture products do require import[213] and export permits.[214] Import permits are also required when importing products under preferential treatment[215] and for importing products within tariff quotas. The Common Customs Tariff, except where the specified trade agreements have otherwise been concluded, sets the import duties. Export permits are also mandatory for exports under customs quotas. Furthermore, the provision of guarantees for the import of agricultural products does not occur in Montenegro.

The **agricultural tax regime** in Montenegro involves an exempted rate for producers. While the standard VAT rate across the economy is 21%, fodder, fertilisers, plant protection products, seeds, planting material and breeding stock have a preferential VAT rate of only 7%. Farmers (who are not VAT payers) are entitled to a lump sum fee of 5% on the selling price of their products, for which a tax credit is given to the taxpayer who purchased the agricultural products.

**Sanitary and phytosanitary measures** in Montenegro are fairly well harmonised with the EU and there is continued effort to further adapt laws on food, veterinary, and phytosanitary measures to EU directives. Most of the regulations were updated in 2019. The sanitary and phytosanitary system in Montenegro is managed by the Directorate for Food Safety, Veterinary and Phytosanitary Affairs with three separate divisions managing the three sectors. The Food and Safety Sector is responsible for food safety of nutrients, feed and by-products of animal and non-animal origin, as well as general food safety requirements. The Veterinary Sector covers animal health, veterinary epizootiology and veterinary activity, identification and registration of animals in the veterinary information system, veterinary medicines, as well as the international transport of animals. The Sector for Phytosanitary Affairs covers plant health, plant protection products and the phytosanitary information system, as well as seeds, planting material, GMOs, and the protection of plant varieties and plant genetic resources in agriculture.

As regards food protection, Montenegro's policy for aligning with and enforcing the EU *acquis* has been enhanced. A general action plan and a specific action plan on classical swine fever have been implemented

since the last cycle of assessment. A food and feed protection policy was adopted and implemented in 2019. Since 2016, the national programme for the Enhancement of the production of raw milk and a corresponding programme on the Processing of non-compliant raw milk have been underway. Their implementation is shared between the Directorate for Food Safety, Veterinary and Phytosanitary Affairs (as part of Ministry of Agriculture and Rural Development), Department of Advisory Affairs in the Field of Animal Husbandry, and the Dairy Laboratory. Reports are prepared twice a year. Alignments with EU *acquis* are being monitored at the national level. One indicator to measure progress is the percentage of milk produced that meets EU quality standards in the total volume of milk produced. This increased from 55.5% in 2018 to 63.8% in 2019.

The introduction of a national programme for the modernisation of food processing establishments has also proceeded, involving some restructuring of businesses. Around 70% of entities (63 manufacturers), producing food of animal origin were compliant with EU regulations, and 11 of them were licensed to export to the EU. The modernisation of food processing establishments has resulted in a total of 244 items that completely meet EU food safety standards, which indicates massive progress compared to the 14 that existed when the strategy was introduced in 2019.

The strategy for the treatment of animal by-products not intended for human use was established in 2019 and is in the process of being implemented. Regulatory capability and facilities need to be strengthened.

Veterinary policy was improved in 2019 by implementing the programme for compulsory measures for animal health protection. The national programme to Improve Facilities Dealing with Products or By-Products of Animal Origin has been pursued further. Capacity building for veterinary services will be continued through EU support programmes. Relevant programmes for the monitoring and control of diseases for 2020 have been prepared and are currently being implemented.

The phytosanitary strategy and several phytosanitary laws were updated in 2019. The development of the National Strategy for the Sustainable Use of Plant Health Goods has proceeded in accordance with the 2016-2021 Action Plan. A scheme for the control of genetically modified food and feed was introduced for genetically modified crops in 2019. Additionally, Montenegro plans to finalise full alignment with the EU's revised Plant Health Law (2016) and Official Controls Regulation (2017) by 2023.

### *Sub-dimension 14.4: Agricultural innovation system*

**Agricultural research** is undertaken on a competitive basis through general requests for research projects by the Ministry of Science and at the international level through Horizon 2020. While the Strategy for the Development of Agriculture and Rural Areas 2015-2020 emphasises the need for innovation in research and development, there are no clear action plans or other policies for agriculture research.

Nevertheless, agricultural research in Montenegro has increased at the national level, with 16 of the last 104 projects financed through the national budget being in the area of agriculture, while 2 of the 8 projects funded by the Collaborative Grants Programme came from agriculture. In addition to the national budget, research is also financed by various other organisations.[216]

As part of the Fisheries Strategy of Montenegro, a joint assessment of shared stocks of economically important species in the Adriatic Sea was launched in order to exploit resources sustainably. Research activities are focused on the preservation of stocks, certain areas with high biodiversity, and traditional types of fisheries.

Montenegro is the first non-EU economy to have adopted a Smart Specialisation Strategy (S3). The main goal of the S3 is to modernise and increase the competitiveness of the Montenegrin economy by concentrating available research, natural and economic resources on a limited number of priority areas. The strategy hopes to see Montenegro recognised for, among others, agricultural innovation and sustainability, preservation of tradition in rural areas, and developing a food value chain for authentic Montenegrin products (S3, 2019[202]). The implementation of the S3 is of great strategic importance for

Montenegro as it can encourage public and private investment in research, boost technological development and innovation, and attract researchers and innovators.

**Agricultural extension services** in Montenegro function well and are wide ranging. However, monitoring and evaluation of these services remain weak. Within the MARD, the Department for Extension Services in Livestock Production and Department for Extension Services in Plant Production are responsible for agriculture advisory services.

The Department for Extension Services in Livestock Production comprises 6 regional centres and 20 employees who cover all municipalities. This department is responsible for selecting and improving farm animals, providing expert advice and instructions to farmers, and the on-site control of compliance with the requirements prescribed by the Agro-Budget regarding livestock for direct payment beneficiaries.

The Department for Extension Services in Plant Production covers the entire territory of Montenegro and is divided into 7 regional centres that employ 22 plant production engineers. This department aims to improve plant production through increasing yields, as well as to improve the quality of products by providing expert advice, recommendations and instructions to farmers, as well as education, training and roundtable events. The service also performs on-site controls of compliance with direct payments and rural development measures.

The Biotechnical Institute also provides extension and laboratory services to the farming sector through its two sister services, Livestock Selection Service (LSS, established in 2000) and Plant Production Extension Service (PPES, established in 2003). Both are entirely financed from the agricultural budget of MARD, while the Biotechnical Faculty is financed by the Ministry of Education. Financing is based on an annual plan of activities and related costs, and reports approved by the MARD. However, a common challenge for both LSS and PPES is setting up performance indicators and clear mechanisms to monitor their achievements.

### *The way forward for agriculture policy*

- **Improve rural infrastructure.** Improving rural infrastructure needs to be a priority for the development of the whole sector as local infrastructure is an essential element in any effort to realise the growth potential and promote the sustainability of rural areas.
- **Revitalise existing systems and gradually install irrigation systems in new areas.** This would allow for more intensive growth of other agricultural activities in Montenegro, such as processing capacity, greater participation of the local population and economic development. Priority should be given to sites and areas where there are quality resources and partially constructed infrastructure elements necessary for the application and development of irrigation. Investing in revitalisation and system building should concentrate on projects that generate fast returns on the funds invested, which will lead to the encouragement, interest and spread of irrigation across larger areas.
- **Continue to implement the measures under the IPARD II** and finalise the preconditions for future measures. In addition, preparations need to be made before requesting budget implementation tasks for the technical assistance measure.
- **Bring direct support measures into line with EU *acquis*** by fully decoupling them from production and linking payments to cross-compliance. As regards the Integrated Administration and Control System (IACS), further implementation of the Land Parcel Recognition System (LPIS) needs to be carried out across the entire territory.

## Tourism policy (Dimension 15)

### *Introduction*

Since 2018, Montenegro has made progress on all the tourism sub-dimensions, improving its overall score from 2.0 in the last assessment to 3.1 in 2021 (Table 23.30). Sound progress has been made on the tourism governance structure through the introduction of a monitoring system. Progress has also been achieved in the capacity and quality of accommodation by facilitating investment in high-quality accommodation and adopting a consistent accommodation quality standard framework. The VET framework has been improved by upgrading qualification standards, and the value derived from natural and cultural heritage has been enhanced through culture and nature-related strategies and programmes. Progress has also been made by easing visa requirements and implementing special policy measures to reduce border crossing times in peak seasons. The main remaining challenges are to strengthen the workforce supply framework, raise awareness of sustainability and digitalisation, and further strengthen dialogue with private stakeholders, education institutions, local communities and NGOs by involving them more actively in the decision-making process.

**Table 23.30. Montenegro's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Tourism governance and co-operation | 3.8 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 3.5 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 2.3 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 3.0 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 2.8 | 1.6 |
| **Montenegro's overall score** | | **3.1** | **2.0** |

### *State of play and key developments*

Tourism is one of the most important sectors in Montenegro. In 2019, its (direct and indirect) contribution to GDP was 32.1%, its (direct and indirect) contribution to employment was 32.8% (66 900 jobs), and the share of tourism in exports was 54% (World Travel and Tourism Council, 2020[24]). International tourist arrivals have grown steadily, reaching 2.5 million in 2019. Tourism arrivals have seen an average annual rate of growth of 9% over the last 10 years. This steady growth in tourism is the result of improvements to promotion and marketing in international markets, air transport accessibility, the quality and capacity of accommodation and the development of new tourist facilities and offers. These improvements have boosted Montenegro's competitiveness in the global market, also evident in the economy's improved standing in the 2019 Travel & Tourism Competitiveness Index – from 72nd place in 2017 to 67th place in 2019 – the best score of the WB6 economies (WEF, 2019[203]).

Despite these positive results, Montenegro is still facing some challenges which hinder even more successful tourism development. The COVID-19 pandemic is the most pressing challenge at the time of writing.

The COVID-19 outbreak triggered a number of restrictions that have had a severe impact on the tourism industry. Montenegro suffered a very deep recession in 2020, which led to a more than 15% decline in GDP. In 2020, tourism plummeted due to COVID19: foreign tourist overnight stays and receipts collapsed by 90%. Consequently, retail trade fell by almost 17%, while industrial production was at 2019 levels (World Bank, 2020[204]). In 2020, there were 79.2% fewer arrivals and 79.9% fewer tourist nights than in the previous year (MONSTAT, 2020[197]). Additionally, private stakeholders felt unheard throughout the process of drafting COVID-19 support measures, which should be a priority for the future of tourism development in the economy. In order to support and mitigate the impact of the crisis on the tourism industry, measures adopted by the government included three-month deferrals of taxes and contributions

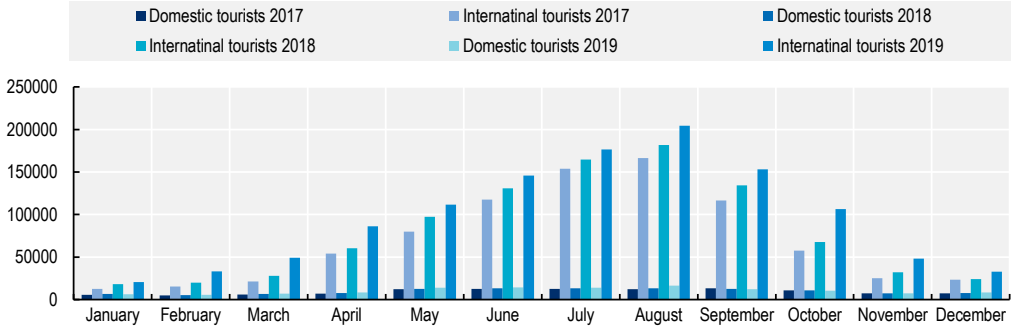
(EUR 45 million), loan repayment deferrals (EUR 160 million), the creation of the Investment Development Fund of Montenegro (IDF) and an IDF credit line of EUR 150 million, and wage subsidies of EUR 19 million to support the tourism sector. The government also reduced VAT from 21% to 7% for the hospitality industry. In a second package of economic measures, the government included grants for salaries for April and May 2020 for entrepreneurs and SMEs in the sector whose work was not prohibited (WB6 CIF, 2020[205]).

To spur the recovery of tourism after the COVID-19 pandemic, the World Tourism and Travel Council (WTTC) has awarded Montenegro the international Safe Travels label. Safe Travels is a specially designed label which allows travellers to identify destinations and companies around the world that have adopted global standards of health and hygiene, as an important prerequisite for safe travel. In the circumstances, this is a very important step for gaining the trust of tourists, and for the recovery and sustainable development of tourism. All interested participants in the tourism sector, such as hotels, restaurants, tour operators, transport providers, airports, airlines and others, can apply to use the label, with the obligatory condition that they meet and implement the conditions defined by health protocols. To assess compliance with the recommendations, measures and protocols of the Institute of Public Health and the regulations of the Ministry of Health of Montenegro, the Commission for Assignment and Control of Safe Travels has been formed. It consists of representatives of the National Tourism Organisation (NTO) Montenegro, the Institute of Public Health, the Ministry of Economic Development, the Directorate for Inspection Affairs, the Chamber of Commerce and the Civil Aviation Agency. Currently in Montenegro there are 61 users of the Safe Travels label, mostly those providing accommodation, especially hotels, but there are also restaurants, transfer service providers, operators of yachting tourism and tour operators.

The COVID-19 pandemic will change the recent fast growth trend of tourism in Montenegro. Montenegro should continue its efforts to move away from promoting mass tourism in coastal areas to developing new, high-quality and personalised tourist experiences around natural and cultural sites. This could be driven by a new marketing strategy and action plan focusing on domestic tourists, who have been relatively neglected so far, but could contribute much to the dispersal of arrivals over the year. This will help tackle a key structural challenge, which is the high seasonality and concentration of tourism in coastal areas. Most tourist arrivals (71% in 2019) occur in the summer season between May and October (Figure 23.17), making Montenegro a so-called sun-sea-sand (3S) destination. This puts great pressure on the sector's employees, who are predominately employed as seasonal workers, and on the accessibility of the destination due to traffic jams. In addition, this type of mass tourism has negative impacts on the environment, cultural heritage and social life of local communities.

## Figure 23.17. International and domestic tourist arrivals in Montenegro (2017-19)

Number of arrivals, monthly




Source: (MONSTAT, 2020[206]), *Database for tourism*, http://bazapodataka.monstat.org/PXWebEng/pxweb/en/Tourism/?rxid=a295fc46-ba4f-4fe9-946b-36008f14d0c8.

StatLink https://doi.org/10.1787/888934255988

In order to address this challenge, Montenegro has already set clear strategic goals in the Tourism Development Strategy to 2020: 1) mitigating summer seasonality in the coastal region by reducing the number of visitors; and 2) developing tourism products outside of the main season as well as in rural areas, while setting up sustainability as a core principle of future tourism development. Concrete programmes and strategies have been adopted recently to reach these goals (Table 23.31), which position Montenegro as a unique high-quality and year-round tourist destination. This represents a sound basis on which to reposition Montenegrin tourism and exploit the potential of its rich cultural and natural heritage for developing authentic, innovative culture and nature-related tourist products and experiences in a sustainable way and for the benefit of local communities and people.

### Table 23.31. Montenegro's tourism-related strategic documents

| Name of the strategy |
|---|
| Montenegro Tourism Development Strategy to 2020 (adopted in 2008 and updated in 2013) |
| Rural Tourism Development Program of Montenegro and Action Plan 2019-2021 |
| Cultural Tourism Development Program of Montenegro with Action Plan 2019-2021 |
| Health Tourism Development Program of Montenegro with Action Plan 2021-2023 |
| National Strategy for Sustainable Development by 2030 (NSSD) |
| Smart Specialisation Strategy of Montenegro 2019-2024 |
| Montenegro Development Directions 2018-2021 |
| Montenegro Economic Reform Program 2020-2022 |
| Strategy of Regional Development of Montenegro 2014-2020 |

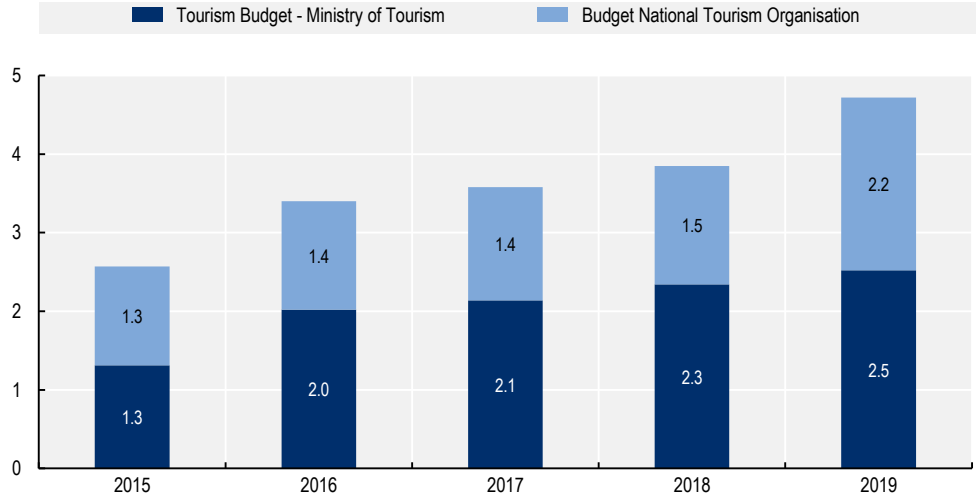
Source: (Ministry of Sustainable Development and Tourism, 2008[207]), *Montenegro Tourism Development Strategy to 2020,* http://www.mrt.gov.me/ResourceManager/FileDownload.aspx?rid=89273&rType=2&file=01%20Montenegro%20Tourism%20Development%20Strategy%20To%202020.pdf.

#### *Sub-dimension 15.1: Governance and co-operation*

The Montenegro Tourism Development Strategy to 2020 (Ministry of Sustainable Development and Tourism, 2008[207]) was designed in 2008 and updated following the Tourism Agenda Reforms in 2013. It commits Montenegro to developing an efficient governance structure involving effective inter-ministerial co-ordination to ensure all relevant ministries are involved in tourism planning and development. Governance of the national tourism policy is overseen by the Ministry for Sustainable Development and Tourism (MSDT), which is responsible for the development, management, co-ordination and implementation of the tourism strategy. The National Tourism Organisation of Montenegro is responsible for promoting and marketing tourism in international markets. The tourism strategy clearly defines policy measures and actions to be implemented by other ministries,[217] as well as the budget allocation and timeframe. To implement this cross-government approach, reflecting the cross-cutting nature of the tourism sector, specific tourism-related strategies/programmes have been prepared, and tourism has also been included in other national strategies in the last two years (Table 23.31). This, and the growth of the budget dedicated to tourism over the last five years (Figure 23.18), show the government's commitment to tourism development.

## Figure 23.18. Budget dedicated to tourism in Montenegro (2014-19)

Million euros




Source: Information based on responses to Tourism Questionnaires completed by the Ministry of Sustainable Development and Tourism.

Since 2017, Montenegro has greatly improved its **tourism governance and institutional set up** by introducing a monitoring system to assess its performance and process efficiency against policy measures and priority actions. The first monitoring report was prepared in 2019, but it lacks measurable indicators. Accordingly, a set of measurable indicators should be prepared for the next report, and an independent evaluation should be conducted.

In terms of **partnerships with stakeholders**, Montenegro has established a public-private dialogue and co-operation framework at the national level, which also includes **vertical co-operation** at the local level. In 2017, the government established the Tourism Council,[218] chaired by the Prime Minister. Its main tasks are monitoring the implementation of the tourism strategy and other strategies, programmes and action plans related to tourism (e.g. the National Human Resources Strategy). In 2019, the Tourism Council established a co-ordination body, chaired by the Minister of Sustainable Development and Tourism. Its main role is to monitor the development of the peak tourist season and take steps to overcome challenges in terms of reservations, border crossing, promotional activities, etc.

In addition to representatives of relevant ministries, the members of the Tourism Council include stakeholders from the private sector (i.e. Chamber of Commerce and their associations), local communities and NGOs. Accordingly, private tourism stakeholders, municipalities and NGOs are actively involved in the preparation, implementation, and monitoring of the tourism strategy. They also play an active role when the government prepares new legislation and regulatory policy. Although the private sector stakeholders are satisfied with the co-operation and communication with public institutions, some would like to see more active involvement of educational institutions and the local population in the tourism decision-making process. Including some relevant indicators in the monitoring and evaluation system for assessing public-private dialogue and co-operation would help to drive evidence-based improvements in the process.

Montenegro's tourism governance structure at the local level is well established. Most local communities have established Local Tourism Organisations (LTO) for managing tourism development. To date, 24 LTOs[219] have been created to develop tourism in their municipalities. Local tourism strategies are prepared in co-operation with private stakeholders and NGOs, and are in line with the national tourism strategy. Being members of the Tourism Council, LTOs are also actively involved in the development and implementation of the national tourism strategy, and also participate in the allocation of funding. They are involved in the working groups set up for designing and implementing tourism projects by the MSDT and NTO. The efficiency of the tourism governance structure at the local/destination level cannot be fully assessed, however, as the monitoring system does not include appropriate indicators for this area.

According to public sector representatives, governance at the local level could be improved by strengthening dialogue and co-operation with private stakeholders and NGOs, building the capacity of public officials and aligning budgetary allocation with local tourism priorities.

Montenegro has developed a **comprehensive data collection system** for baseline statistics on tourism. MONSTAT collects tourism-related data in accordance with Eurostat standards. Statistics on tourism have a permanent depository at MONSTAT and the MSDT (in the Central Tourism Register, which has been improved since 2017 following the adoption of the Rulebook on the content and manner of keeping the Central Tourism Register). The collection and publication schedule for tourism data has been established in accordance with national legislation.[220] Data collected by MONSTAT are published annually and available both online and as hard copy. The on-line statistical portal is user friendly and includes an interactive tool for working with basic tourism statistics (i.e. accommodation capacities,[221] arrivals and overnight stays, foreign vessels on cruises and nautical tourism).[222] The MSDT directorate for monitoring tourist flows and tourist turnover is responsible for upgrading the government's framework for tourism data collection. Montenegro has established active involvement by and co-ordination between key players in the tourism industry who can provide reliable and accessible data to support policy making. However, there is no formal government co-ordination body (e.g. working group or commission) that would ensure the active involvement of all responsible institutions or co-ordinate data collection and sharing. Tourism satellite accounts and e-tourism electronic guest registration are planned to be implemented in 2021, which will further improve the tourism data information framework in the economy.

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

Since 2017, Montenegro has improved destination accessibility and its **connectivity framework** by expanding the eligible categories of travellers who do not need a visa. First adopted in 2009, the Regulation on Visa Regime has since been periodically modified to adapt to the needs of the tourism and business sectors and in line with EU regulations. The last amendment was made in 2020. In 2011, the government started adopting decisions on temporary visa abolishment for citizens of certain countries during the tourist season. In 2019, the Government of Montenegro introduced visa exemptions for short stays for third-country nationals who hold valid visas or residence permits from the countries of the Schengen Zone, Commonwealth of Australia, the Republic of Bulgaria, the Republic of Croatia, Japan, Canada, New Zealand, the Republic of Ireland, Romania, the United States of America and the United Kingdom of Great Britain and Northern Ireland, as well as for people with Asia Pacific Economic Cooperation Business Travel Cards (APEC). Additionally, the government has adopted special regimes for border crossings for tourists in the high season. Article 34 of the Law on Border Control[223] defines the temporary omission of certain actions, and simplified and accelerated procedures for organised arrivals (primarily tourist buses) at road border crossings.

Montenegro has made progress in improving the **capacity and quality of accommodation** by introducing measures to facilitate investment in high-quality accommodation, and by adopting a consistent accommodation quality standard framework. Incentives for investment in high-quality accommodation are available through three programmes (Box 23.21) and their use is monitored. However, it is not clear if an evaluation to assess the efficiency of these measures and their impact on the development of high-quality accommodation facilities has been implemented or is at least planned.

### Box 23.21. Investment incentives for high-quality accommodation in Montenegro

There are three programmes run by the government:

1. The Programme of Incentive Measures in the Field of Tourism 2019/20, which includes:
   - Incentives for developing innovative tourist products. Budget: EUR 140 000.
   - Incentives for improving the offer and quality of services in rural households. Budget: EUR 50 000.
2. The Programme for Improving the Competitiveness of the Economy, which offers an incentive of between EUR 3 000 and EUR 10 000 for each person employed linked to investments of EUR 100 000 to EUR 250 000 (depending on the region) for constructing new capacities within development sectors, including tourism. The total budget of this programme is EUR 1 050 000.
3. Investment Programme of Special Importance for the Economic Interest of Montenegro, adopted by the Government of Montenegro in November 2018. This offers incentives for larger foreign direct investment in the country, including investment in constructing new four or five-star hotels or larger tourist complexes. Investment incentives range from EUR 5 million for projects in the north of the country, to EUR 15 million at the coast.

The Ministry of Sustainable Development and Tourism announced in 2018 a public invitation to express interest in qualifying projects on the list of development projects in the field of tourism. The list was updated by the Montenegro Investment Agency in April 2020, and to date consists of six development projects in tourism sector.

Source: Information based on responses to Tourism Questionnaires completed by national authorities.

Montenegro has been developing a consistent **accommodation quality standard framework** based on the EU standards for categorisation and this has been made mandatory for all types of accommodation.[224] Depending on the issuer of the permit, the categorisation is either implemented by the Commission of the MSDT or the Commissions of Municipalities. According to the Law on Tourism and Hospitality, accredited experts are engaged in the categorisation process and self-assessment is possible up to the three-star category or in the case of re-categorisation. The Rulebook of types, minimum technical conditions and categorisation of hospitality objects was updated in 2018 in line with international standards. Categorised accommodation is inspected regularly. Montenegro currently has 24 inspectors who make sure the quality standards are in place; the process is repeated every three years. However, according to public officials, efficiency is hindered by the lack of human and financial resources. The Law on Tourism and Hospitality also defines other quality standards for accommodation facilities, and other types of services (e.g. bed and bike standards, wild-beauty standards) as a part of the Rulebook of types, minimum technical conditions and categorisation of hospitality objects.

Another key element for tourism is the **availability of high-quality tourist information**. The Montenegrin tourist information system provides reliable information on tourist destinations, accommodation, attractions and tourist services. These are professionally compiled on the main tourism website[225] and available in five languages. The website is managed by the MSDT and the NTO Montenegro and implemented by a range of institutions such as the Chamber of Commerce, LTOs and private companies. The tourist information system in each destination is the responsibility of the LTOs. The quality of the tourism information system is monitored through regular visitor surveys. However, an independent evaluation of tourist information system would be recommended to identify potential weaknesses which are not detected in the surveys.

### *Sub-dimension 15.3: Availability of a qualified workforce*

In Montenegro the **skills supply framework** is defined in the Strategy for Human Resources Development in the Tourism Sector (HRDS), adopted by the Ministry of Tourism and Environment in 2007. The HRDS provides an assessment of skills gaps and training needs, and defines a list of policy measures for human resources development and governance structure. The Tourism Development Strategy to 2020 has as one of its priority goals the creation of qualified professional staff and promising new occupations/jobs. However, the strategy does not set out policy measures – these are contained in the HRDS. The qualification framework for tourism, hospitality and trade comprises 42 qualification standards developed between December 2012 and May 2020. Since 2017, 34 occupational standards have been revised and updated to meet the changing needs of the labour market.

The Employment Agency of Montenegro, in co-operation with Montenegro Tourism Association, conducts regular consultations on policy measures to improve the attractiveness of jobs in the tourism sector. Private sector stakeholders assess recent changes through their involvement in the Accreditation Commission, which helps to match curricula with labour market needs. A significant share of seasonal tourism jobs in Montenegro are filled by foreign workers: in 2019, 27 634 work and employment permits were issued to foreign nationals (the vast majority from Bosnia and Herzegovina and Serbia), 15 582 of whom were within the quota and 12 052 outside it. The key challenge is to encourage more Montenegrin young people into formal tourism education and to develop the required quantity and quality of skilled workers to deliver and maintain the high-quality service standards needed for future tourism development in the economy.

Since 2017, Montenegro has made sound improvements to the **VET framework for tourism**. Implementation is well advanced with clear budget allocations, sufficient funding and well-established co-operation among the relevant institutions and private stakeholders. Curricula are updated according to the needs of the tourism industry, and prepared in co-operation with the private sector. All vocational education programmes contain a compulsory practical element. The Centre for Vocational Education has sufficient funds for developing occupational standards, including the tourism sector. A VET quality assurance and accreditation framework has been established and the institutions responsible for quality insurance have sufficient financial resources and qualified staff. There is room for improvement to the system for monitoring the implementation of educational programmes, which is planned for 2021.

As part of the VET education framework, the Montenegro Government has developed a two-year **higher education framework for tourism**, based on consultations with key public and private sector decision makers. Quality assurance is provided by the Agency for Control and Quality Assurance of higher education. Although the higher education framework is regularly evaluated, according to tourism education experts it is inadequate, and there has been no training for staff over the last two years.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

Montenegro is currently developing a comprehensive **natural and cultural enhancement framework** for tourism. The Ministry of Culture develops annual activities in line with the Tourism Action Plan through the Programme for Development of Culture 2016-2020. This has allowed numerous strategic cultural heritage projects to be implemented. The budget allocated for the Program for Development of Culture is EUR 68 000 and comes from the Ministry of Culture. UNESCO provides funds for involving experts. Moreover, a budget of EUR 9.2 million has been allocated to the Programme of Protection and Preservation of Cultural Goods for 2012-2020. More recently, Montenegro has been developing a comprehensive natural and cultural heritage enhancement framework under the Cultural Heritage Development Strategy for 2020-2025 and the National Strategy of Preservation and Sustainable Use of Cultural Heritage, both entrusted by UNESCO. Inter-sectoral co-operation, as well as the development of strategic documents, laws and regulations, are taken into account in the development of both strategies. The Ministry of Culture has developed four long-term management plans for cultural heritage.[226] There is

an annual budget for the protection of cultural heritage through the Programme for the Protection and Preservation of Cultural Heritage, which falls under the Law on Protection of Cultural Properties.

The Administration for the Protection of Cultural Properties regularly monitors the status and conducts revalorisation of the value of cultural properties. Other mechanisms prescribed by the law, such as studies of cultural heritage protection, management plans and heritage impact assessments, have been adopted. Montenegro also developed an action plan for the period 2016-20 in accordance with the National Biodiversity Strategy. It aims to integrate and develop biodiversity protection measures into the tourism sector. Montenegro is a member of several regional development projects to promote cultural and natural heritage in tourism, including DUE MARI (Box 23.22), and the Regional Cooperation Council (RCC) Triple P Tourism project, aimed at developing joint cultural and adventure tourism products.[227]

### Box 23.22. DUE MARI: Next generation tourism development

The Ministry of Sustainable Development and Tourism has been developing the inter-regional project DUE MARI – Next Generation Tourism Development – under the Interreg Instrument for Pre-Accession Assistance (IPA) Cross Border Cooperation involving Italy, Albania and Montenegro. The aim of the project is to create an interactive site that will promote the tourist offers of Montenegro, Albania and the Italian regions of Puglia and Molise on a common platform. Between 300 and 500 sites of special cultural, historical and other importance for Montenegro will be marked on the platform, which will be displayed through 360° virtual reality. The design and mapping of new cultural tourism routes and marking is done on the spot. Also a new website for the NTO of Montenegro will be developed and will host the platform. The project includes purchasing equipment (e.g. servers and computers) as well as communication and marketing activities to disseminate information on the results of the project.

Source: (Interreg-IPA CBC, 2019[208]), *DUE MARI*, https://duemari.italy-albania-montenegro.eu/.

Montenegro has made progress in **promoting sustainable tourism development** recently. The Tourism Development Strategy to 2020 includes measures for enhancing natural and cultural heritage through tourism. The National Strategy for Sustainable Development (NSSD) defines the principles of sustainable tourism and places tourism as one of the driving forces of the economy. One concrete policy measure in the Tourism Development Strategy is to implement the NSSD actions related to the protection of nature, setting up protected areas, and preparing management plans for them. There is no evidence that the NSSD has been implemented, although its first implementation report was being finalised at the time of drafting.

Montenegro has implemented other actions to improve the sustainability of tourism. A noteworthy development is the innovative Towards Carbon-Neutral Tourism in Montenegro project, financed by the Global Environment Facility (GEF), which started in September 2014 and ended in May 2020.[228] The project was dedicated to promoting carbon-neutral tourism by fostering sustainability and innovation in businesses. The approach engages partners from industry, government and the broader community, and identifies and prioritises innovation opportunities by explaining the links between tourism and climate change from a mitigation perspective. With a budget of USD 3 million, the project helps to reduce greenhouse gas emissions from the Montenegrin tourism sector and thus lowers its environmental impact. The project has supported 30 hotels and tourist apartments in Montenegro to gain EU eco-certificates (eco label), a well-recognised international certificate of sustainability.

However, private stakeholders note that more attention should be paid to sustainable development in tourism, which they feel is still only a priority on paper. They note a lack of awareness of the topic among public and private stakeholders. They suggest the need for awareness-raising campaigns and capacity building of private stakeholders, and especially investors in tourism, to empower them to develop their investments and business models according to sustainability standards.

Policy measures promoting **investment and innovation in tourism** are explicitly reflected in national policies for the promotion of trade and investment, such as in the Montenegro Investment and Business Opportunities, which was issued by the Ministry of Foreign Affairs for the fourth time in 2019.[229] The promotion of innovation in tourism is included in the Smart Specialisation Strategy of Montenegro (Table 23.31), adopted in 2019 (Ministry of Science of Montenegro, 2019[39]). Moreover, the National Tourism Development Strategy 2020 provides some guidance on promoting investment in tourism infrastructure. In addition, there is a raft of fiscal measures available aimed at reducing costs for hotels and restaurants.[230] The capital budget for the Improvement of Tourism Infrastructure Programme has seen progressive increases in investment in tourist infrastructure since 2015. In 2018, the available budget was EUR 13.3 million, a six-fold increase since 2015. The Programme of Incentive Measures in the Field of Tourism for 2019/20 includes measures for developing innovative tourist products that enrich the tourist offer, with a budget of EUR 140 000. In total 21 projects have been supported, including E-bikes Durmitor (Durmitor Adventure), tree house and Hobbit house (Alpine Club Sinjajevina), and a children's playground in Ski Center Kolašin (Ski Centers Montenegro), each of which received more than EUR 11 000 worth of funding (Ministry of Sustainable Development and Tourism, 2020[209]).

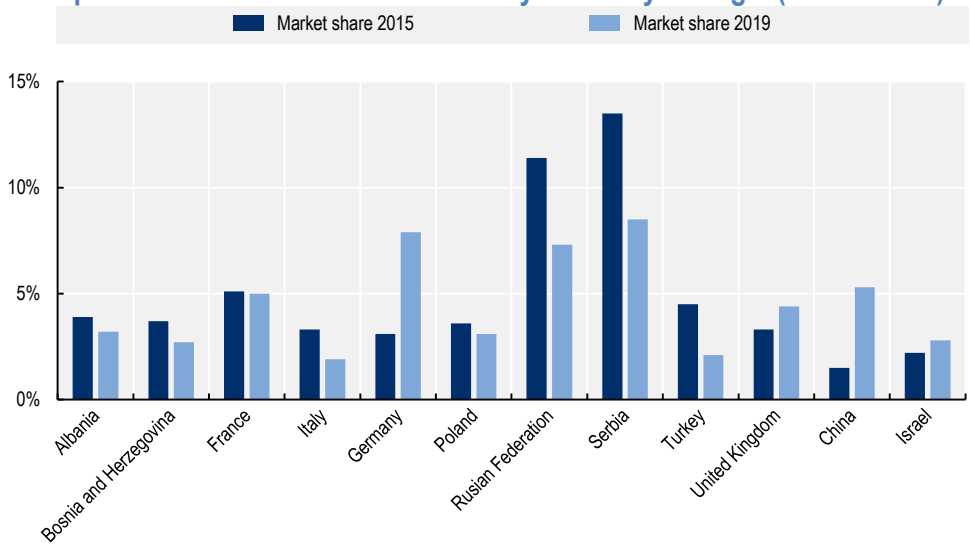
Despite the clear indications that the promotion of investment and innovation in tourism is a priority, the efficiency of the measures could not be assessed as there is no evidence they have been monitored or evaluated. In addition, private sector stakeholders draw attention to long and non-transparent procedures for obtaining building permits, the lack of knowledge among investors of tourism infrastructure, and inadequate spatial planning, which allows investments that are not in line with sustainable development principles. These issues should be addressed in order to ensure successful and sustainable tourism in the economy.

### *Sub-dimension 15.5: Tourism branding and marketing*

Montenegro established its **tourism brand** identity – Montenegro: Wild Beauty – in the New Book of Standards issued in 2015. The Ministry of Sustainable Development and Tourism and the NTO informally manage the promotion of Montenegro as a tourist destination, involving both private and public sectors. The NTO is in charge of planning and implementing information and promotional activities, both within the economy and abroad. It co-ordinates and unites the reporting and promotional activities of all tourism domains and co-operates with tourism organisations across the economy and abroad. The annual budget allocated to the NTO has been raised from EUR 1.09 million in 2014 to EUR 2.20 million in 2019. The number of staff in the 18 local tourist organisations has increased from 173 in 2017 to 193 in 2019. The Marketing Strategy identifies target markets and provides a framework for promotion. However, a formal **marketing** co-ordination body has not yet been established.

Montenegro's ranking on the Effectiveness of marketing and branding indicator in the WTTC Tourism & Travel Competitiveness Index has improved: from 53th place in 2017 to 34th place in 2019 (WEF, 2019[203]). This is a result of regional marketing activities in overseas markets and shared presentations of tourist offers with neighbouring economies at the main international tourist events, such as Internationale Tourismus-Börse in Berlin (ITB). This joint approach contributes to the more efficient use of the budget available for promotion and increases the visibility of Montenegro as a tourist destination in the Western Balkans. Between 2015 and 2018, the Wild Soul of Europe campaign was conducted in the Chinese market together with the Tourist Organisation of Serbia. In 2019, the Western Balkan Crossroads of Civilization campaign was targeted at the Singapore market. This was conducted in co-operation with the Tourist Organisation of Serbia and the Agency for Tourism of the Republic of North Macedonia. All Western Balkan economies participated in the Regional Cooperation Council campaign targeted at the Chinese market and ITB. The positive effects of these marketing campaigns can be seen in the recent increase in the share of Chinese (from 1.5% of the market share in 2015 to 5.3% in 2019), and German visitors (from 3.1% in 2015 to 7.9% in 2019) (Figure 23.19).

### Figure 23.19. Top market shares of tourist arrivals by economy of origin (2015 & 2019)




Source: (MONSTAT, 2020[206]), *Database for tourism*, http://bazapodataka.monstat.org/PXWebEng/pxweb/en/Tourism/?rxid=a295fc46-ba4f-4fe9-946b-36008f14d0c8.

StatLink https://doi.org/10.1787/888934256007

The **digital tourism marketing framework** is in the early phases of development. A first draft of the Digital Marketing Programme for the period from 2021 to 2023 is being prepared. However, public and private stakeholders are not involved in the process yet. In order to establish a robust and effective digital marketing framework, strong involvement from all relevant stakeholders is encouraged.

### *The way forward for tourism policy*

To ensure Montenegro's successful tourism development continues, policy makers should:

- **Empower local communities and tourist destinations to manage tourism development** by providing sufficient budgets and implementing sound capacity-building programmes for local tourism organisations. This is the basis for the faster and more efficient development of competitive tourism products in a sustainable way.
- **Further strengthen the dialogue and co-operation with private sector stakeholders, educational institutions and NGOs** at national and local levels. Organising events such as tourism forums for an exchange of views on tourism development could lead to the more active involvement of a broader spectrum of stakeholders in tourism development and implementation processes and a wider understanding of shared goals and objectives. This would provide the necessary conditions for more co-ordinated action for achieving common strategic goals.
- **Update the human resource development strategy for tourism** to overcome the key challenges regarding workforce availability and quality. This is key for providing a high-quality tourist product and offer, which is the core vision of Montenegrin tourism. The strategy should include measures for increasing the attractiveness of tourism studies and professions, especially among the young; developing flexible educational programmes at all levels in close co-operation with private stakeholders; and running training programmes for the foreign workers who will inevitably represent a significant part of the labour force into the future. Finland offers a best-practice example that can serve as inspiration (Box 23.23). The strategy should also define measures for the mandatory inclusion of sustainability and digitalisation subjects in the curricula at all levels of education and training.

- **Do more to promote sustainable development and business operation by making it mandatory to consider sustainability criteria** in all investments in tourist infrastructure. This should be supported by public incentives, and awareness raising and training for tourism sector stakeholders on how to develop their businesses sustainably. Following best practice in other economies is recommended (e.g. the Green Scheme in Slovenia's tourism sector, - more information in the regional chapter).
- **Further improve tourism data collection and sharing** by introducing Tourism Satellite Accounts to give policy makers reliable information when designing policy measures.

### Box 23.23. Improving the tourism labour supply in Finland

An examination of Finnish employment statistics reveals that although there are people with tourism and hospitality training looking for work, there are multiple vacancies in the sector. However, often the jobseekers do not have the skills and expertise required for the vacant tourism jobs. Other factors behind this labour supply gap may include the low wages; the irregular, seasonal and physically demanding nature of tourism jobs; a fall in the pipeline of students studying tourism and hospitality; and wider problems associated with lack of transport or reasonably priced housing options near the workplace.

In response, the Finnish Government launched the *Matkailudiili* programme in January 2018 to improve the employment and recruitment prospects of the tourism workforce. Over the two-year project measures were taken to boost the image of the tourism sector for work, strengthen co-operation between relevant stakeholders, and introduce a range of pilot projects. In 2018/19, over 30 pilot projects were launched to improve access to tourism employment as well as co-operation between public services and private recruitment agencies. These include training programmes for jobseekers, marketing campaigns aimed at potential employees (e.g. immigrants living in Finland), initiatives to employ workers from other sectors (e.g. forestry) during the high season, and digital platforms and training to alert people to vacancies. The result is greatly increased co-operation between relevant stakeholders, greater knowledge of tourism training and employment opportunities, increased national and international interest in the tourism jobs available, and improved understanding among the national employment services of sector circumstances, business needs and employee requirements. The results and best practices of the programme can be widely adopted in other sectors suffering from labour shortages.

Source: (OECD, 2020[210]), *OECD Tourism Trends and Policies 2020 - Finland*, https://www.oecd-ilibrary.org/sites/cb702fad-en/index.html?itemId=/content/component/cb702fad-en.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 23.32 shows Montenegro's scores for the anti-corruption policy dimension and compares them to the Western Balkans (WB) average. Montenegro has the highest scores for all indicators (along with certain other WB6 economies for some indicators). Montenegro has a generally well-advanced legal framework for the prevention of corruption and for ensuring judicial independence. Compared to the 2018 Competitiveness Outlook, Montenegro has strengthened its practice of corruption risk assessments as well as the capacity of its anti-corruption law enforcement bodies. A good track record of verifications, investigations and sanctions has been established, but some indicators remain weaker than expected.

**Table 23.32. Montenegro's scores for anti-corruption policy**

| Dimension | Sub-dimension | Scores | WB average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 3.5 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 4.0 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 3.5 | 2.8 |
| **Montenegro's overall score** | | **3.6** | **2.5** |

Note: For comparability with the previous assessment, the two new sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 16.1: Anti-corruption policy framework*

Montenegro has tied the strategic planning of its anti-corruption policy to its process of accession to the EU. In terms of **policy documents, co-ordination and implementation**, the Action Plan for Chapter 23 "Judiciary and Fundamental Rights" (AC23) of accession negotiations and the Operating Document (OD) for the prevention of corruption in areas exposed to special risk have served as equivalents of an anti-corruption strategy and action plan. The OD was intended as a follow-up to the Strategy for the Fight against Corruption and Organized Crime 2010-2014, and it included unimplemented measures from the strategy's action plans. The OD also contained information on prospective sources of funding, and, for some activities, the amounts of funds needed. However, the government does not publish the total amounts of its annual budget spent on anti-corruption activities.

In 2016, a working group prepared the draft of the OD, which was submitted for public debate. The debate lasted 40 days and ended on 18 April 2016. The official report of the consultations shows which proposals of civil society representatives were incorporated and reasons why some proposals were rejected. This is a good practice example of accountability (Ministry of Justice, 2016). At the other hand, according to the contribution to this assessment by the NGOs Institute Alternative and the Centre for Civil Liberties, the majority of proposals by civil society were ignored. The Competitiveness Outlook assessment cannot independently verify the validity of stakeholders' claims, and only takes note that there was some controversy surrounding the consultation process.

Multi-stakeholder co-ordination bodies have been set up. On the political level, the Rule of Law Council facilitates co-ordination and monitoring of the implementation of the obligations under the accession negotiation Chapters 23 and 24 "justice, freedom and security", as well as makes recommendations to the relevant institutions for urgent action in order to implement these obligations. Since February 2021, the

Council comprises the Prime Minister, the Minister of Justice, Human and Minority Rights, the Minister of the Interior and eight heads of public institutions from executive and judicial branches.

In December 2020, the government formed the National Council for Combating Corruption. The Deputy Prime Minister heads the Council, which is responsible for, *inter alia*, compiling an overview of the current course of investigations conducted against high-level corruption, monitoring, synchronising the activities of state bodies in the fight against high-level corruption, preparing opinions on how investigations of high-level corruption cases could be improved, and proposing concrete measures. The National Council consists of five members, including two representatives from the NGO sector, one of whom has been appointed as the Deputy President of the Council. At the operational level, the working group for Chapter 23 (established in July 2018, expanded in October 2018) ensures monitoring of and support for the accession negotiations. The working group has 47 members (39 representatives of government bodies and 8 civil society representatives). The NGO representatives are engaged through a public call. The minutes of the working group meetings are published on the website of the European Integration Office (ME4EU, n.d.[211]).

Members of the working group who are designated as co-ordinators in the field of corruption prevention have been monitoring OD implementation by working with contact people from competent implementing authorities. The EU Integration Office maintains the Portal for EU integration as an internal reporting IT tool for implementing institutions. According to Montenegro, the portal collects data on the implementation of measures from the AC23 and the OD. The government used to publish semi-annual reports on their implementation, with the last report covering July-December 2018 (Government of Montenegro, 2019). Since then, according to the government, reporting has switched to: 1) answers to a European Commission questionnaire submitted in August 2019; 2) a report on the implementation of the most important measures from the action plans for Chapters 23 and 24 submitted to the EC in February 2020; and 3) the continuous exchange of information with the EU. Reporting to the EC therefore appears to have partially replaced public accountability for the implementation of the anti-corruption policy, which is not appropriate given the government's duty to serve its citizens.

All public authorities must carry out **corruption risk assessments** by virtue of the legal obligation to develop, adopt and implement integrity plans – internal anti-corruption documents containing legal and practical measures to prevent and eliminate opportunities for corrupt and unethical behaviour. An integrity plan should be based on a self-assessment of the institution of its exposure to risks of corruption, illegal lobbying, and conflicts of interest, as well as its susceptibility to unethical or unprofessional conduct.

By the end of 2019, 689 public bodies (approximately 98%) had adopted integrity plans. The authorities must submit these integrity plans and annual reports on their implementation to the APC, as well as assess the efficiency and effectiveness of the plans every second year. In 2018 and 2019, 632 authorities updated their integrity plans based on this assessment (ASK, 2020[212]).

The APC supports the development of integrity plans by providing methodology, consultations, training, recommendations, etc. In 2018, the APC developed an extensive questionnaire for the assessment of efficiency and effectiveness of the integrity plans. It has also launched an online application for the plans (ASK, 2019). The application comprises three modules: 1) a register of corruption risks for all public bodies, which allows for various kinds of analysis and monitoring of risk trends in selected bodies or sectors, or in the public sector as a whole; 2) a reporting tool on the implementation of measures envisaged in integrity plans; and 3) a questionnaire for assessing effectiveness and efficiency.

The APC publishes annual reports on the adoption and implementation of integrity plans, which show that the majority of measures envisaged in integrity plans have been implemented (as of the end of 2019, 74.9% of measures had been implemented) (ASK, 2020[212]). The general quality of these integrity plans is a matter of somewhat divided opinions. According to information provided by representatives of the APC during consultations in October 2020, the quality of integrity plans has been improving, although around 30% of public bodies do not develop or implement them in a meaningful manner. The NGO Institute

Alternative argues that, judging by the annual reports published by the APC, authorities generally approach the development and implementation of integrity plans in a "bureaucratic" fashion, only complying with formal and technical requirements. Moreover, state administration bodies allegedly often fail to post the integrity plans and implementation reports on their website (Muk, Muk and Sošić, 2020[213]).

Montenegro has the legal basis and methodology for **corruption proofing of legislation**. According to the Law on Prevention of Corruption, the APC should give opinions on draft laws and other regulations and general acts to align them with international standards in the field of anti-corruption. The APC should also take the initiative to amend the regulatory acts in order to eliminate risks of corruption or to bring them in line with international standards. The APC has issued 17 opinions, which contain recommendations for improving regulations, and according to the APC the recommendations have been incorporated into five laws. However, activity in this area has been slowing down. The APC published 11 opinions in 2017, 2 opinions in both 2018 and 2019, and only one opinion in 2020 (a second opinion for 2020 was published in January 2021).

### *Sub-dimension 16.2: Prevention of corruption*

The central **corruption prevention body** in Montenegro is the Agency for the Prevention of Corruption, established in 2016. The law provides elaborate safeguards and mechanisms for the autonomy and accountability of the APC. The APC reports to the Parliament of Montenegro, and its managing bodies are the Council and the Director. The Council consists of five members (two of whom currently represent NGOs). The members are appointed by parliament, on the proposal of parliament's competent committee. Council candidates are selected through a public vacancy announcement. A selection commission interviews the candidates and shortlists five. The last APC Council members were elected in August 2019. The Council also selects the Director through a public call and also decides on the dismissal of the Director. The design of these procedures aims to ensure publicity and transparency, while minimising the possibility for undue influence. The Council proposes the APC's draft budget to parliament via the competent committee. By law, funds approved for the APC may not amount to less than 0.2% of the current state budget. Meanwhile the actual capacity of the APC remains suboptimal. The Rulebook for the APC envisages 60 employees, while at the end of 2020, 55 employees were in fact working full time. The APC regularly prepares quarterly and annual activity reports which are published on its website.[231]

Despite this robust legal framework, trust in the actual independence and effectiveness of the APC is not universal. A 2019 report by the European Commission noted that "challenges to the independence, credibility and priority-setting of the Anti-Corruption Agency are yet to be convincingly addressed" (EC, 2019[73]). The former Director of the APC performed unsatisfactorily, according to several non-government stakeholders, and resigned in 2019 before the end of his term (Freedom House, 2020[214]). The Council appointed a new Director in July 2020. This fresh leadership provides a renewed opportunity to mitigate concerns about the lack of effectiveness and independence of the APC.

The Law on Prevention of Corruption (LPC), adopted in 2014, governs the management of **conflicts of interest** and asset disclosure. The circle of public officials covered is comprehensive, especially in view of the fact that other regulatory acts[232] also contain provisions regarding conflicts of interest. The LPC does not envisage institutions and/or officials responsible for individual counselling, but overall the APC is the competent institution in the areas of prevention of conflicts of interest and restrictions in the exercise of public functions. The APC's section for the prevention of conflict of interest has three specialised officers.

The APC has a steady track record of issuing opinions (158 in 2019) as well as decisions and other administrative acts (72 in 2019, of which 30 concerned conflicts of interest and 42 concerned restrictions in the exercise of public functions). Altogether 42 of the decisions found violations to have occurred. According to the procedure, the Director of the APC adopts a decision on whether a public official has violated the provisions of the LPC and the decision is published on the website of the APC. The APC informs the official's employer and asks them to initiate the procedure of dismissal, suspension, or

imposition of disciplinary measures. In 2019, the authorities took action in 29 out of 44 cases where the APC had found that public officials violated provisions of the LPC. Moreover, violations are sanctioned as misdemeanours. In 2019, the courts imposed sanctions in 30 out of conflict-of-interest violation cases submitted by the APC. The total amount of fines imposed was EUR 8 150 (ASK, 2020[215]). According to the APC, in most cases the fines are below the minimum prescribed by the LPC. It appears that the procedure whereby the APC decides on the existence of a violation while the legal consequences are decided by other bodies results in a general under-enforcement of the law. On the other hand, in August 2020, a court invalidated the APC's own decision, which had found no conflict of interest in a prominent case involving the former Prime Minister of Montenegro (EC, 2020[66]). The case was returned to the APC for repeated review.

All public officials are required to **disclose assets and income**, as are certain categories of civil servants, pursuant to special regulations. Exceptions are the staff of political officials (such as advisors). The data to be declared are generally comprehensive, though there are a few gaps. These include the lack of an explicit requirement to report beneficial ownership; major transactions (expenses) unless reported in the event of an increase in assets of more than EUR 5 000; and virtual assets, e.g., cryptocurrencies. The technical system for declaration is well developed with an online platform for submission, publication by default with certain exempted data, searchable and electronically readable forms available for the public, and possibilities for internal users to manage the declarations. However, advanced electronic analysis, for example, searches for risk indicators or so-called red flags, is not possible. One of the main gaps in the declaration system is the requirement to obtain permission from a declarant in order for the APC to gain access to bank data.

The APC's section for verifying the income and assets of public officials has six employees, four of whom carry out verifications. In 2019, 285 misdemeanour proceedings for violations of asset and interest disclosure rules were completed, with sanctions applied in 263 of the cases. The total amount of fines was EUR 48 460. A 2019 report by the European Commission is critical of the practice regarding inexplicable wealth. It refers to 30 cases of inexplicable wealth opened in 2018, of which 28 were subsequently closed without finding irregularities (EC, 2019[73]). The data for 2019 reveal a similar situation (no violations found out of 31 verifications).

The Law on Prevention of Corruption contains provisions for the **protection of whistle-blowers**. The LPC guarantees protection to individuals who report a corruption-related wrongdoing that they believed to be true at the time of reporting. The APC must protect whistle-blowers who have reasonable grounds to believe that there are threats to the public interest that indicate the existence of corruption and who report this suspicion in good faith. The LPC extends this protection to both public and private sector employees.

However, the law deviates in several ways from EU Directive 2019/1937 on the protection of persons who report breaches of Union law. Under Montenegrin law, only threats that indicate the existence of corruption can be the subject of whistleblowing. Whistle-blowers may submit reports to the APC without first submitting them to the entity concerned, but there is no possibility of public disclosure to the media or public associations. The types of prohibited retaliation listed in the LPC are fewer and narrower than those found in the Directive (even though the LPC list is non-exhaustive, and thus in principle other types of retaliation could be considered too). The provisions are rather vague on the available protection measures and, in particular, compensation for damage. The LPC also does not envisage provisional protection, and it can only be provided in court proceedings. In the past, there have been controversies in Montenegro over decisions to refuse to grant someone the status of whistle-blower. One prominent case concerns a hotel employee fired in 2016 after revealing that a public entity paid the bill for a political party. However, since then the number of whistleblowing reports received by the APC has increased: from 56 in 2016 to 110 in 2019 (ASK, 2020[215]).

The APC considers that the external reporting channel to the APC is most effective, while internal whistleblowing is uncommon. According to government data, the effectiveness of whistleblowing in the

context of criminal proceedings is modest. In 2019, the APC forwarded five reports to prosecutors' offices. In two of these cases the reports were rejected, while in three cases the proceedings are ongoing. In 2018, eight out of nine reports were rejected. In 2017, seven out of nine reports were rejected. Few individuals reporting threats to the public interest request protection (eight requests in 2016, two requests in 2017, one request in 2018, three requests in 2019) (EC, 2019[73]; EC, 2020[66]).

The section of the APC dealing with whistle-blower reports and protection has three employees. According to the APC, whistle-blower reports are also used for policy development. For example, in 2016, a large number of whistle-blower reports received by the APC related to employment procedures. Based on these reports, the APC drafted an opinion on the Labour Law and the Law on Employment and Exercise of Unemployment Insurance Rights concerning public sector employment.[233]

The APC regularly carries out **public awareness and education** campaigns. In 2019, it created fliers (on topics such as prohibitions and restrictions on receiving gifts, etc. in the exercise of public office, submission of asset declarations by public officials, reporting threats to the public interest; brochures on the APC and on the results of the IPA Twinning project; a manual for integrity managers; a billboard and citylight "Report Corruption"; TV announcements "Corruption is not in a game" and "For a Corruption-Free Society"; and a bulletin on anti-corruption. The APC has engaged in numerous training and education activities for public officials, school pupils, university students, and other target groups. It allocates annual funds for awareness raising and public education (EUR 58 000 in 2017, EUR 63 300 in 2018, EUR 58 900 in 2019, and EUR 38 000 in 2020) and has signed co-operation agreements with NGOs to engage in joint training and awareness-raising activities. The effectiveness of these activities is measured with the help of the annual poll on Public Attitudes on Corruption and Awareness of the Work of APC. The poll measures the percentage of citizens who would report corruption to the APC, who claim to know what the APC does, who believe that the APC has contributed to the overall fight against corruption in Montenegro and who think that the APC's campaigns encourage citizens to fight corruption, etc. (ASK and Defacto Consultancy, 2019[216]). According to the APC, the survey findings have been used for targeting communication activities, such as to certain geographic areas. Despite these efforts, there is still a lack of information on permanent anti-corruption education programmes, for example, in schools.

### *Sub-dimension 16.3: Independence of the judiciary*

The legal framework generally ensures the **independence of the judiciary**. Judicial duty is permanent. The institutional setup of the Judicial Council satisfies the minimum requirements for its mandate to secure the autonomy and independence of courts and judges, save for the *ex-officio* membership of the Minister of Justice (EC, 2020[66]). The Judicial Council consists of a president and nine members (including the President of the Supreme Court and four judges to be elected and released from duty by the Conference of Judges). Thus, judges elected by their peers constitute only a minority of members; this should be changed in future reforms. The competent working body of parliament should issue a public call for appointing four members of the Judicial Council from among eminent lawyers. However, since 2020 parliament has been unable to appoint these members due to a political stalemate. In addition to the exclusion of the Minister of Justice, the Group of States against Corruption (GRECO) has also recommended establishing objective and measurable criteria for identifying professional qualities and impartiality amongst non-judicial members (GRECO, 2019[217]). Decisions of the Judicial Council, except for those issued in disciplinary proceedings against a judge, are published anonymously on the website of the Courts of Montenegro.[234]

A judge and a president of the court are to be elected and dismissed from duty by the Judicial Council. Vacant positions for judges should be filled in accordance with the Plan of Vacant Positions for Judges adopted by the Judicial Council. Vacant positions for judges in basic courts should be filled through an internal announcement for voluntary transfer. If the positions are not filled through this procedure, they should be filled following a public announcement. The law prescribes the promotion of judges based on

their position and achievements on a ranking list. The assessment tools for appointment involve work appraisal and an interview with the candidate. Vacant positions for judges in the High Court, the High Misdemeanour Court, the Appeals Court, and the Supreme Court are announced publicly. The procedures for public announcement, submission of applications and processing of the applications, as well as the rights of applicants, are governed by law.

An information system allocates cases to judges randomly. According to the government, all final decisions are regularly published anonymously on courts' website.

The legal framework for judges' disciplinary responsibility corresponds to the requirements for judicial independence. Court presidents may initiate disciplinary proceedings. A judge against whom disciplinary proceedings have been instituted has the right to participate in the proceedings and is entitled to a defence counsel. The disciplinary prosecutor and the judge whose liability is established may file an appeal against the decision to the Supreme Court. However, the non-publication of decisions of the Judicial Council in disciplinary proceedings against judges limits the public accountability of the process. The track record of disciplinary responsibility is limited, with sanctions applied in only three cases in 2015, and in one case each in 2017 and 2019. The Commission for the Code of Ethics for Judges prepares opinions regarding conformity of judges' conduct with the Code of Ethics. Two violations were established in 2019. The proceedings of the disciplinary and ethics bodies are reportedly inconsistent, and the system generally requires strengthening (EC, 2020[66]).

While the legal guarantees for judicial independence are generally adequate, independent sources refer to perceived vulnerability to political interference, as well as hazards to judicial independence. These include state-sponsored apartments or loans on favourable terms for some members of the judiciary, as well as failures to carry out justice according to the law (EC, 2020[66]; Građanska alijansa, 2019[218]). On the other hand, some judges have had temporary salary reductions due to the COVID-19 pandemic. The reappointment of several court presidents in breach of the statutory limitation of two terms is another source of concern (Prelević et al., 2019[219]).

### *Sub-dimension 16.4: Business integrity and corporate liability*

The framework for promoting **business integrity** is limited. The Law on Business Organisations does not set out that it is the responsibility of the board of directors in a joint stock company to supervise corruption risk management. The Law on Prevention of Money Laundering and Terrorist Financing (adopted in 2018) stipulates that the Tax Administration – Central Registry of Commercial Entities (CRCE) should maintain a beneficial owners register. However, in 2019 the law was amended, and in late 2020 the CRCE still had not established the register. The Ministry of Interior adopted a new rulebook on keeping the register on 24 December 2020. According to information provided by Montenegro, practical preparations (work on software support, development of regulations, determination of publicly available data and fees) are in progress. The law provides for sanctions in the form of fines ranging from EUR 3 000 to 20 000 for the failure to provide data on beneficial owners and changes thereof, but in the absence of the register, there are no grounds for applying the sanctions in practice. Under the anti-money laundering legislation, reporting entities, including designated non-financial businesses and professions (DNFBPs), should identify beneficial ownership. The Chamber of Economy, in accordance with the Law on the Chamber of Economy of Montenegro, carries out activities to stimulate and improve the business environment and legislative framework and to inform its members of the need to suppress corruption in the private sector. The chamber adopted the Business Ethics Code in 2011 and established the Court of Honour to rule on violations of good business conduct rules.

The Law on Criminal Liability of Legal Entities stipulates that **legal entities are liable for criminal offences** (those referred to in the special section of the Criminal Code of Montenegro and for other criminal offences provided for under a separate law) if conditions prescribed by the law have been fulfilled. A legal entity is liable for a criminal offence if a responsible person commits the criminal offence while acting within

his/her authorities on behalf of the legal entity, with the intention to obtain gain for the legal entity, or when the activity of the responsible person was contrary to the business policy or orders of the legal entity. The legal entity will be held liable for a criminal offence even if the responsible person who committed the offence has not been convicted, but the physical person who committed the offence must be identified. Fines are determined depending on the amount of damage caused or material gain obtained. In addition to a fine and a suspended sentence, other sanctions (security measures) are also prescribed. An entity may be exempt from punishment if it has undertaken all the effective, necessary, and reasonable measures to prevent and reveal the commitment of the criminal offence. A report by the Public Prosecution Council shows that in 2019, 33 legal entities were prosecuted for offences under Chapter 34 "Criminal offences against service obligations" of the Criminal Law. Courts convicted 17 legal entities (all categories of crime) (Tužilački savjet, 2020[220]).

*Sub-dimension 16.5: Investigation and prosecution*

There is no detailed public information about the course of **investigation and prosecution of high-level corruption,** although the authorities reportedly inform the public at press conferences and publish relevant data on the website of the Special State Prosecutor's Office (SSPO).[235] Moreover, information about cases of high-level corruption is provided in periodic reports submitted to parliament (Tužilački savjet, 2020[220]). According to the government, since the formation of the SSPO in 2015, in all cases of high-level corruption where defendants have been found guilty, effective prison sentences have been handed down.

According to the SSPO, between 3 July 2015 and 1 September 2020, it raised 43 indictments against 137 individuals and 11 legal entities for high-level corruption offences. Thus, the intensity of investigation and prosecutorial activity is relatively high. The evidence is somewhat controversial regarding the track record of convictions for high-level corruption, however. According to data provided by Montenegro, the number of cases involving final convictions for high-level corruption was three in 2015, three in 2016 and one in 2018. A European Commission report mentions four final and enforceable judgements for high-level corruption each in 2018 and 2019, and one further judgement in mid-June 2020. Financial investigations are yet to be launched systematically in parallel with corruption cases investigations (EC, 2020[35]). The most prominent person convicted for corruption (the former President of the State Union of Serbia and Montenegro, and the former President of the Parliament of Montenegro) avoided serving the sentence handed down in 2016 by leaving Montenegro (EC, 2019[73]).

The Special State Prosecutor's Office forms the core of the **specialised anti-corruption prosecutorial and judicial bodies**. The SSPO's remit includes tackling high-level corruption, the abuse of position in business undertakings and the abuse of authority in the economy if the proceeds of crime exceed EUR 40 000, money laundering, etc. The SSPO brings its actions before the Special Division of the High Court in Podgorica.

The Law on the SSPO contains several guarantees for its independence, transparency and accountability. The Chief Special Prosecutor and special prosecutors are selected from applicants who respond to a public advertisement and are then elected by the Prosecutorial Council. The law describes the selection process, including criteria, in detail. The tenure of the Chief Special Prosecutor is five years while a special prosecutor can be elected to serve life tenure if he/she has worked for at least four years as a state prosecutor or as a judge. However, the autonomy of the SSPO is limited in that the Supreme State Prosecutor may directly exercise all powers and undertake all actions for which the head of the SSPO is authorised. The Chief Special Prosecutor should submit a six-month activity report on the SSPO to the Supreme Public Prosecutor, as well as separate reports on request.

There has been some strengthening of the capacity of the SSPO. Since 2018, the number of prosecutors allocated to the SSPO has increased from 10 to 13. The SSPO employs six economic experts. However poor office conditions are a concern reportedly (EC, 2019[73]; EC, 2020[66]). According to the government,

in 2019 special prosecutors participated in numerous training courses on a variety of topics, although few were specifically on corruption.

**Specialised anti-corruption investigative bodies** are located within the Police Directorate. The section for the Fight against Organized Crime and Corruption contains a Special Police Division (SPD),[236] which in turn contains the Group for the Investigation of Criminal Cases of High Corruption and Money Laundering (GICCHCML), headed by the Chief Police Inspector and comprising 14 specialised investigators.

The SPD is an integral organisational unit of the Police Directorate and as such does not have special formal independence guarantees different to those of other police units. The head of the division is appointed by the director of the administrative authority responsible for police affairs, subject to the consent of the Chief Special Prosecutor. The SPD acts on the orders and instructions of a special prosecutor. The Chief Special Prosecutor may form a special investigative team in particularly complex cases in which, besides a special prosecutor, police officers from the SPD, investigators and civil servants from other competent authorities may be included.

Montenegro has taken steps to gradually strengthen the capacity of its corruption investigation. In 2018, the special police unit was allocated 10 additional staff, bringing the total number of filled positions to 29. Today it has 32 staff. However, the staff numbers are reportedly still insufficient relative to the workload (EC, 2019[73]; EC, 2020[66]). The Law on Interior Affairs determines investigators' salaries, but the Government of Montenegro has supplemented the basic salary of anti-corruption investigators by 45%.

### *The way forward for anti-corruption policy*

To strengthen the anti-corruption policy framework and implementation, policy makers should:

- **Develop and adopt a renewed national anti-corruption plan or strategy** based on an overall corruption risk and gap assessment, which reflects the current state of affairs. Montenegro approved the OD in 2016, but this document cannot fully serve the purpose of setting up-to-date goals, responsibilities, deadlines and funding needs relevant in 2021. The United Nations Convention against Corruption requires that states develop and implement or maintain effective, co-ordinated anti-corruption policies that promote the participation of society and reflect the principles of the rule of law, proper management of public affairs and public property, integrity, transparency and accountability (Article 5, Paragraph 1) (United Nations, 2004[221]). Comprehensive strategies and action plans, which define objectives and goals, allocate responsibilities, set deadlines, determine necessary funds, are widely recognised as the optimal way to frame anti-corruption policies. In preparing this strategy, the government should follow public consultation best practice and envisage regular public reporting on its implementation.
- **Widen the scope of corruption proofing of legislation** to cover most of the laws and regulatory acts that may embody corruption risks. For this task, the capacity of the APC may need to be strengthened. Corruption proofing of legislation is a key step for limiting corruption risks that arise from deficiencies in the legal framework. Such work requires substantial analytical capacity. Due to the large number of regulations to be potentially assessed, full implementation of this recommendation will take several years. The APC should strive to return at least to the intensity of the proofing activity of 2017, when it published 11 opinions.
- **Strengthen the verification of asset and interest reports** by encouraging (e.g. in codes of ethics) public officials to give permission for the APC to access the necessary bank information and by exploring the options for developing an advanced electronic risk monitoring system for detecting violations of the law. Explore further possibilities for strengthening the effectiveness of inexplicable wealth detection. The Western Balkan Recommendation on Disclosure of Finances and Interests by Public Officials recommends that banking secrecy should not be an obstacle to using banking data for verification purposes. Moreover, verification should not be limited to

comparing data but should aim at detecting undeclared cash-flows and any possible illicit origin (EIN, 2014[222]). It is possible for a corrupt public official to complete a declaration with data that correspond to public registers and other sources checked by an oversight body while still incurring expenses that vastly exceed his/her legal income. Access to data on at least the turnover and balances of the relevant bank accounts can significantly assist in assessing the economic plausibility of the declared information.

- **Continue the dissemination of information for potential whistle-blowers.** In order to promote whistleblowing activity, encourage whistle-blowers to report quickly any suspicion of corruption threats to the public interest, and maximise the usefulness of whistle-blower reports for follow up by relevant authorities. The relevant EU directive envisages mandatory and optional measures of support for whistle-blowers such as comprehensive and independent information and advice, which is easily accessible to the public and free of charge, on procedures and remedies available, on protection against retaliation, and on the rights of the person concerned; effective assistance from competent authorities before any relevant authority involved in their protection against retaliation; legal aid, counselling or other legal assistance; financial assistance and support measures, including psychological support, for reporting persons in the framework of legal proceedings. Montenegro has taken actions in these areas, but the efforts need to continue. Montenegro should also strive to fully implement the EU directive regarding opportunities for public reporting.
- **Explore ways to strengthen the record of the disciplinary liability of judges**, for example, by encouraging citizens who have grounded belief that a judge has acted illegally or unethically to inform in good faith the Judicial Council. Expand the scope of published information on disciplinary proceedings. International standards allow for the publication of disciplinary decisions with or without naming the judge (ENCJ, 2015[223]). Box 23.24 provides an example from Latvia. Where public trust in the independence and integrity of the judiciary is limited, greater transparency appears the preferrable option.
- **Ensure registration of and oversight over the disclosure of beneficiary owners** of legal entities. The EU Anti Money Laundering Directive requires that the information held in the central register of beneficial ownership is adequate, accurate and current. It is required that states put in place mechanisms to this effect, e.g. ensuring that obliged entities and competent authorities report any discrepancies they find between the beneficial ownership information available in the central registers and the beneficial ownership information available to them. However, note that full assessment of compliance by Montenegro with requirements of the EU directives in this area is beyond the scope of this analysis.
- **Consider further strengthening the independence of anti-corruption investigative and prosecuting bodies.** Standards under the United Nations Convention against Corruption state that a body or bodies or persons specialised in combating corruption through law enforcement should be granted the necessary independence, in accordance with the fundamental principles of the legal system of the State Party, to be able to carry out their functions effectively and without any undue influence (Article 36) (United Nations, 2004[221]). This assessment did not evaluate in-depth the work practice of the SPD, and hence does not argue whether or not any undue influence on its activities has taken place. However, Montenegro should consider potentially introducing additional means for safeguarding the independence of the SPD, such as more public and competitive selection of management and strengthened guarantees of dedicated budget funding. Montenegro should also reconsider whether the authority of the Supreme State Prosecutor to directly exercise all powers and undertake all actions for which the head of the SSPO is authorised is compatible with due independence of the SSPO.

### Box 23.24. Publication of judicial disciplinary decisions in Latvia

According to the Judicial Disciplinary Liability Law, a decision taken in a disciplinary case must be published online, except for a decision to forward the file to the Prosecutor General's Office for deciding on the launch of criminal proceedings. In the published decision, personal data must be concealed, but the name of the person held liable is disclosed.

The published decision must be deleted from the website one year after the day it came into effect. If a disciplinary sanction is set aside before this time limit, the published decision must be deleted from the website after the decision to set aside the sanction is taken.

If a decision in a disciplinary case proposes the removal of a judge but the Parliament votes against the removal and the disciplinary case is returned to the Judicial Disciplinary Board for repeated examination, the initial published decision must be deleted from the website.

Source: Judicial Disciplinary Liability Law, Article $11.^6$, Paragraphs $6^1$ and $6^2$, https://likumi.lv/ta/en/en/id/57677-judicial-disciplinary-liability-law.

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WTO, GATS (1995), *Article I:2*. [296]

## Notes

[1] Montenegro unilaterally adopted the euro in 2002 as its de facto domestic currency; therefore, it has no direct control over its monetary policy.

[2] World Bank WDI data.

[3] https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/montenegro#finance

[4] https://www.doingbusiness.org/content/dam/doingBusiness/country/m/montenegro/MNE.pdf

[5] https://www.wto.org/english/res_e/statis_e/daily_update_e/trade_profiles/ME_e.pdf

[6] http://documents1.worldbank.org/curated/en/642701468179098025/pdf/105019-SCD-P151813-OUO-9-SecM2016-0165.pdf

[7] Fine particulate matter ($PM_{2.5}$) is the air pollutant that poses the greatest risk to health globally, affecting more people than any other pollutant. This becomes of even greater concern in the context of the COVID-19 pandemic knowing that exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to COVID-19 (OECD, 2020[293]).

[8] COVID notes and IMF policy tracker https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

[9] https://data.worldbank.org/indicator/SH.XPD.CHEX.GD.ZS?locations=ME

[10] https://info.undp.org/docs/pdc/Documents/MNE/00049339_Integrity%20Assessment%20of%20the%20Health%20Care%20System%20in%20Montenegro.pdf

[11] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1811

[12] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1811

[13] Staff from the Statistical Office of Montenegro who co-ordinate the statistical data collection.

[14] A person from the Ministry of Economic Development who co-ordinates the whole assessment in Montenegro.

[15] Key sectoral laws include the Law on Free Zones, the Law on Tourism and Hospitality, the Law on Protection of Competition and the Bankruptcy Law.

[16] https://mek.gov.me/en/library

[17] Decree on Selecting NGO Representative to Working Bodies of the State Administration Authorities and Public Consultations while Drafting Laws and Strategies.

[18] https://www.oecd.org/investment/fdiindex.htm

[19] Montenegro has signed 31 international investment agreements (IIAs): 25 bilateral investment treaties (BITs) and 6 treaties with investment provisions (TIPs). Of these, 29 are in force (23 BITs and 6 TIPs).

[20] https://www.gov.me/ResourceManager/FileDownload.aspx?rId=380326&rType=2

[21] The law was adopted in 2019 by the government but is yet to be enacted by the parliament.

[22] http://www.ziscg.me/

[23] A rulebook on the Registration Procedure, Detailed Content and Manner of Keeping the Central Registry of Economic Entities ("Official Gazette of Montenegro", No. 98/20) as well as Rulebook on Determining the Criteria and Amount of the Fee for Registration of Economic Entities with the Central Registry of Economic Entities.

[24] Law on State Administration, Zakon o državnoj upravi, Official Gazette of Montenegro, 2088 and Decree on the organization and functioning of public administration (OG MNE, No. 5 from 23. January 2012, 25/12, 44/12, 61/12, 20/13, 17/14, 6/15, 80/15, 35/16, 41/16, 61/16, 73/16,87/18; 2/19; 38/19; 18/20).

http://www.sluzbenilist.me/pregled-dokumenta-2/?id={FCCBC395-BD0B-4AA9-B941-98E0A6F5CCDF}

[25] Annual GDP data by expenditure categories are available on http://monstat.org/eng/page.php?id=19&pageid=19

[26] The main ministries and bodies involved in the dialogue on trade policy, apart from the Ministry of Economy, are the Ministry of Agriculture and Rural Development, Ministry of Finance (specifically the Directorate for Tax and Customs System) and Statistical Office – MONSTAT.

[27] The Working Group for TRP, led by the Ministries of Economy and Foreign Affairs, is composed of 44 authorities and is charged with making recommendations and drafts relevant to the implementation of WTO *acquis*. It is also responsible for ensuring transparency on trade-related measures and fostering dialogue between the public and private sectors on these issues.

[28] The NTFC was created in 2015 as a permanent multi-agency platform consisting of representatives of all relevant state bodies and the private sector. Its task is to ensure co-ordination and co-operation between the above actors in order to fully and effectively implement the WTO Trade Facilitation Agreement (TFA). The committee operates on the principle of co-chairing between the Ministry of Economy and the Ministry of Finance. It is composed of representatives from across the relevant public administrations (headed by the Ministries of Economy and Finance). It notably also involves representatives from the Customs Administration, Ministries of Agriculture, Transport and Maritime Affairs and private sector associations such as the Chamber of Economy and Employers Association.

[29] Trade Facilitation Strategy 2018 – 2022, https://mek.gov.me/en/wto/library/strategic_documents

[30] Law on State Administration, Zakon o državnoj upravi, Official Gazette of Montenegro, 2018 and Decree on the organization and functioning of public administration (OG MNE, No. 5 from 23. January 2012, 25/12, 44/12, 61/12, 20/13, 17/14, 6/15, 80/15, 35/16, 41/16, 61/16, 73/16,87/18; 2/19; 38/19; 18/20) http://www.sluzbenilist.me/pregled-dokumenta-2/?id={FCCBC395-BD0B-4AA9-B941-98E0A6F5CCDF}

[31] The relevant ministry is obliged to provide an explanation of why it is not necessary to conduct a public hearing procedure if it so decides.

[32] Decree of the Government of Montenegro, Uredba o Vladi Crne Gore, Official Gazette of Montenegro, (OG MNE 80/08; 14/17 and 28/18), http://www.sluzbenilist.me/pregled-dokumenta-2/?id={5AB36DAD-E663-4FFE-99FA-CC48A55A7940}

[33] The portal can be accessed at https://www.euprava.me. The public consultations begin on the day of the announcement of the public invitation on the ministry's website and e-Government portal and lasts from 20 to 40 days, depending on the importance and complexity of the law or strategy under public debate.

[34] This report is usually published within 15 days of the public consultation process.

[35] OECD member states and partner economies (Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa, and Thailand).

[36] The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member states and partners states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.

[37] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[38] Immigration law, Zakon o strancima, Official Gazette of Montenegro (OG MNE No. 12/2018 and 3/2019), 23 February 2018, last updated 15 January 2019.

[39] Rulebook on the Registration Procedure, Detailed Content and Manner of Keeping the Central Registry of Economic Entities ("Official Gazette of Montenegro", No. 98/20) governs in more details the registration procedure, single registration application of economic entities, content and the manner of keeping the Central Registry of Economic Entities (CRPS).

[40] Rulebook on Determining the Criteria and Amount of the Fee for Registration of Economic Entities with the Central Registry of Economic Entities ("Official Gazette of Montenegro", No. 98/20).

[41] With the development of electronic registration, the Decree on detailed conditions and manner of payment of administrative fees electronically offers the option of paying all fees electronically. Activities to establish the National System for Payments of Administrative Fees (NS-NAT) are in the final phase. It will be up and running once the agreement is verified with the Central Bank and the contract with the Ministry of Interior signed.

[42] In order to facilitate comparison with OECD member states that have undergone the Services Trade Restrictiveness Index exercise, the paragraphs below have been drafted in accordance with the methodology of the STRI project publications. The OECD Member's Country Notes, as well as the Sector Notes, are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/

[43] Article 8.4, Council Regulation (EEC) No 95/93 of 18 January 1993 on common rules for the allocation of slots at Community airports, OJ L 14, 22.1.1993, p. 1-6 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.1993.014.01.0001.01.ENG&toc=OJ%3AL%3A1993%3A014%3ATOC

[44] Law on Postal Services, Official Gazette of Montenegro, (OG MNE no. 57/11, 55/2016 and 55/18).

[45] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks' risk management.

[46] The Central Bank of Montenegro prepared and adopted a set of secondary legislation enabling the implementation of the Law (adopted in November and December 2020) in line with the EU regulatory framework, and recent amendments to EU regulations were implemented in the secondary legislation. However, considering the challenges brought by the COVID-19 pandemic, the Association of Montenegrin Banks submitted an initiative to delay the entry into force of the Law on Credit Institutions in July 2020. Banks have expressed concerns over the implementation of the new framework, as it requires a large number of harmonisation activities that they might not be able to undertake in the current context. Accordingly, in August and September 2020 the Central Bank of Montenegro prepared a set of amendments to the law to postpone its application for an additional year (until January 2022). These were adopted by the Parliament of Montenegro on 20 January 2021 (effective from 26 January 2021). Consequently, the Law on Credit Institutions will enter into force on the 1st January 2022.

[47] Law on Electronic Communications, Official Gazette of Montenegro, (OG MNE nos. 40/13, 2/17 and 49/19).

[48] Resulting in a projected market volume of USD 94m by 2025: https://www.statista.com/outlook/243/270/ecommerce/montenegro

[49] Directive 2000/31/EC.

[50] Basel II is an international business standard developed prior to the 2008/09 crisis by the Basel Committee on Banking Supervision. It requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.

[51]Based on the European banking authority's report to the European Commission on the perimeter of credit institutions established in the Member States. URL: https://www.eba.europa.eu/sites/default/documents/files/documents/10180/534414/6bbabcef-ac51-48b8-a4fb-45dfd483e486/2014%2011%2027%20-%20EBA%20Report%20-%20Credit%20institutions.pdf?retry=1

[52] Financial factoring was previously covered under the Law on Banks adopted in 2011.

[53] The law on obligations, the law on enterprises, the law on property relations, the law on collateral security claims, the law on prevention of illegal businesses, and tax laws.

[54] Securities Token Offerings combine the technology of blockchain with the requirements of regulated securities markets to support liquidity of assets. They are essentially the digital representations of ownership of assets (e.g. gold, real estate) or economic rights (e.g. a share of profits or revenue).

[55] In 2010, the New Securities Stock Exchange (NEX) and the Montenegro Stock Exchange merged. NEX Stock Exchange ceased to exist as a legal entity as of December 2011.

[56] http://www.montenegroberza.com/code/navigate.asp?Id=991

[57] Before 2020, a special temporary measure, the "crisis rate" applied to salaries exceeding the average monthly salary in the previous year (EUR 766 per month for 2019). The part of the salary exceeding this amount was subject to an 11% withholding tax.

[58] The OECD Database on General Competition Statistics (OECD CompStats) contains general statistics on competition agencies, including data on enforcement and advocacy initiatives. In 2020, it included data from competition agencies in 56 jurisdictions, including 37 OECD countries (36 OECD countries and the European Union), i.e. Argentina, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas): Australia, Brazil, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other), (OECD, 2020[31]).

[59] Limitations in data availability make it difficult to arrive at a complete picture of the SOE landscape: 1) reporting for this assessment has excluded public-service SOEs with the legal form of "public enterprise"; 2) the Central Depository Agency and the National Statistical Office report slightly different numbers of SOEs and state minority-owned companies (perhaps pointing to definitional differences); 3) SOEs' share of national employment is understand in the available data; and 4) valuation and financial performance data are not centrally collected/available.

[60] Calculations based on data provided by the authorities and labour force data on number of employed from the first quarter of 2020.

[61] The comparison with OECD-area SOE sectors is only an imperfect approximation, owing, among other things, to the fact that data for the OECD area is based on SOEs' share of total non agricultural employment, whereas the data used in the current assessment is based on their share of total employment.

[62] The three companies with 100% state ownership are Crnogorska Plovidba (Maritime and Coastal Freight Transport), Pošta Crne Gore (Montenegro Post) and Aerodromi Crne Gore (Podgorica Airport).

[63] Exceptionally, a public official, other than the President of Montenegro, MP, councillor, member of the Government of Montenegro, Judges of the Constitutional Court of Montenegro, Judge, the head of Public Prosecution office, Public prosecutor, Special Prosecutor for Suppression of Organized Crime, Corruption, Terrorism and War Crimes and Deputy Special Prosecutor, may be a president or member of the management body or supervisory board of a public company, public institution or other legal person in a public enterprise, public institution or other legal person owned by the state or a municipality.

[64] Information provided by stakeholders in the context of the assessment.

[65] According to data from the Central Depositary Agency, the companies currently undergoing bankruptcy proceedings are as follows: Rudnici Boksita U Stečaju A.D. Nikšić (32% of the ownership), Fabrika Elektroda Piva U Stečaju A.D. Plužine (42%), Elektroindustrija « Obod » U Stečaju A.D. Cetinje (52%), N.I.G. « Pobjeda U Stečaju » A.D. Podgorica (86%), Kombinat Aluminijuma U Stečaju A.D. Podgorica (29%), Opšte Gradevinsko Gorica U Stečaju A.D. Podgorica (31%), Radoje Dakić U Stečaju A.D. (51%), Jadransko Brodogradilište U Stečaju A.D. Bijela (62%), Dekor U Stečaju A.D. Rožaje (23%), Preduzeće za Izgradnju Podgorice A.D. Podgorica U Stečaju (29%), Mašinopromet Rezervni Djelovi U Stečaju (60%).

[66] https://balkaninsight.com/2019/12/10/montenegro-govt-to-prop-up-indebted-national-airline/

[67] The privatisation plan is prepared on the basis of proposals from the competent state administration bodies, line ministries, state funds, and the tender commissions of the Privatisation and Capital Projects Council. The privatisation plan must contain: 1) the objectives of privatisation; 2) the approach and detailed conditions and deadlines for its execution; 3) privatisation methods; and 4) a list of companies including the number and ownership structure of shares to be privatised in each company and details of the social aspect of privatisation. Annual privatisation plans are published in the media. They can be updated on a proposal by the competent ministries, on the initiative of the potential investor, or on the proposal of the owner of part of the share capital, in the case of companies that are covered by the decision on the privatisation plan for that year.

[68] For the purpose of this profile, the instruction system refers to teaching and learning processes that take place in school education. It generally consists of curricula, standards for schools and student learning, assessment and evaluation frameworks and other elements that support instruction.

[69] The Bureau for Education Services is a subsidiary institution of the Ministry of Education with responsibilities for monitoring, improving and evaluating pre-university education.

[70] Instrument for Pre-Accession Assistance (IPA) are funds provided by the European Union to help candidate economies align their policies and strategies with EU standards.

[71] The PISA 2018 reading assessment in Montenegro revealed that general/modular programmes had an average of 22% low performers while vocational programmes had 55% (OECD, 2020[234]).

[72] The Centre for VET sets occupational standards, qualifications and offers professional development for VET teachers.

[73] The Bureau for Education Services is responsible for setting general education curricula within VET programmes.

[74] All three-year and four-year programmes in vocational schools have a prescribed minimum portion of classes that is implemented by the employer. The total portion of practical classes ranges from 15% in four-year programmes to approximately 50% in three-year programmes.

[75] Montenegro plans to make Masters studies tuition free in 2020-21.

[76] Selection into higher education requires successful completion of upper-secondary education and a minimum score on the State Matra examination. Specific requirements are set by individual higher education institutions and certain study areas may require an additional entrance examination.

[77] For example, the University of Montenegro has its own Strategy for Internationalisation.

[78] The timeframe refers to 2015-2019, Q2, (World Bank and WIIW, 2020[120]).

[79] Not including the UK.

[80] Administrative data provided by Montenegro.

[81] In December 2019, Parliament enacted a new Labour Law, meant to bring national law in line with the EU directives 2006/54/EC on equal opportunities in employment and 92/85/EEC on pregnant workers, although further progress still needs to be made on alignment with the latter directive.

[82] The new Labour Law is designed to bring national law in line with the EU directives 2006/54/EC on equal opportunities in employment and 92/85/EEC on pregnant workers, although further progress still needs to be made regarding alignment with the latter directive (EC, 2020[35]).

[83] The tasks of labour inspectorates are ruled by the Law on Labour Inspection (Official Gazette no. 79/08 & 40/11), the Labour Law, the Law on Occupational Health and Safety and the General Collective Agreement, as well as the Law on Foreigners (Official Gazette, no. 12/18, 03/19).

[84] The number of available jobs for labour inspectors is 53 (37 in labour relations, including the chief inspector, and 16 in occupational health and safety). A total of 42 inspectors are actually employed, 32 in labour relations, including the chief inspector and 10 in occupational health and safety (Ministry of Public Administration of Montenegro, 2020[113]).

[85] These include the Employment and Social Reform Programme 2015-2020, Strategy for Regional Development 2014-2020, the Youth Strategy 2017-2021, the sectoral operational programme for Montenegro on Employment, Education and Social policies 2015-201, Women's Entrepreneurship Development Strategy 2015-2020, Lifelong Career Guidance Strategy 2016-2020, Strategy for Integration of Persons with Disabilities 2016-2020; and the strategy for Combating the Grey Economy.

[86] These measures are defined in the action plan for Combating the Grey Economy and include: 1) establishing an institutional mechanism for measuring and estimating the grey economy and calculating the tax gap; 2) establishing an appropriate institutional model for measuring the grey economy and its share in GDP; 3) eliminating administrative burdens in a way that reduces both operating costs and the time required to fulfill obligations to the state; 4) improving the regulatory framework in the field of fiscal policy, labour legislation and social policy. The goal of fiscal policy measures is to reduce the benefits, on the one hand, and increase the costs and risks of joining the grey economy, on the other. Therefore, the most important measures in the field of fiscal policy would be to reduce the cost of applying taxes and reduce tolerance of the grey economy. Reducing the costs of tax application could be achieved by reducing the number and simplification of tax procedures, and introducing the obligation to file tax returns and communicate with tax authorities electronically.

[87] The social partners are the Montenegrin Employers Federation and the Confederation of Trade Unions of Montenegro.

[88] The ratio of wage and salary earners that are trade union members to the total number of wage and salary earners in the economy (ILO, 2008[291]).

[89] According to an interview by the local independent consultant with stakeholders.

[90] Information provided by external expert.

[91] See for details ILO (2019), Decent Work Programme 2019-2021 Montenegro.

[92] When the level of education or qualification is less or more than required (ILO, 2014[288]).

[93] Comprising the Law on Adult Education, Adult Education Strategy 2015-2025, Adult Education Plan 2019-2022, and the Law on National Professional Qualifications.

[94] Information provided by the government.

[95] Information provided by the government.

[96] Information provided by the government.

[97] The Ministry of Labour and Social Welfare and the Ministry of Education run the Strategy for Development of Women's Entrepreneurship 2015-2020 (under the Ministry of the Economy), the Strategy for Lifelong Entrepreneurial Learning 2020-2024 (promoting female entrepreneurship) and the Strategy for Development of Micro, Small and Medium Enterprises in Montenegro 2018-2022, which aims at promoting female, youth and social entrepreneurship. The objective of the Action Plan for Achieving Gender Equality 2017-2021 consists of increasing women's employment.

[98] The programme reached the most vulnerable group of unemployed people, as reflected in the structure of the participants: 96% were female, almost two-fifths (38%) were older than 50, more than one-fifth (22%) were long-term unemployed and almost one-half were from the northern region, which has a much higher unemployment rate as compared than other areas of Montenegro. In total, 8.3% of total funds for ALMPs were spent on this programme, see (Employment Agency of Montenegro, 2019[319]).

[99] The budget is sourced from employers and employees' contributions to unemployment insurance (0.5% of wages), special contributions for the employment of persons with disabilities, income from the repayment of loans for self-employment, income from sold shares in privatised companies, assets and other income.

[100] Information provided by EAM.

[101] There was no difference between EU-28 and EU-11 average.

[102] In 2018 there were 29 366 vacancies published, and in 2015 35 574 vacancies through 18 367 vacancy applications (administrative data received from the government of Montenegro)

[103] Official Gazette of Montenegro no. 74/2019 on December 30. Labour Law, Article 24; Law on Mediation in Employment and Rights during Unemployment, Article 26.

[104] However, the number of unemployment benefit recipients who were self-employed in relation to the total number of cash benefit recipients is negligible.

[105] Information provided by the government.

[106] Information provided by EAM.

[107] The programme is carried out in accordance with the Law on Professional Training of People with Acquired Higher Education (Official Gazette, No. 38/12).

[108] See Uljarević, M., Lazić, M., & Krstić, G. (2014). Informal Employment and the Grey Economy in Montenegro Survey. IPSOS. (Uljarević, Lazić and Krstić, 2014[302])

[109] Information provided by the government.

[110] There is a clear link between access to quality and accessible childcare and female employment, (OECD, 2016[290]).

[111] Horizon 2020 is the biggest European Union's framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument. (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020).

[112] Eureka is the largest intergovernmental network for cooperation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and innovation or offers advice, through various programmes (such as EUREKA Clusters, Globalstars, InvestHorizon) (https://www.eurekanetwork.org/).

[113] European Cooperation in Science and Technology (COST) is an EU-funded, intergovernmental framework, currently gathering 38 Members and 1 Cooperating Member. It is a funding organisation for the creation of research networks (COST Actions), which offer an open space for collaboration among scientists across economies. COST funding is intended for collaboration activities and complements national research funds (https://www.cost.eu/who-we-are/about-cost/).

[114] EURAXESS - Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated countries. It supports researcher mobility and career development and enhances scientific collaboration (https://euraxess.ec.europa.eu/).

[115] In November 2016, the government adopted the Decree on Amendments to the Decree on the Organization and Manner of Work of the State Administration, which seized operation of the Ministry of Information Society and Telecommunications. Since the adoption of the Regulation, the Directorate for Electronic Communications, Postal Services and Radio Spectrum has been under the responsibility of the Ministry of Economy, and the Directorate for the Development of Electronic Government (the field of electronic administration and electronic commerce) is in the Ministry of Public Administration. In December 2020, the government adopted the new Decree on the Organization and Manner of Work of the State Administration, according to which the responsibilities of the previous Ministry of Economy fell under the authority of the Ministry of Economic Development.

[116] The project is co-funded by the EU. It involves an initial grant of EUR 520 000, followed by potential investment loans from the Western Balkans Investment Framework (WBIF), and the European Investment Bank (EIB) (https://wbif.eu/project/PRJ-MNE-DII-001).

[117] For details see https://www.worldbank.org/en/country/kosovo/brief/balkans-digital-highway-initiative

[118] The EKIP has prepared broadband mapping through a geographically referenced database of installed electronic communications infrastructure based on data provided by the operators, including telecommunications ducts, poles and buildings, as well as elements like cables, equipment etc. The EKIP is in the process of upgrading this database for mapping broadband access (http://ekinfrastruktura.ekip.me/ekip/login.jsp).

[119] The most recent regulations adopted include the ordinance on the type, manner of submitting and publishing data on electronic communications infrastructure and related equipment that may be of interest for joint use (2018); the rulebook on determining the data transfer speed for functional Internet access via the Universal Service (2018); the rulebook on types of benefits and special measures for access to public electronic communication services for persons with disabilities (2017); the rulebook on providing access to persons with disabilities number 112 and emergency numbers (2017); the rulebook on the quality of public electronic communication services (2018); the rulebook on conditions and manner of prevention and suppression of abuses and fraud in the provision of electronic mail services (2018), etc.

[120] The government Open Data Portal is available at www.data.gov.me.

[121] The open data hackathon "Make it accessible and useful" was organised on the 5th October 2019 by the project Odeon, co-funded by the European Regional Development Fund (ERDF) under the INTERREG Mediterranean Program 2014-2020. The competition was integrated into the Infofest 2019 Conference programme. The topic of the competition was the creation of applications that create added value from available data sets for the public administration, the business community and citizens. Six teams contributed their ideas during the hackathon (https://odeon.interreg-med.eu/pt/news-events/news/detail/actualites/hackathon-open-data-idea-presentations-in-budva-montenegro/)

[122] The Law on Electronic Government was adopted on 3 January 2020, and was applied six months later (3 July 2020).

[123] Legislation adopted in 2019 includes: the Law on Administrative Fees introducing electronic collection of administrative fees; the Law on Public-Private Partnership, regulating the possibilities of public-private partnership during the implementation of projects in the field of ICT; the Law on Fiscalisation, regulating the electronic exchange of data on collected services and goods between taxpayers and the Tax Administration in real time; and the Law on Public Procurement, prescribing the implementation of electronic public procurement.

[124] The e-Government portal is available at: http://www.euprava.me/

[125] In June 2018 the government adopted the Strategy for the Development of the Integrated Health Information System and e-Health for the period 2018-2023, and an action plan for the period 2018-2021. The Framework for Interoperability of the Health System was also adopted and represents the basic act and guidelines for establishing a complete system of interoperability of all existing and future information systems within the entire health system in Montenegro. Several other new services have been developed including e-scheduling, e-recipes, e-results, e-pharmacies, e-insurance, e-ordering and e-exercising rights.

[126] In 2019 the Ministry of Economic Development gathered a variety of programmes under its responsibility into the single Programme for Improving the Competitiveness of the Economy. It consisted of 10 programme lines in 2019, offering financial and non-financial support to potential and existing entrepreneurs, micro, small, medium and large enterprises, as well as clusters. Financial support is available to help firms to hire consulting services to incorporate ICT solutions into their business practices and purchase necessary hardware or software. Certain programme lines, e.g. for innovation enhancement and for implementing international standards, were especially attractive for ICT companies. In 2020, a new, improved programme was prepared, comprising 13 programme lines that meet the needs and requests of the SME sector, with a separate programme line for business digitalisation (http://www.mek.gov.me/program_za_unapredjenje/).

[127] The programme finances up to 80% of justified costs (excl. VAT), and up to EUR 5 000 (excl. VAT) for companies in which women and/or people under the age of 35 make up at least 50% of the ownership structure.

[128] http://www.mek.gov.me/ministarstvo

[129] Data sourced from Eurostat:
https://ec.europa.eu/eurostat/databrowser/view/isoc_ec_eseln2/default/table?lang=en

[130] Informatics and technics is a compulsory subject taught from the fifth to the eighth grade in primary schools, while informatics is taught in the first and second grade in secondary schools. Elective subjects on digital skills are also available in primary and secondary schools, including algorithms and programming, computer and web presentations, and business informatics. In secondary vocational schools, there are various elective subjects in the field of digital literacy. Students also use a range of software packages: AUTO CAD, ARHICAD, FIDELIO, etc. and study subjects and modules such as: introduction to programming, databases, introduction to web programming, web application development, mobile application development, web and mobile communication services, advanced front-end programming, software project management and others using digital technologies (https://zzs.gov.me/naslovna/programi/gimnazija).

[131] Global Kids Online was developed as a collaborative initiative between the UNICEF Office of Research-Innocenti, the London School of Economics and Political Science (LSE), and the EU Kids Online network. The project aims to connect evidence with the ongoing international dialogue regarding policy and practical solutions for children's well-being and rights in the digital age. The Global Kids Online network is active in Montenegro, where the GKO Montenegro project was carried out in 2015/16 and involved a survey and qualitative research with children aged 9-17, their parents and schools' representatives.

[132] Including a EUR 6 million loan from the European Investment Bank.

[133] The British Council, under the project "21st Century Schools" has trained 537 primary school teachers from 95 primary schools and is set to train a total of 800 teachers by the end of the project in 2022.

[134] The reports contain information about the institution, the conditions for programme implementation, the teaching staff implementing the programmes and the teaching methods. A questionnaire for participants obtains information on their opinion of the programme (length, content, applicability of acquired knowledge, etc.), the competence of the teaching staff and the conditions under which the programme was implemented (http://www.cso.gov.me/).

[135] A list of all people subject to self-isolation was published upon the decision of the National Coordination Body and positive opinion of the Agency for Personal Data Protection. In July 2020, the Constitutional Court declared the decision to be in violation of the Constitutional right to privacy and annulled it. The list was subsequently used by a private individual to create a mobile application allowing users to locate those in self-isolation. In April 2020, a list of more than 60 persons infected with the virus, containing their names, birth data and ID numbers, was leaked. In May 2020, an indictment was lodged in this case against one defendant.

[136] See www.uip.gov.me.

[137] A single project pipeline (SPP) is a list of projects developed using a strategic tool for project planning to avoid an ad hoc approach to planning preparation and implementation of investment projects. The SPP helps to ensure strong project prioritisation, enable systematic and timely planning of resources, provide a reliable basis for defining proper sequencing of the priority axis and actions per sector, and help link investment planning and programme budgeting for more information, please see: https://mia.gov.me/en/home/nik). The first SPP was developed by the Technical Secretariat in 2015, before being adopted by the National Investment Committee and the Government of Montenegro. It was later updated several times, with the last update taking place in 2019.

[138] For more information, please see: http://www.eu.me/mn/pregovori-o-pristupanju/dokumenti-pregovori/category/227-izvjestaji-o-realizaciji-obaveza-iz-programa-pristupanja-crne-gore-eu

[139] European Commission Staff Working Documents outline in detail the steps taken so far and initiatives involving WB6 economies in a variety of fields, such as: moving closer towards the EU and enhancing regional co-operation, people-to-people contacts, familiarising people with the EU, civil society development and dialogue, good governance, parliamentary co-operation, trade integration, investment and economic and social development, community financial support and donor co-ordination.

[140] For more information, please see: https://ec.europa.eu/regional_policy/en/funding/ipa/cross-border/

[141] The following elements should be developed during the project selection using the Project Identification Form: coherence with the valid EU policies and strategies; contribution to valid national development objectives; coherence with national Transport Sector Strategic framework; improving intermodality; providing connection to TEN-T corridors; contribution to improvement of the safety and security conditions; improving the characteristics, capacity of the infrastructure (new, upgraded or rehabilitated); impact on the annual traffic demand growth (traffic of freight and passengers); improving accessibility (no. of persons affected); impact on the environment (possible mitigation measures, climate change limitation actions); contribution to overall economic growth (effects on economic environment of the economy and economies in the area); integration with other projects; existence of alternative transport solutions in the same connection; improving transit/transport facilities, mobility, access to new markets, jobs, education; definition of the project - adequate solution, contribution for solving the transport needs; capacity of the proponent related to the project; does the project enhance connectivity; does the project have cross-border impact or impact on other economies in the region; can the project in any other way be earmarked as a regional project; does the project generate revenues from end users; description of the implementation and monitoring capacity of the beneficiary (e.g. technicians who can assess and monitor projects, inspect the works, monitor contracts).

[142] Environmental Law (2016), Law on environmental impact assessment Law on strategic environmental assessment, for more information, please see: https://epa.org.me/regulativa/

[143] Concession Law (Official Gazette of Montenegro No. 93/2019, https://me.propisi.net/zakon-o-koncesijama/), PPP Law (Official Gazette of Montenegro No. 93/2019, http://www.ujn.gov.me/zakon-o-javno-privatnom-partnerstvu-sluzbeni-list-crne-gore-br-073-19-od-27-12-2019/), Law on the Prevention of Corruption (Official Gazette of Montenegro No. 93/2019 42/2017) https://www.paragraf.me/propisi-crnegore/zakon_o_sprjecavanju_korupcije.html), Public Procurement Law (Official Gazette of Montenegro No. 74/2019, https://www.paragraf.me/propisi-crnegore/zakon-o-javnim-nabavkama.html).

[144] The Rulebook on implementation of small value procurement (2017) issued by Ministry of Trasport and Maritime Affairs shall regulate the initiation, implementation and finalisation of the procedure of procurement of goods and services with estimated value under EUR 15 000, i.e. the procurement of works with estimated value under EUR 30 000 (hereinafter: small value procurement) in the Central Bank of Montenegro, if the Central Bank does not implement this procurement in line with the public procurement procedure referred to in Article 20 of the Public Procurement Law.

[145] A one-stop-shop is a business or office where multiple services are offered; i.e., customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one location, instead of having to "drive all over town" to attain related services at different stores. One-stop shop is a way of facilitating trade.

[146] An appropriate definition of “asset management” for the roads sector is the one proposed by the OECD in 2001: “A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organized and flexible approach to making the decisions necessary to achieve the public’s expectations” (OECD, 2001[258]).

[147] Please see: https://uzs.gov.me/vodici/Road_Safety_Assessment_o_Montenegro

[148] Safety Culture is a civil aviation safety programme. The State Safety Programme (SSP) is an integrated set of regulations and activities aiming to improve safety (e.g. safety risk management, safety assurance).

[149] Please see: https://www.eurocontrol.int/service/local-single-sky-implementation-monitoring. The Local Single Sky Implementation (LSSIP) documents are the annual expression of commitment by civil and military domestic organisations (regulators and supervisory authorities), service providers and airport operators, to the implementation of the European ATM Master Plan.

[150] Transport of passengers by specific transport mode over total transported passengers.

[151] Please see: http://www.eu.me/mn/pregovori-o-pristupanju/dokumenti-pregovori/category/227-izvjestaji-o-realizaciji-obaveza-iz-programa-pristupanja-crne-gore-eu

[152] Some of the indicators currently used to measure the performance of the road network are as follows: traffic flows, International Roughness Index, coefficient for HGVs (daily traffic divided by axis/axle weight). One of the projects for assessing the road network (1853 km of the highway and state roads network) is the Road Safety Assessment Program, https://msp.gov.me/en/news/227711/Road-Safety-Assessment-project.html

[153] Directive (EU) 2017/2397 of the European Parliament and of the Council of 12 December 2017 on the recognition of professional qualifications in inland; Directive (EU) 2016/1629 laying down technical requirements for inland waterway vessels; Regulation (EU) 2016/1628 on requirements relating to gaseous and particulate pollutant emission limits and type-approval for internal combustion engines for non-road mobile machinery.

[154] Specifically, with the EU Strategic Plan on Road Safety (2018), https://eur-lex.europa.eu/resource.html?uri=cellar%3A0e8b694e-59b5-11e8-ab41-01aa75ed71a1.0003.02/DOC_2&format=PDF; Road Safety Priorities for the EU 2020-2030 (2019), 2019-07-New-EP-briefing-1.pdf (etsc.eu)

[155] For more information, please see: https://www.who.int/roadsafety/events/unrsc_12_appendix_11.pdf

[156]For more information, please see: https://www.transport-community.org/wp-content/uploads/2020/10/Action-Plan-for-Road-Safety.pdf

[157] For more information, please see: European Commission, EU Road Safety Policy Framework 2021-2030 - Next steps towards "Vision Zero" - https://ec.europa.eu/transport/sites/transport/files/legislation/swd20190283-roadsafety-vision-zero.pdf

[158] For more information, please see: https://www.monstat.org/eng/index.php

[159] These include: 1) An increase in share of renewable energy sources and promote the rational use of energy. This could be achieved through the promotion and introduction of electrical, hybrid and natural gas-fuelled cars, higher share of biofuels, alternative forms of mobility (cycling), public city and intercity transport, eco-rides, diverting cargo trucks to railway transport, improving the organisation and efficiency of road transport in cities and applying integrated concepts ("smart" cities). 2) By 2030 GHG emissions levels should be reduced by 30% compared to 1990 baseline. 3) Develop and promote practice and solutions for sustainable consumption and production that support the efficient use of natural resources and minimise environmental loads. 4) By 2030 in transport implement new technologies (low emission vehicles, low fuel consumption, alternative fuels), promoting forms of transport with less impact on the environment; define and implement incentives including tax exemptions; recycle vehicles at the end of their lifetime. 5) Increase rail freight traffic from 20% to 50%, and increase the share of electric rail freight traffic from the current 33% to 70%; decrease truck transportation from the current 55% share in overall cargo transportation to 40% by 2030. 6) Promote a 5% reduction in fuel used by trucks; introduce hybrid electric vehicles; increasing the share of passengers who use public buses from 5% in the baseline year to 36% by 2030; increase by 30% the efficiency of vehicles using diesel and petrol (hybrid vehicles) and 20% increase in the efficiency of LNG vehicles and buses by 2030.

[160] Combined transport refers to the transport of goods between Member States where the lorry, trailer, semi-trailer (with or without tractor unit, swap body or container of 20 feet or more) uses the road on the initial or final leg of the journey and rail or inland waterway or maritime services on the other leg, where this section exceeds 100 km as the crow flies.

[161] Timeliness of shipments in reaching destination within the scheduled or expected delivery time.

[162] Ability to track and trace consignments.

[163] For more information, please see: Preparation of Maintenance Plans 2019-2023 for Road/Rail TEN-T indicative extensions to WB6, https://www.transport-community.org/library/reports/

[164] For more information, please see: European Environmental Agency (200-2020), Transport and Environment Reporting Mechanism, https://www.eea.europa.eu/publications/Term_summaries

[165] Please note that there has been a recent change in the line ministry as regards energy and energy efficiency, with the portfolio being shifted away from the Ministry of Economy to the newly formed Ministry of Capital Investments. While it is too soon to make a conclusive judgement on whether this will have a positive or negative impact, what is sure is that it will be essential for the energy sector that the transfer is done in a smooth, speedy, sustainable, and transparent manner.

[166] Network codes were established under Article 6 of European Union regulation 714/2009 and are secondary acts, in many cases of a technical nature, to overcome the legislative gaps and barriers in pursuing a non-discriminatory, open internal EU energy market through uniform regulation. In essence they overcome barriers and friction to competition. In some sense, these represent lessons learned over time that aim to perfect the legislative framework for the EU's internal energy market and reflect the EU's standard based on best practice. Gaps in implementation imply that gaps in ensuring a competitive market. Thus not all international good practice is in place in Montenegro. For more details see, for example, (ENTSOE, 2021[322]), (EC, 2021[330]), Florence School of Regulation (2021[268]), and Meeus and Schittekatte (2018[269]).

[167] More precisely, Article 32 Paragraph 2 of the Energy Law stipulates that the government has the final decision on shortlisting their preferred candidate for the regulatory board to parliament and not to the independent selection committee, while Article 40 Paragraph 2 of the Energy Law requires government approval for the internal structure of the regulator. Both paragraphs imply that there could be political influence on the regulator.

[168] The amendments allow for the imposition of sanctions of up to 10% of a company's annual turnover, thus providing a sufficiently dissuasive sanction. This is international good practice and an important instrument of EU regulation.

[169] The policy's third main priority is sustainable energy development, including the "increased use of renewable energy sources" (Ministry of Economy, 2011[169]).

[170] The precise approach to support prosumers differs depending on a wide range of economic specific circumstances. For example, if most dwellings are multihousehold owned, then any promotion of prosumers needs to include regulation to facilitate agreement on installation, ownership, and operation of renewable energy infrastructure in the multi-household dwellings. Additionally, financial support might need to be tailored to improving existing metering system. That is, net metering would be a good approach for supporting deployment of prosumers, however, this would mean, potentially, upgrading metering infrastructure. For more information on prosumers, the current legislative framework and how to support them please see (ERCB, 2020[336]), (European Parliament, 2016[337]), and (PROSEU, 2020[338]).

[171] A Guarantee of Origin (GO) is a tracking instrument defined in Article 15 of the European Directive 2009/28/EC on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC. GO are certificates used to identify and certify that specific consumed electricity was sourced from renewable energy. A certificate is issued per MWh generated from renewable energy to the generator and then transferred to and cancelled by a consumer or supplier who would like to certify that their consumed energy comes from renewable energy. For more information on GO and their use and implementation, see (Association of Issuing Bodies, 2020[334]) or (Umweltbundesamt, 2021[335]).

[172] For a comprehensive list of secondary legislation relating to energy efficiency and their status, please see https://www.energy-community.org/implementation/Montenegro/secondary.html.

[173] For a detailed overview of the ESCO market in the Western Balkans please see Panev et al. (2018[264]). For a global overview please see IEA (2018[261]).

[174] For the relevant Energy Community website please go to: https://www.energy-community.org/implementation/Montenegro/reporting.html.

[175] Balancing markets are an integral part of any energy market. Most markets are settled in advance of physical delivery, as in an organised market forecasted supply is matched with forecasted demand (i.e. the market is cleared). However, to maintain the actual system stability at the moment of delivery, it is essential that the same amount of actual energy is fed into the system as is taken out. To this end, the balancing market is used in as close to real time as possible to correct for any mismatch between what is actually generated and fed into the system and what is taken out of the system for consumption. It is essential that all generators, including renewable energy generators, are "imbalance responsible" as this means that they are liable for any mismatch between their forecasted and generated/delivered electricity. If they were not imbalance responsible, other entities or the consumer would need to cover the cost arising from the imbalance caused by the generator, which would also disincentive the generator to be precise with their forecast. For more detailed explanations of balancing market and design options please see van der Veen and Hakvoort (2016[265]), (Pinson, 2020[267]), Bundesnetzagentur (2020[311]), and 50hertz (2020[307]) and ACER (2020[309]) for an overview of the relevant EU legislation for electricity balancing.

[176]For further information see European Commission (EC, 2017[325]) or the Crossbow project website (Crossbow, n.d.[313]).

[177] For further information see European Commission (2019[327])and European Commission (2019[328]) or the Trinity project website http://trinityh2020.eu/.

[178] EU Horizon 2020 is the EU's flagship Research and Innovative Program that provides financial support of around EUR 80 billion from 2014 to 2020 for research and implementation in key areas including energy. For more details please see (EC, 2020[329]).

[179] For further information please ACER (2020[308]) and ENTSOE (2020[321]).

[180] For more information, please see https://ec.europa.eu/taxation_customs/news/commission-launches-public-consultations-energy-taxation-and-carbon-border-adjustment-mechanism_en.

[181] The Paris Agreement was signed in 2016 and ratified in 2017, and Montenegro ratified the Kyoto Protocol in 2007 (UNFCCC, 2020). Montenegro has also adopted the Law on Ratification of the Kigali Amendment to the Montreal Protocol and the Law on Ratification of the Doha Amendment to the Kyoto Protocol.

[182] Other strategies that take into account climate change in Montenegro are the Nationally Determined Contribution to the reduction of GHG emissions - NDC, the National Strategy for Sustainable Development (NSSD) until 2030, Smart Specialization Strategy (S3) (2019–2023), and the Disaster Risk Reduction Strategy with a Dynamic Action Plan for the implementation of the strategy for the period 2018-2023.

[183] The project focuses on floods around rivers and lakes and not on other potentially affected areas. There have been some instances where soil erosion caused by deforestation has resulted in floods in the northern part of Montenegro, for which the inhabitants and public services were not properly prepared.

[184] Work has begun to construct a recycling yard with a sorting plant in the municipality of Berane. Preparation is also underway to create a recycling yard with a sorting and transfer station in Pljevlja and a recycling yard in Kolašin.

[185] The Decree on Detailed Elements and Methodology for Determining the Prices of Communal Services (Official Gazette of Montenegro, No. 55/20), adopted on the basis of the Law on Communal Services prescribes the manner for determining the prices of communal services, including waste management services. The Decree on Detailed Elements and Methodology for Determining the Prices of Utility Services prescribes four models for calculating the waste management fee: a model based on the area of the facility used by the service user; a model based on the number of household members; a model based on the mass of municipal waste taken over by the service user; and a model based on the volume of municipal waste taken over by the service user.

[186] Funds have been allocated from the budget of the ministry in charge of waste management for this project, which aims to strengthen environmental awareness of the need for separate waste collection and the use of waste as a resource, with recommendations for the effective establishment of a system of separate collection of municipal waste, reuse and recycling.

[187] The team "Zero Waste Montenegro" has been mapping illegal landfills through different projects. More information on: https://www.zerowastemontenegro.me/.

[188] The Water Competition Index measures the amount of water available in an economy as a function of population (quantity of water divided by number of persons with access to a unit volume of water) (EEA, 2015[182]).

[189] Among the EU countries, Finland recorded the highest freshwater resources (with a long-term average of 19 950 m³ per inhabitant) followed by Sweden (19 410 m³). Freshwater abstraction by public water supply ranged across the EU from a high of 179 m³ of water per inhabitant in Greece (2016 data) down to a low of 31 m³ per inhabitant in Malta (2017 data, EUROSTAT).

[190] Freshwater management is regulated by the Law on Waters (Official Gazette of the Republic of Montenegro no. 27/07, and Official Gazette of Montenegro no. 32/11, 48/15 and 52/16) and by the Water Management Strategy 2016-2035. In addition, the Law on Municipal Wastewater Management was adopted in 2017.

[191] Law on Provision of Healthy Water for Human Use (Official Gazette of Montenegro, No. 80/17), Decision on the Designation of Sensitive Areas (Official Gazette of Montenegro, No.46/17) and General Plan for Protections against harmful effects of water, for waters of significance to Montenegro, for the period 2017-2022 (Official Gazette of Montenegro No. 17/17).

[192] The Aichi Biodiversity Targets cover the 2011-2020 period. This plan provided an overarching framework on biodiversity, not only for the biodiversity-related conventions, but for the entire United Nations system and all other partners engaged in biodiversity management and policy development. Parties agreed to translate this overarching international framework into revised and updated national biodiversity strategies and action plans within two years, which are intended to define the current status of biodiversity, the threats leading to its degradation and the strategies and priority actions to ensure its conservation and sustainable use within the framework of the socio-economic development of the country. There are 20 Aichi biodiversity targets grouped around 5 strategic goals: A: Address the underlying causes of biodiversity loss by mainstreaming biodiversity across government and society; B: Reduce the direct pressures on biodiversity and promote sustainable use; C: Improve the status of biodiversity by safeguarding ecosystems, species and genetic diversity; D: Enhance the benefits to all from biodiversity and ecosystem services; and E: Enhance implementation through participatory planning, knowledge management and capacity building (Convention on Biological Diversity, 2020).

[193] In relation to Aichi Target 11, no marine protected areas are established yet in Montenegro, although the target was set at 10% by 2020. Research is currently being conducted into three potential marine protected areas: Platamuni, Katič and Stari Ulcinj.

[194] The Law on Agricultural Land (OG of the RMNE, No.015/92, 059/92, 027/94, "OG of MNE ", no. 073/10, 032/11) regulate agricultural land.

[195] The most recent data (2017) indicate the economy's annual mean concentration of particulate matter ($PM_{2.5}$) to be 21 μg/$m^3$, exceeding the recommended maximum of 10 μg/m3. This is below the WB6 average of 25.77 μg/$m^3$ (in 2016) (EEA, 2019[317]).

[196] Except for Directive 2016/2284 on the reduction of national emissions of certain atmospheric pollutants, which was being transposed at the time of writing.

[197] According to the latest implementation report (July 2019 for the year 2018), most measures had been implemented (more than 50% of those planned). According to the implementation report for 2017, all the measures related to the national air quality management strategy for 2017 had been undertaken.

[198] These include replacing asbestos pipes in all municipalities and reducing losses from the water system.

[199] Primary treatment of (urban) wastewater uses a physical and/or chemical process involving settlement of suspended solids, or other processes in which the biochemical oxygen demand ($BOD_5$) of the incoming wastewater is reduced by at least 20% before discharge, and total suspended solids reduced by at least 50%. Secondary treatment generally involves biological treatment (use of bacteria to digest the remaining pollutants) with a secondary settlement or other process, resulting in a BOD removal of at least 70% and a chemical oxygen demand (COD) removal of at least 75%. Tertiary (advanced) treatment is a treatment (additional to secondary treatment) of nitrogen and/or phosphorus and/or any other pollutant affecting the quality or specific use of water (microbiological pollution, colour etc.) (OECD, 2020[286]).

[200] A vast array of contaminants that have only recently appeared in water are of concern because they have been detected at concentrations significantly higher than expected and/or their risk to human and environmental health may not be fully understood. Examples include pharmaceuticals, microplastics, industrial and household chemicals, personal care products, pesticides, and their transformation products (OECD, 2020[287]).

[201] The project is implemented by the Ministry of Ecology, Spatial Planning and Urbanism, UNDP, CEDIS, UNIPROM KAP and other holders of equipment containing PCBs.

[202] However, according to the Agriculture Census 2010, of Montenegro's 620 029 inhabitants, 98 341 were engaged in agricultural activities on family agricultural holdings, indicating that people actually engaged in agriculture account for almost 30% of the total number employed (SDARAM, 2015). These workers are either registered as unemployed or are partly employed in other sectors.

[203] Support is provided for: 1) constructing local roads (serving single or groups of agriculture holdings, as well as for access to summer mountain pastures); 2) constructing water supply facilities in rural areas; 3) constructing and reconstructing existing public facilities in local communities (schools, health centres, veterinary stations, livestock and green markets, etc.); 4) solving local environmental protection issues, and renovating mountain "katuns" (huts); and 5) purchasing solar panels.

[204] Field crops, fruit production, vineyard production, vegetable production, livestock production, veterinary, milk production, tobacco production, meat production, bakery technicians, etc.

[205] One high school in Bar is vocational, while the schools in Podgorica, Berane, Andrijevica and Savnik are mixed.

[206] The Water Law defines the legal status and approach to integrated water management, including water and coastal land and water facilities, conditions and manner of carrying out aquatic activities and other issues of importance for water management and water resources. This includes territorial water management; use of water (for water supply, irrigation, bottling, fish farming, production electricity, navigation, sports and recreation, etc.); protection of waters against pollution, while defining areas of special protection of waters, vulnerable areas and plans for protection against pollution, monitoring; watercourse regulation and protection against harmful effects of waters (defining areas in danger of floods, protection against erosion and floods, etc.).

[207] Rulebooks on conditions for the treatment of stocks of plant protection products in case of the abolition of the Decision on the registration of plant protection and Rulebook on the content of the list of active substances permitted for use in plant protection products, 2019.

[208] Rulebook on maximum residue level of plant protection products on or in plants, plant products, food or feed, 2019.

[209] Rulebook on conditions regarding professional personnel, equipment and devices to be fulfilled by legal entities for the performance of professional tasks for the verification of the technical correctness of the device for the use of plant protection products, 2020.

[210] Market pricing policy measures cover direct payments for: 1) annual crops (vegetables, cereals, tobacco (per ha); 2) livestock production (per head); 3) milk buy-out per litre; and 4) planting material production (per piece). In addition, there are the support measures for the production of wine and honey, as well as for risk management measures. These include support to farmers to insure their crops and livestock against the long-term negative consequences of damage caused by weather conditions and other unexpected events.

[211] Rural development measures cover support for investments in modernising production technology, including standardisation, mechanisation and equipment; irrigation, support for young farmers, co-operatives, buy-out centres and strengthening the buy-out network for the milk industry. In addition, rural development measures also cover agri-environment measures, organic farming, as well as farm diversification activities and rural infrastructure.

[212] This part of the budget is dedicated to social transfers to the rural elderly population – a kind of social welfare (retirement) package.

[213] This applies to: cereals, rice, sugar, olive oil and table olives, flax and hemp, bananas, wine, live wood, beef and veal, pork, lamb and goat meat, chicken, milk and dairy products, eggs and ethyl alcohol of agricultural origin.

[214] Cereals, rice, sugar, olive oil and table olives, fresh and processed water and vegetables, wine, beef and veal, pork, lamb and goat meat, chicken, milk and dairy products.

[215] The special provisions apply specifically to imports of a mixture of cereals, rice or cereals and rice.

[216] Including the Food and Agriculture Organization (FAO) of the United Nations, AdriaMed, Higher Education Research and Development Project (HERD, funded by Norway), Mediterranean Halieutic Resources Evaluation and Advice Project (MAREA, EU-financed), and Instrument for Pre Accession Assistance (IPA, EU-financed).

[217] Such as Ministry of Finance, Ministry for Economic Development, MTE, SME Development Agency (SMEDA), Ministry of Tourism and Environment (MTE), Ministry of Agriculture, Forestry and Water Management, municipalities, MTE, Ministry of Health, Labour and Social Welfare, Ministry of Education and Science (with universities), etc.

[218] Decision on the appointment of the Tourism Council. Published in the Official Gazette No. 89/2017 of 27 December 2017)
https://www.gov.me/naslovna/Savjetodavna_tijela/Savjet_za_turizam/202536/Obrazovan-Savjet-za-turizam.html

[219] https://www.montenegro.travel/en/objects/tourism-organizations

[220] Law on Statistics, the Law on Tourism and Hospitality, the Law on Tourism Organisations.

[221] Private accommodation such as rented accommodation in houses, rooms and apartments are not included in the statistics.

[222] MONSTAT Dashboard for Tourism: http://monstat.org/eng/pxweb.php

[223] Official Gazette of Montenegro" No. 72/09, 39/13 and 17/19.

[224] Hotels, motels, boarding houses, touristic settlements, wild beauty resorts, rooms, touristic apartments, guesthouses, camps, rural households.

[225] https://www.montenegro.travel/en

[226] For the natural and cultural-historical area of Kotor; for the historical core of Cetinje; for medieval tombstones and Necropolis Grčko groblje and Bare Žugića, Novakovići in Municipality Žabljak, and Grčko Groblje, Šćepan Polje in Municipality Plužine; and for the Besac Fortification.

[227] Project website: https://www.rcc.int/tourism

[228] Project website: http://www.lowcarbonmne.me/

[229] Montenegro Investment and Business Opportunities. Fourth Edition. Ministry of Foreign Affairs. Podgorica July 2019.

[230] Including reduced local community fees, lower import VAT for delivery of products and services for the construction of 5-star hotels, and a lower VAT (7%) on food and beverage in hotels with at least 4 stars in the northern region and at least 5 stars in the central and southern region.

[231] Website of the APC: https://www.antikorupcija.me

[232] The Law on Civil Servants and State Employees, the Code of Ethics of a Judge, the Code of Ethics of Public Prosecutors, the Code of Ethics of a Representative.

[233] Regarding the obligation to advertise, mandatory details of the advertisement, time limit for a decision on the selected candidate, and the legal basis for the adoption of a by-law that will set out the conditions and procedures for employment.

[234] Website of the Courts of Montenegro (https://sudovi.me/sdvi); the section for the Judicial Council (https://sudovi.me/sdsv)

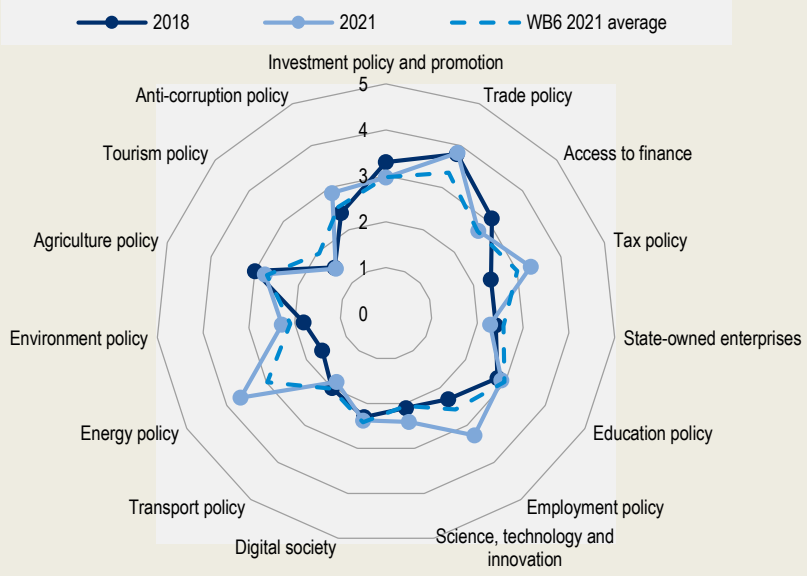
[235] Website of the Special State Prosecutor's Office: https://sudovi.me/spdt

[236] Website of the Police Administration: http://www.mup.gov.me/upravapolicije/naslovna/Nadleznost_i_organizacija

# 24 North Macedonia profile

# Key findings

## Figure 24.1. Scores for North Macedonia (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See Scoring approach section for information on the assessment methodology. Scores for Dimension 5 (Competition policy) are not included in the figure due to its different scoring methodology (see Scoring approach).

Since the publication of the 2018 Competitiveness Outlook (CO), North Macedonia has improved its performance in 8 of the 15 policy dimensions[1] scored in the assessment (Figure 24.1). Although there is clear progress in setting up polices to enhance competitiveness – at least in about half of the dimensions covered in this assessment – if they are to have a lasting impact then their effective and continuous implementation, monitoring and upgrading should remain a key priority. North Macedonia's highest average scores are in the dimensions on trade, energy, tax, employment and anti-corruption policy (above or just marginally below 3.0). North Macedonia also outperforms the WB6 average for these five policy dimensions. Its main achievements since the last CO assessment have been the following:

- **Greater international tax policy alignment and co-operation, and a stronger capacity to model and forecast tax revenues.** In August 2018, North Macedonia joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS); in January 2020 it signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. North Macedonia has prepared a first legislative draft on country-by-country reporting, based on OECD model legislation, which is currently under internal review. It also signed the Convention on Mutual Administrative Assistance in Tax Matters in June 2018, which entered into force in January 2020. Since the last assessment, North Macedonia has also strengthened its forecasting capacities and expanded its simulation models.
- **A less restrictive trade policy, greater regulatory transparency, improved public consultations and a sound e-commerce policy framework.** The conclusion of the Additional Protocol 6 on Trade in Services to the Central European Free Trade Agreement (CEFTA) in December 2019 created an important stimulus for reducing services restrictions between parties

and for making services markets more attractive to third-country investors. All 12 service sectors in North Macedonia analysed here using the OECD Services Trade Restrictiveness Index methodology have become more open. This assessment also reveals progress in increasing regulatory transparency, improving public consultations and increasing inclusiveness in trade policy. Several amendments to the 2007 Law on Electronic Commerce have continued to strengthen the e-commerce policy framework and to align it with European Commission recommendations and the Directive on Electronic Commerce 2000/31/EC.

- **Significant upgrades to the energy policy and legislative framework**. With the adoption of its Energy Law in 2018, the economy has transposed a significant part of the European Union's Third Energy Package and the Energy Community *acquis*. In December 2019 North Macedonia adopted its Energy Development Strategy 2040, aiming to increase the share of renewable energy to 35-45% of gross final energy consumption by 2040. The strategy foresees the introduction of carbon pricing and convergence with the EU's Emission Trading System. Significant efforts have also been made on energy efficiency. The Law on Energy Efficiency, adopted in February 2020, is considered best practice by the Energy Community Secretariat.
- **Better employment policies, particularly for bringing the most vulnerable into the labour market**. North Macedonia's 2018 pilot Youth Guarantee Scheme to tackle high youth unemployment is now being implemented more widely. This has seen a strong fall in the youth unemployment rate, from 44% in the fourth quarter (Q4) of 2018 to 35% in Q4 of 2019, although this is still above the WB6 and EU average. Notable improvements have also been made to co-operation between social services and employment services in order to bring vulnerable groups into employment. North Macedonia has also increased the institutional capacities of its public employment service, in particular by categorising unemployed people according to their employability profiles, the use of case management and setting up individual employment plans.
- **A strengthened national anti-corruption body.** The State Commission for the Prevention of Corruption (SCPC) has expanded its responsibilities through a 2019 law on the prevention of corruption and conflicts of interest. The SCPC has made major progress in drafting the National Strategy for Combatting Corruption and Conflict of Interest 2020-24, a holistic policy document aimed at guiding anti-corruption efforts in key sectors (the political system, judiciary, law enforcement bodies, healthcare and education) and two cross-cutting areas (public procurement and employment in the public sector). The SCPC's annual budget has also been increased, from MKD 27 million (Macedonian denar) in 2018 to MKD 55 million in 2020 (around EUR 0.9 million), although staffing concerns remain an issue given the SCPC's high caseload.

### Priority areas

Of the 15 policy dimensions in this assessment, North Macedonia scores lowest for tourism policy, transport policy, environment policy, state-owned enterprises and digital society (Figure 24.1), with its scores for tourism policy, transport policy and state-owned enterprises below the WB6 average. To improve its performance in these five policy areas, North Macedonia should:

- **Improve municipal waste and wastewater management.** Less than 1% of solid waste is recycled in North Macedonia (compared to a 47% average in the EU), meaning almost 99% goes to landfills. Moreover, only 24 wastewater treatment plants (WWTPs) were operating in 2019, which is 24.5% of the required capacity. Municipal waste management and wastewater treatment depend largely on donor funds, impeding regular maintenance. North Macedonia needs to invest in WWTPs and ensure regular maintenance of the existing network. Effective implementation of recycling and circular economy policies will require a whole-of-government approach, with collaboration among the relevant ministries to steer the transition. The government's next step should be to encourage exchanges between municipalities by helping

local government associations or environmental non-government organisations (NGOs) to develop guidelines, training and initiatives to recognise best practice.

- **Develop strategies for environmentally sustainable and combined transport.** Transport is a significant contributor to North Macedonia's emissions, at 13% of all greenhouse gas emissions in 2014. Integrating environmental sustainability goals into its transport strategy is crucial; these are currently scattered across various policy documents, making progress harder to monitor. The use of combined transport, a more environmentally friendly and cost-efficient mode of moving freight, is increasing: the total tonnage of goods transported through this mode increased by 30% in the period 2017-19. However, combined transport still accounts for only 1.3% of total freight, compared to the EU average of 6.2% in 2017. North Macedonia also lacks a policy framework to develop this mode; creating one will help it to fully capitalise on its potential.
- **Strengthen the tourism governance and institutional set up at national, regional and local levels**. North Macedonia lags behind in tourism development, mainly due to inefficiencies in the overall governance of the tourism sector. As a result, few of the policy measures in the National Strategy for Sustainable Tourism Development have been implemented. North Macedonia should establish an intra-governmental body to improve co-ordination among ministries and other public institutions, while actively involving private and public stakeholders in developing and implementing tourism strategies. The government should also develop regional and local destination management organisations, as defined in the tourism strategy. These could take over managing tourism development within individual destinations and design and implement destination tourism master plans.
- **Step up support to digital government and private sector information and communication technology (ICT) adoption, while promoting digital inclusion**. Only 25% of individuals in North Macedonia used the Internet to interact with public authorities in 2019, compared to 55% in the EU. Many important services are unsophisticated, allowing only one-way interaction. Policy makers need to prioritise and support the digitalisation of the most frequently used services. This should include harmonising legacy legislation on e-services and e-payments, while creating a publicly available dataset of e-government indicators to evaluate service quality. Digital transformation of the private sector should also be supported through an overarching national strategy and adequate financial support schemes. The public procurement of ICT products and services should include accessibility requirements to ensure digital inclusion.
- **Develop a comprehensive state ownership policy for state-owned enterprises.** The ownership arrangements for North Macedonia's centrally held state-owned enterprises (SOEs) are dispersed across the administration and there is no unified state ownership policy to guide corporate decision making on SOE performance. There has been no attempt to define, disclose or estimate the costs of SOEs' non-commercial objectives, which can be quite wide ranging, including delivering public services and supporting local employment. As a result, many SOEs are loss-making. Developing a state ownership policy that outlines the rationales for state ownership and the expectations on SOEs would be a first step towards professionalising state ownership practices. The policy should clearly outline the main principles guiding state ownership decisions, such as setting objectives and board nominations, and define the roles and responsibilities of the different state bodies responsible for state ownership decisions and monitoring SOEs' activities. At a later stage, the authorities could establish a co-ordinating entity to monitor implementation of the state ownership policy, and other subsequent policies or decisions applicable to SOEs, across the public administration.

1: Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses a different scoring model (See the Scoring approach section for information on the assessment methodology).

## Economic context

### *Key economic features*

The Republic of North Macedonia is a small, open economy with a sizable and diversifying service sector and an expanding manufacturing base. The economy is dominated by services, which account for 54.5% of gross domestic product (GDP) (World Bank, n.d.[1]) and 55% of employment (ILOSTAT, 2021[2]). The largest contributions among services come from wholesale and retail trade, ICT, transport, and logistics (MAKStat, 2019[3]). Industry, including construction, has expanded significantly over the past decade and now accounts for 23.9% of GDP (World Bank, n.d.[4]) and 31.1% of employment (ILOSTAT, 2021[2]). The most notable expansion in the industrial sector has been the increase in manufacturing from 8.8% of GDP in 2009 to 13.3% in 2019 (MAKStat, 2020[5]) on the back of significant inflows of export-oriented foreign direct investment (FDI). There has also been a considerable increase in public and private construction activity. The contribution of agriculture, forestry and fishing has been declining continuously since the 1990s and now accounts for only 4% of GDP (World Bank, n.d.[6]). However agriculture still accounts for nearly 14% of total employment (ILOSTAT, 2021[2]) and there is considerable scope to increase the growth and productivity of this sector.

Over the past decade the economy's growth has become more broad based and balanced. Prior to the global financial crisis, growth was mainly driven by domestic consumption and investment, underpinned by strong credit growth and significant FDI inflows into the banking sector. Between 2001 and 2008, exports accounted for just 34.2% of GDP and the heavy dependence of consumption on imports resulted in large current account deficits that peaked at 12.4% of GDP in 2008 (World Bank, n.d.[7]). In the post-crisis period, moderating domestic demand and rising external demand have resulted in a significant improvement of the external balances and the current account deficit remained below 3% of GDP throughout most of the past decade.

The rise in external demand in the post 2008/09 crisis period was driven primarily by significant inflows of export-oriented manufacturing FDI into North Macedonia's special economic zones. These investments, mainly related to the automotive industry, resulted in a significant increase in total exports, which in 2019 accounted for 61.7% of GDP, the highest share in the Western Balkan region (World Bank, n.d.[8]). Exports of services have also increased considerably but are still only 25% of total exports. This is the case despite the strong potential for the development of services linked to manufacturing global value chains (e.g. transport and logistics), the rapidly growing domestic ICT sector, and strong potential for growth in food processing exports and tourism.

Despite the positive developments in diversification and the expansion of the tradable sector, their impact on overall GDP growth has been moderated by weak links between the export-oriented FDI sector and local small and medium-sized enterprises (SMEs). Supplier linkages remain relatively weak as foreign investors rely on imports for most of their inputs other than low-cost local labour. In fact, the share of imported inputs is higher in North Macedonia than in its regional and global peers. Combined with the fact that they have been mainly in labour-intensive manufacturing activities, these investments have thus made a limited contribution to value added and GDP growth. With domestic demand moderating, the limited value added from exports has meant that GDP growth overall has declined from an average rate of 3.5% during 2001-08 to 2.6% between 2010 and 2019 (World Bank, 2021[9]).

## Table 24.1. North Macedonia: Main macroeconomic indicators (2015-20)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 3.8 | 2.8 | 1.1 | 2.7 | 3.2 | -4.5 |
| GDP per capita[2] | Current international $ | 13 827 | 15 078 | 15 650 | 16 672 | 17 583 | 16 927 |
| National GDP[2] | USD billion | 10.1 | 10.7 | 11.3 | 12.7 | 12.5 | 12.3 |
| Inflation[1] | Consumer price index, annual % change | -0.3 | -0.2 | 1.4 | 1.5 | 0.8 | 1.2 |
| Current account balance[1] | % of GDP | -2.0 | -2.9 | -1.1 | -0.1 | -3.3 | -3.5 |
| Exports of goods and services[1] | % of GDP | 48.7 | 50.9 | 55.0 | 60.2 | 62.1 | 58.1 |
| Imports of goods and services[1] | % of GDP | 65.0 | 66.2 | 69.1 | 72.9 | 76.5 | 70.9 |
| Net FDI[1] | % of GDP | 2.2 | 3.3 | 1.8 | 5.6 | 3.2 | 1.9 |
| Public and publicly guaranteed debt[3] | % of GDP | 46.6 | 48.8 | 47.7 | 48.4 | 49.4 | 60* |
| External debt[4] | % of GDP | 69.3 | 74.7 | 73.4 | 73.3 | 71.9 | .. |
| Unemployment[1] | % of total labour force | 26.1 | 23.8 | 22.4 | 20.7 | 17.3 | 16.4 |
| Youth unemployment[2] | % of total labour force ages 15-24 | 47.3 | 48.2 | 46.7 | 45.4 | 35.6 | .. |
| International reserves[1] | In months of imports of G&S | 4.2 | 4.9 | 4.1 | 4.4 | 4.6 | 5.3 |
| Exchange rate (if applicable local currency/euro) [1] | Value | 61.61 | 61.60 | 61.57 | 61.51 | 61.51 | 61.7 |
| Remittance inflows[2] | % of GDP | 3.0 | 2.7 | 2.8 | 2.7 | 2.5 | 3.4 |
| Lending interest rate[5] | % annual average | 7.5 | 7.0 | 6.6 | 6.1 | 5.6 | 5.2 |
| Stock markets (if applicable) [1] | Average index | 1 731 | 1 887 | 2 406 | 3 154 | 3 939 | 4 378 |

Note: G&S = goods and services; * estimates for 2020

Source:

1. (EC, 2021[10]), EU Candidate Countries' and Potential Candidates' Economic Quarterly (CEEQ) Q1 2021, https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf.
2. (World Bank, 2021[11]), World Bank WDI data, https://databank.worldbank.org/source/world-development-indicators.
3. (World Bank, 2020[12]), World Bank Western Balkans Regular Economic Report, https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report.
4. (EBRD, 2020[13]), Transition Report 2020-21, https://2020.tr-ebrd.com/countries.
5. (IMF, n.d.[14]), IMF Data, https://data.imf.org/regular.aspx?key=61545855

Low and weakly growing productivity is at the core of many of the above-mentioned trends over the past decade. Productivity growth slowed considerably in the period following the global financial crisis, due to both weaker productivity growth within sectors and slower reallocation of labour from less productive to more productive sectors (World Bank, 2020[16]). This poor productivity growth in the midst of strong growth in public and private investment since 2009 suggests weaknesses in how investment has been allocated. In particular, in the public sector considerable amounts were invested in public works related to monuments with limited potential to increase productivity (IBRD/World Bank, 2018[17]). It also points to significant market friction, preventing the reallocation of capital and other inputs to the most productive sectors and firms. This friction stems from numerous structural challenges including inadequate access to finance; inadequate competition, including from the informal sector; and unpredictable and discretionary enforcement of regulations and corruption (see the Structural economic challenges section below).

Modest growth and weak integration of enterprises into global value chains (GVCs), whether through the FDI sector or otherwise, also reflects enterprises' limited capacity to innovate and adopt new technology. Enterprises in North Macedonia tend to invest considerably less in research and development (R&D) or other innovation activities than their aspirational peers in the EU. They cannot meet the quality standards required by the automotive or other relevant industries and value chains. This reflects first and foremost difficulties accessing finance that are particularly pronounced for micro and small enterprises and start-ups. It also reflects problems with access to human capital and skills, which, in turn, reflect underlying challenges with the quality and relevance of the education system and weaknesses in the implementation of active labour market policies. This challenge is exacerbated by the emigration of highly skilled people to the EU and other developed economies, which has intensified over the past decade (see the Structural economic challenges section below).

Gaps in North Macedonia's infrastructure undermine connectivity, trade and GVC integration. Despite significant investment and improvement in its physical infrastructure over the past decade, some gaps remain. Combined with weaknesses in its "soft" infrastructure (customs, logistics) these undermine connectivity and further trade integration. They also undermine efforts to strengthen the FDI and export sectors (see the Structural economic challenges section below).

Despite notable improvement in labour market indicators, which was in part thanks to significant fiscal support provided to FDI investors and domestic companies in the post-crisis period, unemployment remains high at 16.4% and labour force participation is still relatively modest at 55%. This is particularly the case among the youth, with unemployment at 35.6% and labour force participation at 37.7%. Likewise, the share of young people who are not in education, employment or training is high at 23%, double the OECD and EU averages. Participation rates for women are also low, at 43%, contributing to the underutilisation of domestic human capital (World Bank, 2021[9]).

Looking ahead to the next decade, North Macedonia has considerable potential to accelerate its convergence with EU income levels on the back of further expansion and upgrading of the export-oriented manufacturing sector. This could come through continuing to attract FDI but also fostering a more conducive environment for the growth of dynamic, productive, adaptive and innovative SMEs that can be externally competitive and take part in global value chains across a variety of sectors with high development potential. Addressing the key constraints identified in this economy profile, as well as the Competitiveness Outlook more broadly, will support this agenda.

### *Sustainable development*

North Macedonia has committed to the United Nation's Agenda 2030 for Sustainable Development. It also takes part in the National Voluntary Review Programme, which encourages countries to conduct regular and inclusive reviews of their progress on the Sustainable Development Goals (SDGs) at both the national and sub-national level. The goal is to foster the exchange of experiences, success stories and lessons learned in order to strengthen the implementation of the 2030 Agenda (Sachs et al., 2021[18]).

Overall, over the past two decades, North Macedonia has made positive progress towards achieving the goals of Agenda 2030, but the pace of progress has been relatively modest on most of the key indicators across all dimensions of the SDGs (Table 24.2). North Macedonia is on track to achieve or has maintained its achievement of the SDGs only in one main area – poverty rates are declining with proportions of the population that lives on less than USD 1.90 and USD 3.20 decreasing (Sachs et al., 2021[18]).

### Table 24.2. North Macedonia's progress towards achieving the SDGs

| SDG | Current assessment | Trends |
|---|---|---|
| 1 - No poverty | Challenges remain | On track or maintaining SDG achievement |
| 2 - Zero hunger | Significant challenges remain | Moderately improving |
| 3 - Good health and well-being | Significant challenges remain | Moderately improving |
| 4 - Quality education | Challenges remain | Stagnating |
| 5 - Gender equality | Significant challenges remain | Moderately improving |
| 6 - Clean water and sanitation | Significant challenges remain | Moderately improving |
| 7 - Affordable and clean energy | Significant challenges remain | Moderately improving |
| 8 - Decent work and economic growth | Significant challenges remain | Moderately improving |
| 9 - Industry, innovation and infrastructure | Significant challenges remain | Stagnating |
| 10 - Reduced Inequalities | Major challenges remain | Information unavailable |
| 11 - Sustainable cities and communities | Significant challenges remain | Moderately improving |
| 12 - Responsible consumption and production | Significant challenges remain | Information unavailable |
| 13 - Climate action | Significant challenges remain | Stagnating |
| 14 - Life below water | Information unavailable | Information unavailable |
| 15 - Life on land | Significant challenges remain | Moderately improving |
| 16 - Peace, justice and strong institutions | Significant challenges remain | Moderately improving |
| 17 - Partnerships for the goals | Challenges remain | Moderately improving |

Note: The order of progress (from greatest to least) is as follows: SDG achieved; challenges remain; significant challenges remain; major challenges remain.
Source: (Sachs et al., 2021[18]), *Sustainable Development Report 2021: the Decade of Action for the Sustainable Development Goals,* https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

Moderate improvements have been noted across most SDG thematic areas. While North Macedonia's health outcomes have improved in most areas and are on track to achieve the SDG targets, the high prevalence and death rates from non-communicable diseases including cardiovascular disease, diabetes and cancer remain a significant problem (SDG 3). Significant challenges remain in education, in particular in lower secondary completion rate (SDG 4). In the area of work and economic growth, unemployment still remains high and poses considerable challenges for well-being (SDG 8). High air pollution also has a strong impact on the health and life expectancy of the population (SDG 7 and 11) (Sachs et al., 2021[18]).

According to the SDG assessment, the most significant challenges lie in the areas of institutions (SDG 16) and inequality (SDG 10). Corruption remains an important challenge as does the prevalence of child labour. Likewise important issues are still noted in the area of property rights. Inequality, as measured by the Gini Coefficient, also remains high (Sachs et al., 2021[18]).

## *Structural economic challenges*

North Macedonia faces a number of key structural challenges that undermine its competitiveness, investment and GVC integration.

### *Lack of skills is undermining economic growth and the development of a knowledge economy*

- **Quality of education** is at the root of this issue. For example, student performance on standardised tests like the Programme for International Student Assessment (PISA), is well below not only the OECD average but also most regional peers: fewer than 50% of students in North Macedonia achieved the minimum level of proficiency in reading (45%) and mathematics (39%) and only 51% achieved this for science, compared to the OECD average of over 75% (OECD, 2019[19]). This, in turn, reflects inefficient use of resources in the education system. Student

performance is weak despite low student-teacher ratios at all levels of education up to tertiary. The low teaching quality partly reflects the low compensation of teachers, outdated curricula, etc.

- **Lack of skills** also reflects the relevance of education. About one-third of employers have noted that they had difficulty filling job openings because they could not find workers with the required skills. Moreover, about 50% of employers, many of whom are in the automotive industry, have noted that their employees do not have sufficient skills for the jobs that they occupy and require significant on-the-job training. In addition to technical skills, the skills gaps also include cognitive and soft skills, such as communication, management and interpersonal skills, many of which are critical for the development of the services sector (World Bank, 2017[20]). These challenges reflect underlying issues with the vocational and tertiary education system – see Education policy (Dimension 7). They also include lack of adequate labour market information systems and lack of active labour market policies – see Employment policy (Dimension 8).
- **The incentives to learn and acquire skills** are significantly diminished by the fact that job prospects, salaries and career advancement are strongly determined by other factors such as political or family connections, monetary compensation or bribery in the public sector. According to the latest Balkan Barometer survey, the top two assets for finding a job identified by respondents were a network of family and friends in high places (39%) and personal contacts (38%). In comparison, only 19% of respondents identified the level of education/qualifications as one of the top two assets for getting a job (Regional Cooperation Council, 2019[21]).
- **Early childhood education** lays the foundations for cognitive and other skill development. Yet in North Macedonia, participation in early childhood education is very low and this also negatively affects women's participation in the labour market. Enrolment is particularly low for the poorest 20% of households, where it is less than 1%, while even among the richest quintile it is just 55% (World Bank, 2017[20]). In most OECD countries, the average rate of enrolment is over 80% (OECD, n.d.[22]).

### *The economy underuses its human capital*

- **Low labour force participation** remains a problem: in 2019, more than half of the population (53%) was either unemployed or inactive. Young people are particularly underused: 15-24 year-olds have a labour participation rate of only 31% (World Bank, n.d.[23]) and an unemployment rate of 38% (World Bank, n.d.[24]). Women have even lower activity rates (43% compared to more than 50% for the total population), which reflects, in part, limited affordable childcare options and social norms in some segments of the population. The ageing population (the median age is 39 years) and high levels of emigration, particularly of highly skilled youth, further exacerbate the challenges of underutilised and underdeveloped human capital.

### *A challenging business environment stifles enterprises, particularly SMEs*

Over the past two decades, North Macedonia has made considerable progress in reducing the administrative and regulatory burden on businesses by introducing the so-called regulatory guillotine, as well as other measures. As a result, North Macedonia's ranking in the Doing Business report has increased significantly and is now 17$^{th}$ globally (World Bank, n.d.[25]). Nevertheless, many outstanding challenges in this area undermine enterprises' competitiveness, investment and growth:

- **Contract enforcement** is lengthier and costlier than in peer countries and well below the global leaders (634 days compared to 590 days for the OECD average and 120 days for the global leaders). Likewise, there are still outstanding challenges with insolvency, with considerably lower recovery rates (48% compared to 70% in the OECD) (World Bank, n.d.[25]). Businesses also complain about unpredictable changes in regulation and uneven and discretionary oversight and

enforcement of regulations. This latter partly reflects the weak governance and capacities of inspection bodies (World Bank, 2018[26]).

- **Inefficient customs** impede the development of the export sector and GVC integration. While the special economic zones circumvent some of these issues by introducing dedicated customs terminals for their investors, the majority of other firms still face challenges in this area. In the latest Logistics Performance Index, North Macedonia' score was lowest in the customs indictors compared to its performance in other indicators, leading to an overall ranking of 81st out of 160 countries (World Bank, 2018[27]).
- **Unfair competition**, particularly from the informal sector, represents an important constraint for businesses in North Macedonia. In the latest Business Environment and Enterprise Performance Survey (BEEPS), 54.5% of firms stated that they compete against informal competitors (World Bank, n.d.[28]). Informal employment is also high at 17.2%, as is the prevalence of other practices including under-reporting of wages and envelope wages in cash, under-reporting sales and not issuing fiscal receipts (WIIW, 2020[29]). This not only creates an uneven playing field for some firms, it also significantly reduces public revenues and consequently limits public spending and investment on priority development areas.

*Firms' capacities to innovate and adopt technology are still relatively limited*

- **Investment in R&D** by businesses remains low (0.1% of GDP compared to the EU average of 1.5%), as is their adoption of quality standards (World Bank, 2020[16]). The low amounts firms invest in innovation reflect some of the constraints in the business environment that limit the flow of resources from less to more competitive firms. Lack of skills, including management and entrepreneurial skills, also limit innovation.
- **Limited Access to finance** (Dimension 3) has a significant impact on firms' capacity to invest in new technology and quality standards, particularly for small and micro-enterprises and start-ups. These firms cannot meet the commercial banks' stringent lending standards (for collateral, credit history, turnover and other requirements) but have limited access to alternative financing. In recent years, some progress has been made in improving access to finance through the Fund for Innovation, but the gap still remains significant, especially in the context of limited private-sector alternatives to bank finance.

*Cross-cutting and sector-specific constraints undermine the growth of key sectors*

- **Agriculture**: Agricultural productivity is very low (less than 25% of the EU average) undermined by fragmented land (the average farm is 1.62 ha), lack of adequate infrastructure for irrigation and limited access to machinery. The sector is also plagued by significant inefficiencies. Studies have shown that the average farm could produce the same output with 55% fewer inputs. High agricultural subsidies, which are well above the EU average, make matters worse by reducing the incentives to restructure the sector to enhance productivity – subsidised farms are less efficient than non-subsidised farms (World Bank, 2018[26]) – or to reallocate labour from agriculture to the more productive manufacturing and service sectors.
- **Tourism**: The tourism sector has significant potential due to North Macedonia's location, natural endowments, and rich history and culture. The sector is constrained by the lack of people with the skills needed for higher value-added activities, limited capacity to innovate and adopt new technology, and limited access to finance high-quality transport services. Businesses in the sector also complain about the bureaucratic red tape and corruption when it comes to accessing utilities, permits and licences (World Bank, 2018[26]).
- **ICT**: The ICT sector has grown significantly in recent years but it still has a great deal of unfulfilled potential especially in the area of service exports. The sector is constrained by the limited size of

the domestic market, insufficient supply of skilled workers and their high turnover across firms, underdeveloped collaboration between the sector and the relevant educational institutions, and lack of access to finance, particularly for start-ups and high-risk venture capital.

### *Weak revenue performance and high and rising current expenditure limit the government's fiscal space*

- **Fiscal policy has been expansionary** for most of the past decade in order to support economic recovery in the wake of the global financial and Eurozone crises and increase employment. Support for employment has been both direct (through public construction projects) and indirect (through subsidies and tax exemptions for FDI investors and domestic companies as well as ad hoc increases in pensions, although the latter are also linked to the election cycle). At the same time, revenue performance has been relatively weak, down from 32.9% of GDP in 2008 to 29.6% of GDP in 2019 (Ministry of Finance, n.d.[30]) due to low tax rates, a narrow tax base and considerable tax avoidance from the informal economy. This has resulted in deficits widening from an average of less than 1% in the pre-crisis period to 2.9% between 2009 and 2019 (Ministry of Finance, n.d.[30]), and public debt doubling from 24% in 2008 to 51% in the second quarter of 2020.
- **Narrowing fiscal space** has important implications. Since the local currency is pegged to the euro, the central bank has limited monetary policy options to stimulate the economy in times of crisis, leaving fiscal policy as the main instrument. Moreover, with roughly 80% of government expenditure going on public wages, social transfers and subsidies, which are difficult to cut, the government's ability to adjust expenditure in response to declining revenue or to redirect spending toward other pressing needs such as the ongoing economic crisis has become much more limited. This is also why capital expenditures are most frequently cut mid-year to accommodate the higher current expenditure needs.

### *A greener growth model would improve well-being*

- **Air pollution** has become one of the most acute problems in North Macedonia with significant consequences for health, mortality and economic development. At 33 μg/m$^3$ (in 2017) exposure to $PM_{2.5}$ (particulate matter) air pollution is the highest in the Western Balkan region, more than double the EU average of 13.1 μg/m$^3$ and the OECD average of 12.5 μg/m3, and well above threshold limits recommended by the World Health Organization (WHO) air quality guidelines of 10 μg/m$^3$ annually (EEA, 2020[31]). Pollution is particularly acute in winter when residential heating, including from burning of solid fuels, compounds the pollution from transport, power generation and industry. In fact, residential heating accounts for 63% of all $PM_{2.5}$ air pollution and 46% of all $PM_{10}$ pollution (MEPP, 2017[32]). Transport pollution is also high, particularly in urban areas, due to the high numbers of old vehicles on the streets. According to the State Statistics Office, the average car is 19 years old. (MAKStat, 2020[33]).
- **Climate change.** North Macedonia is vulnerable to the impacts of climate change due to its high exposure and low resilience to natural hazards. Yet the transition to low-carbon growth has been slow and efforts to strengthen resilience to these hazards have been relatively weak. The economy is still highly dependent on highly polluting lignite coal and the intensity of energy consumption is high. Water resource management also remains a challenge, increasing the risks of future droughts. The lack of a coherent national strategy and policies to enhance climate change preparedness and resilience as well as slow progress in the development of emergency response systems makes the economy more at risk from future disasters.

*More inclusive growth is also needed to improve well-being*

- Even though living standards have improved significantly over the past two decades (GDP per capita increased by 60%), high poverty levels and inequality remain an important challenge for North Macedonia. Nearly 18% of the population still lives on less than USD 5.5 a day, and there is also considerable inequality across different regions and ethnic groups. For example, Macedonians of ethnic Albanian origin represent more than 40% of the poorest quintile of the population and only 15% of the richest, while the ethnic Roma community is overwhelmingly in the bottom two income quintiles (World Bank, 2018[26]). The Roma population lag significantly behind others in education completion rates: only 31.3% of the Roma ethnic group have completed secondary education compared to over 86.8% for the rest of the population in North Macedonia. Gender inequality is also persistent. Lower activity rates, employment and entrepreneurship among women are estimated to have reduced GDP by 16% (World Bank, 2018[26]).

*COVID-19 has exacerbated structural challenges*

The Macedonian economy has been strongly affected by the COVID-19 pandemic, which resulted in significant declines in domestic and external economic activity. Domestic demand was strongly reduced by the confinement measures imposed in the second quarter of 2020, as well as the slow restart of the economy following their relaxation. Meanwhile, slowing economic activity in key trading partners and related disruptions in the automotive value chain notably affected external demand, resulting in a decline in exports of over 30% in Q2 of 2020. Even though economic activity picked up in the second half of the year, the recovery has been subdued. As a result, annual GDP contracted by 4.5% on the back of declining investment (-10.2%), exports (-9.6%) and private consumption (-5.6%). Declining imports (-9.2%) meanwhile mitigated the impact on GDP (Table 24.1) (EC, 2021[10]).

The pandemic strongly affected a number of critical sectors including industry, trade, transport and tourism. Industrial production declined strongly in the second quarter of 2020 as a result of the confinement measures as well as disruptions in the global supply chains. Automotive and textile manufacturing were particularly badly hit, with their volumes nearly halving compared to the same period in the previous year. Retail was affected by lower household spending related to the confinement and declining consumer confidence amid the uncertain economic recovery (EC, n.d.[34]). Air and rail transport were particularly strongly affected by limitations on travel and reductions in the movement of goods (MAKstat, 2020[35]) (EC, 2021[10]).

However, the fiscal support measures that the government took in the wake of the pandemic have helped moderate its impact on the economy, and particularly the labour market. This support included liquidity support for firms (subsidising employees' social security contributions for companies that retained employment, deferring income tax payments, more favourable lending terms and credit guarantees) as well as sector-specific support for the most affected sectors, including tourism, agriculture and catering through direct payments and grants. As a result, employment declined by just 0.3% compared to 2019 and unemployment continued to decline from 17.3% in 2019 to 16.4% in 2020 (EC, 2021[10]). **Error! Reference source not found.** outlines some of the tax measures in response to COVID-19.

The impact on household incomes and poverty was also mitigated by the government's support measures. Social security schemes provided additional support to individuals who lost their jobs a result of the crisis (e.g. a new unemployment insurance scheme and accelerated access to the social protection system). Low-income households were also supported through cash vouchers as well as delays in rent demands for social housing. At the start of the crisis, the government also introduced price controls on basic food products, medicines and disinfection products, and abolished the import duties on medical supplies and select goods.

Many of the structural challenges discussed above have played a role in either amplifying the impact of the COVID-19 pandemic or limiting the scope of the policy responses to it. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** Among its political and administrative responses to the COVID-19 pandemic, North Macedonia introduced a number of tax policies including:
  - Advance corporate income tax (CIT) payments for certain sectors were postponed in March 2020 for five months. This deferral was available to companies which had suffered a 40% decline in revenues. Companies which took advantage of it could not pay dividends or reduce the number of employees. This provision was extended until February 2021.
  - The threshold for CIT liability was increased from MKD 3 million to MKD 5 million.
  - Advance personal income tax (PIT) payments for independent activities were also postponed in March 2020 for five months. This provision was also extended until February 2021.
  - Direct cash transfers of EUR 150 were paid to individuals with monthly incomes below EUR 250, EUR 100 to students and up to 40% of their salary to medical workers.
  - During April, May and June 2020, entrepreneurs could opt for a subsidy of up to 50% of social security contributions (SSCs).
  - For businesses that suffered a 30% loss in revenues, a wage subsidy scheme was implemented of up to the minimum wage (paid to the employer). Beneficiaries of this scheme could not pay dividends or reduce the number of employees. This subsidy was capped at EUR 350 per month during October, November and December 2020.
  - The value-added tax (VAT) refund system was simplified and facilitated.
  - A new 10% VAT rate was introduced for restaurants and catering services from January 2021. The VAT rate was also reduced for craft activities from 18% to 5% in January 2021.
  - More flexible tax-debt repayments, notably by lowering penalty interest rates.
  - The ability to carry forward losses was extended from three to five years.
  - North Macedonia has implemented a wider set of responses to COVID-19 than other WB6 economies. For example, few implemented wage subsidy schemes or direct cash transfers to households, but these are centrepieces of North Macedonia's response. North Macedonia's comprehensive COVID-19 response package broadly aligns with those of OECD/G20 countries (OECD, 2020[36]). While the fiscal response has been critical to preventing significant economic fallout from COVID-19, especially for the labour market, it has resulted in a significant narrowing of the fiscal space. With revenues likely to be weaker in the wake of the crisis, particularly if the recovery is slow, improving the efficiency of public spending will be critical over the coming months, as will prioritising expenditures that can support the recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This also includes increasing public investment which has suffered significantly due to high and rising current expenditure. The crisis also highlights the importance of rebuilding fiscal buffers in the post-crisis period. In addition to better management of expenditure this will also require tackling some of the structural constraints that undermine revenue performance.
- **Innovation and technology adoption:** The COVID-19 crisis starkly demonstrated the importance for firms of being able to adapt to new challenges and changing circumstances. It also revealed the advantages to firms of embracing digitalisation and modern practices. The resilience of the post-pandemic recovery will therefore depend on addressing the structural issues limiting innovation and technology adoption among firms and to what extent digitalisation and digital skills become mainstream.

- **Access to finance:** The crisis has highlighted the significance of having a well-developed and diversified financial sector that can respond to the financing needs of enterprises not only during a crisis but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis came from government support through subsidised lending or lending guarantees. But a robust financial sector comprised of diversified financial institutions that can provide financing for riskier and innovative ventures, and not just established enterprises, will be very important during the recovery phase and beyond.
- **Informality:** The large informal sector – and significant levels of informal employment even within the formal sector – have limited the scope of measures aimed at protecting the income and employment of workers in the most affected sectors. Informality is widespread in these sectors, including retail and tourism, and informal firms have not been able to benefit from government subsidies, favourable loan terms and loan guarantees, and other support measures. Developing a more resilient economy will depend on enhancing the incentives for formalisation and improving the oversight and sanctioning of non-compliance.
- **Health sector*:*** North Macedonia's vulnerability to the pandemic was increased by its already comparatively poor health outcomes and inefficient health system. This challenge is compounded by relatively low spending on health care (6% of GDP in 2017 compared to 12.6% in the OECD) (World Bank, 2020[16]). The health sector's revenues are highly sensitive to employment and economic downturns since they depend on payroll contributions. North Macedonia will need to strengthen the resilience of its health sector through measures such as increased funding; improving pandemic preparedness, including training of health workers and increasing the supply of relevant equipment; and strengthened supply chains for essential medicines and other supplies.

### *EU accession process*

Following the signing of the Cooperation Agreement with the European Community in 1997, North Macedonia was the first Western Balkan economy to sign a Stabilisation and Association Agreement (SAA) with the EU in 2001. The government formally applied for EU membership in March 2004 and was granted candidate status in December 2005. The EU adopted the Accession Partnership for North Macedonia in February 2008.

For over a decade, North Macedonia's accession negotiations were stalled by the bilateral dispute with Greece over the name "Macedonia". However, in 2018, the breakthrough Prespa Agreement which, among other things, changed its name from Republic of Macedonia to North Macedonia, renewed the prospects for the start of accession negotiations. On 24 March 2020 the EU foreign ministers approved the start of negotiations and on 1 July 2020, the European Commission (EC) presented to the member states the negotiating framework with North Macedonia. However, at the time of the writing of this report, North Macedonia's EU accession course had hit another roadblock as Bulgaria vetoed the start of the negotiations over disagreements regarding the origins of the Macedonian language. It has demanded that the resolution of this bilateral issue be added to the framework for the accession negotiations.

Despite these political challenges to its quest to become an EU member state, the importance of advancing the socio-economic reform agenda remains a priority for North Macedonia. As the government negotiates its accession to the EU, the findings in this Competitiveness Outlook 2021 offer monitoring relevant to a number of critical chapters of the *acquis*, while its recommendations provide the guidance needed to meet the accession requirements. The Competitiveness Outlook also provides a good basis for assessing the critical challenges that the economy faces as a starting point for the development of the Economic Reform Programmes (Box 24.1).

### Box 24.1. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[37]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[38]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

*EU financial and development support*

North Macedonia has received considerable financial support from the EU, which has been its largest provider of financial assistance. Under the Instrument for Pre-Accession Assistance (IPA), North Macedonia received a total of EUR 1.25 billion between 2007 and 2020. North Macedonia has also received EUR 832.6 million in loans from the European Investment Bank since 1999. Finally, EUR 185.2 million in grants through the Western Balkans Investment Framework have leveraged an estimated EUR 2.1 billion in financing since 2009 (EC, 2021[39]).

On 6 October 2020 the EC adopted the Economic and Investment Plan for the Western Balkans, which seeks to support the long-term economic recovery of the region, a green and digital transition, and regional integration and convergence with the EU. The plan envisages the mobilisation of up to EUR 9 billion in investment in sustainable transport, human capital, competitiveness and inclusive growth (EC, 2020[40]).

In addition to grant funding the EU also provides important guarantees that support public and private investment by reducing the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade (EC, 2020[40]).

The Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the Western Balkans Investment Framework, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment in support of better connectivity in the WB region. It also represents the first step in implementing the flagship projects under the Economic and Investment Plan for the region.

The EU has also been instrumental in supporting North Macedonia as it deals with the fallout from the COVID-19 pandemic. At the start of the pandemic, the EU reallocated bilateral financial assistance to support North Macedonia's health sector in combatting the disease (EUR 4 million) and to support the government in its efforts to combat the economic impact of the crisis (EUR 62 million) (EC, 2020[41]). This help was followed by EUR 160 million in macro-financial assistance to further support the government in dealing with the economic fallout from the pandemic, EUR 80 million of which was disbursed in July 2020 (EC, 2020[42]).[1]

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced North Macedonia's Competitiveness Outlook Government and State Statistical Office coordinators to the new digitalised assessment frameworks (see Assessment methodology and process chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, the Cabinet of the Deputy President of the Government of the Republic of North Macedonia disseminated the materials among all 16 Policy Dimension Co-ordinators and Statistical Office contact points in North Macedonia. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All 16 Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from the Cabinet of the Deputy President of the Government of the Republic of North Macedonia, Policy Dimension Co-ordinators and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders (including chambers of commerce, academia and NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook Government Co-ordinator,[2] Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 9 December 2020. The draft Competitiveness Outlook economy profile of North Macedonia was made available to the Government of North Macedonia for their review and feedback from mid-January to mid-February 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 24.3).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Assessment methodology and process chapter.

**Table 24.3. Competitiveness Outlook scoring system**

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

#### *Exceptions*

Unlike the other 15 policy dimensions, competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time, are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

North Macedonia's performance has slightly worsened in the investment dimension. Its score has decreased from 3.25 in the 2018 Competitiveness Outlook to 3.0 in the 2021 assessment. While the economy has made notable progress in enhancing its investment policies, North Macedonia ranks fourth among the six Western Balkan (WB6) economies for this dimension (Table 24.4), as its investment promotion and facilitation as well as its green investment framework are limiting its potential to attract foreign investors.

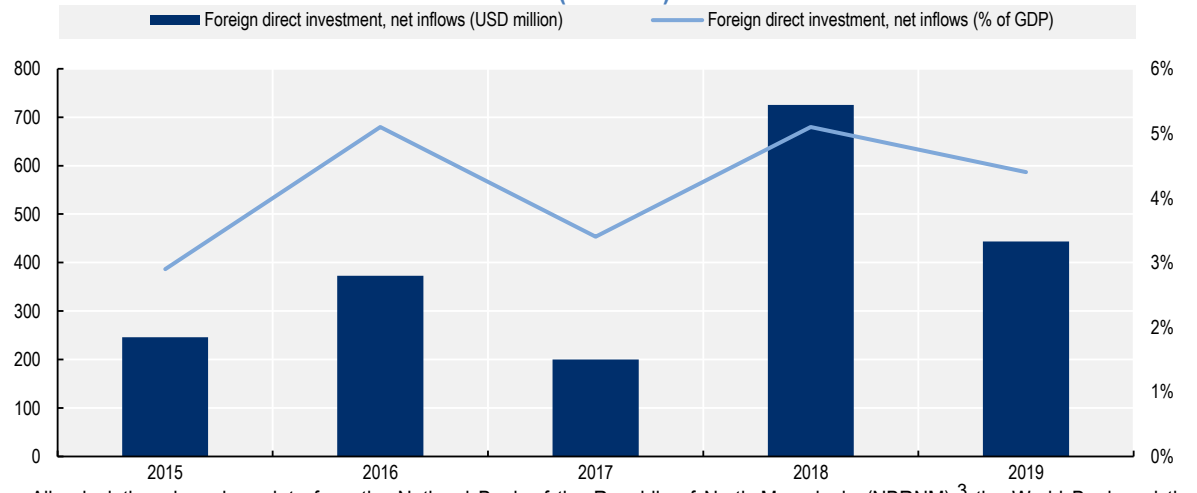
### Table 24.4. North Macedonia's scores for investment policy and promotion

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1: Investment policy framework | 3.5 | 3.2 |
| | Sub-dimension 1.2: Investment promotion and facilitation | 2.8 | 3.0 |
| | Sub-dimension 1.3: Investment for green growth | 1.5 | 2.0 |
| **North Macedonia's overall score** | | **3.0** | **3.0** |

### *State of play and key developments*

In 2020, North Macedonia attracted net FDI inflows of USD 444 million, representing 3.8% of its GDP (Figure 24.2) (EC, 2020[43]). This level is below most of its regional peers: Montenegro attracted net inflows worth 8.4% of GDP, Serbia 8.3% and Albania 7.9%. North Macedonia was on a par with Kosovo, also at 3.8% of GDP, and outperformed Bosnia and Herzegovina which attracted FDI worth only 1.9% of GDP in 2019 (World Bank, 2020[16]). Its total FDI stock was estimated at USD 6.4 billion in 2019 with investments originating primarily from the United Kingdom (14%), Austria (13%), Greece (9%), the Netherlands (8%) and Slovenia (7%). The manufacturing sector attracts the most FDI, ahead of financial and insurance activities.

### Figure 24.2. Net FDI inflows to North Macedonia (2015-19)




Source: All calculations based on data from the National Bank of the Republic of North Macedonia (NBRNM),[3] the World Bank and the International Monetary Fund.

StatLink https://doi.org/10.1787/888934256026

*Sub-dimension 1.1: Investment policy framework*

Although North Macedonia's **legal framework for investment** activities is favourable to investment, it remains complex and complicated to navigate. Its investment framework is comprised of several laws including the Law on Trading Companies, the Law on Technological Industrial Development Zones, the Law on Financial Support of Investments, the Law on the Establishment of ASIPI, the Law on State Aid Control, and the Law on Strategic Investment, adopted in 2020.[4] In 2018, the Law on Technological Industrial Development Zones was amended to introduce a new built-to-lease option that provides leaseholders with the opportunity to build a facility to meet the needs of new investors in development zones, which allow greater flexibility and competitiveness.

However, the legislation could benefit from some clarification. For instance, the national laws have no unified definition of a foreign investor. Despite the government's efforts, the overall regulatory environment remains full of complexities. Frequent changes and inconsistent interpretation of the rules tend to create an unpredictable business environment conducive to corruption (US Department of State, 2020[44]).

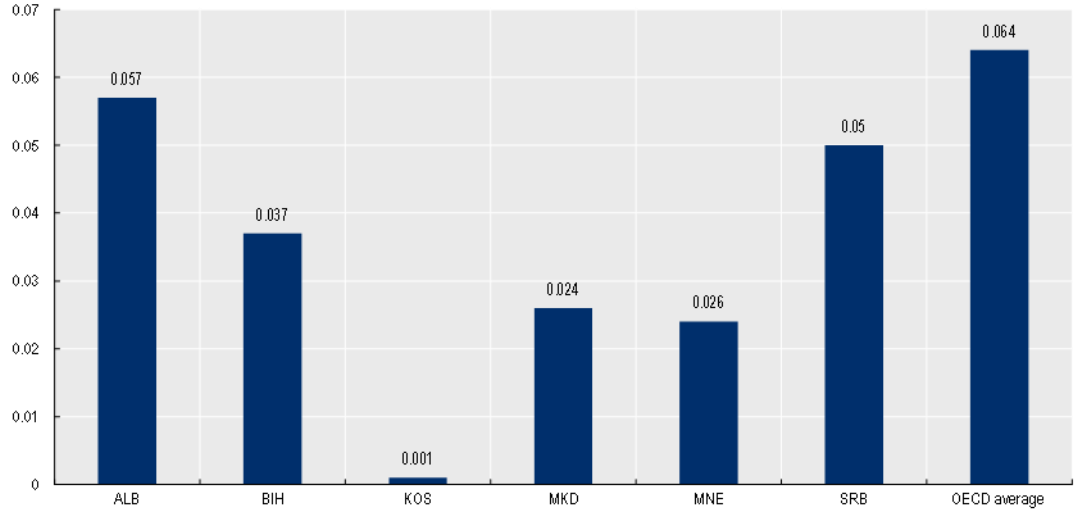
Despite recent improvements, transparency and consultation with key stakeholders could be further enhanced. North Macedonia does not have a single website or portal dedicated to investors providing investment laws and regulations, and English versions of laws are not always available. However, the government is striving to increase transparency and is in the process of gathering all regulations onto the Unique Electronic Register of Regulations (ENER) website.[5] This website also includes all draft regulations and encourages public consultations by allowing stakeholders to make comments and suggestions. Transparency has also been reinforced throughout the implementation of a regulatory impact assessment (RIA) programme,[6] which aims to improve the regulatory environment and increase and enhance consultations with stakeholders.

Based on stakeholders' feedback, the RIA and the consultation processes were recently improved. However, the RIA process for laws and consultation procedures provides little information on the background, rationale or expected goals of proposed laws. Moreover, the process only allocates a short amount of time for stakeholders to provide analysis and feedback and does not establish clear deadlines for submitting comments. Stakeholders also complained that consultations are not systematic and are sometimes marginalised or avoided by the government for key legislation. For instance, the Law of Strategic Investments was adopted in 2020 in the space of two months and without proper consultation with stakeholders or the involvement of key public bodies including, notably, the state aid authority.

The market in North Macedonia is open and **exceptions to national treatment** are very limited. Its score on the OECD FDI Regulatory Restrictiveness Index, which assesses and benchmarks market access and exceptions to national treatment, was 0.026 in 2019. This reflects the fact that it maintains only a handful of restrictions, specifically in the transport sector, making its FDI regime less restrictive than the OECD average of 0.064 (Figure 24.3). It does maintain discriminatory restrictions on real estate ownership by legal entities established abroad, which is subject to reciprocity with exceptions for EU and OECD residents, who have the same rights as local residents. In addition, foreign residents cannot acquire agricultural land in North Macedonia and the leasing of agricultural land by foreigners and foreign-owned enterprises is subject to reciprocity or approval from the Ministry of Justice. Overall, North Macedonia's foreign investment rules do not constitute impediments to FDI, however it does not have a negative list of sectors where foreign investment is prohibited or subject to discriminatory conditions.

## Figure 24.3. FDI Regulatory Restrictiveness Index (2019)

Restrictions are evaluated on a scale of 0 (open) to 1 (closed)




Source: OECD (2019[45]), *FDI Regulatory Restrictiveness Index* (database), www.oecd.org/investment/fdiindex.htm.

**Investor protection against expropriation** without fair compensation is enshrined in the Constitution of North Macedonia[7] and its modalities are defined by the Law on Expropriation.[8] The law stipulates that expropriation measures can only be used in a non-discriminatory manner, for a public purpose, under due process of law and with fair compensation. It also instructs public authorities to pay investors the market value within 15 days, after which interest will accrue. The Law on Expropriation clearly defines 1) the procedure for calculating the compensation value by a lawful assessor; 2) the process for paying compensation; and 3) the procedures for taking court action in the event of non-payment of the value of the private property. The Macedonian Model Agreement on the Encouragement and Reciprocal Protection of Investments provides additional protection against expropriation. However, the legal framework does not explicitly recognise the concept of indirect expropriation, which deprives investors of the certainty of compensation in cases where the state interferes indirectly with their operations and affects their benefits, investments or use without taking their property.

In 2019, North Macedonia adopted a new law on administrative disputes which aims to improve all administrative acts and procedures. Under this law, appeals against the expropriation decision to the administrative court and to the higher administrative court are better regulated and shortened.

When it comes to **dispute settlement**, foreign investors have the same rights and remedies before the national court system as domestic investors. The justice system is continuing the reform efforts of the 2017-22 Strategy on Judicial Reform. This primarily focuses on reinforcing the independence of the judiciary, which often suffers from executive interference, and strengthening the fight against corruption. The court system maintains a clearance rate of 100% and there is no backlog of cases (EC, 2020[46]). The judicial system is also stepping up its modernisation efforts through the use of information technology (IT) but these efforts are being hindered by limited funding. Judges are undergoing special training for mediation mechanisms and procedures in accordance with programmes of the Academy for Judges and Public Prosecutors.[9]

North Macedonia does not have dedicated commercial courts. Commercial disputes are handled by specialised court divisions in the basic courts with extended competencies. Following the amendment of the Law on Courts in 2019, 3 additional courts gained extended competency to decide on commercial cases, increasing the total to 16 courts. However, investors still complain that lengthy and costly commercial disputes through the court system are creating legal uncertainty (US Department of State, 2020[44]). In 2019, there were a total of 1 879 cases in progress (876 of which were from the previous

period) while the number of cleared cases was 1 000. In 2019, it took 320 days to complete a case (up from 268 days in 2018) with a 99.77% clearance rate (111% in 2018).

North Macedonia offers alternative dispute resolution (ADR) mechanisms but their use is limited**.** It has ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the 1958 Convention on the Recognition and enforcement of foreign arbitral awards (New York Convention). Local courts recognise and enforce foreign arbitration awards issued against the Government of North Macedonia. The economy has also developed a mediation framework following the Law on Mediation, adopted in 2013, and all commercial disputes under EUR 15 000 must be subjected to mediation before legal action can be initiated in the courts. However, as the use of ADR mechanisms is not common and has become less so in recent years, arbitration is not yet considered a viable tool to ensure justice by either parties or the courts (EC, 2020[46]).

North Macedonia has strengthened its **intellectual property rights (IPR) legal framework** adopting several intellectual property (IP) laws[10] and regulations, which are being harmonised with EU legislation and contain the minimum requirements of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).[11] It is a member of the World Intellectual Property Organization and adheres to the main international treaties and conventions on IPR. It has integrated the key dispositions of international IP agreements into its national legislation,[12] notably in the Law on Industrial Property, as well as its patent and industrial design regulations.

However, the institutional framework for **IPR enforcement** and implementation is fragmented, with multiple institutions with overlapping mandates and a lack of human resources, limiting their co-operation and efficiency. These institutions include the State Office of Industrial Property (SOIP), the Ministry of Culture and the Ministry of Agriculture, Forestry and Water Economy (MAFWE). In addition, the State Market Inspectorate is responsible for monitoring markets and preventing the sale of counterfeit and pirated goods in co-operation with customs, and the Ministry of Interior is in charge of IP crimes.

The Coordination Body for Intellectual Property, the body responsible for IP enforcement, has recently undergone improvements that have allowed it to increase the number of actions it takes against infringers including increasing its human resources capacity and securing increased funding from the SOIP. In response to requests for action by rights holders, about 30 co-ordinated actions were carried out against violations of industrial property rights, such as patents for inventions, industrial designs and trademarks, in North Macedonia in 2020 (20 in Ohrid and 10 in Skopje). Between 1 February and 31 December 2020, the Customs Administration received 45 requests for customs protection measures and 86 requests for extension of the deadline for customs protection. In the numerous actions conducted in the reporting period, customs impounded 69 518 individual items on account of reasonable doubt that the goods had violated IPR. Representatives of the State Market Inspectorate, the Public Revenue Office and the Ministry of Interior participated in the supervision and efficient implementation of these measures and activities.

The SOIP, the body responsible for industrial property rights, has improved its registration process, making it both quicker and cheaper; it now takes less than six months to register an industrial property right. The office provides information kits and databases of trademarks, patents and industrial design. It is expected to start offering online filing for patents in 2021 and to start the procedure for online filing for trademarks and industrial design. While there are no specialised courts dealing with IPR cases, judges and public prosecutors are regularly trained on IPR laws and enforcement.

While co-operation among the many institutions charged with IP enforcement is currently lacking, the SOIP is expected to begin implementing the EU-funded Technical Assistance for Development of a National Strategy on Intellectual Property 2020-25 project in March 2021. The programme will include the development of a dedicated e-network for data exchange between IPR institutions in as well as e-filing solutions for trademarks, patents, industrial designs and e-services. The new long-term National Strategy on Intellectual Property 2021-30 also includes a concrete set of proposals to improve the functioning of IP

institutions, including the establishment of special IP rights departments within institutions and increasing the number of staff dealing with IP-related issues.

The government has also reinforced its **IPR awareness raising and improved access to information**. The SOIP leads IPR awareness seminars, workshops and training courses that are included in its annual work programme. It recently organised seminars and workshops about IPR in co-operation with universities and private sector actors.[13] Additional activities include the organisation of training for judges on IP matters.

### *Sub-dimension 1.2: Investment promotion and facilitation*

North Macedonia has a solid **investment promotion agency structure and strategy**. Two agencies are responsible for attracting FDI and servicing investors: the Agency for Foreign Investments and Export Promotion (ASIPI), also known as Invest North Macedonia,[14] and the Directorate for Technological Industrial Development Zones (DTIDZ, the national special economic zones authority). With the establishment of the new government in 2020, the role of supporting ASIPI to promote and facilitate investment has been transferred from the cabinets of four ministers in charge of attracting FDI to the cabinet of the Deputy Prime Minister in charge of economic affairs and co-ordination of economic sectors and investments as well as the department for FDI in the cabinet of the Prime Minister.

The co-ordination of investment promotion and facilitation activities is also enabled by the use of the national customer relations management (CRM) system which is used by all parties to communicate with potential investors. While ASIPI manages the system, the employment of economic promotors have made the functionality of the CRM limited, although it is in the process of being updated.

North Macedonia is doing well at fostering linkages between local firms and multinational firms. The Law on Financial Support of Investments encourages these linkages, providing financial support for the establishment and promotion of co-operation with suppliers registered in North Macedonia.[15] The economy also has active policies for developing clusters, of which there are currently 20 active groups. These policies are inscribed in the Competitiveness Strategy (2016-20) that aims to create an attractive business environment for foreign investors through reforms and public private dialogue, mobilising remittances from the diaspora, and improved data collection as well as in the Industrial Strategy (2018-27), and the Innovation Strategy (2012-20) that supports the integration of local companies into global value chains.

Finally, the government is providing support to local companies that are taking actions to increase their competitiveness and ability to link with foreign enterprises, such as adopting standards, digitalising, developing or improving products, improving their organisational structure, or investing in development and equipment.

North Macedonia also has a strong institutional setting and co-ordination mechanisms for its **investment facilitation services and activities.** This is reflected in its ranking in the World Bank's Doing Business index of 17th out of 190 countries. Since 2006, the National Registry has operated as a one-stop-shop for registration and allows rapid registration (1-2 days). North Macedonia is also implementing a one-stop-shop for business licences and permits to start and run a business, which was expected to be fully functional in 2020. The economy is also accelerating the digitalisation of public services used by investors. In 2018, DTIDZ also introduced a key change in the Law on Technological Industrial Development Zones in order to facilitate the establishment of businesses in the zones and allow more flexibility through a new build-to-lease option for investors in zones.

However, ASIPI has a limited investment facilitation mandate. This role was previously undertaken by the cabinet of the Vice-Prime Minister for Economic Affairs which organised a public-private platform called Learning From the Business Community, allowing representatives from the private and public sectors to discuss issues raised through yearly cycles of company visits.[16] However, this platform has recently ceased to operate and the role has been transferred to the Deputy Prime Minister who executes a programme of company visits throughout the year. These meetings discuss initiatives, problems, requests

and the needs of companies and business sectors in the economy, which are then brought to the government's attention.

North Macedonia has a clear **investor targeting** strategy and ASIPI has a well-defined set of priority sectors[17] that it promotes. The 2020 Strategic Investment Law also defines strategic sectors including energy, transport, telecommunications, tourism, manufacturing, agriculture and food, forestry and water economy, health, industrial and technological parks, wastewater and waste management, sport, science, and education. ASIPI continues to promote, target and attract investors to locations around the entire economy, including in development zones, while DTIDZ regularly reaches out to potential high value-added manufacturing companies about hosting in the technological industrial development zones in order to support a competitive environment and generate linkages with domestic firms.

North Macedonia has put complex and multi-layered **investment incentive** schemes in place to attract investments. In March 2018, the government passed the Plan for Economic Growth (Government of North Macedonia, 2020[47]) which provides substantial incentives to both domestic and foreign companies. These include a variety of measures including job creation subsidies, capital investment subsidies for the acquisition of new markets and financial support to increase competitiveness. All other incentives are included in the Law on Financial Support to Investment, the Law on Technological Industrial Development Zones and the Strategic Investment Law. Tax incentives introduced in the tax laws are under the authority of the Public Revenue Office (PRO) which is the institution authorised to carry out tax assessment and collection. The PRO also provides information to the state aid provider on how much state aid has been given in the form of tax incentives in accordance with the Law on Technological Industrial Development Zones.

In North Macedonia, **aftercare services** are provided by the cabinet of the Deputy Prime Minister, which is in charge of economic affairs, and co-ordinating the economic sector and investments, as well as ASIPI and DTIDZ. ASIPI helps investors to find suppliers through an online platform of local companies (Invest North Macedonia, 2020[48]) and facilitates communication with other administrations and local authorities. It is also actively involved in the work of the Foreign Investor Council (FIC).[18] This channel enables companies to raise problems which ASIPI then relays to the competent institutions. DTIDZ offers a wider range of services[19] to ease and streamline business procedures for investors in the zones. In addition, DTIDZ is developing an online aftercare registration platform to improve communication protocols and aftercare services to investors in the zones. Both organisations play a major part in policy advocacy, negotiating with the government on behalf of investors to help overcome their challenges.

### *Sub-dimension 1.3: Investment for green growth*

While North Macedonia has reinforced its commitment to green energy through several green strategies, the economy lacks a clear framework for **green investment policy and promotion**. The 2018 amendment of the Energy Law made it possible for investors using renewable energy sources to obtain the status of privileged power producer who could then use premiums and feed-in tariffs as support measures.

Meanwhile, the Law on Industrial and Green Zones regulates the conditions and establishment, management and activities of industrial and green areas; the conditions for their performance; and the obligations on the landowner on use of the area. The law aims to accelerate the economic development of local governments and increase employment and the competitiveness of the economy by attracting foreign and domestic capital to develop the zones. The regulation was amended in 2019 to include new provisions for regulating the benefits and opportunities for zone users, unifying applicable provisions for industrial and green zones, and better defining the conditions for performing activity in these areas.

Following the recommendations of the Innovation Strategy, which emphasises the importance of an effective national innovation system, North Macedonia established the National Fund for Innovations and Technology Development of North Macedonia in 2014. The fund aims to encourage innovation by providing additional resources for financing innovative activities through regular tenders and call for proposals.

Meanwhile, the 2020 Programme for Competition, Innovation and Entrepreneurship calls for expert analysis to contribute to the preparation of technical-project documentation and feasibility studies for planned investment projects, the establishment of enterprises to increase energy efficiency, and the introduction of the concept of a circular economy, such as a system for environmental protection and the green economy.

North Macedonia has primarily focused on transitional energy and the environmental practices of existing SMEs, while the promotion of green investments has lagged behind. ASIPI has posted for government approval on several renewable energy projects in the fields of solar, wind and hydropower to be opened to public tenders. However, while North Macedonia has reaffirmed its commitment to environmental good practice, it lacks a clear strategy or programme to attract or encourage green investments.

North Macedonia's framework for **choosing public and private partnerships for green growth** lacks specific provisions to mobilise and scale up green investments by leveraging public and private investments in large-scale infrastructure projects. However, the Energy Efficiency Law requires the contracting authorities to procure the most energy-efficient products, when procuring energy-related products that are not subject to energy labelling and valued over EUR 70 000, taking into account the competition between economic operators during public procurement. In accordance with the same law, as well as the Law on Concessions and Public Private Partnerships which is in the process of being amended, energy services contracts are established in the form of a public-private partnership when an energy services beneficiary is considered to be a public partner.

### *The way forward for investment policy and promotion*

North Macedonia is striving to improve its investment climate and to attract FDI as a source for growth and job creation. It has made considerable efforts to create a favourable business environment. However, these efforts could be reinforced through the following actions:

- **Continue to simplify and increase the transparency of the investment framework** by accelerating the RIA programme and improving the consultation process. Providing additional information on the proposed laws such as background, rationale and expected goals; more time for stakeholders' analysis and feedback; and clear deadlines for feedback would improve the way the RIA process is applied and the consultations with stakeholders.
- **Reinforce the independence, resources and capacity of the court system, particularly for commercial disputes.** While the reform of the judiciary system has progressed very well over recent years and no backlog of cases remains, investors still complain about the uncertainty created by the slow and costly settling of disputes in the economy. As commercial cases are currently heard in general administrative courts, North Macedonia should focus on establishing a dedicated commercial court to effectively handle business disputes.
- **Increase public awareness and implementation of the recently adopted mediation mechanisms**. North Macedonia should use awareness-raising campaigns to increase businesses' access to information about alternative dispute resolution mechanisms. These mechanisms could be promoted by reinforcing the role, resources and capacities of the Chamber of Mediators as well as the work of the Permanent Elected Court-Arbitration at the Economic Chamber of Macedonia.
- **Reinforce the co-ordination between IPR implementation and enforcement bodies, increase IPR agency capacity and resources, and step up IPR awareness-raising efforts**. IPR bodies currently only have the capacity to conduct low-level awareness-raising campaigns and lack the capacity to train and allocate specialised judges and prosecutors to handle IPR disputes. Increasing the allocation of resources to IPR institutions would enable authorities to better implement IPR awareness raising campaigns and streamline inter-institutional co-operation when it comes to carrying out actions and seizures.

- **Give ASIPI the capacity and resources it needs to fully implement its mandate.** As its remit covers several sectors and divisions, ASIPI will need more resources to promote linkages between SMEs and multinational enterprises effectively. The government should also reinforce the co-operation between DTIDZ and ASIPI and clarify the institutional framework for investment and the competencies of the agencies and departments in charge of investment promotion, facilitation and aftercare
- **Streamline existing investment incentives and reinforce the evaluation of their costs and benefits, appropriate duration and transparency.** Simple and unified tax incentive regimes can make it easier for governments to evaluate the cost and benefits of such measures to allow for the better allocation of resources while improving the clarity of the system for investors.

## Trade policy (Dimension 2)

### *Introduction*

North Macedonia has made progress since the previous assessment round in all sub-dimensions analysed. The economy has increased its score on this dimension from an already high score of 3.7 in 2018 to 3.8 in 2021. Table 24.5 shows North Macedonia's scores for the trade policy sub-dimensions, and compares them to the WB6 average. The scores for Sub-dimension 2.2 do not follow the same scoring methodology hence are not displayed (for more information please refer to the STRI methodology displayed in Sub-dimension 2.2: Services trade restrictiveness).

In particular, North Macedonia has made progress since the last assessment in 2018 in implementing regulatory transparency, improving public consultations and increasing transparency in trade policy making, and in trade policy development and co-ordination. As a result, the climate in which the private sector operates has continued to improve. Public consultations have improved thanks to a dedicated online consultation system. However, some efforts still need to be made, as the government makes relatively frequent use of shortened and urgent procedures for the adoption of legislation. The quality of its regulatory impact assessments has slightly improved, but its budgetary impact assessments are still only partial. Together these explain its above-average score of 3.8 in Sub-dimension 2.1.

There have been significant reductions in restrictions on trade in services through the conclusion of Additional Protocol 6 to the Central European Free Trade Agreement (CEFTA) in December 2019. North Macedonia has not reported any protectionist legal changes. This is particularly important in a context where regulations restricting services have tended to increase among OECD economies in 2020 (OECD, 2021[49]). In general, North Macedonia has continued to make its economy more attractive to trade in goods and services. All of the service sectors analysed have demonstrated a greater degree of openness than in previous years, but more could be done. There are cross-cutting policies affecting foreign service providers such as restrictions on the acquisition and use of land and real estate by foreigners, as well as mandatory minimum capital requirements in the form of a deposit that must be placed in a bank or notary's office to register a limited-liability entity. North Macedonia also applies limitations on movement of people through quotas and labour market tests for work permits issued to third-country nationals. Reducing these and other efforts could significantly reduce the costs of trade in services.

Finally, North Macedonia has put in place a sound e-commerce policy framework, bringing it more in line with EU regulations, which explains its very high score of 4.0 in Sub-dimension 2.3.

**Table 24.5. North Macedonia's scores for trade policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 3.8 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 4.0 | 3.1 |
| **North Macedonia's overall score** | | **3.8** | **3.4** |

### *State of play and key developments*

North Macedonia has an open economy and is highly integrated into international trade, with a total trade-to-GDP ratio of over 138.8%, (Table 24.5). Since 2017, its main trading partners have remained the 27 EU member states, which account for more than 80% of total exports and 53% of imports.[20]

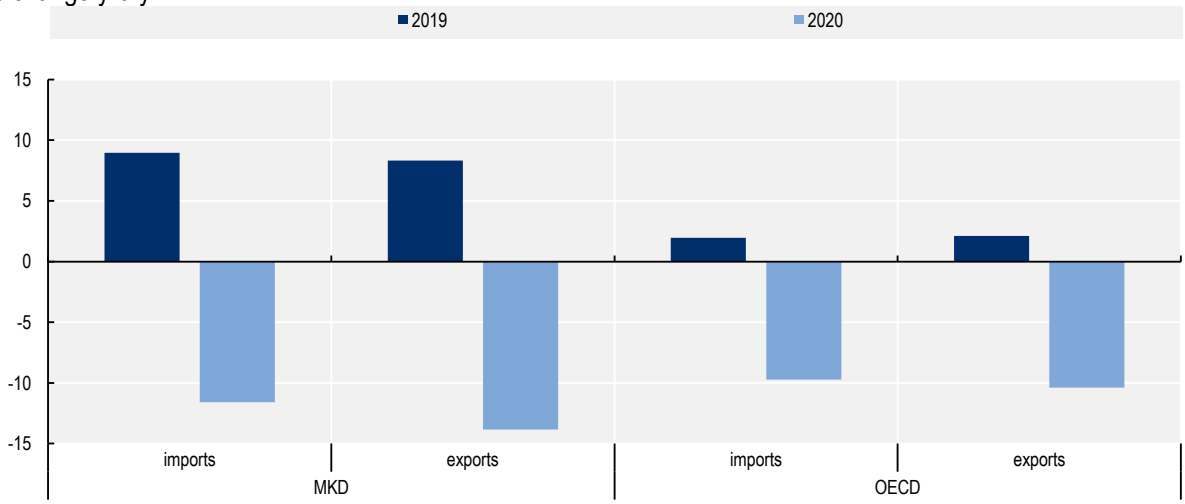
In 2019, exports of goods and services were worth EUR 6.5 billion – an increase of 24% since 2017 – and imports EUR 8 billion (+17% over 2017). In 2019, exports amounted to 62.2% of GDP and imports 76.5%. Although the gap between imports and exports was gradually narrowing before the COVID-19 pandemic,

the trade structure of North Macedonia remains in deficit and has been hovering at around EUR 1.8 billion since 2017. The overall trade deficit for 2019 was around 14.2% of GDP (EC, 2020[46]).

Although North Macedonia had one of the highest trade levels in the region in 2019. In 2020, pandemic-related export bans, restrictions on the movement of people, and closures of shops and services, led to a significant decline in imports and exports. Although North Macedonia was not the most severely affected economy in the region, imports declined by 11% and exports by 13% in Q2-Q3 2020. The similarity in the scale of both contractions meant the trade balance was comparable to that in 2019. Trade, tourism and transport, which are substantial drivers of growth in the economy, were the most affected, contracting by almost 12.3%.

## Figure 24.4. Impact of COVID-19 on trade, North Macedonia versus the OECD (2019-20)

% change y-o-y




Source: IMF (2020[50]), *World Economic Outlook*, www.imf.org/en/Publications/WEO; OECD (2020[51]), *OECD Economic Outlook*, https://doi.org/10.1787/0d1d1e2e-en.

StatLink https://doi.org/10.1787/888934256045

*Slowdown in trade flows*: Industries in the WB6 were affected by the supply shock caused by the COVID-19 pandemic and the resulting slowdown in trade flows. The decline in North Macedonia's exports was primarily due to the breakdown of global value chains (GVCs). As one of the economies in the region with a greater level of integration into GVCs, it felt the immediate effects more severely (OECD, 2020[51]). In particular, it suffered from the disruption to supply chains from the manufacturing slowdown in the People's Republic of China and reduced demand in the United States and especially the EU, its main trading partner. GVCs are concentrated in a few sectors (automotive, electrical equipment, machinery, chemicals and metals) and are located around a few European economies (OECD, 2019[52]). In North Macedonia, the producers of machinery and equipment, and mechanical appliances were most affected, as they were the most integrated into European value chains. However, given the relatively high import content of its goods exports, the volume of trade is expected to recover once production resumes alongside the revival of GVCs and demand, especially in the EU.

*Slowdown in services*: Although they make up a smaller share of its exports as goods, services generate 55.2% of GDP in North Macedonia and 54.9% of employment (IMF, 2019[53]). They have been strongly affected by the fall in domestic and external demand during the pandemic, as well as by travel restrictions and social distancing measures.

*The benefits of green lanes*: The closure of EU borders to non-EU citizens and other regulatory responses, combined with the existing logistical challenges of the Western Balkans, have particularly affected freight transport services. The WB6 set up the CEFTA co-ordinating body to exchange information on trade in

goods at the beginning of the pandemic. They also set up priority "green lanes" (with the EU) and “green corridors” (within the WB6) to facilitate the free movement of essential goods within the WB6 and with the EU, involving priority green border/customs crossings. At the peak of the crisis (April-May 2020), most road transport in the WB6 economies passed along these green corridors. These have helped to maintain a certain degree of international trade in goods in the region. In fact, only about 20% of the goods benefitting from the Green Corridor regime were basic necessities, the rest being regular trade.

### *Sub-dimension 2.1: Trade policy framework*

The importance of a transparent legislative procedure has increased over the past few years. A fundamental aspect of regulatory transparency is that the regulatory development process is open to all relevant stakeholders through formal and informal consultation channels before and after the adoption of new regulations. These consultation mechanisms have a positive impact on the efficiency of economic activities and the degree of market openness, as they can improve the quality and enforceability of regulations (OECD, 2012[54]). Governments in many economies are also adopting cross-cutting policies or guidelines to further improve the consultation process. This sub-dimension assesses the government's effectiveness in formulating, evaluating and implementing trade policy through two indicators: the institutional co-ordination of trade policy formulation, and public-private consultation and transparency.

North Macedonia has a solid **inter-institutional co-ordination of trade policy formulation** framework (Table 24.5) through official committees, councils and working groups led by the Ministry of Economy.[21] Inter-ministerial committees focus on the implementation and negotiation of regional and international commitments such as CEFTA and the World Trade Organization (WTO), facilitation of the EU accession process (through the preparation of relevant trade policy-related chapters of the *acquis*), and the design and amendment of specific trade measures. They also establish co-ordination mechanisms to address the more challenging areas of trade policy. Under the auspices of the Ministry of Economy, committees meet whenever a trade issue arises or a regulation is foreseen. For each issue of this nature, the law requires consultation with the ministries concerned before the project is discussed in government sessions.[22] Each ministry or institution preparing information on a trade issue is required to obtain the opinion of the Ministry of Economy and all other ministries and institutions concerned.[23] The opinion of the Secretariat for Legal Affairs is mandatory on any document sent to the government.[24]

One of the fundamental aspects of regulatory transparency is that the regulation-making process is open to all concerned stakeholders through formal and informal consultations prior to and after adoption. North Macedonia has formal instruments for **public-private consultation** with businesses and civil society, which involve the most relevant stakeholders (domestic and foreign companies, business associations, logistics providers, trade unions, consumer groups, etc.). The economy performs well on the frequency of its consultations, the depth of stakeholder participation in practice and the availability of online information through the Unique National Electronic Register of Regulations (ENER) platform.[25]

Since the last assessment, the recently started consultations for trade policy strategies cover both draft legislation and trade policy strategies. In 2018, North Macedonia had the highest number of stakeholders involved in regular public-private consultations among the WB6 economies (OECD, 2018[55]) and this trend has continued in this assessment cycle (Government of North Macedonia, 2019[56]).

A legally formalised consultation procedure exists within the legal processes for the adoption of acts. The authorities have set up a dedicated website to enable the private sector to comment on draft laws in a transparent manner. Inclusive participation in public consultations is encouraged through ENER. Stakeholders can therefore be consulted both while policy is being made and as it is implemented. The private sector has full access to draft trade normative acts, including relevant material from regulatory dossiers (supporting analysis, impact assessment results, reasons for regulatory decisions and other relevant data). Consultations include strategic, tactical and operational issues. The timelines, goals and topics of consultations are published in advance. Once the consultation process has ended, the law

mandates that the outcomes be made publicly available as the authority receiving the comments is required to respond within 15 days. This includes the reasons why comments were taken into account or discarded.

However, the system is not fully exploited, as business and citizens' associations are mainly consulted at the end of the development of strategies and are not sufficiently involved in their preparation. Moreover, feedback from local stakeholders found that in some ENER-supported consultations there were no responses to stakeholders' comments, complaints and recommendations. Stakeholders also raised sporadic concerns that they were given too little time to comment on some documents, effectively preventing some stakeholders from participating in consultations.

The various chambers of commerce and economy of North Macedonia are regularly involved when a new trade bill is being considered. The chambers then disseminate the proposals through their business networks for comment. Similarly, in the period after regulations enter into force, the chambers have the opportunity to feed back the private sector's comments about the effects of regulations on the business environment to government institutions.[26]

Compared to 2018, North Macedonia has improved its regulatory transparency by increasing the openness of its consultation mechanisms, in particular by making them simpler and more accessible. However, there is no systematic quality control of the public consultation process. Nor is the process always enforced: the number of laws adopted under shortened procedures, mainly on the proposal of members of parliament (MPs), has increased considerably, from 20% in 2018 to 61.6% in 2019 (EC, 2020[43]). These laws have not been subject to a genuine public consultation process and have not been regularly supported by impact assessments.

North Macedonia generally ensures that its policy and legislation development is based on evidence. The collection of administrative data has improved since 2018, but the information is not always used optimally in the decision-making process. One of the reasons for this is the lack of a specialised administrative unit for this type of analysis. Regulatory impact assessments (RIAs) remain an issue. Until mid-2019, the government regularly prepared RIAs for all regulations sent to parliament through the ordinary legislative procedure, but since then parliament has enacted an unusually high number of laws without impact assessment or public consultation (EC, 2020[46]). The government explanation for this is the large number of new bills, urgency and the lack of some of the information needed for *ex ante* evaluations. In addition, the RIA process does not include the financial impact on the budget, nor the financial implications for stakeholders of implementing regulations. Evaluations of the effects of regulations are only very rarely carried out after they have been adopted and implemented.

North Macedonia is party to a number of bilateral and multilateral **free trade agreements**, the first of which was signed between North Macedonia and Turkey in 2000, followed by a bilateral agreement with Ukraine in 2001. Having entered into a free trade agreement with the European Free Trade Association (EFTA) in 2002, North Macedonia opened the door for market access to its European partners.

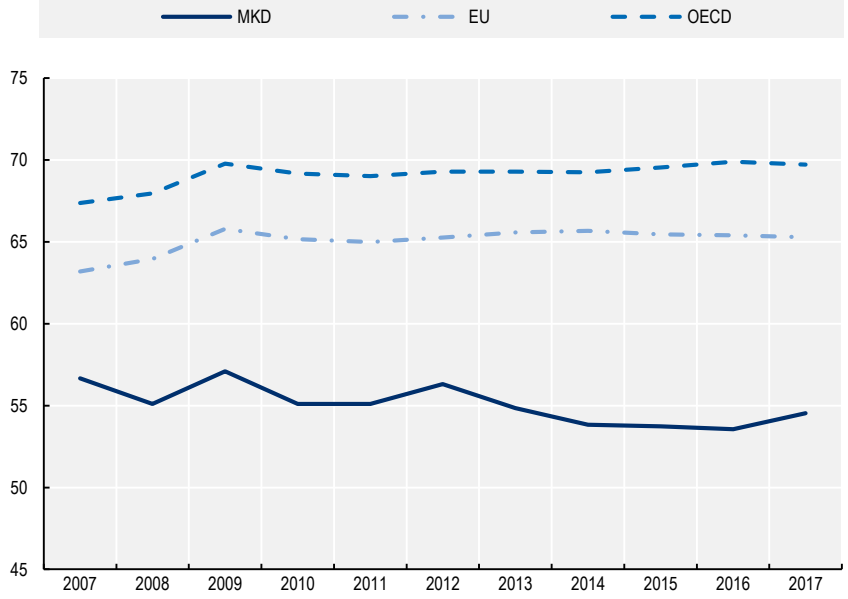
In 2004, North Macedonia adopted the Stabilization and Association Agreement (SAA), providing for the free movement of goods and service between EU and potential candidate countries. It continues to bring its legislation in line with the EU *acquis*. Shortly after it joined the WTO in 2006, it became a founding member of CEFTA the same year, with the aim of achieving full tariff liberalisation on trade in manufactured products and agricultural goods, and to establish a negotiating framework for eliminating non-tariff barriers (NTBs).

In 2018, North Macedonia brought the CEFTA Additional Protocol 5 on Trade Facilitation into force, simplifying trade-related procedures and cross-border documentation processes. Most recently, it adopted Additional Protocol 6 on Trade in Services in 2019, which allows it to ease licensing and professional qualification procedures, as well as developing the regional e-commerce capacities.

*Sub-dimension 2.2: Services trade restrictiveness*

Services contribute close to two-thirds of GDP in the WB6 economies, underlining how strongly economic growth, innovation and job creation depend on effective policies for services that promote open and competitive markets. In 2019, in North Macedonia, services contributed to 55.2% of GDP and accounted for 54.9% of employment, a steady though moderate increase compared to previous years (Figure 24.5), underlining the extent to which economic growth, innovation and job creation depend on effective service sector policies that promote open and competitive markets.

**Figure 24.5. Services, value added (% of GDP) - North Macedonia (2007-17)**




Source: (World Bank, 2020[16]), *World Development Indicators* (database), https://databank.worldbank.org/source/world-development-indicators.

StatLink https://doi.org/10.1787/888934256064

More and more business models rely on services rather than sales of manufactured goods. This is the so-called "servitisation" of manufacturing (Miroudot and Cadestin, 2017[57]). Enhancing the openness of trade in services can improve domestic firms' efficiency and productivity. Trade in services allows countries to specialise according to their comparative advantages in services and skills. The potential gains from liberalisation in services trade are significant because increased domestic and foreign competition, complemented by effective regulation, can enhance performance (OECD, 2018[55]) and lower costs provoked by regulatory barriers (Box 24.2).

### Box 24.2. The costs of regulatory barriers to trade in services

Recent OECD analysis reveals that services trade restrictions significantly affect trade by raising the costs for firms to operate in the host economy (Rouzet and Spinelli, 2016[58]). Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rule-making. The costs resulting from barriers to trade in services are much higher than those to trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services. Even exporting to the most liberal countries still requires compliance with regulation at a cost that correspond to around 30% of the export value in most sectors and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are around 10% in most sectors and around 32% for financial services.

Source: (Benz and Jaax, 2020[59]), *The costs of regulatory barriers to trade in services: New estimates of ad valorem tariff equivalents*, https://dx.doi.org/10.1787/bae97f98-en.

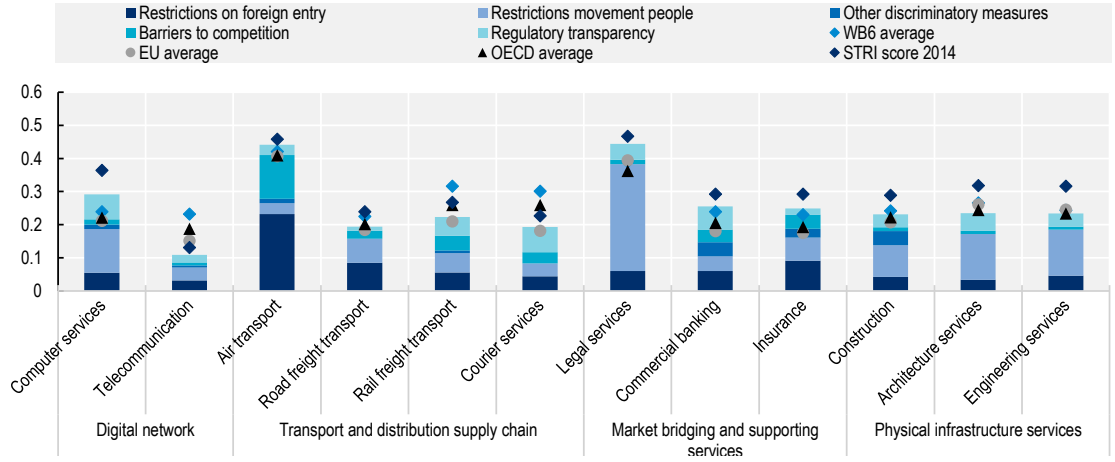
The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse barriers to trade for 12 services sectors** in North Macedonia. The OECD STRI project is a unique, evidence-based diagnostic tool that inventories trade restrictions in 48 economies,[27] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts. For this CO assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices quantify restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[28]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[29] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[60]).

Figure 24.6 shows the STRI indices for each of the sectors as well as the average scores for the WB6, EU and OECD. Like most economies in the WB6 region, North Macedonia's services trade markets are generally more open than some OECD and STRI partner states. Compared to the OECD and key partners' average STRI indices (represented by a "+" in Figure 24.6), North Macedonia is in the low range for the restrictiveness of its service sectors, making it a preferred candidate for foreign service providers; especially in its three least restrictive sectors: telecommunications, road transport and courier services. In contrast, it remains less competitive in computer services, air transport and legal services, the three sectors with the highest STRI score. The analysis which follows displays the scores, explains sector by sector what drives the results and provides a brief description of the most common restrictions and good practices.

## Figure 24.6. Services trade restrictiveness index for North Macedonia (2020)



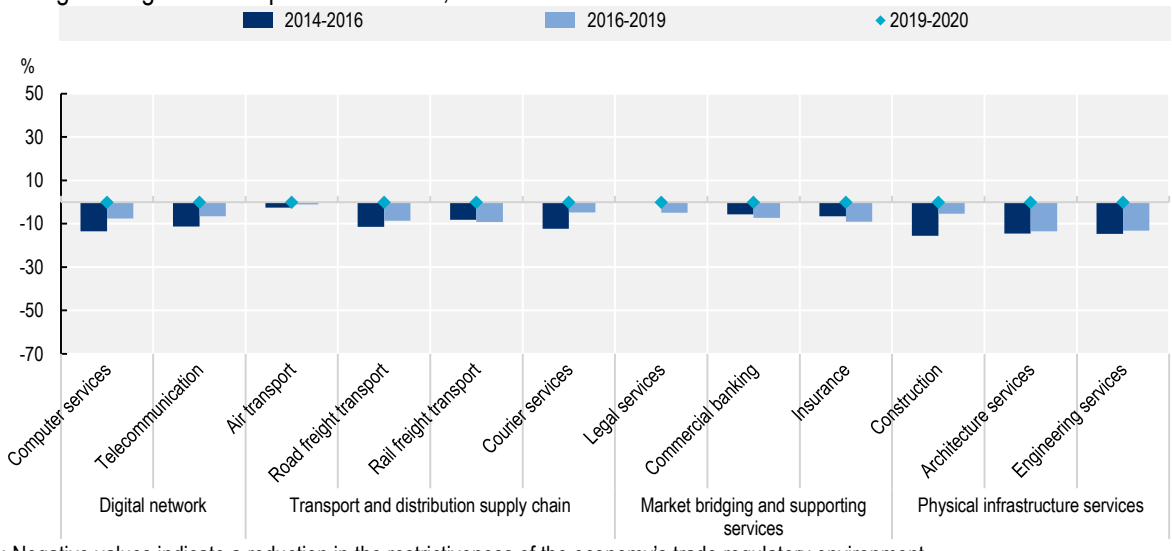

Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[61]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256083

As Figure 24.7 shows, North Macedonia has continued to reduce restrictions on the trade in services. The slowdown in reforms to open up services markets in the years 2019-20 is explained by the reorganisation of regulatory efforts caused by the COVID-19 pandemic.

## Figure 24.7. Evolution of STRI scores by sector in North Macedonia (2014-20)

Percentage change over the periods 2014-16, 2016-19 and 2019-20




Note: Negative values indicate a reduction in the restrictiveness of the economy's trade regulatory environment.
Source: OECD (2020[61]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256102

The following analysis starts with the horizontal measures that are included in all sectors and that typically hamper services trade in the economy as a whole. In particular, in the area of general business regulations (horizontal regulations), restrictions on foreign entry, restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. It then reviews each of the 12 sectors analysed, displaying the STRI

scores, explaining what drives the results, and providing a brief description of the most common restrictions and good practices.

### General business regulations affect firms' ability to operate in North Macedonia

*General business regulations* can affect firms' ability to operate. North Macedonia could improve its company regulations in a number of areas. Foreigners need to obtain authorisation before they can acquire or use land and real estate, affecting the companies' ability to establish offices in the economy. In order to register a limited-liability company, a minimum amount of capital[30] must be deposited in a bank or notary's office, which also affects foreign companies. Cumbersome procedures for obtaining business visas limit the search for investment opportunities.

*Restrictions on the movement of people* are also an issue in North Macedonia. Although the conclusion of Additional Protocol 6 has made significant progress in easing the conditions for the movement of persons between CEFTA economies, people from outside CEFTA or the EU remain subject to restrictive requirements. North Macedonia applies quotas and labour market tests for work permits issued to third-country nationals, although intra-corporate transferees are exempted. Labour market tests are undertaken to determine whether suitably qualified local workers are available (or could easily be trained to do the work). They typically involve seeking advice from industry representatives and government agencies to determine current skill shortages. The initial length of stay of these categories of foreigners (12 months) also falls short of international best practice (OCDE good practice threshold is set at 36 months) (OECD, 2021[49]).

*Standards for the cross-border transfer of personal data* are set at EU level. Data may be transferred to non-European Economic Area (EEA) economies which ensure an adequate level of data protection or, failing that, where appropriate safeguards (e.g. binding corporate rules or standard data protection clauses) are in place.

North Macedonia's laws do not contain any elements restricting trade in services in terms of investment screening. *Screening of foreign investments* refers to the laws or regulations enabling governments or regulators to alter or prohibit foreign investment projects, where consideration of economic motives or economic interests is explicitly included in the criteria for approval. North Macedonia's regulations do not mandate the consideration of economic interests in the review of foreign investments but nor is it explicitly ruled out. There is threshold above which a foreign investment project is subject to screening.

### How restrictive are individual service sectors?[31]

On top of the regulatory measures that affect North Macedonia's trade in services across the board, there are a number of sector-specific restrictions in the 12 sectors analysed.

**Air transport services** are defined as passenger and freight air transport (code 51 under the International Standard Industrial Classification – ISIC Rev 4), carried domestically or internationally. The STRI for this sector covers commercial establishments only. In light of the range of air transport sub-sectors, the STRI project focuses on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant where regulations could have affect foreign carriers' ability to transport passengers and goods. The other aviation services are covered more fully in the STRI for logistics services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601. With a score of 0.441, North Macedonia's air transport sector is the most restrictive of the WB6 economies and it scores higher than the EU (0.406), OECD (0.409) and WB6 (0.421) averages.

*Restrictions on foreign entry* figure prominently in the results of North Macedonia's STRI for air transport services. Foreign natural or juridical persons can only hold up to 49% of the equity share in an air transport services company in North Macedonia. This restriction is in line with EU legislation, and can be found in

many of the countries that have undergone the STRI exercise. However, it greatly impacts the score (and therefore the level of restrictiveness) in air transport markets. Economies that have reformed in this area have been able to lower their level of restrictiveness substantially. Another measure that limits the openness of this sector is the limitations on leasing. Dry leasing (leasing foreign aircraft without crew) is allowed but subject to prior authorisation, but wet leasing (leasing foreign aircraft with a crew) is prohibited. Both measures negatively affect the economy's score for this sector.

*Barriers to competition*. Unlike several WB6 economies, North Macedonia does not maintain public ownership in the aviation sector through a national company. Macedonian Airlines (MAT; Македонски Авиотранспорт or Makedonski Aviotransport) was the national flag carrier, but it ceased operation in 2009. Slots are allocated in a fair, non-discriminatory and transparent manner, following the principle of equal opportunities to all airlines. The general principle regarding slot allocation is that an air carrier having operated its particular slots for at least 80% of flights during the summer/winter scheduling period is entitled to the same slots in the equivalent scheduling period of the following year (so called grandfather rights). Consequently, slots which are not sufficiently used by air carriers are reallocated (the so called "use it or lose it" rule). North Macedonia prohibits the commercial exchange of slots, which is more restrictive than the EU *acquis,* where slots can be freely transferred (EUR-Lex, 1993[62]).

**Road freight transport** (ISIC Rev 4 code 4923) covers commercial road freight establishments only. Cross-border trade is governed by a system of bilateral and plurilateral agreements which provide for permits, quotas and other regulations.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.124 and 0.624. With a score of 0.194, North Macedonia is the third-most restrictive economy among the WB6 economies. It scores higher than the EU average (0.184) but lower than the OECD (0.201) and WB6 (0.225) averages.

The most restrictive sector-specific measure is the practice of imposing licensing and permits subject to quotas for domestic traffic. Sector-specific regulations induce *foreign entry restrictions* in North Macedonia. Licences are established on the basis of technical, legal and financial criteria. Licences and certificates issued by the competent authorities in economies which have signed a bilateral or multilateral agreement with North Macedonia are fully recognised. The Law on Recognition of Professional Qualifications provides adequate solutions for third-country licences.

Public transport of goods by road refers to transport for which the relation, the price of transport and other conditions are determined by agreement between the carrier and the customer. The government only mandates set prices for inter-municipal line passenger transport, bus lines, taxi services, etc, meaning there are no specific *barriers to competition* for road freight. There are no specific visas for road freight transport crews, although there are transit visas. These can be issued for a single or double entry and, in exceptional cases, multiple transits through the territory for a maximum of five days during each individual transit.

**Rail transport** (ISIC code 4912) is provided over a dedicated network in which the market structure may take different forms. The two most common are: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between the infrastructure management and operations. Regardless of the market structure, there are well-established best practice regulations that also take into account competition from other modes of transport, particularly road transport.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.129 and 1. With a score of 0.223, North Macedonia is the second-least restrictive economy of the WB6 in this sector. It scores higher than the EU (0.210) and OECD (0.260) averages, and below the WB6 average (0.317).

In terms of *foreign entry restrictions*, unlike many economies, North Macedonia provides transit rights for international rail transport, as well as access rights for international combined transport and rail transport. A licence is needed to operate in the Macedonian railway sector. A carrier with a licence and a certificate of safety may offer public transport services using the railway infrastructure if it has been given access to it. The infrastructure manager approves access to the railway infrastructure for carriers that meet the conditions in a transparent and non-discriminatory manner. Commercial presence is only required for operators willing to obtain a licence. North Macedonia recognises licences issued to carriers by the competent authorities of other states in accordance with EU legislation and on a reciprocal basis with third countries. Duly licensed freight transporters can provide cross-border services without a commercial presence.

Regarding *barriers to competition*, access fees are regulated. The infrastructure manager charges a fee for the use of the railway infrastructure by the carriers using it. The infrastructure manager prepares rules for determining the amount of compensation for infrastructure use. The applicant may not transfer the assigned infrastructure capacity to another carrier or service provider. Trading with the infrastructure facilities is also prohibited and is the basis for exclusion from further distribution of capacity. Makedonski Železnici (MŽ) (Македонски Железници, Macedonian Railways) is the public enterprise for railways North Macedonia. Railway operations are run by Makedonski Železnici and the infrastructure maintained by Makedonski Železnici - Infrastruktura. The latter has dominance on the infrastructure.

**Courier services** (ISIC Rev 4 code 53) comprises postal and courier activities. While courier services have traditionally been an important means of communication, the rise of modern ICT means letters are less frequently used for communication. The STRI for courier services covers regulations that have an impact on the pick-up, transport and delivery (door-to-door) of letters and parcels, and express delivery services, regardless of who provides the service. These services include both addressed and unaddressed items.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.106 and 0.881. With a score of 0.206, North Macedonia is the least restrictive of the WB6 economies and performs better than Poland, the worst performer among the Central and Eastern European EU countries, scoring 0.251. North Macedonia scores higher than the EU average (0.182), but below the OECD (0.259) and WB6 average (0.301).

Unlike many economies, North Macedonia does not impose a commercial or local presence requirement when providing courier services and firms do not need a licence. North Macedonia does not have a monopoly in any area of courier services, which improves its score for this sector.

Companies wishing to provide postal services must obtain general authorisation from the Postal Agency on the basis of prescribed minimum requirement. Foreign investors are entitled to tax reductions for their initial period of operation. The publicly owned Post of North Macedonia, which is the major firm in the sector, is the designated postal operator for universal postal services. Before any change in the prices for providing universal services, a request must be submitted to the Postal Agency explaining the cost analysis behind the need for a price change. Special accounting is used to calculate the net cost of the universal service.

**Legal services** (ISIC Rev 4 code 691) cover advisory and representation services in both domestic and international law and, where relevant, measures are entered separately for each of them. International law includes advisory services in home country law, third-country law, international law and appearing in international commercial arbitration. Domestic law extends to advising and representing clients before a court or judicial body in the law of the host country.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.141 and 1. With a score of 0.444, North Macedonia is the third-most restrictive of the WB6 economies in this sector, scoring higher than the EU (0.394), OECD (0.362) and WB6 (0.391) averages.

*Restrictions on the movement of people* contribute significantly to the restrictiveness score in North Macedonia. Such restrictions are present in the form of a licence requirement, needed to provide legal services in the economy. The right to practise law in accordance with this law is acquired by registration in the Directory of Lawyers of the Chamber of Lawyers of the Republic of North Macedonia. Upon registration in the Directory of Lawyers of the Chamber of Lawyers of the Republic of North Macedonia the registered lawyer is granted a licence. To obtain a licence, the person in question must be a citizen of North Macedonia or of an EU member state; otherwise a reciprocity clause applies. A foreign professional who wants to practise law in North Macedonia must pass the Macedonian bar exam, but foreign university degrees are recognised by the Bar Association. After the entry in the Directory of Foreign Lawyers of the Bar Association of the Republic of North Macedonia, the foreign lawyer, after three years of continuous and effective practice of law or after passing the North Macedonia bar exam, may request to be registered in the Directory of Lawyers of the Bar Association of the Republic of North Macedonia and practise the full scope of the law. An EU citizen who is not registered in the Directory of Foreign Lawyers may be able to perform individual activities within the practice of law, i.e. provide advice on the law of their home country, the law of the European Union, international law and law of the Republic of North Macedonia.

The registration with establishment of a legal entity in North Macedonia indicating commercial presence is required to provide cross-border services, acting as a *restriction on foreign entry*. Furthermore, local presence is also required. Liability insurance must be purchased to an insurance company in the jurisdiction. Lawyers from the EU can practise in North Macedonia under certain conditions and can be covered for liability in their country of origin.

In the area of *barriers to competition*, North Macedonia restricts advertising of legal services. The Bar Association sets mandatory minimum fees for providing legal services.

**Commercial banking** (ISIC divisions 64-66) is defined as deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of a dynamic economy; they provide financing for investment and trade across productive activities, and thus underly all value chains.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.131 and 0.517. With a score of 0.255, North Macedonia is the third-most restrictive of the WB6 economies in this sector, scoring higher than the EU (0.180), OECD (0.205) and WB6 (0.239) averages.

North Macedonia's laws impose restrictions on cross-border mergers and acquisitions, which has a negative effect on the STRI score. Only banks established and based in North Macedonia may perform statutory changes of mergers, mergers and divisions. North Macedonia also deviates from the international Basel Committee on Banking Supervision (BCBS) risk weighting standards, but it is taking steps to change to the international capital and liquidity standards prescribed by Basel III.[32] Foreign banks may open a branch after obtaining permission from the governor as well as obtaining a licence, which requires the bank to meet a list of requirements. If the application for a licence is denied, there is no legal requirement to inform applicants of the reasons for denial, which negatively affects its score in this sector.

**Insurance services** (ISIC Rev 4 codes 651 and 652) comprise life insurance, property and casualty insurance, reinsurance, and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.104 and 0.565. With a score of 0.249, North Macedonia is the second-most restrictive of the WB6 economies in this sector, scoring higher than the EU (0.175), OECD (0.193) and WB6 (0.231) averages.

Regarding *restrictions on foreign entry*, North Macedonia applies cross-border restrictions on mergers and acquisitions in the insurance sector. A cross-border merger with a company from an EU member state is only possible if the law of the relevant country allows cross-border mergers against the form of companies that merge. There is a commercial presence requirement for providers of cross-border services. The

provisions of the Law on Insurance Supervision apply to insurance companies with a head office in the territory of any EU member state provided they establish a branch office in North Macedonia. A licence is needed to operate in the insurance sector, which only citizens of North Macedonia can obtain, and residency is required in order to practise. Licences and certificates issued by the competent authorities of countries with which North Macedonia has signed a bilateral or multilateral agreement are fully recognised. For third-country licences, the Law on Recognition of Professional Qualifications provides adequate solutions, which positively affects the score in this sector.

North Macedonia's rules on accounting (International financial reporting standards or IFRS), transparency and Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) deviate from international standards. In its 2019 progress report, the European Commission noted that North Macedonia still has not completed the process of aligning its national standards with international standards in this sector (EC, 2019[63]).

In terms of *barriers to competition*; North Macedonia places restrictions on asset holdings for both life and non-life insurance companies. An insurance company's total financial investment in a bank may not amount to more than 25% of its capital. Its total financial investments in other individual entities that are not banks may not amount to more than 10% of its capital. Total financial investments are considered capital investments of the insurance company (investments in stocks), debtor's securities bought, approved loans, approved bank deposits, as well as calculated interest rate on the basis of such investments. Moreover, the insurance company is obliged to obtain a licence by the Insurance Supervision Agency for introduction of a new class of insurance.

**Construction services** (ISIC Rev 4 codes 41 and 42) cover the construction of buildings (residential and non-residential) as well as construction work for civil engineering. Construction has historically played an important role in the functioning of economies, providing the infrastructure for other industries. It accounts for a significant share of GDP and employment in most countries. Public works, such as roads and public buildings, account for about half of the market for construction services so the STRI for construction services covers detailed information on public procurement procedures. There is a good deal of regulatory complementarity between the construction services sector and architectural and engineering services (below). The regulatory landscape of North Macedonia reflects these similarities, with all three sectors having very similar STRI scores.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464. With a score of 0.231, North Macedonia is the second-most restrictive of the WB6 economies in this sector, scoring higher than the EU (0.207) and OECD (0.223) averages but below the WB6 average (0.242).

The *movement of people is restricted* by licensing requirements needed to provide engineering services in North Macedonia. A foreigner with a licence from another economy may perform design, auditing, construction and surveillance works in North Macedonia if the authorisation is confirmed by the Chamber of Chartered Architects and Engineers. In order to apply for a contractor's licence, the legal entity needs to submit proof that it is registered to perform the relevant activity and that it has at least 20 employees, at least 3 of whom have an A licence for a performance engineer and 1 with a B licence.

Regarding *restrictions of foreign entry:* There are no restrictions on the purchase of buildings and houses by individuals and legal entities from EU and OECD states. Non-EU and non-OECD nationals or legal entities can only purchase real estate under reciprocity conditions which increases the restrictiveness score according to the STRI methodology.

**Architecture services** (ISIC Rev 4 code 711) cover architectural services and related technical consultancy. These services form the backbone of the construction sector, with key roles in building design and urban planning. An important feature is the regulatory complementarity between architecture, engineering and construction services. Architectural and engineering activities are often combined into

projects managed by a single company, and are sometimes subsumed in the building and construction sector. The STRI definition of architecture services includes several related activities, such as advisory and pre-design architectural services, architectural design, contract administration services, and urban planning and landscape architecture services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.113 and 0.684. With a score of 0.235, North Macedonia is the third-least restrictive of the WB6 economies in this sector, scoring lower than the EU (0.261), OECD (0.244) and WB6 averages (0.266).

As regards *restrictions on foreign entry*, a licence or authorisation is required to practise in this sector. In order to develop or revise urban plans, legal entities need a licence issued by the state administration body responsible for spatial planning. Individuals require authorisation issued by the Chamber of Certified Architects and Certified Engineers in order to develop or revise plans. There is no temporary licensing system which would enable foreign architects to carry out a specific project or advise in a particular area. North Macedonia has a procedure for recognising foreign qualifications.

Even though there is no requirement for legal entities to have a commercial or local presence to carry out design, audit, execution and supervision of construction, they are required to have liability insurance for damages from an insurance company based in North Macedonia.

In the area of *regulatory transparency*, laws and other regulations are published before they come into force. Laws come into force on the eighth day after the day of their publication at the earliest, or on the day of publication in exceptional cases determined by the Assembly. Laws and other regulations may not have a retroactive effect, except in cases when this is more favourable for citizens. According to the STRI methodology, this amount of time is scored as restrictive.

**Engineering services** (ISIC Rev 4 code 711) cover several related activities, such as engineering and integrated engineering services, and engineering-related scientific and technical consulting services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.118 and 0.575. With a score of 0.234, North Macedonia is the third-most restrictive of the WB6 economies in this sector, scoring lower than the EU (0.246) and WB6 (0.244) averages and in line with the OECD average (0.234).

Engineering services are the backbone of construction and supply. Engineers are involved in the construction of key infrastructure, such as buildings and roads. They also play an important role in the development of production processes and the adoption of new technologies.

Regarding *foreign entry restrictions*, in order to develop or revise urban plans, legal entities need a licence issued by the state administration body responsible for spatial planning. Individuals require authorisation issued by the Chamber of Certified Architects and Certified Engineers in order to develop or revise plans. There is no temporary licensing system which would enable foreign engineers to enter North Macedonia temporarily to carry out a specific project or provide advice in certain fields. Legal entities are required to have liability insurance for damages from an insurance company in North Macedonia in order to carry out the design, audit, execution and supervision of construction. The STRI score is further affected by the imposition of quotas for contractual and independent service providers, and labour market tests for these and intra-corporate transferees. In this regard North Macedonia is the most restrictive of the WB6 economies.

**Computer services** (ISIC Rev 4 codes 62 and 63) are defined as computer programming, consultancy and related activities, and information service activities.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.448. With a score of 0.291, North Macedonia is the second-most restrictive of the WB6 economies in this sector, scoring higher than the EU (0.211), OECD (0.222) and WB6 (0.239) averages.

This sector is very rarely regulated by sectoral legislation and in North Macedonia computer services are only subject to the general laws that apply to the economy as a whole. This is why restrictions on the movement of people account for one-third of the total STRI score for the sector. The need for skilled labour in computer services, combined with the complementarity between cross-border trade and the movement of natural persons, explains why restrictions on movement of people feature so prominently.

**The telecommunication sector** (ISIC Rev 4 codes 611 and 612) comprises wired and wireless telecommunications activities. These services are at the core of the information society and provide the network over which other services including computer services, audio-visual services, and professional services are traded.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.108 and 0.682. With a score 0.108, North Macedonia is the second-least restrictive of the WB6 economies in this sector, scoring lower than the EU (0.151), OECD (0.188) and WB6 (0.232) averages.

The STRI results in this sector depend on two policy areas: 1) restrictions on foreign entry; and 2) barriers to competition. In all of the states taking part in the STRI, barriers to competition account for 30% of their total scores in the telecommunications sector. This reflects the sector's particular characteristics as well as the policy environment in which it operates. It is a capital-intensive network industry and its strategic importance has led many countries to restrict foreign investment and activity in the sector.

In order to ensure fair competition in the telecommunications market, North Macedonia has an independent telecommunications regulator, the Agency for Electronic Communication (AEK). The regulator may impose obligations regarding cost recovery and price control related to providing interconnection or access on the operator with significant market power (SMP) in the relevant market. It also designates one or more universal service provider, selected through public tender. When determining a universal service provider, AEK must apply the principles of objectivity, transparency, efficiency and non-discrimination. AEK also provides decisions which mandate the access to mobile networks. Makedonski Telecom qualifies as an SMP in the market. ONE.vip is an SMP in the access to passive and active wholesale products, and Makedonski Telecom, ONE.vip, Laikamobil and TDR Robbie are considered SMPs in the termination and interconnection market. The government has a minority share in Makedonski Telecom but does not control any major firms in the sector.

The laws of North Macedonia require number portability and regulate the time and conditions for porting. Numbers should be transferred within two days of receipt of the request. Interconnection is also regulated. North Macedonia applies a "use-it-or-lose-it" policy to frequency bands – an important measure that prevents incumbent operators from hoarding valuable frequency licences and freeing up tradeable spectrum and telecom services.

In absolute terms, the regulatory framework for this sector in North Macedonia is competitive and restricted only by measures that apply to the economy as a whole, notably on the movement of people. Although telecommunications lend themselves easily to cross-border trade from a technical point of view, restrictions on movement account for a modest share of the total STRI score in this sector. Cumbersome procedures to obtain visas and register companies also negatively affect the sector to some extent.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring about significant gains for businesses, driving firms' process innovation (Ferencz, 2019[64]). In addition it enlarges businesses' market scope, reduces operational costs at various stages of business activities and lowers barriers to entry, thus intensifying competition (OECD, 2013[65]). E-commerce also benefits consumers by providing information on goods and services, helping consumers identify sellers and compare prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[65]).

In the context of the COVID-19 pandemic, e-commerce appears to have been essential for maintaining trade flows despite the restrictions put in place to preserve public health. Buying on line rather than in person also reduces the risk of infection. Being able to keep selling in locked-down economies preserves jobs despite social distancing and movement restrictions. Finally, e-commerce increases the acceptance of prolonged physical distancing among the population and allows them to maintain a certain level of consumption (OECD, 2018[55]).

It is clear that 2020 will be a turning point in electronic commerce. This digital transformation underlines the importance of adopting a more holistic approach to policies as well as more international co-operation (Ferencz, 2019[64]). This sub-dimension assesses those policies which are implemented in parallel and in addition to those discussed under Digital society (Dimension 10). However, it is mainly focused on the trade in digitally enabled services given the rapid growth of trade in services in the region.

North Macedonia has a solid **e-commerce policy framework**. In 2018 it already had the most developed one in the region. The Law on Electronic Commerce was adopted in November 2007 and lays down the conditions for the provision of information services related to electronic commerce, the responsibilities of providers of information services, commercial communications and the rules regarding the validity of contracts in an electronic form.

Regulations related to e-commerce fall under the competence of several institutions. North Macedonia's institutional framework allows for effective institutional co-ordination across ministries and agencies regarding e-commerce. The Ministry of Information Society and Administration (MISA) is responsible for all activities regarding the enhancement of e-commerce and co-ordinates all existing inter-ministerial working groups with competences related to e-commerce. Meanwhile, the Ministry of Economy is responsible for the implementation of the law on e-commerce and related documents, such as the law on consumer protection (which has some measures regulating contracts concluded at a distance).

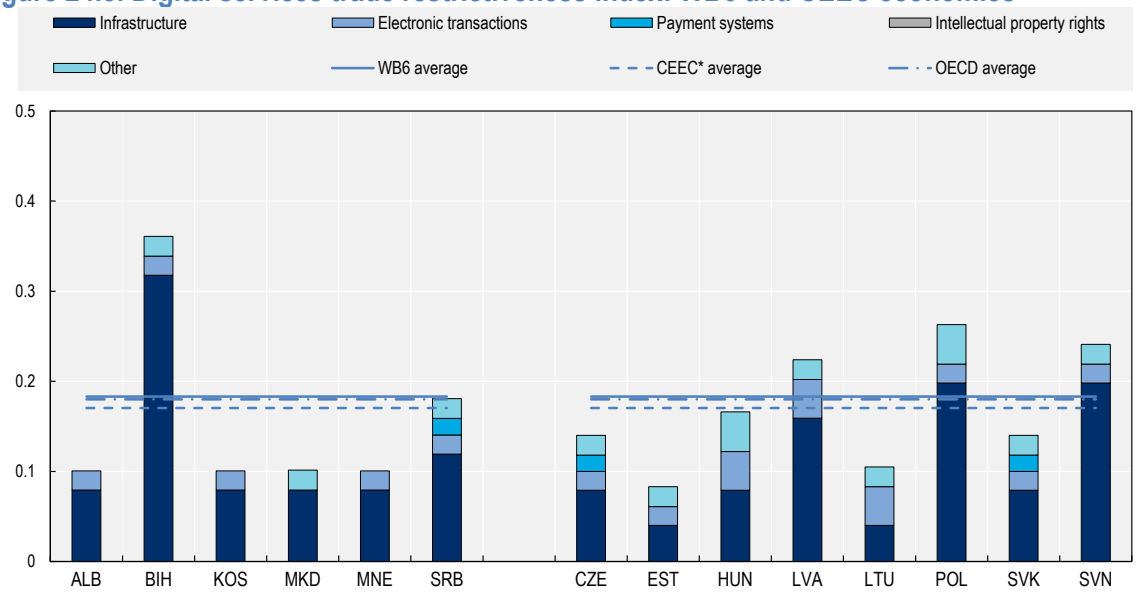
It is recognised that modern e-commerce regulation needs to focus on a number of key elements including electronic documentation and signatures, online consumer protection, data protection and privacy, cyber security, intellectual property rules and intermediary liability. An attractive regulatory environment also refrains from creating disproportionate rules such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold on line (other than for generally accepted public policy considerations) and restrictions on cross-border data flows.

The relevant legislation in North Macedonia was effectively amended in 2011, 2015 and 2020 after the government conducted a gap analysis of its e-commerce legislation and proceeded to align the law with European Commission recommendations and the Directive on Electronic Commerce 2000/31/EC. The latest amendments harmonised the relevant articles with the Misdemeanour Act in order to promote interoperability with related documents and policy areas, such as trade or consumer law. In regulatory terms, the legal corpus in North Macedonia contains all the necessary e-commerce elements.

Moreover, new e-commerce programmes have been put in place to boost the usage of e-commerce in the economy. The Economic Reform Programme (ERP) 2019-21 highlights new legislation and initiatives under the remit of MISA regarding the digital economy, such as the Law on Electronic Documents, Electronic Identification and Trust Services (2019), the Law on Electronic Management and Electronic services (2019), the National Cyber Security Strategy and Action Plan (2018-22) and the National Operational Broadband Plan (2019-23). The ERP foresees the development of citizens' e-skills in the education system and among public administration staff (e.g. in the use of the national portal for e-services). The project is in line with previous Macedonian digitalisation programmes. Recent issues related to the pandemic have demonstrated the need for a connected society and efficient e-commerce. COVID-19 introduced the need for online education for all levels of education (basic schools, high school and universities) and working from home for the majority of public servants.

The OECD digital STRI captures **the restrictiveness of digitally enabled services** by identifying cross-cutting barriers that inhibit or completely prevent firms from supplying services using electronic networks, irrespective of the sector in which they operate. The regulatory data underlying the digital STRI were extracted from the OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. Digital STRIs are the result of aggregating the identified barriers to trade into composite indices. Digital STRI scoring uses a binary system: scores are assigned a value of 0 when there are no trade restrictions and a 1 when full restrictions are in place. The rating takes into account the specific regulatory and market characteristics as well as the links and hierarchies between regulatory measures affecting digitally enabled services (Ferencz, 2019[64]). Figure 24.8 shows North Macedonia's digital STRI score.

## Figure 24.8. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[61]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256121

The scores in this sector were moderate to high in 2020, ranging from 0.043 to 0.488, while the WB6 average was 0.183. North Macedonia has a digital STRI score of 0.101, which places it among the four least restrictive WB6 economies. Its score has not changed since 2014. North Macedonia's results in the digital STRI sector are mainly due to infrastructure measures, but electronic transaction measures also play a part.

The Law on Electronic Communications mandates interconnection in both the fixed and mobile networks. The telecommunications regulator, AEK, decides which firms have significant market power in any given market (see Sub-dimension 2.2: Services trade restrictiveness for more information). There is an obligation to publish interconnection reference offers for the fixed network, but no such obligation for the mobile network.

North Macedonia does not impose excessive conditions on cross-border data flows beyond those put in place to ensure the protection and security of personal data. Unlike most of the WB6 economies, North Macedonia does not require that some types of data be stored locally. No specific licences or authorisations for e-commerce activities are required. International standards are used for electronic contracts and key

electronic authentication measures such as the recognition of electronic signatures, and there is a dispute settlement mechanism to resolve litigations arising from the cross-border digital trade.

Policy areas relating to intellectual property rights and payment systems account for a smaller share of states' digital STRI score. North Macedonia is relatively open in this category from a regulatory point of view, following the principles of European regulations in this field.

### *The way forward for trade policy*

The Government of North Macedonia has taken important steps to improve the trade policy framework, especially in the area of consultations, but it could improve its decision making by paying attention to the following:

- **Strengthen inter-institutional co-ordination and stakeholder participation in consultations.** A comprehensive system for review, based on both qualitative indicators (e.g. broadness of consultation, stakeholder satisfaction with their involvement) and quantitative indicators (e.g. frequency of consultations), and would help to measure the success of reforms and allow for consultation frameworks to be adjusted where necessary. Box 24.3 gives an example of how guidelines can be used to improve consultations. North Macedonia could also should follow the example of the stakeholder involvement in the European Commission policy cycle (Box 24.4) to develop a feedback mechanism to improve its consultations.

- **Improve the evaluation and monitoring of implemented trade measures**. Ideally, this should include a monitoring programme with adequate budget and staff to enable systematic evaluations.
- **Broaden trade in services efforts**. The WB6 economies have made significant improvements to open trade in services through the conclusion of CEFTA Additional Protocol 6 in December 2016. Nonetheless, The STRI analysis has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness.
- **Lift some of the existing stringent restrictions on trade in services:**
  - **Ease conditions on the temporary movement of natural persons** to further encourage innovation and knowledge transfer, and contribute to economic growth. A starting point could be to remove the remaining quotas and labour market tests which apply to foreign services suppliers.
  - **Reduce the remaining barriers to market entry and competition** in the computer, legal and insurance services and make further efforts to increase competitiveness.
  - **Remove restrictions in the insurance sector** on cross-border mergers and acquisitions, as well as on asset holdings.
  - **Amend the localisation requirements for professional liability insurance** in the legal sector.
  - **Ease the cumbersome and lengthy procedures for registering a company** which hamper all services sectors. North Macedonia could make efforts to facilitate the process and shorten the time it takes to register a company in order to increase its attractiveness to foreign investors.

#### Box 24.3. Consultation guidelines in the United Kingdom

The United Kingdom's 2008 Code of Practice is a good example of how a government can provide its civil servants with a powerful tool to improve the consultation process and its review, even though it is not legally binding and only applies to formal, written consultations. The 16-page Code of Practice was divided into 7 criteria, which were to be reproduced as shown below in every consultation:

- **Criterion 1: When to consult.** Formal consultation should take place at a stage when there is scope to influence the policy outcome.
- **Criterion 2: Duration of consultation exercises**. Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- **Criterion 3: Clarity of scope and impact**. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- **Criterion 4: Accessibility of consultation exercises**. Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- **Criterion 5: The burden of consultation**. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- **Criterion 6: Responsiveness of consultation exercises**. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- **Criterion 7: Capacity to consult**. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

The Code of Practice was replaced with the much shorter Consultation Principles in 2012. The Consultation Principles highlight the need to pay specific attention to proportionality (adjusting the type and scale of consultation to the potential impacts of the proposals or decision being taken) and to achieve real engagement rather than merely following a bureaucratic process.

Source: (UK Government, 2008[66]), *Code of Practice on Consultation*, www.bis.gov.uk/files/file47158.pdf; (UK Government, 2016[67]), *Consultation Principles 2016*, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/492132/20160111_Consultation_principles_final.pdf.

### Box 24.4. Stakeholder engagement throughout the policy cycle at the European Commission

Following the adoption of the 2015 Better Regulation Guidelines, the European Commission has extended its range of consultation methods to enable stakeholders to express their view over the entire lifecycle of a policy. It uses a variety of different tools to engage with stakeholders at different points in the policy process. Feedback and consultation input is taken into account by the Commission when further developing the legislative proposal or delegated/implementing act, and when evaluating existing regulation.

At the initial stage of policy development, the public has the possibility to provide feedback on the Commission's policy plans through roadmaps and inception impact assessments (IIA), including data and information they may possess on all aspects of the intended initiative and impact assessment. Feedback is taken into account by the Commission services when further developing the policy proposal. The feedback period for roadmaps and IIAs is four weeks.

As a second step, a consultation strategy is prepared setting out consultation objectives, targeted stakeholders and the consultation activities for each initiative. For most major policy initiatives, a 12-week public consultation is conducted through the website “Your voice in Europe” and may be accompanied by other consultation methods. The consultation activities allow stakeholders to express their views on key aspects of the proposal and main elements of the impact assessment under preparation.

Stakeholders can provide feedback to the Commission on its proposals and their accompanying final impact assessments once they are adopted by the College. Stakeholder feedback is presented to the European Parliament and Council and aims to feed into the further legislative process. The consultation period for adopted proposals is eight weeks. Draft delegated acts and important implementing acts are also published for stakeholder feedback on the European Commission’s website for a period of four weeks. At the end of the consultation, an overall synopsis report should be drawn up covering the results of the different consultation activities that took place.

Finally, the Commission also consults stakeholders as part of the *ex post* evaluation of existing EU regulation. This includes feedback on evaluation roadmaps to review existing initiatives, public consultations on evaluations of individual regulations and “fitness checks” (i.e. comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose). In addition, stakeholders can provide their views on existing EU regulation at any time on the website “Lighten the load – Have your say”.

Source: (OECD, 2017[68]), *OECD Best Practice Principles on Stakeholder Engagement in Regulatory Policy* (draft), www.oecd.org/gov/regulatory-policy/public-consultation-best-practice-principles-on-stakeholder-engagement.htm; (OECD, 2016[69]), *Pilot database on stakeholder engagement practices in regulatory policy. Second set of practice examples*; (OECD, 2019[70]), *Better Regulation Guidelines*, https://ec.europa.eu/info/law/law-making-process/planning-and-proposing-law/better-regulation-why-and-how/better-regulation-guidelines-and-toolbox_en.

## Access to finance (Dimension 3)

### *Introduction*

North Macedonia has slightly worsened its performance in the access to finance dimension. Its score has decreased from 3.0 in the 2018 Competitiveness Outlook to 2.4 in the 2021 assessment, partially due to its weak performance on access to alternative financing. North Macedonia's score is below the WB6 average in both access to bank finance and access to alternative financing while it scores above the WB6 average for the mobilisation of long-term financing (Table 24.6).

**Table 24.6. North Macedonia's scores for access to finance**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Access to finance dimension** | Sub-dimension 3.1: Access to bank finance | 3.0 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 1.6 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 3.5 | 2.8 |
| **North Macedonia's overall score** | | **2.4** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

North Macedonia's financial sector is bank dominated and the banks' assets constitute over 80% of total financial sector assets. At the end of 2019, 15 banks were operating in the economy, including 1 state-owned bank (Macedonian Bank for Development Promotion) and 11 private banks with a market share of over 70% of the total assets predominantly owned by foreign shareholders. As of March 2020, the cumulative share of the top three banks was 57.1% of banking system assets, while the share of the state-owned bank was 1.8%.

North Macedonia has a relatively well-developed regulatory framework for the **banking industry**. It has been largely compliant with Basel II core principles since 2009 (OECD et al., 2019[71]).[33] The 2016 amendments to the Banking Law on the regulation of capital adequacy introduced capital buffers and requirements for the structure and quality of banks' own funds. The National Bank of the Republic of North Macedonia (NBRNM) has adopted a new methodology for managing credit risks and enhanced its criteria for licensing banks, following the Basel III core principles for effective banking supervision. Consequently, since 2017 banks have been obliged to determine and monitor their leverage ratio on a semi-annual basis. Starting from January 2021, banks will be obliged to maintain the liquidity coverage ratio, while the implementation of the long-term Basel III liquidity standards is in progress. In response to COVID-19, the NBRNM revised its credit risk regulation to encourage banks to temporarily restructure loans and relaxing the loan classification standards for non-performing loans.

The NBRNM is responsible for the design and implementation of secondary legislation on the banking system while the Ministry of Finance is responsible for primary legislation. However, in practice the Ministry of Finance co-ordinates all activities regarding the development of the Banking Law, its amendments and other regulations relevant for banking activities. In addition, the NBRNM consults the Ministry of Finance as part of the public hearing process when developing relevant secondary legislation.

There is no explicit regulation that encourages domestic currency lending, however lending criteria differ. Overall, denar loans represent 57.8% of total loans while foreign currency loans account for 14.7% and indexed loans 27.5%. The regulation on credit risk management requires banks to pay special attention to foreign currency (FX) lending by adequately assessing the credit risk arising from the FX risk the client is exposed to but it lacks any explicit provision to encourage or facilitate denar lending. In addition, the regulation on reserve requirements sets a 0% reserve requirement ratio for denar liabilities to natural

persons with a contractual maturity of more than one year while, for FX-linked liabilities, the 0% ratio only applies if the contractual maturity is longer than two years.

Two **registers** operate in North Macedonia. The Real Estate Cadastre Agency operates cadastres which are publicly accessible on line, while the register of pledges over movable assets is the remit of the Central Registry of the Republic of North Macedonia. Information from this register is accessible upon request. As in the previous assessment, the registry includes ownership information on more than 75% of pledges on registered assets. According to the Real Estate Cadastre Agency's strategic work plan for 2020-22, it will draft an action plan for the registration of the state-owned property rights to enhance the coverage of the cadastre register.

**Credit information services** are supplied by one public credit registry and one private credit bureau. The private bureau is regulated by the Law on Credit Bureau, while the public registry was established under the National Bank Law. The law establishes the inclusion of both positive and negative information, for a maximum of five years after payment of liabilities or settlement of a bill. The data subject can request a copy of a report that has already been prepared for the needs of a particular data user and may submit a written notice disputing the accuracy or completeness of any data contained in the report. Data are available to the financial institutions and public on request. The credit registry covers around 42% of the adult population, while the credit bureau covers the entire adult population (World Bank, 2019[72]).

**Collateral requirements** remain relatively strict, making it challenging for businesses to access bank loans in North Macedonia. Around 76% of loans require collateral, more than the OECD average of 58%, amounting on average to 174% of the amount borrowed, compared to an average of 88% in the OECD economies (World Bank, 2019[73]). The law allows companies to use non-fixed assets such as movable assets, intangibles and pledge of rights to secure loans. However, there is no threshold of loan size allowing collateral requirements to be more flexible for small businesses.

There are some schemes offering **credit enhancement and risk mitigation**. The Development Bank of North Macedonia offers a credit guarantee scheme to micro, small and medium-sized enterprises (MSMEs) which are at least 51% privately owned and registered in North Macedonia. MSMEs which have increased the number of employees or invested in energy saving or environmental protection infrastructure can benefit from a loan of up to EUR 300 000 with an annual fixed interest rate of 6.5%. The scheme offers flexible monthly/quarterly or semi-annual repayments which are defined in advance, based on the business plan, with a grace period of six months. In addition, the European Investment Bank offers a scheme aimed at increasing working capital, with loans of a maximum of EUR 666 700 repayable in six years with an annual interest rate of 1.6%. Businesses can profit from the programme if they have: increased their exports by at least 5% over the previous year; invested in modernisation, energy saving or environmental protection; or increased the number of employees.

To mitigate the effects of the COVID-19 pandemic on small businesses, the European Bank for Reconstruction and Development (EBRD) has announced two support packages. In July 2020 it granted a EUR 20 million loan to Sparkasse Bank Makedonija for on-lending to local businesses and in November 2020, gave a loan of EUR 15 million to ProCredit Bank Macedonia to help local MSMEs.

### *Sub-dimension 3.2: Access to alternative financing sources*

**Factoring** activities remain very limited in North Macedonia, partly due to the absence of an adequate legal framework. Factoring activities are regulated by the Law on Financial Companies and the Law on Obligations. The legislation provides a general definition of factoring and regulates the transfer of future and bulk receivables. However it does not cover specific definitions such as reverse factoring, the detailed content of factoring agreements and bankruptcy procedures. To improve the legal framework, the government, with the support of the EBRD, has drafted amendments which were planned to be published on the Electronic National Registry of Regulation in February 2020 for public consultation. However, the

government postponed the process due to the COVID-19 pandemic and it is now expected to be adopted in December 2021.

**Leasing** activities are also limited. As of December 2019 the total value of active leasing contracts was EUR 118 million (1% of GDP). The market demand is highly concentrated: 73.8% of contracts are for passenger vehicles, 20.6% for trucks and only 0.5% for equipment and machinery. Leasing activities are regulated by the Law on Leasing under the supervision of the Ministry of Finance. The ministry issues licences and oversees all providers of financial leasing except the banks. The law regulates the rights and obligations of contracting parties, the manner and conditions for the lease of movable and immovable property, and the rules on repossessions of assets.

**Private equity** and **venture capital** are partially regulated by the Law on Investment Funds. However, the law does not cover the instruments in which private equity and venture capital alternative investment funds may invest, nor the restrictions, types and timeframes for subscriptions by members or shareholders. Although the development of the sector is part of the Innovation Strategy 2012-20, no progress has been made since the previous assessment. According to a government statement, it expects to implement a new law on alternative investment funds in 2022 which will be in line with EU directives,[34] with the technical assistance of the World Bank. Overall, equity investments in the economy remain limited with barely any active equity funds present. Since 2014, two seed stage companies and three start-ups received a total of EUR 6 million in investments under the Enterprise Innovation Fund (ENIF), which is a stand-alone venture capital fund covering the Western Balkans region.

North Macedonia has relatively active **business angel networks**, involving smaller investments. It has two active networks, both created under the umbrella of the United States Agency for International Development (USAID), which made 15 separate investments in 2018 totalling EUR 250 000. However, this represents a decrease in investment of 50% compared to 2016 (EBAN, 2019[74]). Despite the active market, there is no regulatory framework nor any plans or strategies to encourage the development of business angel networks.

Although **crowdfunding** is taking place, North Macedonia does not yet have a dedicated regulatory framework for it. Since 2014, regular crowdfunding campaigns have taken place though a local platform,[35] with the amount collected each year fluctuating considerably: from a low of MKD 30 000 in 2015 to a high of MKD 263 000 in 2014. Nevertheless, as of 2014, no project has achieved its crowdfunding target. The domestic crowdfunding platform doesn't provide clear information about the financial risks and charges that investors may incur, including insolvency risks and project selection criteria, which may be partially due to the absence of a regulatory framework. The authorities should assess the demand for such tools. The Macedonian Stock Exchange (MSE) has begun co-operating with a foreign crowdfunding platform Funderbeam. This platform provides all the information investors need but so far no investment has occurred since the establishment of the co-operation agreement (Box 24.5).

### Box 24.5. North Macedonia's crowdfunding initiative: Funderbeam

In 2019, the Macedonian Stock Exchange entered into an exclusive co-operation agreement with Funderbeam South East Europe, registered in Croatia. Funderbeam SEE is part of the Funderbeam Market Limited group which offers a global scheme for collective financing, a crowdfunding platform based in Estonia. The MSE plays an educational and promotional role by presenting the platform to small and medium-sized enterprises and start-ups as an alternative financing source to develop their businesses into companies suitable for future listing on the exchange.

Funderbeam offers clients a simple four phase process for listing, marketing and public relations expertise, ready-to-use legal templates and access to private business angel and venture capital networks. With a community of over 60 000 users and more than EUR 29 million raised, Funderbeam offers domestic entrepreneurs a quick, transparent and simple way to finance their innovative ideas, and encouraging Macedonian investors to get involved in new and growing companies.

Source: (Funderbeam, 2021[75]), *Funderbeam: The Global Funding & Trading Platform*, www.funderbeam.com/; (MSE, 2019[76]), Macedonian *Stock Exchange has signed an exclusive cooperation agreement with Funderbeam SEE*, www.mse.mk/en/news/22/5/2019/macedonian-stock-exchange-has-signed-an-exclusive-cooperation-agreement-with-funderbeam-see.

In 2016, the NBRNM proclaimed that crypto assets were illegal under the article of the law which prohibits residents from investing in foreign securities. Since 2019, as North Macedonia entered the second phase of the Stabilisation and Association Agreement, domestic residents have been allowed to invest in foreign securities and foreign real estate, but they are still generally not allowed to open foreign bank accounts (except for some specific exceptions in accordance with NBRNM by-laws) making the legality of investment in crypto assets unclear. Consequently, no activity has been reported in **initial coin offerings** based on blockchain technologies.

#### *Sub-dimension 3.3: Mobilisation of long-term financing*

North Macedonia adopted the Law on Concessions and Public-Private Partnership in 2012 and by 2018, central government and municipal authorities had implemented 29 **public-private partnership** (PPP) projects. The law is not fully harmonised with the Concessions Directive of the EU,[36] but it respects the general principles of public procurement (OECD, 2019[77]). The general principles of transparency, equal treatment and non-discrimination are well reflected in the legislation. To increase implementation and improve the quality and consistency of PPP project results, the government has drafted a new PPP law which was in the parliamentary validation process at the time of writing.

North Macedonia's domestic **institutional investor and asset management** base remains small and highly concentrated, limiting capital market development. At the end of 2019, five asset management firms were operating in the economy, and the top three firms were managing 94% of the total assets under management. However, data on the breakdown of the total assets under management are not publicly available.

The Securities and Exchange Commission (SEC) is the supervisory authority and is responsible for granting and withdrawing licences. Foreign institutional investors that want to operate in North Macedonia need to have a local branch or operate through a domestic institution. The laws on securities and investment funds that govern institutional investors regulate market manipulation and insider trading. However, they do not clearly govern voting rights. Overall, a provision in the law on trading companies regulates proxies and voting rights, but there are no specific rules for institutional investors, providing room for potential conflicts of interest.

North Macedonia has **capital markets** but their contribution to financing the economy is limited and they have not attracted investments from large institutional investors. There have been no developments

regarding financial market infrastructure. The law on capital markets, which aims to align national legislation on securities markets and investment services to the EU *acquis,* has still not been adopted (EC, 2020[46]). Between January and June 2020, the stock exchange registered a total turnover of securities amounting to MKD 3.82 billion (around EUR 62 million; 1.25% of GDP), which was 124% higher than the same period in 2019. Of this, the turnover of shares totalled MKD 3.59 billion (EUR 61 million) and the turnover of bonds totalled MKD 234 million (EUR 3 million).

The **stock market**, the MSE, was established in 1995 and became operational in March 1996. It is regulated by the law on securities and is organised as a joint-stock company. The major shareholders comprise banks and stockbroker companies. The SEC is responsible for stock market supervision. The commission is an autonomous organisation and is responsible for the legal and efficient functioning of the securities market, as well as the protection of investors' rights. The MSE is a member of the Federation of Euro-Asian Stock Exchanges and affiliated member of Federation of European Stock Exchange. In 2014, to facilitate integration with other South East Europe markets, the MSE, together with the Bulgarian Stock Exchange and the Croatian Stock Exchange, established SEE Link.

The law clearly enumerates the requirements for listing companies in North Macedonia, with more flexible requirements for smaller companies. The listing rules of the MSE define four listing categories for the market: 1) super listing; 2) exchange listing; 3) mandatory listing; and 4) listings of small joint-stock companies (Table 24.7) There has only been one initial public offering since 2018, with a value of MKD 575 million (around EUR 9.3 million), but the secondary public offering (SPO) market was slightly more active. Since 2018, there have been two SPOs of shares, totalling MKD 320 million (around EUR 5.2 million), and three SPOs of bonds, with a total value of MKD 492 million (around EUR 8 million). To stimulate IPOs, the SEC decided to exempt issuers from the SEC fee (around EUR 80) during 2019 and 2020.

### Table 24.7. Listing rules in North Macedonia

| | Super listing | Stock exchange | Mandatory | Small joint-stock companies |
|---|---|---|---|---|
| Financial statements | Audited financial statements for the last three years | Audited financial statements for the last two years | Audited financial statements for the last two years | Audited financial statements for the last year |
| Financial results | Profit in the last 3 years | n.a | n.a | n.a |
| Capital | At least EUR 10 million | At least EUR 5 million | At least EUR 1 million | At least EUR 250 000 |
| Free float ratio | At least 20% | At least 10% | At least 1% | n.a |
| Number of shareholders | At least 200 | At least 100 | At least 50 | n.a |

The **bond market** is relatively stable, but volumes are small. During the first half of 2020 the trading volume of bonds was MKD 234 million (around EUR 3.8 million), 4% more than the same period in 2019 (MKD 223 million – around EUR 3.6 million).

The legislative and regulatory framework is in place to regulate the bond market in North Macedonia. According to the law, bonds may be issued by the Ministry of Finance on behalf of the Republic of North Macedonia, municipalities and the City of Skopje; joint-stock companies; limited partnerships by shares; and any other domestic or foreign legal entities. The total nominal value of a single issuance of bonds, which are not guaranteed by a bank, cannot exceed the issuer's basic capital. If an issuance of bonds is guaranteed by a bank, the highest value of the issuance shall not exceed the amount of the basic capital and the amount of the issue guarantee. Investors can access the information on the maturity and coupon rates of the issued securities. However, the law does not provide any obligation to provide information on the liquidation preference, tax status or call provisions. This means no actors, including the SEC, publish bond ratings in North Macedonia, hampering the transparency of the bond markets.

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finance, policy makers should:

- **Continue to align North Macedonia's banking regulations with international standards**. The economic shock caused by COVID-19 means building the resilience of the sector to shocks has become even more important. Regularly monitoring the relevant regulations and bringing them into line with internationally agreed norms would further enhance the capacity of North Macedonia's banking sector.
- **Continue to build a business environment with diverse financing sources.** Given the economy's limited success in attracting venture capital, supporting crowdfunding by adopting a dedicated legal framework and targeting the diaspora could be a more successful approach. Following the example of Lithuania (Box 24.6), such initiatives could increase the number of potential financing sources, especially for smaller companies, widening the sources of private financing and boosting foreign direct investment.
- **Create a comprehensive strategy for capital market development**, involving government and private sector stakeholders, and formulate an action plan for undertaking appropriate development activities. One solution to increase the liquidity of the private sector could be to establish a special framework for private bond placements by smaller companies, following the successful recent example of the Italian mini-bond market framework (Box 24.7).
- **Promote the use of infrastructure project bonds**. While PPPs are an efficient way to finance infrastructural projects, bonds can bring beneficial dynamics to capital markets and enable a more productive use of institutional funds for long-term investments. The government can promote the use of infrastructure project bonds through streamlining issuance and placement procedures, providing a clear definition of infrastructure project bonds, and providing tax incentives.

#### Box 24.6. Lithuania's crowdfunding legislation

While Lithuania's crowdfunding market is smaller than other European fintech hubs, the economy is only one of 11 EU member states with dedicated national legislation for crowdfunding platforms and boasts a mature and comprehensive regulatory framework for crowdfunding. Although its crowdfunding is in its infancy, Lithuania currently has 15 registered crowdfunding platforms. There has been a positive increase in the total value of crowdfunding platform loan portfolios, from EUR 6.6 million in 2019 to EUR 9.13 million in the first half of 2020 (Bank of Lithuania, 2020[78]).

Lithuania adopted its Law on Crowdfunding in 2016 with the aim of providing a hospitable, clear and transparent setting for cross-border crowdfunding platforms. The law adopted all aspects of the European Commission's Regulation for European Crowdfunding Service Providers, allowing for a seamless transition once the EU Directive comes into force (EC, 2018[79]). It was established through a multiple stakeholder consultation process and provides protection and guarantees for investors through information disclosure obligations, governance rules, risk management and a coherent supervision mechanism. The law covers equity, real-estate, and debt-based crowdfunding models, while donation and rewards models continue to fall under the Civil Code of the Republic of Lithuania.

Transparency regulations for crowdfunding platforms help mitigate misinformation and legal risk to better protect investors. Therefore, platforms must be included on the Public List of Crowdfunding Platform Operators, subject to an efficient reliability assessment conducted by the Bank of Lithuania's supervisory authority within 30 days. Platform operators, board members and significant stakeholders also undergo a criminal record check, while platforms must instate measures to avoid, identify and address any conflicts of interest that would prejudicially benefit the funder or project owner.

In addition to the EUR 40 000 minimum capital requirement, platform owners are required to put up 10% of starting capital themselves. In the case of offerings between EUR 100 000 and EUR 5 million, platform operators are obligated to publish a light prospectus, while offerings over EUR 5 million require a full prospectus detailing the project and project owner characteristics, proportion of own funds used, details of the offering, security measures, and existence of secondary markets.

In all cases, Lithuania's crowdfunding regulations require platforms to publish wide-ranging information on their websites for investors including data on the company, risks associated with investment, project selection criteria, conditions and procedures for repayment of funds, disclaimers on tax and insurance information, as well as monthly and yearly progress reports.

Meanwhile, Lithuania is continuously improving its innovative business environment to give financial institutions and crowdfunding platforms more investment opportunities. In 2016, the economy began allowing the use of remote identity verification via qualified electronic signatures and video streaming/transmission and is harmonising itself with the EU regulation on electronic identification. Lithuania has also recently amended its Law on the Legal Status of Aliens to include an e-residency programme, allowing foreigners to set up companies, open bank accounts and declare taxes through digital identification, furthering financing opportunities for its fintech platforms.

Source: (EC, 2017[80]), *Identifying Market and Regulatory Obstacles to Cross-Border Development of Crowdfunding in the EU: Final Report*, https://ec.europa.eu/info/sites/info/files/171216-crowdfunding-report_en.pdf; (Bank of Lithuania, 2019[81]), *Consumer Credit Market Review: 2019*, www.lb.lt/lt/leidiniai/vartojimo-kredito-rinkos-apzvalga-2019-m; (Bank of Lithuania, 2020[78]), *List of Crowdfunding Platform Operators*, www.lb.lt/lt/finansu-rinku-dalyviai?list=36.

## Box 24.7. Italy's mini-bond market

In 2012 the Italian Government introduced a series of laws to initiate a mini-bond framework for unlisted companies to enable them to issue corporate bonds. The mini-bond framework provides a simplified process whereby unlisted companies with more than 10 employees and an annual turnover and/or assets in excess of EUR 2 million (except micro-enterprises and banks), can issue bonds that are available only to qualified investors. Firms are not required to publish a public prospectus – an admission document is sufficient.

In response to this new regulatory framework, Borsa Italiana introduced the ExtraMOT PRO segment in 2013, dedicated to the listing of bonds whose trading is only permitted to professional investors. Since its introduction, the mini-bond market has seen steady growth, with the number of issuances increasing from 16 in 2013 to 171 in 2018. The cumulated proceeds during this period amounted to EUR 10.6 billion, 25% of which was raised in 2018. Moreover, mini-bonds have also been securitised through special purpose vehicles which have created a diversified pool of mini-bond issuers available for institutional investors.

In 2019 the government introduced mini-bond placements on equity crowdfunding platforms. In October 2019, the operating rules for equity crowdfunding platforms willing to place mini-bonds were published by the competent authority (Consob). These include that the offers must be published on specific sections of the platforms; the issuers are limited to joint stock companies; and eligible investors are required to hold financial assets of at least EUR 250 000, invest at least EUR 100 000 in the mini-bond, or be client of an asset management company. The first offerings were published on crowdfunding platforms in January 2020.

Source: (OECD, 2020[82]), *OECD Capital Market Review of Italy 2020*, www.oecd.org/corporate/OECD-Capital-Market-Review-Italy.htm.

## Tax policy (Dimension 4)

### *Introduction*

Table 24.8 compares North Macedonia's scores on two tax policy sub-dimensions with the WB6 average. With regard to tax policy framework sub-dimension, North Macedonia scores above the WB6 average as a result of recent efforts to improve tax expenditure reporting and forecasting of tax revenues. For the tax administration sub-dimension, North Macedonia scores slightly above the average as a result of its efficient risk assessment system for tax compliance.

**Table 24.8. North Macedonia's scores for the tax policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 3.0 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 3.5 | 3.3 |
| | Sub-dimension 4.3: International co-operation | n.a. | n.a. |
| **North Macedonia's overall score** | | **3.3** | **3.0** |

Note: Sub-dimension 4.3 on international co-operation is analysed qualitatively and therefore remains unscored.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

North Macedonia's **tax revenues** are relatively low as a share of its economy. In 2019, its tax-to-GDP ratio was 25.9%, below both the WB6 (30.6%) and OECD (33.8%) averages for 2019 (Table 24.9). Tax revenues as share of GDP have remained relatively stable in recent years. North Macedonia relies heavily on social security contributions (SSCs) and goods and services taxes (GSTs), which together accounted for 81.1% of its total tax revenues: in 2019, SSCs accounted for 34.4% of the total, and GSTs for 46.6%. This aligns with regional trends (the WB6 average was 80.7% in 2019), but is significantly above the OECD average of 58.4% in 2018. Consequently, other taxes play a smaller role. In OECD countries, personal income tax (PIT) and corporate income tax (CIT) together account for nearly one-third of annual tax revenues on average (33.5% in 2018). In North Macedonia, these taxes made up 16.8% of the total in 2019, only half of the OECD average. North Macedonia's reliance on SSCs and taxes on goods and services leaves room to diversify the tax mix. SSCs support the direct funding of the welfare system, meaning North Macedonia can avoid funding social welfare funds from general tax revenues, which would create challenges to its budget. The reliance on SSCs may leave the economy relatively exposed to a decline in formal employment or a rise in informal employment.

**Table 24.9. North Macedonia's tax revenues as a percentage of GDP**

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| North Macedonia | 1.7% | 2.7% | 8.9% | 12.1% | 25.9% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 11.9% | 33.8% |

Note: CIT=corporate income tax; PIT=personal income tax; SSC: social security contributions.
Source: (OECD, 2020[83]), *OECD.Stat*, https://stats.oecd.org/ (2019 for overall tax/GDP ratio, 2018 for specific tax/GDP ratio).

Corporate income tax in North Macedonia is mainly levied at a 10% flat rate (Table 24.10), which broadly aligns with regional trends (the WB6 average was 11.5% in 2020) but is below the average of OECD countries (23.3% in 2020). This average rate is reflected to a certain extent in the economy's tax revenues: CIT revenues accounted for 1.7% of North Macedonia's GDP in 2019, which is similar to the WB6 average (1.8% in 2019) but below the OECD average (3.1% in 2018). A 1% CIT rate applies to companies under a

simplified tax regime or for business income of non-governmental organisations (NGOs) (explained further below).

**Dividend income** is excluded from the CIT base (provided the income was taxed at distributor level), while **capital gains** are treated as regular business income and taxed at a rate of 10%. A 10% rate is withheld on payments of dividends and **corporate interest** made to individual shareholders whether residents or non-residents. North Macedonia operates a worldwide taxation system in which resident corporations are liable for taxes on income arising from domestic and foreign sources, while non-resident entities pay taxes on domestically sourced income. In 2019, North Macedonia reformed its CIT and amended its transfer pricing rules. This reform introduced a transfer pricing documentation threshold of MKD 10 million (EUR 162 860); entities whose related-party transactions are above the threshold must submit transfer pricing documentation.

### Table 24.10. Selected tax rates in North Macedonia

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| North Macedonia | 10.0% | 10% | 28.0% | 18.0% |
| WB6 | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions; VAT= value added tax.
Source: (OECD, 2020[83]), *OECD.Stat*, https://stats.oecd.org/ (2020 for CIT and VAT, 2019 for PIT and SSCs).

North Macedonia uses a mix of cost-based and profit-based **investment incentives**. Cost-based incentives lower the cost of investment and increase with the size of the investment. In North Macedonia, reinvested profits can be deducted from taxable corporate profits, which makes the tax system similar to that used in Estonia. North Macedonia also has profit-based tax incentives, which generally reduce the tax rate applicable to taxable income. Companies in Special Economic Zones (referred to as Technological Industrial Development Zones) are exempt from CIT for up to 10 years. North Macedonia also implements a simplified tax regime for 'micro-enterprises' based on annual turnover. Companies with annual turnover under MKD 3 million (EUR 48 700) are exempted from CIT and companies with income between MKD 3 million and 6 million (EUR 97 400) may opt for a simplified tax regime with a 1% rate levied on their turnover, instead of the 10% CIT rate levied on profits. North Macedonia also has an employment incentive system whereby companies receive a monthly subsidy per employee depending on the salary of the employee.[37] Research shows that cost-based incentives are preferable to profit-based incentives, which risk leading to high redundancy of expenditure since the investments may have proceeded anyway (UNCTAD, 2015[84]).

North Macedonia has undertaken significant **personal income tax (PIT) reforms** in recent years. In January 2019, the rate for personal capital income was increased from 10% to 15% and a progressive PIT rate schedule was implemented to replace the previous 10% flat rate on labour income, with the introduction of an additional 18% rate.[38] This placed its top rate as second only to Albania (at 23%) among its WB6 peers. However, in January 2020, the 18% PIT rate was suspended until the end of 2022 and the personal capital tax reform was postponed until 2023. North Macedonia has the second-highest PIT revenues as a share of GDP (2.7% in 2019) among the WB6 economies (2.7% average in 2019). Similar to most WB economies, North Macedonia has a personal tax allowance for individual income which was MKD 96 000 (EUR 1 560) per year in 2020. Prior to 2019, there were other allowances for other types of income including rental and intellectual property income.[39] With regards to the taxation of personal capital income, a 10% rate currently applies for most income types, except for income from games of chance where the rate is 15%.[40] The capital gains tax rate is 15% for shares held for less than a year, 10% for shares held for 1-10 years, and zero for those held for more than 10 years. Taxation of capital gains from the disposal of shares will begin in 2023.

North Macedonia's reliance on **social security contributions** is similar to other WB6 economies. They amount to 8.9% of North Macedonia's GDP, which is slightly below both the WB6 average (9.3% in 2019) and the OECD average (9.0% in 2018). Only employees pay SSCs on labour income,[41] with a total SSC rate of 28%. This includes 18.8% for pension and disability, 7.5% for health insurance, 0.5% for health insurance in case of an injury at work or occupational illness, and 1.2% for unemployment insurance. The total rate is similar to the WB6 average of 29.4% in 2020. North Macedonia's practice of only levying SSCs on employees differs from most OECD countries where, on average, employers' SSC rates are higher than employees'. The self-employed in North Macedonia pay the same SSC rate as employees; this rate is similar to the average SSC rate in WB (29.7% in 2020). High SSC rates increase the tax burden on labour income, and reduce workers' disposable income and incentives to work in the formal economy, particularly those on low incomes. North Macedonia could shift its tax mix away from employee and self-employed SSCs to PIT through re-introducing a progressive PIT rate schedule (OECD, 2018[85]). This would shift the tax burden from those with lower incomes to those with higher ones, increasing equity and, if designed properly, efficiency. Such a reform would have to be accompanied by reforms to prevent tax avoidance. Increasing the top PIT rate might further strengthen the tax-induced incentives for self-employed entrepreneurs to incorporate in order to turn highly taxed labour income into lower taxed capital income. Increasing the top PIT rate therefore requires increasing the tax rate on personal capital income that applies to dividends.

Like most WB6 economies, North Macedonia relies heavily on taxes on goods and services. These amounted to 12.1% of North Macedonia's GDP, which is below the WB6 average (15.9% in 2019) but above the OECD average (10.9% in 2018). **Value-added tax** accounts for more than half of revenues from GSTs, or 7.5% of GDP. North Macedonia levies a standard VAT rate of 18%, which is the second lowest rate of the WB6, alongside Kosovo; the WB6 average VAT rate is 19% and the OECD average was 19.3% in 2020. North Macedonia's VAT base is narrowed further by a series of reduced rates of 0% and 5%; the latter is levied on goods and services including food products, medicines, books and print media, computers, and school supplies. In 2020, the mandatory VAT registration threshold was raised from MKD 1 million (EUR 16 180) to MKD 2 million (EUR 32 360). Changes to other GSTs were introduced in January 2020, including the introduction of a tax on motor vehicles, based on the purchase price and a calculation based on carbon dioxide ($CO_2$) emissions. OECD research has found that consumption taxes, particularly value-added tax (VAT), may be less distortive on the decisions of households and firms, and thus on GDP per capita, than income taxes (Johansson et al., 2008[86]).

North Macedonia has an aggregated **tax revenue forecasting model** for all major types of taxes. It also operates a microsimulation model, which estimates firm-level CIT revenues, sector-specific CIT revenues and the revenue effects of rate or incentive adjustments. The PIT microsimulation model also analyses different redistributive indicators, such as the Gini and Atkinson index. North Macedonia is currently undertaking a Public Financial Management Reform Programme (2018-21). As part of this programme, it will further strengthen its forecasting capacities and simulation models.

**Tax expenditure reports** in North Macedonia are currently not published as part of the annual budget, but are only used to inform the government. However, as in several WB6 economies, North Macedonia plans to introduce regular tax expenditure reporting as part of the New Organic Budget Law due to come into force at the end of 2020. This is a step in the right direction. Indeed, to support transparency and accountability, the government should follow through on developing regular and systematic tax expenditure reporting in order to monitor the use and effectiveness of tax incentives along with the tax revenue forgone (OECD, 2010[87]).

### *Sub-dimension 4.2: Tax administration*

The Public Revenue Office (PRO) of North Macedonia is a unified administrative body managing direct and indirect taxes. It is in charge of all **tax administration functions** except tax fraud investigation, which

is conducted by the Financial Police and the Ministry of Interior. It is organised under a mixture of functional and taxpayer approaches: its internal organisation follows the different functions of a tax administration, such as audit or taxpayer services, while it has a Large Taxpayer Office focused on large taxpayers. OECD research shows that having a unified body that covers all taxes and all the core tax administration functions is an important factor in strengthening the efficiency of tax administration (OECD, 2018[55]). The PRO is regularly audited by the Department of Internal Audit, which prepares annual and multi-annual audit plans. In 2019, the PRO and its regional offices underwent eight internal audits. A Tax Academy has been established as an internal unit, providing training to the PRO's employees.

With regards to **compliance and risk assessment**, the PRO carries out tax audits following a risk-based approach: it focuses on taxpayers showing certain abnormalities with regard to a predetermined set of risk criteria. OECD research shows that risk-based selection is a key element of effective and efficient compliance programmes as it allows administrations to make effective trade-offs to make the best use of their scarce resources (OECD, 2018[55]). This function is the responsibility of the General Tax Inspectorate, its six regional offices and an inspectorate in the Large Taxpayers Office. The PRO prepares a monthly tax audit plan, structured around three methods: electronic risk-assessment, analysis of individual cases and random audit based on a certain sample of risk activity. The PRO uses the DANIS system to monitor implementation of the national audit plan. While the procedure for tax audits is well established, with the Law on Tax Procedure and the Law on Administrative Disputes, it could be further developed by introducing a general framework that guarantees taxpayers' rights throughout the tax audit process.

In terms of **independence and transparency**, the PRO is organised as an administrative body integrated into the Ministry of Finance, to which it submits monthly reports. The PRO's budget is fixed in the annual budget process but it also receives additional funds in proportion to the amount of additional revenue raised from certain items. A Code of Conduct is in place defining the rights and obligations of the PRO's employees, which provides disciplinary actions for violations of these obligations. Existing rules also provide protection for whistleblowers. OECD research suggests that corruption among tax administration employees may deter individual taxpayers from paying taxes, or they may opt to pay a bribe or enter into the informal economy (OECD, 2018[55]).

Electronic **tax filing** is widely used in North Macedonia. While e-filing is only mandatory for VAT, its use is close to universal for PIT (99.3% of returns) and CIT (96.3%). Since January 2019, the PRO has prepared an annual tax return for taxpayers, which contains data on annual income and any advance payments made. Access to e-filling is based on a free software, with no payment obligations to complete a declaration. Regular audits of the tax collection process are conducted by an internal audit unit as well as the State Audit Office, an independent body. The PRO is in the process of implementing an assessment of compliance by different categories of taxpayer, but the audit process currently does not asses the efficiency of the tax collection system.

The PRO and its regional services offer various **taxpayer services**. The public may access information on line or communicate with it electronically or make inquiries in person. The tax legislation also provides for an ombudsman, which defends citizens' rights against their tax administration. A quarterly managerial report, not specific to taxpayer services, conducts a regular assessment. The PRO also conducts regular surveys of taxpayer satisfaction.

### *Sub-dimension 4.3: International co-operation*

North Macedonia has also been proactively involved with the **international taxation framework**. In August 2018, North Macedonia joined the Inclusive Framework on BEPS (base erosion and profit shifting), which led to a series of initiatives. With regards to harmful tax practices (Action 5), a peer review began assessing North Macedonia's system in July 2020. In January 2020, North Macedonia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) on tax treaty abuse (Action 6). North Macedonia has prepared a first legislative draft on country-by-country reporting (Action 13),

based on the OECD model legislation, which is currently under internal review. It has not implemented the mutual agreements procedure (Action 14) but requested a deferral of the peer review process.

North Macedonia also signed the Convention on Mutual Administrative Assistance in Tax Matters in June 2018, which entered into force in January 2020. Additional initiatives may be highlighted in the field of exchange of information. North Macedonia has been subject to a second round of peer review on exchange of information on request (EIOR), receiving an overall rating of "largely compliant". It has not yet engaged in any initiatives on the automatic exchange of information (AEOI). This involvement in the international taxation framework could help North Macedonia to strengthen the protection of its domestic tax base from erosion due to tax avoidance and evasion.

North Macedonia is engaged in several initiatives in the field of **digital taxation**. It has not yet formally implemented the international VAT/GST guidelines. However, it levies VAT on cross-border digital services using a logic close to the destination principle, which is the cornerstone of the international VAT/GST guidelines. In North Macedonia, income earned through digital platforms are included in the PIT base and taxed at the 10% flat rate. North Macedonia has not participated in the discussions on Pillar 1 and 2 of the OECD's Tax Challenges Arising from Digitalisation project. These developments might have an impact on North Macedonia's taxation of corporate income, especially under Pillar 2, which intends to define a minimum taxation of corporate profits. While the final rate will depend on ongoing discussions, North Macedonia has a low CIT rate and is at high risk of being affected. If the minimum rate is set higher than 10%, it would be faced with the choice of either raising its rate or risk forgoing tax revenues. Pillar 2 might also challenge North Macedonia's use of tax incentives. This topic will have a great importance in the near future and it may wish to evaluate its position on this topic and prepare an action plan.

North Macedonia is undertaking several initiatives in the field of **regional co-operation**. Since June 2006, the PRO has had a co-operation agreement with Bosnia and Herzegovina, Bulgaria, Montenegro, and Serbia. This agreement covers preventing and investigating tax fraud, co-operation on research and compliance, information for compliance purposes, and the training of staff. North Macedonia has also concluded 49 agreements on avoidance of double taxation, 24 of which were with member states of the European Union.

### *The way forward for tax policy*

To enhance the tax policy framework and achieve their objectives, policy makers may wish to:

- **Continue to support the economy and facilitate the economic recovery** in light of COVID-19 with targeted tax and subsidy measures.
- **Assess the balance between employee SSCs and PIT.** In order to encourage low-income workers to participate in the formal labour market, some of the employee SSC burden could be shifted to the PIT by introducing a progressive PIT rate schedule, as planned for 2022. This reform might require accompanying measures to avoid tax avoidance among entrepreneurs who would face a strong incentive to incorporate their business and turn higher taxed labour income into lower taxed capital income.
- **Continue to strengthen its tax expenditure report** and publish it as part of the annual budget, as planned.
- **Avoid the use of profit-based tax incentives.** North Macedonia's CIT is already competitive due to its low rate and the deduction of reinvested profits from the tax base. This excludes the need for overly generous profit-based tax incentives.
- **Follow the discussion of the OECD/G20 Tax Challenges Arising from Digitalisation project** and in particular the work on Pillar 2 which would introduce a global minimum tax. This reform would encourage North Macedonia (and other WB6 countries) to increase its CIT rate and redesign its CIT incentives.

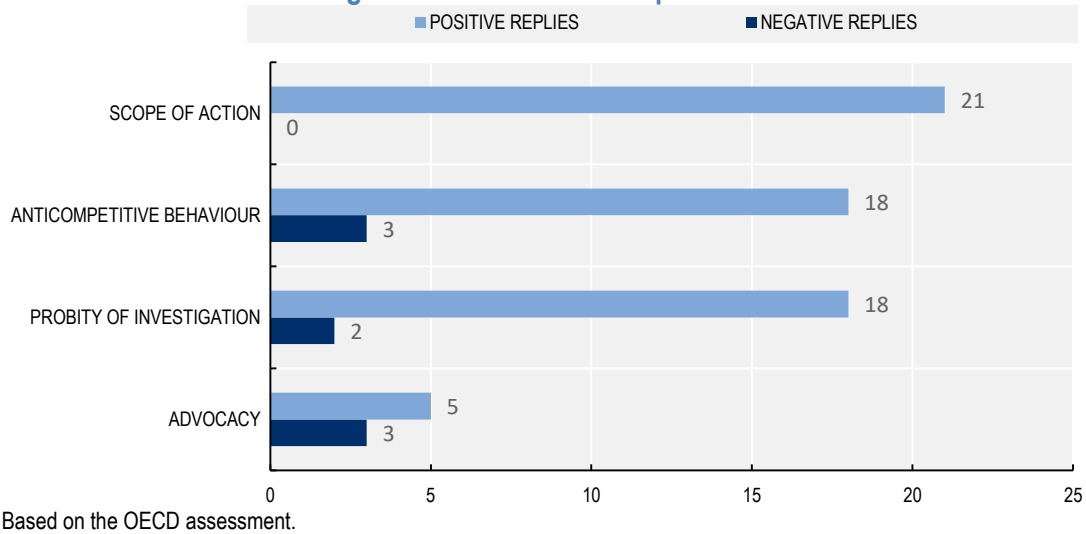
- **Re-evaluate the merits and disadvantages of worldwide taxation for resident companies.** For small open economies such as North Macedonia, worldwide taxation may entail high administrative costs without raising significant revenues.
- **Strengthen the available forecasting and microsimulation models to assess the tax system and reforms, as planned.** This could be through a wider use of microsimulation models and the use of forward-looking effective tax rates.
- **Continue to engage with the international tax community and implement international best practices.** Since the last assessment, North Macedonia has strengthened its involvement in international tax matters and this approach is very much welcomed.
- **Foster regional co-operation and co-ordination on common tax issues.** North Macedonia shares common challenges with other WB6 economies; enhanced collaboration might benefit all the economies involved. Areas such as tax compliance, training of tax staff and the exchange of information would greatly benefit from a co-ordinated regional approach.

## Competition policy (Dimension 5)

### *Introduction*

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas (i.e. scope of action, anti-competitive behaviour, probity of investigation and advocacy) and is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administrated by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy area has a different number of possible criteria that can be stated as having been adopted. Each policy areas is assessed though data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

**Figure 24.9. North Macedonia's legal and institutional competition framework**




Source: Based on the OECD assessment.

### *State of play and key developments*

#### *Sub-dimension 5.1: Scope of action*

The legislative and institutional frameworks for competition in North Macedonia are in line with international good practice. Its competition rules reflect EU provisions on restrictive agreements and abuse of dominant position (Articles 101 and 102 Treaty on the Functioning of the European Union; TFEU) and include *ex ante* control of mergers, following the principles of the EU Merger Regulation.

The Commission for Protection of Competition (CPC) is responsible for implementing the Law on Protection of Competition. The CPC is an operationally independent authority with the power to adopt enforcement decisions in anti-trust and mergers, as well as to advocate competition principles to national policy makers.

The main challenge for the CPC remains implementation. The number of significant anti-trust and merger cases it has undertaken is still limited and the related fines imposed are not enough to ensure strong deterrence. The leniency system is not proving effective in supporting cartel detection. Advocacy action should be expanded, with a view to both embedding competition principles in the legislation and spreading a competition culture.

All this requires adequate financial and professional resources. The CPC appears to need a significant increase in its budget and specialised staff to support the development of competition enforcement and advocacy.

The Commission for Protection of Competition was established in 2005, following the adoption of the Law on Protection of Competition. Its board consists of the President and four members appointed for a five-year period by the Assembly of North Macedonia, with the right to reappointment. The current board was appointed in October 2018. The CPC's investigative activities are performed by four departments managed by a Secretary General, appointed and dismissed by the board.

The total number of staff has fallen slightly, from 26 employees in 2015 to 23 in 2019, and it only employed 6 actual competition case handlers in 2019. In comparison, according to the OECD CompStats database,[42] the average total staff of the 15 competition authorities in small countries (with a population below 7.5 million) was 114 in 2019, of whom 43 were working on competition. The CPC's staffing levels are also at the low end for the region: on average the competition authorities in the WB6 economies employed 33 staff in 2019, of whom 21 were working on competition.

The CPC's budget has grown slightly, from EUR 289 000 in 2015 to EUR 397 000 in 2020. However, despite also having responsibility for state aid control, its budget is the smallest of the 48 respondents to the CompStats survey.

The Law on Protection of Competition ensures competitive neutrality, insofar as the **competence** of the CPC encompasses both private and public undertakings. This includes entities that have been entrusted with services of general economic interest, except where the application of the law would hinder the performance of the tasks stipulated by law or the purpose for which those entities were established.

The CPC has appropriate **powers to investigate** and **powers to sanction** possible anti-trust infringements, i.e. restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms.

The CPC may impose cease and desist orders, and remedies and sanctions on firms that have committed anti-trust infringements. It may also adopt interim measures *ex officio* and based on preliminary evidence (*prima facie*), if the alleged competition breach poses a risk of serious and irreparable damage. It may also order behavioural and structural measures needed to eliminate harmful effects on competition and set deadlines for their implementation. The duration of such interim measures has to be clearly indicated by the CPC and be proportionate and consistent with the objectives of the measure.

After the initiation of proceedings, and no later than the notification of the statement of objections, parties may offer commitments to address the competition concerns. The Commission for Misdemeanour Matters, an internal body of the CPC, cannot accept such commitments in cases of a significant distortion of competition.

The CPC may compel investigated firms and third parties to provide relevant information and may perform unannounced inspections on the premises of the parties. The assessment of alleged anti-competitive conduct must follow a thorough scrutiny of the collected evidence, which may include an economic analysis of the competitive effects of vertical agreements or possible exclusionary conduct.

The Commission for Misdemeanour Matters can impose a fine of up to 10% of the value of the total annual turnover of the undertaking in the last business year. The Law on Protection of Competition includes a leniency programme, which offers partial or total immunity from sanctions to firms that report the existence of an anti-competitive agreement and submits valid evidence to the CPC.

The Law on Protection of Competition also provides for *ex ante* control of **mergers**, following the principles of the EU Merger Regulation. The CPC can compel merging firms and third parties to provide relevant information and can perform unannounced inspections on the premises of the parties. The assessment of

notified mergers must follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the notified transaction.

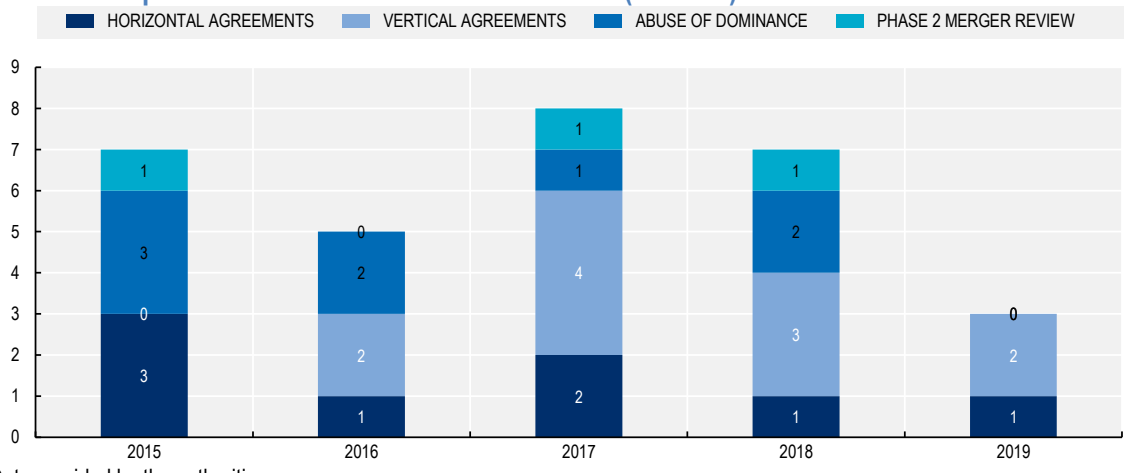
In the case where a merger would create or strengthen a dominant position in the relevant markets, the CPC may prohibit the transaction. If the merging parties propose modifying the transaction and the CPC finds that the modifications address the anti-competitive concerns, the CPC may accept the proposed remedies and clear the merger.

Regarding **private enforcement**, individuals, firms and consumers – either collectively or through consumer associations – can bring a legal action to seek damages from firms that have committed anti-trust infringements.

*Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. The actual **implementation** of these provisions through competition enforcement is still limited in North Macedonia (Figure 24.10). Very few decisions have tackled hard-core **horizontal agreements** (cartels), which represent the most harmful competition infringements, particularly in the last few years. In comparison, on average the 15 competition authorities in smaller jurisdictions in the OECD CompStats database tackled 4.2 cartel cases a year during 2015-19.

**Figure 24.10. Competition decisions in North Macedonia (2015-19)**




Source: Data provided by the authorities.

The sanctions on cartels were negligible until 2019, when the CPC imposed a total fine of EUR 1.7 million on two pharmaceutical companies (on average the total fines imposed annually on cartel infringers by the competition authorities in smaller jurisdictions in the OECD CompStats database were EUR 2.7 million during 2015-19). The CPC has primarily invested its investigative resources in **vertical agreements**. However, the amount of fines imposed relating to vertical agreements was also modest, totalling EUR 143 185 in 2018 and EUR 206 850 in 2019.

The CPC has not received any leniency applications to date. It has made progress on unannounced inspections (also called “dawn raids”), which are crucial for collecting evidence of competition breaches, particularly with respect to cartels. After conducting only one such inspection each year in 2016-19, it carried out three in 2019.

The number of decisions on **exclusionary conduct** ranged from three in 2015 to zero in 2019.

In 2019 the CPC received 58 **merger** notifications, after receiving 67 in 2018 and around 40 in each of the previous three years. The vast majority of the transactions were cleared without any need for a closer examination and only a small portion had real economic implications for the national economy. Over the last five years only one merger has been blocked, in 2017, while two were approved with remedies (in 2015 and 2018).

The ratio of in-depth (Phase 2) investigations and notifications is lower than in other jurisdictions, if benchmarked against the 15 competition authorities in smaller jurisdictions in the OECD CompStats database. In particular, the average annual number of in-depth merger investigations in the 15 competition authorities in the years 2015-19 was 4, out of 36 notifications.

### *Sub-dimension 5.3: Probity of investigation*

The CPC is an **independent** state body, i.e. it is autonomous in its work and decision-making process within the competencies provided by the law. It is **accountable** before the Assembly of the Republic of Macedonia, to which it must submit an activity report no later than March each year.

In terms of **procedural fairness**, the decisions of the CPC and the Commission for Misdemeanour Matters as well as the judgements by the courts, must be published on the website of the CPC and in the Official Gazette. The text of the decision has to specify the names of the parties to the proceedings and the basic contents of the decision. All data qualified as business or professional secrets may not be published.

The decisions of the CPC issued in administrative proceedings are final. They may be appealed before the Administrative Court within 30 days of the day of the notification of the decision, without deferring the enforcement of the decision. The judgements of the Administrative Court may be further appealed before the High Administrative Court. The decisions of the Commission for Misdemeanour Matters are also final. A legal action before the Administrative Court may be brought within eight days of the day of the notification of the decision.

Before making a final decision, the Commission for Misdemeanour Matters has to provide the parties with a statement of objections, which should also indicate the type and amount of the sanction to be imposed and the circumstances taken into account to determine the sanction. The parties have the right to state their views in writing. Likewise, merging parties have the right to be heard and submit evidence before a decision on a merger is taken.

A large number of by-laws, guidelines and brochures are published on the CPC website (mostly translated from EU documents). They include notices on the notion of concentration, horizontal and vertical agreements, as well as a number of guidelines, including on the calculation of fines, vertical restrictions, and horizontal and vertical mergers.

### *Sub-dimension 5.4: Advocacy*

The CPC can issue opinions on existing and draft laws and regulations. The public body concerned must inform the CPC of the reasons for not accepting the Commission's opinion. The CPC can provide opinions on issues in the area of competition policy, protection of competition on the market and granting state aid which it can do on request by the Assembly, the Government of North Macedonia, other state authorities, undertakings or *ex officio*.

In exercising its functions, the CPC has to co-operate with other state authorities and bodies on issues related to the protection of competition. The CPC and the state authorities and bodies can exchange the data and information needed to carry out their responsibilities, as long as the exchange is appropriate and proportionate to its purposes.

The CPC usually receives draft laws and regulations before they are adopted and has sufficient time to examine and comment on them. There is no specialised unit within the CPC in charge of the assessment of laws and regulations. There is no manual or guidance for conducting such an assessment.

In 2019 the CPC issued seven formal opinions, compared to six in 2018 and four each in 2017 and 2016. Recent relevant opinions concerned the Law on Public Procurement and the Law on Misdemeanour, and the CPC's suggestions were implemented. In December 2014, the CPC issued guidelines for detecting bid rigging in public procurement, in co-operation with the Bureau for Public Procurement.

The CPC has the power to perform market studies but has not issued any over the last few years.

It organised three public events to promote competition culture in 2019. In previous years, the CPC also organised workshops for judges and for members of the national chamber of commerce.

### *The way forward for competition policy*

The CPC needs to improve its competition enforcement capacity and efforts, with a view to increasing the number of decisions on cartels and abuses of dominant position and the resulting fines.

In addition, it should engage in advocacy initiatives to promote greater awareness of competition principles among the general public and foster a competition culture among policy makers and the business community. The recent challenges arising from the COVID-19 pandemic make it even more urgent for the CPC to expand its advocacy role to contributing to the economy's quick recovery.

In addition, policy makers and the CPC should focus on the following measures:

- **Provide the CPC with adequate financial and professional resources**. Its current budget and the number of specialised staff appear insufficient to allow the CPC to effectively perform its duties. Substantially increasing the budget would align the CPC with other comparable competition authorities. Additional financial resources would enable the CPC to recruit officials with appropriate competition skills and thus develop its potential in terms of competition enforcement and advocacy. See Box 24.8 for information on how Italy's competition authority is funded.

- **Prioritise boosting cartel enforcement and increasing fines.** Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. The efforts of the CPC should be focused on detecting cartels and imposing heavy fines on infringers, in order to deliver a strong message that firms that engage in collusion risk will be severely punished. If the amount of fines sufficiently exceeds illicit gains, offences will be deterred even when the probability of paying a fine is low. Concern over fines is also a key driver of leniency applications, thus increasing the effectiveness of the leniency programme – which has been unproductive so far – and further boosting detection. The CPC could also expand its detection skills, for example by further strengthening the fight against bid rigging (see the next recommendation on public procurement) and continue to perform on-site inspections to collect evidence.

- **Pay particular attention to public procurement, particularly during the COVID-19 crisis.** Public procurement is a key sphere of action both for cartel enforcement and for encouraging competition. Bid rigging results in significant harm for public budget and taxpayers, dampening innovation and encouraging inefficiency. Figure 24.11 shows how co-operation between competition and procurement authorities can help detect and avoid big rigging. The CPC has issued guidelines for detecting bid rigging in public procurement, in co-operation with the Bureau for Public Procurement and successfully advocated to improve the Law on Public Procurement. The CPC should further explore ways to enhance its detection of cartels and prevent bid rigging through better tender design by procurement officials. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012[88]) calls on governments to assess their public procurement laws and practices at all levels of government in order to promote more effective procurement and reduce the risk of bid rigging in public tenders. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[89]), which form a part of the recommendation, are designed to reduce the risks of bid rigging through careful design of the procurement process and to detect bid-rigging conspiracies during the procurement process. The OECD can also provide assistance through a project aimed at assessing the main rules governing the procurement of public works and the procurement practices of major public buyers and providing recommendations for competitive procurement and fighting bid rigging in accordance with international good practices, while offering training to both competition and public procurement officials based on the Guidelines on Fighting Bid Rigging in Public Procurement.

### Box 24.8. Financial independence for the Italian Competition Authority

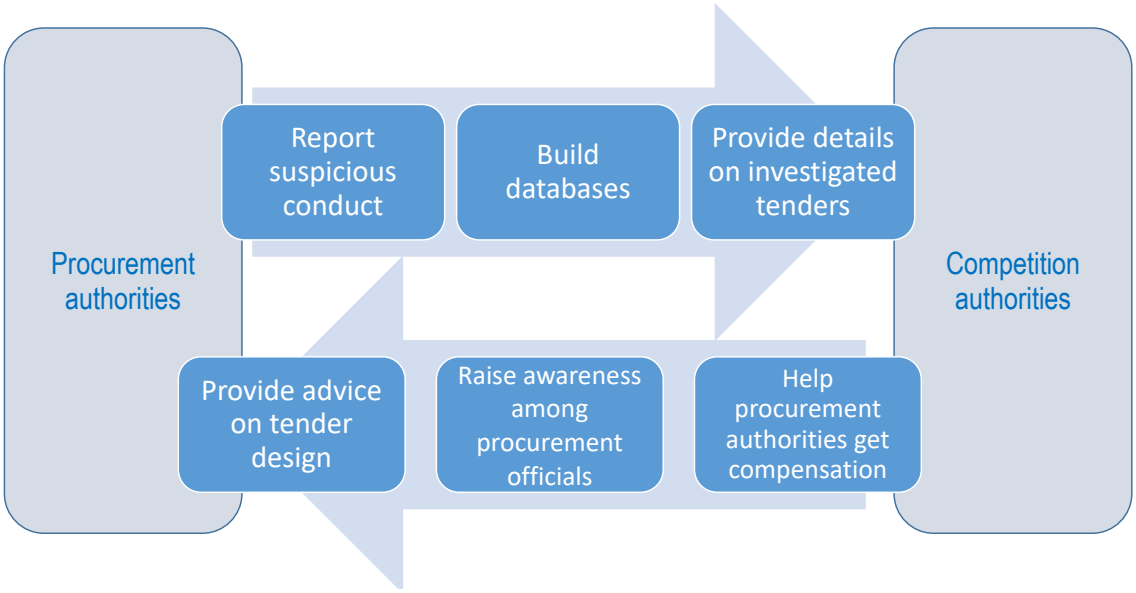
Until 2012, the financing of the Italian Competition Authority (AGCM) was based on two main sources: annual funding from the state and fees paid by companies subject to merger notification requirements.

Legislative Decree no. 1/2012 modified the AGCM's funding system, which is now based on mandatory contributions imposed on companies incorporated in Italy whose turnover exceeds a threshold of EUR 50 million. The revenues from these contributions replace all previous forms of funding. The level of contribution, originally fixed at 0.06 per thousand, has been gradually lowered by the AGCM to 0.055 per thousand. The authority's financial statements have to be approved by 30 April of the following year, and are subject to auditing by the Court of Auditors.

This funding system can be regarded as an indirect recognition of the positive role played by the AGCM in supporting a healthy and level competition field, which justifies the imposition of a small contribution on the largest businesses incorporated in Italy.

Importantly, the previous funding system entailed the risk of possible fluctuations in the size of the annual budget, due to the unpredictability of the number of notified mergers and levels of state funding. The new system shelters the AGCM from that risk, thus allowing for more stable and forward-looking recruitment planning.

Figure 24.11. Example of co-operation between competition and procurement authorities




- **Perform market studies**. Market studies are used to assess how competition in a sector or industry is functioning, detect the source of any competition problems, and identify potential solutions. They can uncover problems such as regulatory barriers to competition and demand-side factors that impair market functioning. Because market studies are a versatile tool, and they allow the examination of a broader set of issues than competition enforcement, their use is growing. International organisations, notably the OECD and the International Competition Network (ICN), have developed a wide range of documents on market studies, including the OECD Market Studies Guide for Competition Authorities. The OECD Competition Division can also assist competition authorities, regulators, ministries or other policy makers with market study projects.
- **Promote a competition culture through dedicated events.** In this phase of the development of the CPC, it needs to strengthen its standing and reputation and persuade policy makers and the business community of the key role competition plays in supporting economic growth and consumer welfare. Tailor-made conferences in co-operation with other public authorities, training events and seminars addressed at the business community or the judiciary, as well as educational materials for the general public, are effective tools to increase competition awareness.
- **Expand international co-operation and training.** In the face of increasingly complex anti-trust issues and the frequent cross-border nature of competition infringements, the management and the staff of the CPC should have frequent opportunities to meet and participate in policy discussions. International organisations like the OECD, the ICN and the United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities to this end. The OECD-GVH Regional Centre for Competition in Budapest also provides an ideal forum for capacity building and sharing of good practice with colleagues from other jurisdictions, focusing on the specific challenges of Eastern European and Central Asian countries. The CPC is already a regular participant in the centre's events and would benefit from actively continuing.

## State-owned enterprises (Dimension 6)

### *Introduction*

The ownership arrangements for North Macedonia's approximately 50 centrally held state-owned enterprises (SOEs) are dispersed across the administration. There is no unified state ownership policy to guide corporate decision making around SOE performance. As a result, many SOEs are loss making and North Macedonia scores on the lower end of the scale for the sub-dimension on their efficiency and governance (Table 24.11). Its performance in the transparency and accountability practices sub-dimension is around the regional average, reflecting sound basic disclosure requirements at the company level, but limited disclosure by the state on the performance of its SOE portfolio as a whole. Similarly, North Macedonia achieves an average score for providing a level playing field between state-owned and private companies. This reflects issues that are common across the Western Balkan region – namely that many SOEs are not incorporated according to general company law and that they enjoy some competitive advantages, such as lenient rate-of-return expectations, from the state as owner. North Macedonia's overall performance in this dimension remains essentially unchanged since the last Competitiveness Outlook (2018), as no state ownership reforms have been undertaken since then.

**Table 24.11. North Macedonia's scores for state-owned enterprises**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 1.8 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 2.8 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 2.5 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising state-owned enterprises | n.a. | n.a. |
| **North Macedonia's overall score** | | **2.3** | **2.6** |

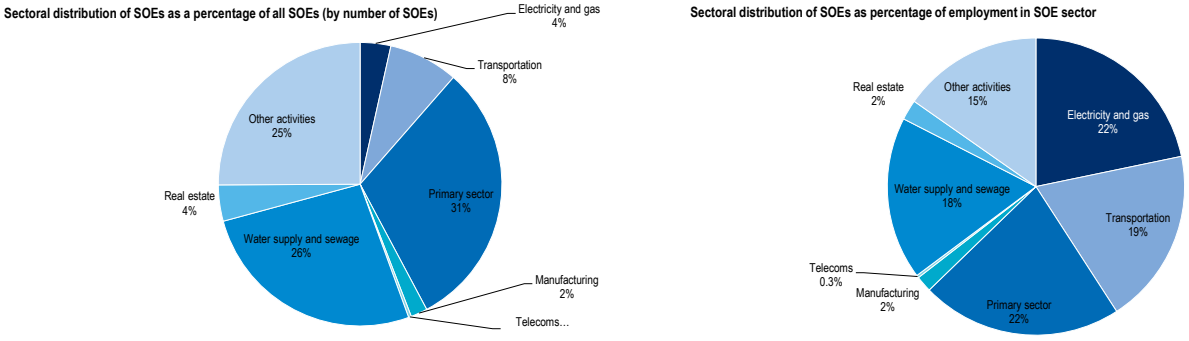
Note: For comparability with the previous assessment, Sub-dimension 6.4 (reforming and privatising state-owned enterprises) has not been scored but is discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

The central and municipal governments of North Macedonia own a reported 318 enterprises, of which 50 are solely held by the central level of government.[43] Similar to most OECD countries, these SOEs are highly concentrated in the network industries: telecoms, electricity and gas, transport, and other utilities (including water supply and sewage companies owned by municipalities). Together they account for 59% of all SOE employees (Figure 24.12).[44] Individual examples include the Public Enterprise Macedonian Railways, the Public Enterprise for State Roads, and the natural gas distributor Public Enterprise Strumica-Gas. The primary sector – which includes, for example, the state forestry enterprise – is also quite important, accounting for 22% of all SOE employment in the economy.[45] Beyond these more "traditional" state ownership sectors, the government also owns 13 real estate companies and 6 manufacturing companies, together accounting for 4% of all SOE employment. Three SOEs are nominally listed on the national stock exchange, operating in residential and government real estate and gambling (the state lottery).[46]

## Figure 24.12. Sectoral distribution of SOEs by number and contribution to employment




Note: North Macedonia's authorities excluded primary-sector SOEs from their aggregate figures, but they have been included in this profile's figures.

Source: Calculations based on data provided by North Macedonia's authorities, aggregating figures for SOEs owned at both the central and municipal level.

SOEs at all levels of government employ approximately 51 000 people, accounting for an estimated 6.4% of all employment in North Macedonia. The authorities did not provide distinct data on SOEs held only by central government (except reporting that the central level of government owns 50 of them). This makes it difficult to draw international comparisons, including with OECD economies for which the available data are usually only based on central government SOEs (OECD, 2017[90]). As an imperfect point of comparison, centrally held SOEs account for 2-3% of national employment on average across OECD countries, with the 10 largest sectors accounting for between 2.9% (in Sweden) and 9.6% (in Norway) of national employment (OECD, 2017[90]; IMF, 2019[91]). A 2019 assessment by the International Monetary Fund (IMF) of SOEs held at all levels of government in Central, Eastern and South-eastern Europe found that SOEs in North Macedonia accounted for the smallest share of employment in the region, second only to Kosovo (IMF, 2019[91]). The same study found that North Macedonia's SOEs accounted for the least amount of value added as a share of GDP compared to the other WB6 economies (IMF, 2019[91]).[47]

External assessments suggest significant inefficiencies and, in many cases, outright losses among SOEs in North Macedonia. A 2019 IMF study found that more than 70% of SOEs in North Macedonia are less profitable than their private sector peers (IMF, 2019[91]). A 2015 examination of the financial statements of 101 SOEs found that one in three of them were loss making (BIRN, 2014[92]). A more recent analysis of 29 SOEs, undertaken by Portalb, found that 13 of the reviewed SOEs had posted pre-tax losses in 2018 (Dodevska, 2019[93]). Among these loss-making SOEs were the national postal services operator and the railway transport and infrastructure companies. It is not uncommon for SOEs across the world to be less profitable than their private sector peers. They are often expected to fulfil costly public policy objectives that are subsidised from commercial activities, rather than being transparently compensated through the state budget. The authorities in North Macedonia have not so far attempted to define, disclose, or estimate the costs of SOEs' non-commercial objectives, which can be quite wide ranging, including delivering public services and supporting local employment. In the absence of information, understanding and addressing the sources of SOEs' weak performance could prove to be challenging.

Concerning the **clarification of ownership policy and rationales**, the authorities have not developed a publicly available policy that defines the overall objectives for state ownership or the roles of different state bodies in executing ownership decisions. Some of the rationales for state ownership can be ascertained from existing legislation, such as the Law on Public Enterprises, which references undertaking activities in the public interest as a reason to establish SOEs but provides little additional details on what constitutes the "public interest". There are 23 SOEs that do not fall under the scope of the Law on Public Enterprises, and for which the rationales for state ownership are therefore even less clear. For some individual enterprises, the founding legislation and/or articles of association implicitly outline the reasons for state ownership, while for other SOEs, the reasons for state ownership are simply not articulated. There is

significant scope to define and disclose the rationales for state ownership – both in general and for specific SOEs – so that public ownership of companies is a transparent and informed policy decision more clearly.

North Macedonia has a dispersed ownership architecture, with no single state institution responsible for executing ownership decisions. It has no co-ordinating body to harmonise and **professionalise state ownership** practices across the state administration. While the ultimate responsibility for state ownership resides, by law, with the Government of Macedonia, the practical division of responsibilities among ministries is unclear. Public bodies with state ownership responsibilities include the Ministry of Economy, the Ministry of Finance and the Ministry of Transport and Telecommunications. A portfolio of SOEs was also previously overseen by the Privatisation Agency, but the agency was disbanded in 2005 and the remaining enterprises under its purview were divided among the Ministry of Finance, the Ministry of Economy, the Pension and Disability Fund, and the Public Company for Real Estate Management.

North Macedonia is reportedly in the process of establishing a **robust board nomination framework** for SOEs, but there is currently no common approach to board appointments and the process does not seem to be very transparent. In practice, board nominations to SOEs are decided by the government based on proposals by individual line ministries. The absence of a transparent nomination process increases the risk of board positions being awarded to people with limited professional qualifications and, in the worst cases, used as tools for political patronage. Because boards of directors are in turn responsible for appointing chief executive officers (CEOs), there is a risk that any politicisation of boards could trickle down to the management level, leading to political influence over corporate decision making. According to stakeholders interviewed in the context of this assessment, the senior management of SOEs frequently changes when there is a change in government, indicating a strong degree of politicisation in SOE management oversight.

Despite these shortcomings, there are at least some basic legislative requirements to **promote independent and professional boards** for companies from North Macedonia, including most SOEs. The Trade Companies Law – which is applicable to SOEs that are incorporated as limited-liability or joint-stock companies – establishes that board members are liable for any damages to the company as a result of their decisions. It also includes requirements that company boards comprise a minimum of one-quarter independent directors. Individuals are considered independent if they and their immediate family members 1) have not had any material interests or business relationships with the company during the preceding five years; and 2) are not holding over 10% of its shares. Nonetheless, in practice, SOE boards are often seen as extensions of the ministries that own them, rather than as strong corporate decision-making bodies that operate independently under clear objectives communicated by the government. Public officials serving on SOE boards receive instructions on how to vote, indicating a boardroom culture in which members are not expected to make decisions independently in the interest of the enterprise and its shareholders.[48] The presence of politicians on SOE boards – which in some other WB6 economies is either barred by law or goes against applicable policy – also raises significant concerns regarding boards' professionalism and independence. North Macedonia's authorities have not taken steps to promote gender diversity on SOE boards, reflecting the wider underpinning issue of underdeveloped board nomination criteria. It is considered good practice to take gender diversity into account in the process of establishing a board of directors with varied backgrounds and experiences.

### *Sub-dimension 6.2: Transparency and accountability practices*

While legislation establishes multiple **financial and non-financial reporting** requirements for SOEs, there is an overarching concern over SOEs' compliance with these requirements. Like all companies, SOEs are required to submit annual reports and financial statements to the Central Registry, which must then make them publicly available. SOEs are also required by the Law on Public Enterprises to publish their financial statements on their own websites – or, if they do not have a website, on the website of the responsible ownership ministry – within 15 days of their submission to the Central Registry. Earlier external studies indicate that many SOEs have in the past complied with the requirement for reporting to the Central

Registry and that at least their financial reports were readily available to the public.[49] However, according to the assessment, the majority of SOEs do not fully implement their reporting requirements. SOEs are also required by law to submit reports on their performance, together with their annual accounts, to the responsible line minister. A more in-depth and up-to-date review of SOEs' compliance with existing disclosure requirements, as well as of the quality of their disclosures, could help determine whether additional policy measures are needed to strengthen disclosure at the enterprise level.

Concerning disclosure by the state, no single report on the aggregate performance of SOEs is compiled or made available to the general public. However, the state has established a basic online directory of SOEs, which includes their names, addresses, and contact information (in Macedonian) (KOMSPI, n.d.[94]). The Central Registry is required to publish the corporate disclosure documents that it receives from individual enterprises, including SOEs, but more information would be required to assess whether such information is in practice publicly available for most SOEs.

North Macedonia appears to have established sound basic legislation to ensure high-quality **auditing practices** among SOEs, but a fully informed assessment of this area would require a qualitative review of how this legislation is implemented in practice. The Law on Audit requires all legal entities of public interest – which presumably includes all SOEs under the scope of the Law on Public Enterprises – to have their financial statements reviewed by an external auditor. In practice, however, the government reports that independent external audits are only performed for SOEs with mixed capital and that the State Audit Office audits the financial statements of SOEs that are 100% owned by the state. This suggests a general lack of clarity about SOEs' audit requirements and there is a need to clearly identify which SOEs should undergo external audits of their financial statements.

External stakeholder assessments also point to insufficient state monitoring of SOEs' operations as well as the absence of clearly defined criteria for determining which SOEs should undergo state audits and when. The Centre for Civil Communications, a local NGO, highlighted in a recent report that the majority of SOEs had not undergone a state audit in the past 15 years. The report also highlighted the lack of clarity regarding how SOEs are selected for audits and how frequently they take place: one of North Macedonia's largest SOEs (the electricity company AD Elektrani) was last subject to a financial audit by the state in 2007, while the state road construction company was audited four times between 2005 and 2016 (Centre for Civil Communications, 2019[95]). This report also highlighted that several SOEs have received negative opinions on the soundness of their financial statements or their compliance with applicable legislation. This points to the need to improve the quality and credibility of their corporate disclosures and also to strengthen their compliance with legislative requirements.

Very few SOEs have non-state shareholders, making the **protection of minority shareholders** a somewhat low-priority issue. However, if the government ever wishes to broaden the ownership of SOEs – including the three SOEs that are currently nominally listed on the national stock exchange but do not include any private shareholders – minority shareholder rights will be paramount. Currently, there are sound laws in place for the protection of basic minority shareholders' rights, including the right to equitable treatment, to participate in shareholders' meetings and to participate in specific corporate decision making. North Macedonia has had positive external assessments of its minority shareholder protections and notably scores relatively high (5 out of 6) on the World Bank's *Doing Business* indicator on the extent of shareholder rights (World Bank, 2020[96]). It is not clear why the authorities have listed three SOEs on the stock exchange but maintained 100% state ownership in them. Although listing rules in North Macedonia normally require a company to have at least 50 shareholders and 20% free float in order to list, SOEs that operate in the public interest are exempt from these requirements.

### *Sub-dimension 6.3: Ensuring a level playing field*

The fact that most SOEs in North Macedonia are incorporated as joint-stock or limited-liability companies establishes a strong foundation for ensuring a level playing field with private companies. Nonetheless,

some differences in SOEs' **legal and regulatory treatment** exist owing to 1) the fact that several SOEs operate under the distinct legal form of "public enterprise" and have not been incorporated as joint-stock or limited-liability companies; and 2) the existence of a separate Law on Public Enterprises, which applies to its 195 SOEs (of all legal forms) that are considered to perform activities in the public interest.[50] While the existence of a dedicated law applicable to SOEs is not necessarily of great concern – in some countries, such laws may help to clarify and improve SOEs' corporate governance and disclosure practices – some of the provisions of the Law on Public Enterprise establish operational differences for SOEs that are not considered good practice. For example, the law explicitly allows for ministries owning SOEs to use the profits of some to subsidise the losses of others, which is not a transparent way to finance public-service activities.[51]

The Law on Public Enterprises establishes that public enterprises can be founded as joint-stock companies or limited-liability companies, which are also regulated by the Trade Companies Law applicable to private companies. A further 23 SOEs which are incorporated as joint-stock companies do not fall under the scope of the Law on Public Enterprises, presumably because they are not considered to undertake a public-interest activity. This suggests a patchwork of legislation applicable to SOEs. An additional concern is that, according to their founding or sectoral legislation, some SOEs cannot undergo bankruptcy proceedings. This means that they are not subject to an important market pressure – the threat of bankruptcy – faced by their private competitors, which distorts the playing field. This is supported by a provision in the Law on Public Enterprises stipulating that enterprises performing a public-interest activity must do so "permanently and without interruption".

While such provisions are intended to ensure the continued provision of public services, they may also have unintended negative effects on SOEs' commercial viability. While many SOEs in North Macedonia do not actually compete with private companies – for example public utilities with no private competitors – it is still considered good practice to subject them to a similar legal regime as private companies, to promote corporate efficiency and ensure a level playing field if the market is ever opened to competition at a later stage. An additional issue affecting competition with private companies is that, according to stakeholders interviewed for this assessment, SOEs often offer higher wages than private competitors, making them attractive vehicles for political patronage and limiting their corporate productivity at the expense of market efficiency.

North Macedonia's authorities provided little formal information for this assessment on **SOE access to finance**, including the terms and conditions attached to financing from both the state and commercial banks. However, online media sources indicate that the state does issue explicit guarantees for (some) SOEs' commercial debt, which may constitute a competitive advantage for SOEs over their private competitors. Notably, these guarantees have been issued for large infrastructure projects, for example in road construction. The state's most recent fiscal strategy document establishes the intention to limit the total value of the state's guarantees on SOE debt for the period 2020-22 to no more than 13% of GDP (Dodevska, 2019[93]). In addition to such explicit guarantees, it is likely that SOEs also benefit from implicit guarantees – in that banks expect the state to step in if SOEs are unable to pay their debts – which would constitute an undue competitive advantage over private companies.

As an EU accession candidate, North Macedonia is expected to comply with EU rules on competition, which include state aid rules intended to ensure that state equity financing is provided on market-consistent terms and does not distort competition. It does not appear that North Macedonia's authorities have made any efforts to ensure that capital injections are made on market-consistent terms. Many SOEs in North Macedonia have benefitted from the economic assistance offered to all economic entities to help them survive the economic downturn related to the COVID-19 pandemic. Information on the terms of this support – and plans to phase it out – would be useful to better understand the current national approach to supporting SOEs. It is worth noting that the European Commission issued new guidance in May 2020 on temporary recapitalisations made by the state to keep otherwise healthy companies from going out of business due to the economic downturn related to COVID-19 (EC, 2020[97]).

Other areas affecting SOEs' financial conditions – and where state policy seems underdeveloped – include the apparent absence of rate-of-return and dividend expectations that are benchmarked against the private sector, and the use of direct state subsidies that are not calibrated to the cost of public service obligations and therefore support corporate inefficiencies. On a more general note, establishing separate accounting and performance indicators for SOEs' commercial and non-commercial activities would allow for a more informed assessment of their corporate efficiency, which in many cases might be hindered by costly public-policy obligations.

*Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

North Macedonia has not undertaken any significant **state ownership reforms** over the past few years. Reform efforts have mostly been limited to addressing structural issues with individual SOEs. For example, there has been a recent assessment of the state-owned railway operator and ongoing discussions about its potential future privatisation.

North Macedonia does not currently have an active **privatisation** programme in place. As mentioned above, the Macedonian Privatisation Agency, which was responsible for privatising over 1 600 enterprises from 1993 to 2005, was disbanded in 2005 and its remaining assets were divided among other public institutions and ministries. The authorities report that management and employee buy-outs were a common privatisation method during that time. Both the Ministry of Economy and the Ministry of Finance maintain some enterprises that were slated for privatisation and transferred to them when the Privatisation Agency was terminated but plans for their privatisation appear to be either stalled or terminated.

Today, the privatisation process is nominally overseen by the government and a dedicated Governmental Privatisation Commission, but the authorities report that no enterprises have been privatised in the last few years. The legislative foundation for privatisations is enshrined in the Law on Privatisation of State-Owned Capital, the Law on Transformation of Enterprises with Social Capital and dedicated government regulation concerning the sale of company shares by the state.

### *The way forward for the state-owned enterprises*

As in most WB6 economies, ensuring that SOEs in North Macedonia operate efficiently, transparently and on a level playing field with private companies requires reforms in multiple policy areas. These cannot be done all at once: choosing the appropriate sequencing of reforms is just as important as their content and depends in large part on the national political climate and current reform priorities.

This being said, the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* provide a guidepost for reforms that North Macedonia's authorities can use to inform their policy efforts in this domain. Based on the state of play of SOE policy development in North Macedonia, the following priority reform areas – which are in line with the OECD guidelines – could offer a basis for discussions with the authorities:

- **Develop a state ownership policy that outlines the rationales for state ownership and the expectations of SOEs.** This would constitute a first step towards professionalising state ownership practices in North Macedonia. The policy should provide a clear overview of why the state owns enterprises and what it expects SOEs to achieve. It should clearly outline the main principles guiding state ownership decisions, such as setting objectives and board nominations. It should also define the roles and responsibilities of the different state bodies responsible for executing state ownership decisions and for monitoring SOEs' activities. At a later stage, the authorities might consider establishing a co-ordinating entity to monitor implementation of the state ownership policy, and other subsequent policies or decisions applicable to SOEs, across the public administration.
- **Clarify and streamline the legal forms of SOEs.** Several SOEs, including some undertaking commercial activities, are not (yet) incorporated as companies and instead operate as "public

enterprises". The authorities should review the rationale for keeping SOEs in this separate legal form and consider fully corporatising those that are engaged in predominantly commercial activities, to further align their legal and regulatory treatment with that of private companies. Where the authorities determine that it is more appropriate for an entity to remain a public enterprise, the rationale for this decision should be clearly and publicly stated. The authorities should also take steps to clarify and streamline the legislation applicable to all SOEs, which could involve updating the Law on Public Enterprises.

- **Establish a transparent and objective board nomination process**. Steps should be taken to minimise the risk of politicisation of boards of directors and to ensure that boards contain qualified professionals who make decisions independently in the interest of the SOEs and their shareholders. This could include establishing clear selection criteria for SOE board members, publishing vacancies, and involving professional recruitment agencies. Some countries, including Australia and the United Kingdom, have found it useful to involve state ownership co-ordination agencies in the board nomination process, by allowing them to review and advise on board member nominations made by line ministries (OECD, 2018[98]). While North Macedonia lacks such a centralised agency, these practices could still serve as useful examples of increasing transparency in board nominations by involving more than just responsible ministries in the process. Improving SOE board independence is a difficult task and requires not only changes to processes and requirements, but also sustained political commitment at the highest level of government. In implementing reforms in this area, the authorities should be aware of the risk that the spirit of new rules can easily be subverted and should take steps to manage this risk.[52]
- **Develop centralised data and publicly available aggregated reporting on SOEs.** The state should establish a central overview of all SOEs, including information on how many companies are under the remit of the central and municipal levels of government. The state already requires SOEs to submit their annual reports and financial statements to both the Central Registry and their responsible ministries. The state could build on this to produce annual aggregate reports on the activities and performance of the SOE sector as a whole. Aggregate reports can be a useful way to drive changes in the corporate governance and performance of SOEs, since they support public accountability and put pressure on ownership ministries and SOE management to improve. Even if not all SOEs provide the required information (an area which requires further assessment), this in itself can be included in the aggregate report, to highlight non-compliance and encourage improvements. The aggregate reports produced by Lithuania, Finland and Sweden could serve as inspiration for such a report (see Box 24.9 for an overview of the Swedish state ownership report).[53]
- **Review and improve the quality of disclosure by individual SOEs**. This assessment has pointed to significant shortcomings in SOEs' implementation of the state's reporting requirements. The authorities should undertake a thorough review of SOEs' compliance with reporting requirements and the quality of their disclosures, to identify gaps and establish mechanisms to improve disclosure if necessary. The state should clarify the auditing requirements and ensure that at least all large SOEs undergo an external audit of their financial statements by an independent audit firm.

### Box 24.9. Reporting on state-owned enterprises in Sweden

The Swedish state ownership report is available online, in both Swedish and English. It provides extensive information on the state's expectations of SOEs as well as details of SOEs' operational performance and governance, including:

- An overview of the state's portfolio of companies, including those with minority state ownership.
- Detailed information on the state's public policy expectations and financial targets for SOEs.

- Aggregate financial results of the SOE portfolio, including dividend pay-outs.
- An overview of policy guidelines on board member remuneration and external reporting by SOEs.
- Detailed company overviews, including financial performance data, public policy assignments and identification of board members.

Source: Government Offices of Sweden (2018[99]), *Annual Report for State-Owned Enterprises 2018*, www.government.se/4ad5ee/contentassets/42e5b5c1afbc4e65a4b08411db01167e/annual-report-for-state-owned-enterprises-2018.

## Education policy (Dimension 7)

### *Introduction*

Table 24.12 shows North Macedonia's scores for the four education policy sub-dimensions and the cross-cutting dimension on system governance, and compares them to the WB6 average. North Macedonia has the highest score (along with Albania) of the WB6 economies for the tertiary education sub-dimension, driven by its slightly above-average ratings for each indicator. Likewise it scores highest (along with Kosovo) for the system governance cross-cutting dimension. However, it scores below the WB6 average for the early childhood and school education sub-dimension – explained by its comparatively low score for the prevention of early school leaving indicator.

**Table 24.12. North Macedonia's scores for education policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 2.3 | 3.0 |
| | Sub-dimension 7.2: Teachers | 2.5 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 3.5 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 3.0 | 2.8 |
| | Cross-cutting sub-dimension: System governance | 4.0 | 3.3 |
| **North Macedonia's overall score** | | **2.9** | **3.0** |

### *State of play and key developments*

North Macedonia has made significant improvements to its education system policies. Recent reforms included several policies and practices that align with European and OECD countries. For example, the new school and the vocational education and training (VET) curricula focus on developing competencies to prepare students for success in the labour market. There are also plans to introduce a compulsory year of pre-primary education and a new national assessment to monitor student learning outcomes. Similar to other economies in the region, participation in primary education is now on a par with EU and OECD levels and student learning outcomes, as measured by PISA, have seen significant progress. Notably, North Macedonia's share of low performers in each subject measured by PISA fell by at least 9 percentage points between 2015 and 2018 (OECD, 2020[100]). However, educational disparities persist, linked to ethnic group and gender (OECD, 2019[70]). Maintaining progress in the aftermath of the COVID-19 pandemic and implementing newly introduced policies will be crucial to achieving education and development goals.

Like many countries around the world, North Macedonia closed its schools on 10 March 2020 to help slow the spread of COVID-19. Working with donor agencies, the education ministry launched a rapid shift to remote learning with a range of online and broadcast instructional programmes and activities to support the continuation of teaching and learning. Following the parliamentary elections in the summer of 2020, the new administration introduced a unified National Distance Learning Platform. While the youngest students (up to Grade 3) were able to attend in-person classes starting in September 2020, older students received instruction through this online platform. The shift to remote learning in North Macedonia was not without challenges. As in many other economies, teachers reported feeling stressed and unprepared for working in a new online environment and the lack of computers and technical infrastructure appears to have been a problem in some areas. The National Distance Learning Platform also experienced a major crash a few days before the start of the new school year. North Macedonia will need to redouble its efforts to address challenges related to educational quality and equity that are being exacerbated by the COVID-19 pandemic if the system is to continue advancing towards its national education goals (Kajosevic and Marusic, 2020[101]; Hawke, 2020[102]; Apostolov, 2020[103]).

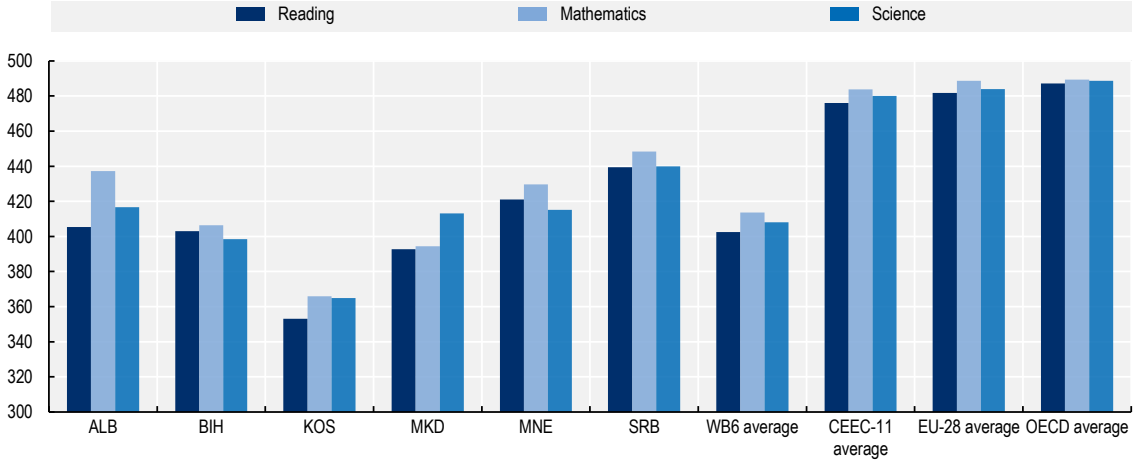
*Sub-dimension 7.1: Early childhood and school education*

North Macedonia's score in this sub-dimension is below the WB6 average. Since the last assessment, North Macedonia has taken steps to expand pre-primary coverage, develop a new national assessment of student learning and sustain progress towards reducing the share of early school leavers. As of 2018, net enrolment in North Macedonia was nearly universal (98%) for primary education, and stood at 88.5% for lower secondary education and 71% for upper secondary education (UIS, 2020[104]). Gross enrolment at the upper secondary level in North Macedonia is lower than the averages for the WB6 region (84.7%), OECD (121.2%) and EU (121.9%) for the same year (UIS, 2020[104]).[54]

North Macedonia's mean PISA scores are slightly below the WB6 average, except in science. Scores for reading, mathematics and science are much lower than the European Union and OECD averages (Figure 24.13).

## Figure 24.13. Performance in reading, mathematics and science in Western Balkan education systems (2018)

PISA 2018 mean scores




Note: CEEC - Bulgaria, Czech Republic, Estonia, Croatia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
Source: (OECD, 2020[100]), *PISA 2018 Database*, Tables I.B1.4, I.B1.5 and I.B1.6, www.oecd.org/pisa/data/.

StatLink https://doi.org/10.1787/888934256140

North Macedonia has a large share of students who do not demonstrate baseline levels of proficiency in reading (55%) and mathematics (61%); significantly higher than the OECD averages of around 23% in reading and 22% in mathematics (OECD, 2020[100]). These findings have implications for North Macedonia's long-term economic development, as students without basic skills are less likely to attain better-paying and more rewarding jobs. One positive trend is that the percentage of low performers in each subject shrank by at least 9 percentage points between 2015 and 2018 (OECD, 2020[100]). Nevertheless, there is evidence that disparities in educational opportunities and outcomes persist among children from socio-economically disadvantaged backgrounds, those living in rural areas and those from ethnic minorities (OECD, 2019[70]).

North Macedonia's performance on **early childhood education** is below the regional average. Pre-primary education is neither compulsory nor free and, as of 2018, gross enrolment in pre-primary education stood at 42%. This is lower than the averages for the WB6 (53%), the OECD (81%) and EU (98%) (UIS, 2020[104]). Children in rural areas and marginalised communities, especially Roma communities, are less likely to participate in pre-primary education (World Bank, 2015[105]). North Macedonia has set a goal to expand coverage and gradually reach EU levels of participation.

North Macedonia has many of the elements of a strong early childhood education (ECE) sector, including professional requirements for staff and standards for service delivery and infrastructure (World Bank, 2015[105]). In the last two years, it amended its Law for Child Protection, increasing the salaries of childcare professionals (Eurydice, 2021[106]). There have also been major financial investments (mostly from donor agencies) to help expand and improve ECE facilities. While the Comprehensive Education Strategy 2018-25 sets out activities to improve the quality and equity of ECE, it does not connect the goals and curricula in ECE with those of primary education. Moreover, the accompanying action plan lacks a clear budget – a notable concern since public spending on ECE is low in North Macedonia (Eurydice, 2021[106]).

The **instructional system**[55] scores below the regional average for this indicator. The Comprehensive Education Strategy 2018-25 and its action plan set out objectives and activities for improving educational quality and inclusion but they do not define clear budgets or monitoring processes (OECD, 2019[70]). Without more sustainable planning, North Macedonia may continue to rely on donor agencies to support education reforms and struggle to improve learning outcomes. Implementing North Macedonia's competency-based curriculum has been a challenge as there are several inconsistencies in learning expectations across grades and subjects (OECD, 2019[70]).[56]

A notable strength of the instructional system is the National Examinations Centre, which manages North Macedonia's participation in international assessments such as PISA and the Trends in International Mathematics and Science Study (TIMSS). However, participation in these assessments has been intermittent, limiting the amount of comparable data on student learning. The Examinations Centre is also responsible for national examinations. Unlike other systems in the region, there is only one central exam in North Macedonia, the State Matura. This exam is highly regarded and used to certify the completion of upper secondary school and select students for tertiary education. North Macedonia is also developing a new national assessment, with support from the World Bank,[57] which will provide a better understanding of student learning against national learning standards and allow for more timely comparative data to support system monitoring.

To ensure the quality of its instruction, North Macedonia has a set of School Performance Quality Indicators that cover factors such as teaching and learning practices, the school environment, and school planning and management. These indicators also serve as the main reference for school self-evaluation[58] and external evaluation. Similar to many European systems, North Macedonia has a central State Educational Inspectorate, which is responsible for conducting external evaluations of schools on a three-yearly basis and publishing reports on line. However, the inspectorate's evaluations are mainly based on desk reviews rather than a more comprehensive evaluation of instructional quality and, while their reports provide recommendations for improvement, there are no mechanisms to allocate additional support to help schools act upon these recommendations (OECD, 2019[70]). Nevertheless, North Macedonia's 2019 Law on Primary Education introduces some measures that stand to improve the instructional system. In particular, it sets out a broader range of responsibilities for school principals, expanding their traditionally administrative function to include tasks related to instruction.[59]

The **early school leaving** rate in North Macedonia has gradually declined over the last decade, largely because secondary education became compulsory in 2008 (MoES, 2017[107]). The share of early school leavers was 5.7% in 2020, well below the EU target of less than 10% of early school leavers by 2020 (Eurostat, 2021[108]).[60] While there is no specific strategy to combat early school leaving, several policy documents – for example, related to lifelong learning, Roma inclusion and poverty alleviation – include measures relevant to addressing this issue (Eurydice, 2021[106]). The Ministry of Education and Science (MES) also introduced the Inclusion of Out-of-School Children project in 2017 to help identify, enrol and retain students in compulsory education. While such efforts can help reduce early school leaving, they appear to lack sufficient budget and are largely supported by donor agencies. Moreover, North Macedonia has not evaluated its policies to prevent early school leaving in the past three years. This may be related to the fact that there are no proxy indicators for students' socio-economic background and student absenteeism is not tracked. As a result, the data to monitor early school leaving and the factors that

contribute to this situation are limited. Such information will be crucial if the government wishes to improve policies that target groups of learners at risk of early school leaving.

### *Sub-dimension 7.2: Teachers*

North Macedonia's score in this sub-dimension is roughly on a par with the WB6 average. A new Law on Teachers and Professional Associates (2019) has introduced several measures to promote the professional development and management of teachers. There are also regulations on the initial education and selection of teacher candidates; however, implementation of these policies remains a challenge. All primary and secondary school teachers in North Macedonia are required to have a bachelor's degree (level 6 in to the International Standard Classification of Education; ISCED), a requirement that has been enforced, according to national data received for this assessment.[61] In the last decade, North Macedonia has taken steps to increase the competitiveness of the teaching profession by improving working conditions, allowing greater professional autonomy and raising salaries. In fact, teachers' salaries increased by more than 20% between 2018 and 2019, according to national data received for this assessment. While average gross salaries are lower than other European countries, they compare favourably relative to GDP (EC/EACEA/Eurydice, 2019[109]).

Before teachers can start working in schools, they must graduate from an **initial teacher education (ITE)** programme, complete a practicum and pass a state examination to receive their teaching licence. North Macedonia also offers alternative pathways into teaching for mid-career individuals with experience gained outside of education. However, these candidates must still participate in pedagogical-psychological and methodological preparation.[62] In 2015, North Macedonia adopted a law[63] to regulate higher education institutions that offer ITE programmes. While this set minimum entry thresholds[64] for ITE, its policies have not been implemented because of a lack of human and financial resources. Moreover, placement quotas (a common feature of all tertiary programmes in North Macedonia) are very large for ITE, meaning nearly everyone who applies for a place is accepted (OECD, 2019[70]). This lack of competitiveness contributes to a general oversupply of teachers, although some subjects, such as mathematics and physics still experience shortages.[65] Another challenge facing North Macedonia's ITE system is the lack of a programme-specific accreditation process, meaning that providers do not have to demonstrate how they help candidates develop competencies specific to teaching.

North Macedonia introduced a new Law on Teachers[66] in 2019 linking teachers' **professional development and career management**. The law creates three categories of teachers (teacher, mentor, and advisor) aligned with years of work experience and specific professional standards for each level. To advance to higher categories, teachers must undergo an external appraisal and demonstrate they fulfil the corresponding professional standard. Similar practices are found in several OECD countries (OECD, 2013[110]). While this law – and the rulebooks that support it – represents a significant policy achievement for North Macedonia (considering previous efforts to implement such policies had stalled), the measures are largely based on technical and financial input from donor agencies (OECD, 2019[70]).

Teachers' professional development needs are determined through self-assessment surveys and appraisals conducted by schools and external experts. While there is some variety in the type of activities and programmes offered, there are no online courses or seminars, nor peer- or self-observation and coaching. Teachers are required to complete at least 60 hours of professional development over 3 years.[67] The Bureau for Development of Education accredits and subsidises teachers' professional development; but there is some evidence that programmes not identified as government priority areas are not covered in practice (OECD, 2019[70]). The cost of training partially helps explain low levels of participation in teacher professional development in North Macedonia. For example, only 21% of teachers had participated in professional development in the three months leading up to PISA 2018, a much lower share than the WB6 (39%), OECD (53%) and EU (51%) averages (OECD, 2020[100]).

### *Sub-dimension 7.3: Vocational education and training*

North Macedonia's score in the sub-dimension on vocational education and training (VET) is on par with the WB6 average. The VET sector has undergone several changes in the past two years, including the introduction of a new modular curriculum and the implementation of policies to promote work-based learning. Professionally oriented education starts at the upper secondary level, when students are allocated into either general (gymnasium) or vocational programmes.[68] Around 60% of upper secondary students in North Macedonia were enrolled in VET programmes as of 2018, which is similar to the Western Balkans average (60.5%) but higher than EU (49%) and OECD averages (42%) (UIS, 2020[104]). Unlike many other systems in the region, North Macedonia does not use examination results to select students into education tracks. Instead, teachers guide students into different programmes based on their marks in the classroom.[69] As these assessments may be subject to teachers' bias, there is a risk that students' background, rather than capability, influences which track they go into. Data from PISA found that students enrolled in vocational programmes in North Macedonia scored on average 48 points lower than students in general programmes, after accounting for gender and socio-economic status,[70] a considerably larger difference than the average across the EU (45 score points), the OECD (40 score points) and the WB6 economies (36 score points) (OECD, 2020[100]).

A series of laws[71] regulate the **governance of VET** in North Macedonia and government strategies[72] guide policies to help increase the attractiveness, quality and relevance of VET programmes. Responsibilities for VET are shared by several bodies, including the MES and the Ministry of Labour and Social Policy. Other agencies are also involved in the design and implementation of VET programmes. For example, the Center for Adult Education is responsible for adult VET, while the Center for Vocational Education and Training is responsible for developing VET schools' professional curriculum and the Bureau for Development of Education for developing their general subject curriculum. North Macedonia engages social partners in VET governance through policy consultations, where they can propose reforms. Employers can also participate in commissions to evaluate final VET examinations and offer placements for work-based learning, which helps ensure that VET students have developed relevant skills for the labour market.

In 2019, North Macedonia achieved a key objective of its Education Strategy for 2018-25 by legally establishing three regional VET centres in different parts of the country. These centres aim to serve as innovation hubs and optimise the VET school network by actively engaging the business community in **work-based learning** (WBL). They offer a variety of programmes and training to prepare people for the labour market (ETF, 2019[111]). The regional centres are being funded by the EU Sector Reform Performance Contract and were expected to become fully operational and accredited by the end of 2020. North Macedonia has partnered with other donor agencies in recent years to further develop the foundations of WBL through a dual education programme that allows students to gain qualifications by attending classes and participating in on-the-job training.

Prospective VET students can learn about study programmes and WBL opportunities through public awareness campaigns, presentations to social partners and an online portal listing opportunities. The MES also published a guide to VET qualifications to help guide students into different VET pathways at the upper secondary level. Despite these positive developments, closer monitoring of VET and WBL is needed to address the mismatch between the supply and demand of school places (EC, 2020[46]). While North Macedonia reports that it collects data on the completion, employment and earning rates of VET graduates, there is no information on the number of students who are hired after completing a WBL opportunity. There is also a lack of information on the location, type and skills gained through WBL nor demographic data to better understand which students participate in these programmes and opportunities. This information may be collected by individual institutions and providers but is not centralised. North Macedonia plans to use its new regional VET centres to collect and analyse this type of information to strengthen policy development in the sector.

### *Sub-dimension 7.4: Tertiary education*

North Macedonia's score in the tertiary education sub-dimension is slightly above the WB6 average, largely because of reforms in the last two years that introduced new agencies and policy frameworks to improve the quality, equity and labour market relevance of the sector. In the last decade, the number of years a student in North Macedonia might expect to stay in education has increased. In 2018 it was around 13.5 years; slightly lower than the WB6 average (14.8 years) and well below the EU (16.6 years) and OECD (17 years) averages (UIS, 2020[104]). Gross enrolment in tertiary education has also been rising and was around 43% in 2018. However, this remains lower than the regional average (52%), and the EU (70%) and OECD (76%) averages (UIS, 2020[104]).[73] While national data received for this assessment show that the share of adults who have attained some form of tertiary education has slightly increased in the last two years, some studies have found that completion of higher education remains low (EC, 2020[46]).

The Education Strategy and Action Plan 2018-25 set out key goals for the higher education sector, namely to improve the content of programmes, align the system with European good practice and increase the employability of graduates. Since 2018, the government has been working to develop by-laws and implement its new Act on Higher Education. The new law introduced major changes to the higher education system, including greater institutional autonomy for universities; more democratic, transparent and equitable process and governance arrangements; and stronger quality assurance measures (Eurydice, 2021[106]).

The majority of higher education students (87%) in North Macedonia attend public institutions (Eurydice, 2021[106]). There are transparent selection processes[74] and several types of scholarships to help support more **equitable access to higher education**. Annual scholarships are available to students who apply and meet the relevant criteria based on merit and/or financial need. Students with disabilities and orphans can also benefit from free tuition to pursue higher education. North Macedonia also introduced a subsidised meal plan in February 2020 to ensure that students participating in higher education programmes have access to healthy meals (Eurydice, 2021[106]). While it is unclear how this policy has been affected by the COVID-19 pandemic, such initiatives have the potential to support students in completing their study programmes.

While North Macedonia collects some disaggregated data that can help monitor equity in the tertiary sector, such as enrolment by age, gender and ethnic background, there are no centralised data on socio-economic or immigrant background. Nor are there any regular evaluations or studies to identify associations between students' characteristics and participation to help address barriers they face. North Macedonia draws on a range of sources, such as employer surveys, surveys of workers or graduates, quantitative forecasting models and data on employment rates by field of study to assess the quality of its higher education and its relevance to the labour market. The data are available on the State Statistical Office and State Employment Agency websites. The Ministry of Education and Science has received technical assistance from the World Bank to develop a new education management information system that will collect and store essential information about accredited higher education institutions (Eurydice, 2021[106]).

North Macedonia also has a number of policies and programmes to promote the internationalisation of students and staff but it is its reforms to its quality assurance mechanisms that have contributed its improved score for the **labour market relevance of higher education.** In the last two years, agencies with responsibilities for quality assurance were merged to create a new and independent Higher Education Accreditation and Evaluation Board. This aim of this change was to align North Macedonia's accreditation and quality assurance policies with the standards and guidelines of the European Higher Education Area. Higher education institutions are also now required to have a Board of Trustees to engage the public in helping plan, design and deliver relevant and high-quality study programmes. These types of education policies, combined with broader employment policies, like the Youth Guarantee Scheme,[75] have contributed to North Macedonia's steady decrease in unemployment rates and the share of youth who are neither employed nor in education or training (NEET) – see Employment policy (Dimension 8).

*Cross-cutting sub-dimension: System governance*

North Macedonia's score for this cross-cutting sub-dimension is slightly above the WB6 average, as several system governance features are either being developed or already align with the policies and practices found in European and OECD education systems. For example, it has an established national education strategy that has been monitored and evaluated both by the government and through independent analysis. The new Law on Primary Education (2019) stipulates that every four years, the ministry is to prepare a comprehensive and public report on the state of education with recommendations to improve quality. North Macedonia also has a qualifications framework that regulates the acquisition and use of qualifications and is fully aligned with the European Qualifications Framework. As a result, the Macedonian Qualifications Framework (MQF) serves as a tool to provide visibility on qualifications and their acquisition and quality.

The Education Strategy and Action Plan (2018-25) set out important actions for improving the education system. For example, there are goals to expand coverage for preschool education, make school curricula more relevant to labour market demands and strengthen the competency of teaching staff at all levels of the system. These high-level strategic documents were developed in consultation with a range of stakeholders and contain clear timelines and allocations of responsibilities. However, the strategy does not include targets to raise learning outcomes, which is notable considering North Macedonia's performance in international assessments (OECD, 2019[70]).

While there is information about the education system's inputs, outputs and outcomes, comparative data on student learning outcomes have mainly been collected through intermittent participation in international assessments. For example, North Macedonia participated in the first round of PISA in 2000 but did not participate again until 2015. It did maintain participation in the latest round of PISA (2018), which is a positive development since regular participation provides important trend data on the performance of the education system. Another positive development for system governance is the government's plan to develop a new national assessment, which will provide valuable information to help monitor national education goals. An area for improvement in this indicator involves the management of education data. North Macedonia has had an operational education management information system (EMIS) since 2010; however, education data remain fragmented as various ministries and agencies continue to collect their own information (OECD, 2019[70]).

## *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education in North Macedonia can help increase regional competitiveness and create opportunities for more individuals to develop the competences needed for sustainable development and social cohesion. Officials have already made impressive progress in developing education reforms in recent years; however, the challenge for the future will be to operationalise and implement these policies. This task will be especially challenging in the aftermath of the COVID-19 pandemic. The new coalition government will need to reflect on the economy's political, social and fiscal environment to determine how best continue advancing its education goals. While the OECD review on evaluation and assessment in North Macedonia's education system (OECD, 2019[70]) provides detailed recommendations on how to strengthen the equity and quality of the education sector, the following considerations in particular can provide insights for discussions on the way forward for enhancing education:

- **Strengthen the collection and management of education data**. North Macedonia should consider ways to modernise the collection and management of education data by establishing the EMIS as a central source of information about the education system. This will entail linking databases that are managed by various institutions and co-ordinating data collection to avoid creating administrative burdens. The government should also consider developing user-friendly

portals to increase the functionality of the EMIS. The Florida Department of Education's online EMIS portal provides an example of this type of platform (Box 24.10).

- **Finalise the development of the national assessment and set national targets for improving student learning outcomes**. North Macedonia should move forward with plans to develop and administer a national standardised assessment, which would provide valuable information to monitor student performance at key stages of their education. Careful attention should be paid to the dissemination and use of the results to enhance their formative value. North Macedonia should also establish national targets based on results from the international or national assessments to help everyone across the system focus on the need to improve learning outcomes.
- **Establish clear budgets to support the implementation of policy reforms**. North Macedonia benefits from the technical and financial support of donor agencies, which has led to significant achievements but risks undermining the sustainability of reforms. The government should establish clear budgets to better understand resourcing needs and ensure there is enough funding for the education agencies to implement their planned activities. This might reveal that the Bureau for Development of Education requires additional resources in order to sufficiently subside mandatory teacher professional development programmes.

### Box 24.10. Florida's Education Information Portal, a data access portal from the United States

In Florida, in the United States, the PK-20 Education Information Portal provides access to public schools from kindergarten through to grade 12, public colleges and universities, a statewide vocational and training programme, and career and adult education. Through an online interface, any individual can view data aggregated by school, district and state. Comparisons can be made across different schools and districts.

The Florida's PK-20 Education Information Portal is powerful in that it allows data to be organised not only by governance level, but also subject matter. Florida's state assessments test students in English, mathematics and science, with further delineation of different mathematics and science domains. Users of the portal can choose to view all data according to a single domain (instead of by a single school) and make further contextualised comparisons according to the domain. This saves users from having to navigate to through different schools or districts in order to find the same indicator for each.

Along with providing access to data, the portal provides simple tools for users to perform their own analysis. For example, they can format the data into tables they define themselves or the standard tables provided. They can also generate custom reports that contain several tables according to their specifications. The portal also has a strong data visualisation component which allows different types of graphs and charts to be created from the data. District-level analysis can be plotted as maps that display indicators geographically.

Source: (Florida Department of Education, n.d.[112]), *PK-20 Education Information Portal*, https://edstats.fldoe.org/SASPortal/main.do.

## Employment policy (Dimension 8)

### *Introduction*

Since the last Competitiveness Outlook assessment in 2018, North Macedonia has made progress in aligning its employment regulatory framework with the EU *acquis*, although actual implementation has been limited. No progress has been made in reducing informal employment. A framework for co-operation between social and employment services has been made at the local level to deliver comprehensive and integrated services, but institutional capacity will need to be further strengthened. There has been significant progress in reducing youth unemployment, but it remains very high – above the regional average and well above the average for the EU. Problems with school-to-work transitions persist and no progress has been made in reducing the NEET rate. Some progress has been made to analyse the gender gap, and gender mechanisms in institutional settings have been introduced at the local level. Nevertheless, barriers to women's employment remain, related to difficulties in reconciling work and family lives.

Table 24.13 shows North Macedonia's scores for the four employment policy sub-dimensions, and compares them to the WB6 average. North Macedonia has the highest scores in the region for all sub-dimensions, except for skills, where it is second to Montenegro. As a result, North Macedonia has the highest employment dimension score of the WB6 economies. It also recorded the biggest improvement in its score, with an increase of 1 point compared to 2018.

### Table 24.13. North Macedonia's scores for employment policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 3.3 | 2.6 |
| | Sub-dimension 8.2: Skills | 2.8 | 2.2 |
| | Sub-dimension 8.3: Job quality | 3.5 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 3.5 | 2.9 |
| **North Macedonia's overall score** | | **3.3** | **2.6** |

### *State of play and key developments*

### Table 24.14. Key labour market indicators for North Macedonia (2015 and 2019)

| | North Macedonia | | WB6 average | EU average |
|---|---|---|---|---|
| | 2015 | 2019 | 2019 | 2019 |
| **Activity rate (15-64)** | 64.9% | 66.3% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 47.8% | 54.7% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 26.3% | 17.4% | 16.3% | 6.4% |

Note: WB6 average rates are based on author's own calculations using simple averages.
Source: (Eurostat, n.d.[113]), *Labour Force Survey data base*, https://ec.europa.eu/eurostat/web/main/data/database.

As Table 24.14 shows, the activity rate of the working-age population (15-64 year-olds) increased from 64.9% in 2015 to 66.3% in 2019, above the WB6 average,[76] but still largely below the EU average and the 71.2% average for other EU transition countries in the region (Bulgaria, Croatia, Hungary, Romania and Slovenia).[77] Over the same period the number of working-age people in employment increased steadily, rising by 13%. Between 2015 and 2019 the employment rate among 15-64 year-olds increased by 6.9 percentage points, amounting to 54.7% in 2019, similar to the WB6 average, but 14.6 percentage points below the EU average (Eurostat, 2020[114]). The increase was particularly marked for young adults (25-34 year-olds), who saw an increase of nearly 12 percentage points.[78] There was a strong decrease of 8.9 percentage points in the unemployment rate among 15-64 year-olds, falling to 17.4% in 2019, although it is still 1.1 percentage point higher than the average for WB6 economies and 11 percentage points higher than the EU average (Eurostat, n.d.[115]). Unemployment has since risen again in 2020 because of the COVID-19

pandemic although financial support to keep workers in employment has helped to contain its impact on the labour market so far.

Labour Force Survey (LFS) data indicate that the COVID-19 pandemic has had a negative impact on employment: the number of people in employment fell by 2.8% between the first and second quarter of 2020 and by 1% between the second and third quarter. Compared to the second quarter of the previous year, employment fell by 0.4%, showing employment growth has stalled (in comparison, between the second quarters of 2018 and 2019, employment grew by 5.6%). The unemployment rate in the third quarter of 2020 was 16.5% (compared to 16.7% in the second quarter of 2019) slightly higher than in the first quarter (16.2%), but still below the level one year earlier (17.5%). As of 30 September 2020, there were 151 359 active job seekers registered with the Employment Service Agency of the Republic of North Macedonia (ESARNM), the public employment service (PES). The increase in unemployment after 11 March 2020 amounted to 14 819 people. LFS data show that the inactivity rate increased by 1.4 percentage points between the third quarters of 2019 and 2020, indicating that some people are leaving the labour market, rather than becoming or remaining unemployed.

A short-term work scheme has been set up with the support of the World Bank to cope with the labour market impact of the pandemic. Initially, the scheme was designed to provide salary subsidies to adversely affected firms for three months (April, May and June). The scheme included the conversion of the subsidy from a reimbursable grant into a non-reimbursable one to allow companies to invest in improvements that could help them recover from the crisis, and the publication of a list of all recipients and follow-up actions to help ensure companies used the subsidies to pay salaries. This support was limited to viable small and medium-sized enterprises, and covered 50% of social contributions from employees for viable firms in tourism and transport – two of the hardest hit sectors during the pandemic.

Approximately 20 000 companies (one-third of all active companies in North Macedonia) benefitted from this wage subsidy scheme, helping over 120 000 employees (one-third of all private sector employees). According to studies conducted by local NGOs, thanks to this measure the private sector only had to release 3% of their employees during this first period. According to a simulation by the World Bank, without the subsidy, more than 130 000 Macedonians would have fallen into poverty if the pandemic lasted two quarters (World Bank, 2020[116]). In November 2020, the job preservation scheme was still active. Similar short-term work schemes have been widely used in the EU to contain unemployment.

The ESARNM had mainly been offering face-to-face services, but has speeded up the delivery of digital services. In most EU countries face-to-face services were suspended during the first lockdown and resumed thereafter.

In September 2020 the operational plan for active labour market programmes (ALMPs) was revised to include people who had lost their job due to the COVID-19 crisis as one of the target groups (additional grants for self-employment, employment and growth of legal entities for employment of people who lost their jobs due to COVID-19) (Duell, 2020[117]; Duell, 2020[118]). Further initiatives have included sick pay and general measures such as reducing taxes and postponing loan repayment obligation by banks.

### *Sub-dimension 8.1: Labour market governance*

Over the past decade, North Macedonia has improved its regulatory framework for occupational health and safety, the protection of vulnerable groups in the context of collective dismissals, and in the area of social dialogue. In 2018, the Law on Private Employment Agencies was adopted, which is in line with the International Labour Organization's (ILO) Private Employment Agencies Convention. In June 2018, amendments to the Law on Labour Relations created additional criteria to be taken into account when terminating employment for business reasons, such as employees' vocational training and qualifications, work experience, performance, the type and importance of their position, length of service, and other criteria determined by a collective agreement. These amendments also included protection for people with

disabilities, single parents and parents of special needs children who have their employment terminated for business reasons. If an employee is terminated for business reasons, the employer cannot employ another similarly qualified person for the same position for a period of two years. If the need to fill that position arises before the two-year period ends, the previously terminated person is given priority. These changes give companies the flexibility to adapt their workforce to the market situation, while protecting against unfair dismissal and increasing the chances of re-employment. In this respect it resembles the temporary lay-off schemes in place in some Northern European countries. This scheme has been extended several times and is donor supported. Take-up of the benefits and re-employment should be closely monitored in order to assess the effectiveness of the measure.

The protection of employees whose employer becomes insolvent is not yet aligned with EU directives, and the government plans to start revising the relevant legislation. It proposes protecting 100% of employees' salaries in the public and private sector, instead of at the level of the minimum wage, as is the current rule. Another proposed measure is for the government and companies to cover salaries in case of illness.

A new Law on Labour Relations is currently being drafted with more focus on flexible working arrangements which are intended to be acceptable to both employers and employees. Implementation of this law will be important for promoting employment among women. Drafting of a new Law on Labour Relations is also ongoing, where more attention will be paid to improving the regulation of non-standard forms of employment. The self-employed, employed with temporary work contracts, platform workers, etc. are fully included in the social protection system, i.e. they contribute to the health, pension and unemployment insurance. Employment protection legislation and regulations for working time and working conditions also apply to non-standard workers, although it is not clear whether this is sufficiently enforced.[79]

Progress has been made in the area of occupational health and safety (OHS), although the implementation of the 2017-20 Occupational Health and Safety Strategy was still incomplete in 2019 (EC, 2019[63]). The current Strategy on Safety and Health at Work 2020, building on previous strategies, sets out 10 main national priorities for action. These are:

1. Creating an open and efficient legal framework and strengthening the national policy for health and safety at work.
2. Promoting and developing administrative capacities and human resources in the field of OHS.
3. Developing training and education programmes in the field of OHS.
4. Strengthening the role of the OHS Council80.
5. Developing the system and services of occupational medicine within the national health system.
6. Setting priorities for research and development on new and emerging or increased risks.
7. Promoting a culture of prevention and promotion of workers' health.
8. Improving monitoring and detection of occupational diseases and prevention and reduction of the number of occupational injuries.
9. Strengthening information systems in the field of health and safety at work.
10. Strengthening international co-operation.

In the first half of 2020, on the initiative of the National Council for OHS and in co-ordination with the Ministry of Labour and Social Policy, a comprehensive report (Ministry of Labour and Social Policy, 2020[119]) was prepared on the implemented activities, in accordance with the priorities of the strategy and 2020 action plan. This 60-page report detailed the activities and measures that have been implemented in the past (primarily during 2017-19) as part of the implementation of the strategy and action plan and the achievement of the goals and priorities set. The report was reviewed and adopted by the OHS Council in August 2020. The report highlighted the successful implementation of a number of activities in the 2020 action plan by various OHS stakeholders in all of the priority areas within the strategy.

There are few indicators on working conditions available. One is work on weekends. In 2019, 43.7% of workers in North Macedonia worked on Saturdays, higher than the EU average of 26.3% (Eurostat, n.d.[115]). In 2015, 29% of workers were exposed to vibration from tools and machinery, which is high compared to EU member states; only Romania had a higher rate according the European Survey on Working Conditions (Eurofound, n.d.[120]). North Macedonia has relatively poor working conditions in terms of exposure to high or low temperatures, working in tiring or painful positions, and working at high speed and under time pressure, but is in the middle of the range of EU countries with regard to other indicators such as exposure to breathing in smokes, fumes, powder or dust and exposure to breathing in vapours (Eurofound, n.d.[120]).

The key pillars of North Macedonia's **employment policy framework** are the National Employment Strategy 2016-20, the Strategy for Formalization of the Informal Economy 2018-22, and the Action Plan for Youth Employment 2016-20. The implementation of the employment strategy is regularly monitored and the large majority of planned activities have been implemented. However, monitoring reports are not publicly available, the monitoring of outputs and outcomes is still weak, and impact evaluations are rarely carried out. The reports are shared with participants from all relevant stakeholders including social partners and NGOs. To overcome current weaknesses in monitoring, the Action Plan for Employment 2018-20, which is the action plan corresponding to the National Employment Strategy, has recently included aims to develop performance monitoring indicators for the employment policies. It remains to be seen whether this will eventually help to improve ongoing assessments of policies.

The National Employment Strategy included the objective of increasing the employment rate to 46.9% and reducing the unemployment rate to 21.5% by 2020 (Government of North Macedonia, 2019[121]); these objectives were already exceeded by 2019. Despite these improvements, the high unemployment rate in general, and the high youth unemployment rate in particular (35.6% of 15-24 year-olds in 2019, which is above the WB6 average of 33.1% and the EU average of 14.4%[81]) represent a major challenge. The EU's main recommendations to implement the poverty alleviation policy, the Roma inclusion strategy, and relevant action plans had not been implemented in 2018/19 (EC, 2019[63]).

The **labour inspectorate** oversees the application of laws and collective agreements and employment contracts. Activities are carried out according to monthly, quarterly and annual work plans. The annual programme is based on the inspectorate's risk assessment. The number of labour inspectors increased from 102 in 2015 to 118 in 2016, but then fell to 115 in 2019. This represents a ratio of 6 900 employees per inspector (a higher ratio than for example in Montenegro, where the ratio is 5 800 to one). The number of inspectors is low considering the huge challenges faced, such as the level of informal employment, and in view of plans to foster preventive activities in the area of OHS. The structure of the economy, with a large share of smaller enterprises, adds to the difficulty of covering a significant share of companies and targeting actions on those most likely to be in breach.

A lack of transparency and inter-agency co-operation is another factor limiting the effectiveness of inspectorates. The Inspection Council concludes memoranda of co-operation and data exchange with other bodies for the needs of the inspection services.[82] Experience from other economies shows that electronic connection and data sharing between authorities are crucial for effective labour inspections. A new Law on Inspection Supervision, enacted early in 2019, created a new legal basis for risk-based inspections and introduced good practices such as warnings and grace periods for infractions, and the use of checklists and risk criteria to increase transparency (World Bank, 2020[122]). The drafting of relevant by-laws is still in progress at the time of writing.[83] Improving the effectiveness of the labour inspectorates would also require strengthening the capacity of the inspection service in terms of training, equipment and working conditions.[84]

A **social dialogue** framework is in place. Collective bargaining mainly takes place at sector level every 2-3 years. According to a recent study by the Helsinki Committee of Human Rights, social partners such as trade unions and employer organisations do not have the capacity to implement health and safety

regulations and social protection of workers, and trade union members should be better trained (Najcevska et al., 2019[123]). Workers' representation is weak, even in some of the larger companies. The Ministry of Labour and Social Policy's strategic plan for 2020 contains activities for strengthening tripartite and bipartite social dialogue through training on various themes for the social partners.

Sector-level collective agreements are estimated to cover 24-29% of the all North Macedonian employees.[85] In comparison, estimated coverage is around 30% of employees in Serbia, and 25% in Albania (Eurofound, 2019[124]), and the EU average is 60% (Ladjevac, 2017[125]). While sector-level collective agreements mainly fix wages (and more rarely other working conditions), nationwide general agreements fix working conditions such as working hours, annual leave and social protection.[86] The new Labour Relations Act may task the Economic and Social Councils with the function of extending collective agreements (Guardiancich and Molina, 2019[126]), a practice that has been used by a range of EU countries, such as Germany and France.

The national Economic and Social Council (ESC) has a clear mandate and is comprised of 12 members: 4 members of different government bodies (headed by the labour ministry), 4 from employer organisations and 4 from trade unions. The ESC has no rotating presidency and there have been issues with selecting members linked to conflicts of interest (Guardiancich and Molina, 2019[126]). No progress has been made since the last assessment to solve these issues. The ESC has six permanent working bodies and various ad hoc working groups covering matters in the economic and social sphere mainly related to labour relations, employment, pension and health insurance, wages (minimum wage, wage growth), the legal framework for defining non-standard employment, self-employment, skills mismatch, occupational health and safety (consultation on these issues is mandatory) and other issues regarding fiscal policy. Working groups meet occasionally, depending on the documents to be reviewed and commented on. Economic and Social Councils are also operating at local levels, with local representatives of social partners and relevant stakeholders, however, not all work properly (Guardiancich and Molina, 2019[126]).

In 2019, only one of the six permanent working bodies was functioning (Guardiancich and Molina, 2019[126]) and the working groups only held occasional meetings. There are no action plans, strategies or reports on ESC activities. Consultations are mainly made by the Ministry of Labour and Social Policy, and here improvements have been recorded in the recent past. However, other ministries are consulting the ESC much less. Overall, the ESC is relatively effective for those issues that are regularly reviewed, and opinions are being adopted for them (Guardiancich and Molina, 2019[126]). The employers have voiced the need to put also the Law on Education under the ESC umbrella (Guardiancich and Molina, 2019[126]). A tripartite action plan for the Economic and Social Council for 2020-21 aims to further strengthen social dialogue. Another issue is the lack of financial resources to conduct research on specific topics that would help the ESC make informed statements. The ILO is implementing an EU-financed project over the period 2019-21 to help social dialogue institutions participate in policy making at national and local levels and foster the regular consultations through the national and local ESCs (ILO, 2021[127]).

### *Sub-dimension 8.2: Skills*

A **skills mismatch** analysis framework is in place. Supply and demand mismatches in the labour market are assessed based on the Labour Force Survey data[87] and analysis of the vacancy database and the employers skills needs survey of the Employment Service Agency. The results of the skills needs survey are publicly available, which is good practice. The chambers of commerce and social partners also carry out labour market analyses. The Ministry of Labour and Social Policy uses the HERMAK forecasting model to forecast the demand for skills and occupations in the labour market.

Between 2015 and 2019, the unemployment rate fell for workers of all education levels, and in particular among the medium-educated (Eurostat, 2021[128]).[88] In 2019, as in previous years, the unemployment rate was higher for low-educated workers (23.4%) than for both the medium-educated (16.6%) and the highly educated (14.3%). Employment growth between 2018 and 2019 was driven by growth of employment for

medium and high education levels (WIIW/World Bank, 2020[129]). Those with low education levels are not only more likely to be unemployed, but also at higher risk of being in informal employment.

A skills mismatch analysis found that 22.2% of tertiary-educated workers (15-64 year-olds) were overqualified for their jobs in 2017, as they were working in semi-skilled occupations. This is a reduction since 2015. Men were more likely to be affected than women. The share of workers with an upper secondary education in elementary occupations[89] was 14.3% in 2017, similar to 2015, and affecting more women than men (ETF, 2019[130]). Overqualification was more widespread than in Montenegro; comparison with other WB6 economies should be possible in the future (ETF, 2019[131]).

The first tracer study[90] of VET and higher education graduates in North Macedonia was conducted in 2014/15 with the support of the European Training Foundation (ETF). It pointed to poor matching of skill levels and jobs early in the careers of young graduates, particularly among those graduating from VET (Mojsoska-Blazevski, 2017[132]). In general, a gap in managerial skills has been reported (World Bank, 2020[122]). Results also found that about 45% of employed VET graduates had a discrepancy between their skills and field of study and the requirements for their job. Less than half of all employed VET graduates (45%) reported that they were using the knowledge and skills they had acquired during their education in their current job. The government does not run regular tracer studies.

The school-to-work transition has been a major challenge in North Macedonia. As in many EU countries, the youth unemployment rate is in general higher than the total unemployment rate, and the levels reached in North Macedonia have been extremely worrying. Young people very often enter the labour market through temporary contracts (World Bank, 2020[122]) and unstable employment conditions are a key feature for low-educated young people.[91] Discussions are underway to shorten the period before a temporary contract is automatically converted into a permanent one from five years to six months (World Bank, 2020[122]). This change may have a detrimental effect on young people, as it is not longer than the usual probationary period in many countries and may thus represent an obstacle to employment. Its effect also depends on employment protection levels and how rigid permanent work contracts are. On the other hand, it is certainly crucial to offer young people a long-term perspective for their careers and to avoid underinvesting in increasing their employability. Therefore, it may be advisable to consider a longer period than six months, though shorter than five years. Alternatively, employers could be offered financial incentives to convert fixed-term contracts into permanent ones, as has been done in Portugal, for example (Düll et al., 2018[133]).

Several improvements have been made to the education system in recent years to improve skills matching – see Education policy (Dimension 7). The web-based Occupational Outlook has been designed to inform young people about the career prospects of selected occupations and sectors in the medium term (ILO, 2018[134]). The number of careers included in the outlook has been increasing by 15 each year (Zanimanja, n.d.[135]). Progress on active labour market policy is being made through implementing the Youth Guarantee (Box 24.12).

The dual vocational education project was launched on 27 September 2017 to improve the quality of VET and increase employability among young people, based on the German dual VET system. It opened for first-year students in the 2019/20 school year in all vocational education schools, for all 52 qualifications. It is based on the new reformed modular curricula and the European Credit system for VET (ECVET) credits, based on learning outcomes for both vocational and general education subjects). In the 2018/19 school year, pilot activities began for the introduction of dual vocational education into high schools (Eurydice, 2020[136]). This pilot phase will need to be monitored carefully and any implementation problems discussed. These reforms have the potential for improving skills and employability of future graduates if they are carefully implemented.

North Macedonia has a legal framework for **adult learning** (the Law for Adult Education of 2008 and the Law for Open Civic University for Lifelong Learning). Employers have a legal obligation to provide workers with training and education related to their job requirements. There are no current data on the participation

of adults in continuing education. However, the Eurofound Working and Living Conditions Survey in 2016 found that 81% of employees in North Macedonia had not participated in training during the past year, significantly higher than the EU average of 66% (Eurofound, 2019[137]). The World Bank found that only about 25% of firms offered on-the-job training, and these are typically the most productive firms (Koettl et al., 2017[138]). There is no evidence that the situation has improved since then. Several awareness-raising campaigns on training and education aimed at workers and employers have been conducted as part of donor-funded projects but it would be better to have a sustainable awareness-raising strategy. There are no schemes offering incentives to either employers or workers to invest in continuing training.

A concept paper on non-formal adult education and informal learning was adopted in 2015, but there is no information on any progress towards implementing it in a sustainable way. In 2016, the roadmap for implementing a system for validation of non-formal and informal learning was adopted, representing an important step towards developing an adult learning strategy. In 2017, a guidance note for the validation of non-formal and informal learning processes was adopted and a proposed law is in process, while specifications for the information and methodology package were adopted in 2017. The bulk of this reform project is still in the process of being implemented and is supported by ETF and EU funds.

The Adult Education Centre is tasked with the verification of adult education programmes, monitoring the adult education process and establishing the system of validation of non-formal and informal learning. Since 2010, the centre has been implementing a government programme to provide secondary vocational education for adults who have completed only primary education (European Basic Skills Network, 2021[139]). However, the effectiveness of these activities cannot be assessed since there are no data available on how many people have participated in remedial education or in improving their skills. In October 2017, the Adult Education Centre officially launched a newly developed web platform listing certified adult education providers and training programmes (Eurydice, 2020[136]). This is likely to increase transparency for potential trainees. The centre also implements training programmes for the registered unemployed according to the annual operational plans for active employment programmes. Fourteen percent of the participants in these programmes have only completed primary education. The number of participants increases every year, but the investment in increasing the skills of low-educated adults is not sufficient to address the huge challenges of unemployment and informal employment.

There is a need for better training offers to match the skills needed by employers, both for initial education, university studies and for continuing education. Outside the ICT and automotive sectors, fewer than 10% of firms communicate regularly with any educational institution (World Bank, 2020[122]).

### *Sub-dimension 8.3: Job quality*

When it comes to **quality earnings,** the minimum wage is set by the government in agreement with the Economic and Social Council. The minimum wage was reformed in 2017 and is currently set based on changes in the cost of living, average salaries and GDP. The latest reform included a 19% increase of the minimum wage, which is the same in all sectors (ILO, 2019[140]). The minimum wage is moderate and in line with North Macedonia's economic development. In 2018, the minimum wage amounted to 48% of the average gross wage, based on the Jobs Gateway database (WIIW/World Bank, 2020[129]). There has been no analysis of the impact of the recent increase in the minimum wage (EC, 2020[141]) on informal employment or its effect on gross wages, employment in low productivity sectors or productivity.

There is no policy framework in place to reduce taxes or non-wage labour costs for low-wage earners. The contributions and taxes paid on employees' salaries are the same for all workers. The allowance paid in the case of unemployment and pension levels depend on the salary the worker received. Every formal employee, self-employed worker and platform worker has to contribute to health, pension and unemployment insurance. The unemployed who have previously worked are covered by health insurance, while those who are inactive would be covered by the health insurance of other family members.

In-work poverty fell by 2.1 percentage points between 2012 and 2016, affecting 8.9% of workers aged 18-64 in 2016. It was highest among those with lower secondary education or below (25.5%), part-time workers (24.7%), the self-employed (18.6%) and single employed adults with dependent children (30.8%). Data from the structure of earnings survey (SES) also suggest a significant incidence of low wages, with 25.1% of all employees earning low wages in 2014 (Gerovska-Mitev, 2019[142]). Implementation of the minimum wage should be monitored by labour inspectorates and monitoring reports made publicly available. Overall, despite a continuous downward trend in poverty and inequality, 21.8% of the population was still at the risk of poverty rate in 2018 (Government of North Macedonia, 2019[121]). According to Eurostat, the "at risk of poverty or social exclusion rate" amounted to 41.1% in North Macedonia in 2017, above the rate of 36.7% in Serbia, 38.9% in Bulgaria and 35.7% in Romania (the two highest rates in EU), and the EU average of 22.4% (Eurostat, 2017[143]). An improvement in the in-work-poverty rate is expected to follow the adoption of the proposed new Law on Social Protection and amended Child Protection Law, which was anticipated in early 2019. According to estimates accompanying the reform, it is expected to increase social assistance coverage by 44.2%, while an additional 40 000 families are expected to receive child allowance. Most of those affected are estimated to receive the minimum wage or are on low incomes (Gerovska-Mitev, 2019[142]). It will be crucial to analyse the impact of this reform.

When it comes to **policies to promote female employment**, significant progress has been made in analysing gender inequalities. The Ministry of Labour and Social Policy has developed and published a national gender equality index in co-operation with the State Statistical Office (Bashevska, 2019[144]). North Macedonia is only the second economy in the region, after Serbia, to calculate this index, which follows the methodology developed by the European Institute of Gender Equality (EIGE). The index shows that overall, North Macedonia is below the EU average (in 2015 it ranked 15th as compared to EU countries[92]). North Macedonia was well below the EU average for the money dimension (including earnings and access to finance) and time dimension, but the gaps with the EU average were smaller for the work and knowledge dimensions (Bashevska, 2019[144]).

Since 2015, when the data for the index were gathered, some improvements have been made in employment: between 2015 and 2019 the employment rate among women in North Macedonia increased by 5.9 percentage points to 44.7% (Eurostat, n.d.[115]). However, men's employment rose even faster.[93] In 2019, the employment rate among men was 19.7 percentage points above that of women, having widened since 2015, when the difference was 17.7 percentage points. In 2019, the women's employment rate was 2.6 percentage points above the WB6 average, but 19.4 percentage points below the EU average of 64.1% (Eurostat, n.d.[115]).

The gender activity rate gap among 15-64 year-olds was 22.5% in 2019 (Eurostat, 2020[145]), more than double the EU average, and also double the average for Bulgaria, Croatia, Hungary, Romania and Slovenia.[94] A study published in 2017, supported by UN Women, showed that the main employment barriers for women were related to culture and gender stereotypes, caring and household duties, and women's lack of confidence in their skills and labour market prospects. This led to women becoming discouraged workers, meaning they would accept work if it were offered to them (Mojsoska-Blazevski, Petreski and Ayhan, 2017[146]). Analysis by the Ministry of Labour and Social Policy showed that the main stereotype women faced was traditional roles linked to patriarchal lifestyles, particularly for women in rural areas. Measures to balance family and working life have not been sufficient; only 4.6% of workers were employed part time in the second quarter of 2019 (WIIW/World Bank, 2020[129]). Flexible work schedules that would enable workers to combine family duties and employment are not widespread, and parental leave does not follow good practice in OECD countries.[95]

North Macedonia has made significant progress in developing policies to reduce gender inequality. Following the Law on Equal Opportunities for Women and Men, the Strategy for Gender Equality 2013-20 contains basic measures for the systematic inclusion of equal opportunities for women and men in the processes of creating and implementing policies and budgets. It also includes basic and special action measures to promote equality between women and men in certain priority areas of action. Gender

mechanisms are also included at the local level within institutions. Commissions for equal opportunities for women and men have been established within the local self-government councils and there are co-ordinators for equal opportunities for women and men within the public sector. An evaluation of the strategy was expected to become available in December 2020, which will shed light on its effectiveness and potential implementation barriers.

Activities to reduce gender stereotypes have included gender sensitive revisions of school books. Awareness-raising campaigns have been implemented in co-operation with the Agency for Audio and Audiovisual Media Services. The MES awards scholarships to female university students in the bio-technical, technical-technological, natural-mathematical, IT, chemistry, physics, mathematics and medical science fields.

The new Law on Prevention and Protection against Discrimination was adopted in March 2019. The Organization for Security and Co-operation in Europe (OSCE) and its Office for Democratic Institutions and Human Rights (ODIHR) commented that the draft did not include adequate awareness-raising and other measures to implement the proclaimed principles of equality and non-discrimination, aside from the public dissemination and educational activities of the Commission. The draft law also does not use the notion of "equal treatment", unlike relevant EU directives (Eurostat, n.d.[115]).

The share of women participating in ALMPs varies by type of intervention: In 2019, women made up 33.5% of participants in measures supporting self-employment, 45.8% in job creation measures, 43.2% in training measures, 64.2% in internships, and 59.0% in work engagement schedule measures. According to the ESARNM, in December 2019, 48% of all unemployed people were women, and many of them were low-educated: 55% of them have never been enrolled in formal education or have only primary education.

A framework for childcare is in place and annual actions plans adopted. Primary schools are obliged to organise all-day stay/classes and provide care between the end of school activities and the end of the working day. It would be useful to follow up whether the availability and quality of childcare is improving over time. The participation of children in early childcare education is below the EU average, but has improved recently – see Education policy (Dimension 7) (EC, 2019[147]).

The latest survey of wages in North Macedonia found that the gender pay gap was 12.5% in 2017. When characteristics such as education, years of service, age and occupation profile are taken into account, the gap increases to 17.3%. Considering primary education, the gap reaches 28% (Eurofound, 2019[137]). An increase in the minimum wage in the last two years, and particularly the equalisation of the minimum wage in the textile and leather industry sector with the national minimum wage, has recently reduced the gender wage gap. But still more measures are needed in order to achieve equal pay, even though the labour law regulates equal pay for equal work.[96]

### *Sub-dimension 8.4: Activation policies*

Since the last Competitiveness Outlook assessment in 2018, progress has been made in improving the institutional capacities of the **public employment service**, ESARNM. It has introduced a profiling tool which divides the unemployed into three groups, according to their level of employability. Counsellors use a standardised questionnaire to categorise jobseekers into these groups and set up individual plans with them. They may then refer those jobseekers who need them most to ALMPs. The law requires every registered unemployed person to be given an individual employment plan (IEP). For those who will be easy to employ and who face few barriers to employment, a simplified and short IEP is developed, while a more detailed IEP is used for those who might be hard to employ. While the use of individual action plans for people with (severe) employment barriers is good practice (Desiere, Langenbucher and Struyven, 2019[148]), the effectiveness of its implementation may be questioned given the capacity of the PES in terms of staff. According to the PES, follow-up interviews should be conducted once a month. The average duration of the initial interview is 30 minutes. According to good practice, hard-to-place jobseekers, in particular the long-term unemployed, benefit from intensive counselling (OECD, 2019[149]).

At end of 2019, ESARNM had 414 employees, 61% of whom were working on active measures.[97] There is one counsellor working on active measures for every 400 registered jobseekers, which is high,[98] particularly given the high share of vulnerable groups among unemployed. For instance, according to LFS data for 2018, 74.7% of all unemployed people were long-term unemployed.[99] The PES's capacity was recently improved through staff training: 188 employees from 30 employment centres were trained in integrated case management, in implementing the Labour Market Skills Survey for the period 2018-19 and implementing the Youth Guarantee Project (Government of North Macedonia, 2019[121]). However, North Macedonia should develop a training strategy for the PES that includes initial training for new staff, and regular thematic training for those already employed.

The PES has limited capacity to provide employer services and gather vacancies. According to the law, all vacancies must be advertised through the PES, even though international experience shows that this is difficult to implement. In 2019, the PES had recorded only 8 344 vacancies for 101 700 registered unemployed, an extremely low ratio. In 2019, nearly 60% of unemployed people looked for work through the PES.[100] The number of unemployed people fell by 12% between 2015 and 2019 according to registration figures, while according to the LFS unemployment fell by 32% over the same period. This may either indicate improvements in registering the unemployed, or a greater difficulty in reducing unemployment among those registered, given the greater share of long-term unemployed and vulnerable groups registering, and the small number of vacancies registered.

North Macedonia has an unemployment benefit system. Workers with a 25-year contribution history can receive unemployment benefit for a maximum of 12 months, with a shorter duration for the rest. Older unemployed adults with a long employment history and who are no more than 18 months from qualifying for an old-age pension can also receive benefits for longer. In this case unemployment benefits are being used as an early retirement scheme. This is understandable in the light of the difficulty older unemployed people can experience in finding employment but efforts should still be made to place them in work instead of effective early retirement.[101] The level of unemployment benefits is linked to previous earnings, but is comparatively low, which may limit its effectiveness in reducing informal employment. It amounts to 50% of previous net earnings, with a ceiling of 80% of the national average monthly net salary in the past month.[102] Its effectiveness is also limited by its low coverage compared to the large majority of EU countries. In 2019 only 2.8% of all unemployed adults, as measured by LFS data, received unemployment benefits, as did 4.6% of the registered unemployed, down from 8.5% in 2015 (EC, 2017[150]). As of 30 September 2020, there were 6 800 beneficiaries of unemployment benefits, and 8 191 beneficiaries under the Law on Material Security of the Unemployed due to the Privatisation of Enterprises with Dominant State Ownership (information provided by the Government of North Macedonia). The number of people receiving guaranteed minimum assistance (26 000) in May 2020 was higher by 8.7 percentage points compared to April 2019, when the former social assistance scheme was in place (data provided by the government).

Significant progress has been made in designing a social assistance system and linking it to the activation strategy. The policy design was based on lessons from international experience. The Law on Social Protection, adopted in 2019, regulates cash benefits in the area of social protection for persons at social risk, who are financially insecure or need financial assistance due to other reasons.[103] The amount of the guaranteed minimum assistance is calculated on the basis of a one-member household, increased by a coefficient of the equivalent scale for other members of the household, up to a maximum of five. It starts at MKD 4 000 (around EUR 65) per month for a single adult. To reach the goal of reducing the poverty rate to 16% by 2021, from 22.7% in 2017, the aim is to integrate 20% of existing social welfare beneficiaries into the labour market.[104] Significant progress has been made in setting up a structure for inter-institutional co-operation with the aim of integrating vulnerable groups into the labour market (Box 24.11). Lessons from other countries indicate that these types of reforms are of great importance, but implementation is challenging and requires political commitment and resources (Duell et al., 2018[151]).[105]

North Macedonia does have a **mutual obligation framework.** The entitlement to guaranteed minimum assistance ceases if: 1) the beneficiary fails to register with the relevant employment centre within 30 days of becoming unemployed (which is longer than in EU countries) and to regularly comply with their obligations under the Law on Employment and Insurance in Case of Unemployment; and 2) the beneficiary refuses twice to meet the obligations in their individual employment plan for inclusion in programmes for active employment measures or to take part in employment mediation in compliance with the law. The mutual obligation principle should also be implemented for informal workers who register with the PES, as long as this gives them access to health care. In this case, the PES's task would be to ease the transition from informal to formal employment.

### Box 24.11. Co-operation between social services and employment services to integrate vulnerable groups into the labour market

Since 2019, the Centre for Social Work and the Employment Centre have co-operated to put together individual employment plans to map out beneficiaries' participation in active employment measures and job seeking. The Centre for Social Work implements plans for each working age member of a household that benefits from the minimum guaranteed assistance, using the information from the individual employment plan, obtained from the Employment Centre. The staff in the two centres communicate regularly and meet as needed, at least once a month. Employment Centre staff electronically notify the relevant Centre for Social Work staff promptly (i.e. within three days) if a beneficiary 1) fails to register as part of the regular registration; or 2) refuses to participate in preparing their individual employment plan or participate in the employment services, refuses to take part in employment mediation or refuses the offer of employment. Therefore the reform has involved upgrading the existing software for administering cash benefits.

The professional workers in the two centres perform joint assessments of the needs and employability level of all registered unemployed persons or beneficiaries from one household, with the aim of identifying the most employable person and including that person in the active employment measures and services, taking into account their age, educational attainment, previous work experience, professional qualifications, acquired skills, the job demand in the labour market and whether there are any obstacles to participation, and other circumstances.

The capacities for implementing the Law on Social Protection have been strengthened; 177 professional workers were employed in the Centre for Social Work in 2018 and 2019 and staff in both centres have been trained in individualised work with beneficiaries (case management).

During the reform process, research was carried out to determine the areas in which the Centre for Social Work's capacity to implement the planned reforms needed reinforcing. Although the previous Law on Social Protection had allowed the provision of social services to be pluralised, in practice, it was mainly carried out by the state. Municipalities did not take the initiative to establish institutions for institutional or extra-institutional social protection, or encourage greater activity and involvement of local communities in the implementation of policies in these areas. Co-ordination was lacking at the local level between relevant stakeholders or their greater co-operation with institutions at the national level. There is an evident lack of provision of social services by the civil sector, which usually depends on funds provided by external donors.

Source: (EC, 2019[63]), *North Macedonia 2019 Report*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-north-macedonia-report.pdf; (Government of North Macedonia, 2019[121]), *Economic Reform Programme: 2019-2021*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/north_macedonia_erp_2019-2021.pdf; Information received from the government.

The National Strategy for Employment 2016-20, National Action Plan for Employment 2018-20 and National Action Plan for Youth Employment 2016-20 form the strategic basis for **active labour market**

**programmes** (ALMPs) and their target groups. The focus of employment policy has remained on youth and the long-term unemployment. Significant improvements have been made to the youth unemployment rate,[106] which fell from 44% in the fourth quarter of 2018 to 35.1% in the fourth quarter of 2019 (Eurostat, n.d.[115]),[107] although this is still more than double the EU average and above the WB6 average. The improvement was linked to the implementation of the Youth Guarantee (Box 24.12). The emigration of young people has also contributed to the reduction of unemployment (EC, 2020[46]). The share of 20-24 year-olds neither in employment nor in education and training, the so-called NEET rate, has remained at a high level and stood at 25.8% in 2019, well above the EU average of 14.5% (Eurostat, 2020[152]) and also above the WB6 average of 22.1% (WIIW/World Bank, 2020[129]).

### Box 24.12. Implementing the Youth Guarantee scheme

Reducing youth unemployment has rightly become a national priority for North Macedonia; prompting ESARNM, the PES of North Macedonia, to start the Youth Guarantee scheme in 2018 as a pilot in three employment centres (Skopje, Strumica and Gostivar). The goal of the Youth Guarantee is that each young person under the age of 29 is given the right job offer, the opportunity to continue education or be included in some of the active employment measures. Once unemployed people are on the unemployment register, they are immediately referred to their first interview with an employment counsellor who will do the profiling and set up an individual employment plan for the next four months. Young unemployed adults are offered group and individual counselling and information, job search assistance services, motivational training, and inclusion in one of the labour market integration measures (employment incentives, education and training measures). In total, 47 599 young people have been included in the scheme so far (as of 31 October 2020), of which 35% successfully exited within a period of four months.

The next step will be to reach out to young NEETs, which will mainly be the role of non-government youth organisations. If effective, this has the potential to reduce the NEET rate. Some 10 000 young people (aged 15-29) are expected to benefit from the Youth Guarantee in the underdeveloped regions, which represents one-quarter of all potential beneficiaries. As pointed out by the EC (EC, 2019[147]), its efficient implementation will require a significant effort by the Ministry of Labour and Social Policy, the ESANRM as well the National Youth Council, responsible for the fieldwork activities.

Source: (Government of North Macedonia, 2019[121]), *Economic Reform Programme: 2019-21*, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/north_macedonia_erp_2019-2021.pdf.

The unemployment rate among working-age adults (15-64 year-olds) has fallen significantly: from 26.3% in 2015, to 24% in 2017 and to 17.4% in 2019.[108] While the unemployment rate of men fell considerably, the fall for women was less marked (WIIW/World Bank, 2020[129]). The unemployment rate of Roma (around 50%) and people with disabilities has not improved in the recent past and continued to be high (EC, 2019[63]). The incidence of long-term unemployment has been very high; it was 80.7% in the first quarter of 2019 and the situation has not improved since 2015 (WIIW/World Bank, 2020[129]). While ALMPs exist for specific vulnerable target groups, take up seems to be low. In 2019, around 22% of the participants in ALMPs were long-term unemployed, 3% were Roma and 3% were people with disabilities.[109] The ALMPs have not been evaluated since 2015. Expenditure on ALMPs increased from 0.11% of GDP in 2015 to 0.13% in 2017 and 0.19% in 2019,[110] but the share still remains significantly below many European countries.

#### *Cross-cutting sub-dimension: Informality*

In 2018, the share of workers in informal employment was similar to the situation in Serbia and below the corresponding level in Albania.[111] It has fallen from 22.6% of workers in 2014 to 18.6% in 2018. Worryingly, the composition of informal employment shows a slight shift from low-educated to medium-educated

workers. Informal workers were mainly self-employed and unpaid family members (WIIW/World Bank, 2020[129]). The incidence of informality is higher among men (20% in 2016) than among women (15%). Slightly less than half of informal workers are aged 25-44 years, and about one-fifth (20-22%) are aged 45-54 years. Most informal workers have completed only primary education or a four-year secondary education (about 40% each). Informal workers carry out mainly elementary occupations (about 62%).[112]

In 2018, the government adopted the Strategy for the Formalisation of the Informal Economy 2018-22. The corresponding action plan for 2018-20 was adopted in 2018, defining measures and allocating a budget. The strategy's objectives include: 1) improving the measuring, monitoring and detection of the informal economy; 2) improving the business environment for companies; 3) stimulating and supporting the formalisation of informal economic activities; and 4) strengthening the tax morale and reducing the tolerance of the informal economy. The action plan defines the budgets for these activities. While the objectives are all relevant, there is no explicit link between the quality of jobs and informal employment. At first sight, it is also not clear how the mechanisms for implementing laws and regulations are going to be strengthened.

*Cross-cutting sub-dimension: Brain drain*

In 2018, 2.1% of North Macedonia's population emigrated (24 300 people), the second highest rate in the WB6 economies after Albania. In a recent survey, 35% of young people indicated that they had a strong desire to move to another country for more than six months (Lavric, 2020[153]). Given the high youth unemployment these results are not surprising, but they are alarming. Previous research has indicated a high level of emigration among highly skilled adults (Government of North Macedonia, 2019[154]). The prospects for development are reduced if young people, and in particular well-educated young people, emigrate.

The government adopted a national strategy for co-operation with the diaspora in 2019 (Government of North Macedonia, 2019[154]). The overall objective is to create the legal, institutional and other preconditions to develop a sustainable and comprehensive framework for co-operation between the state institutions and the diaspora. The strategy aims to turn brain drain into "brain circulation" (Daugeliene and Marcinkeviciene, 2009[155]) and "brain linkage" by co-operating for the transfer of know-how and technology in different areas; learning about the demand for exports of Macedonian products to countries or areas with a large diaspora; increasing activities in the area of education and co-operation with the youth, as a precondition for preserving their cultural identity; and identifying possibilities for co-operation between the scientific diaspora and Macedonian scientific institutions, in order to accelerate the development of the economy.

### *The way forward for employment policy*

- **Continue improvements to working conditions, to align with the EU *acquis*.** The capacity of the labour inspectorates to implement the regulatory framework needs to be strengthened. This will not only involve staff training, but also improving the methodology for risk assessment, co-operation with other relevant institutions, and a potential increase in the number of staff. The Occupational Health and Safety Strategy and the Strategy for the Formalisation of the Informal Economy are highly relevant and should be implemented. Awareness raising among employers as well as training measures and support for SMEs in the area of human resource management should be implemented.
- **Define and implement activities to combat informal employment.** The first steps would be to update the analysis of informal employment, investigating the incidence of the main forms of informal employment (unregistered self-employed, envelope wages, unpaid family members) and the main motivations behind it**.** Horizontal co-ordination could be improved to reduce taxes or lower non-wage labour costs for low-wage earners in order to reduce the incentives for informal employment.

- **Assess the impact of the minimum wage on both poverty reduction and informal employment.** The ESC should be given the resources to make the relevant labour market assessments. An analysis of the earnings structure, the development of productivity and development of low-wage sectors should be regularly conducted. Raising the productivity of companies will be key to improving the quality of earnings. One example to follow could be Germany's Minimum Wage Commission, which includes members from the scientific community in a consultative role. It has a mandate to constantly evaluate the impact of the minimum wage on the protection of workers, conditions of competition, employment in certain industries and regions, and productivity. The commission presents the results of its evaluation to the Federal Government in a report together with its resolution every other year (Mindestlohn Kommission, 2021[156]).
- **Increase employment rates among women** by improving access to and coverage of high-quality childcare[113] (OECD, 2016[157])**,** promoting flexible working schemes by revising labour laws, and launching awareness-raising activities targeted at employers. The government should continue its efforts to overcome gender stereotypes at all levels of education and in the workplace and develop gender-sensitive professional guidance. Women who have become discouraged should be encouraged to rejoin the workforce through measures aimed at increasing their self confidence and skills.
- **Monitor the employability of graduates from the VET system**, differentiating between various VET streams and dual VET streams, and universities, through regular tracer studies. It is also recommended to monitor the participation of employed and self-employed workers in continuing learning.
- **Introduce incentives to invest in adult learning**. Experiences from other countries show that tax credits, learning accounts and learning leave are all valuable incentives (OECD, 2019[158]). The strategy for adult learning should also envisage counselling activities for employees as well as employers, particularly for SMEs, such as is offered in Portugal through the Qualifica Centres (OECD, 2019[159]). In France, every individual has the right to information, advice and career guidance support; the Advice for Professional Evolution *(Conseil en Évolution Professionnelle)* scheme was launched in 2014 to achieve this, offering free and personalised services (OECD, 2019[159]).
- **Implement programmes to substantially improve the skills of vulnerable groups of employees and the self-employed** (Box 24.13).

### Box 24.13. Continuing training for vulnerable groups: Examples from Ireland and Germany

Springboard+ is an Irish programme originally conceived to offer free courses for the unemployed leading to qualifications. In 2017, Ireland extended it to the self-employed who want to improve their skills in certain sectors.

Germany provides study leave incentives that focus on the low-skilled and SMEs. The WeGebAU programme, established in 2006, supports low-skilled unemployed people and workers in SMEs – as well as employees aged 45 and over – wishing to acquire a vocational training degree or to participate in certified continuous training. The participant receives an education voucher which means the PES will cover some of the costs of the training. In addition, unemployment benefits can be paid during the course of the subsidised further training. The PES also pays wage subsidies and social security contributions for low-qualified employees during their training.

Source: (OECD, 2017[160]), *Financial Incentives for Steering Education and Training*, https://dx.doi.org/10.1787/9789264272415-en; (OECD, 2019[161]), *OECD Employment Outlook 2019*, https://doi.org/10.1787/9ee00155-en,

- **Continue to increase the capacity of the public employment service.** This would involve increasing the number of employment counsellors to reduce their individual caseloads, as well as providing training in counselling. At the local level, the capacities of the social work centres and private and non-government social service providers also need to strengthened, as these providers could also be involved in reaching out to unemployed and discouraged workers who are not currently registered at the PES. The capacity of the PES to promote the transition from informal to formal employment should be strengthened. This would include the recognition and validation of informally acquired skills linked to upskilling activities and providing financial incentives for the conversion of informal to formal jobs. Delivering effective employment services would also mean taking an active approach towards employers and delivering services to them. Developing the planned performance indicator system to measure the outcomes of employment policies on different groups of jobseekers and conducting evaluations would also improve capacity. Finally, increasing the budget for ALMPs could level up activities to integrate the long-term unemployed, young people and the most vulnerable groups into the labour market.
- **Assess the impact of the new Law on Social Protection and amended Child Protection Law** on in-work poverty and on activity rates.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Table 24.15 shows North Macedonia's scores for science, technology and innovation, and compares them to the Western Balkan average. The economy scores above the WB6 average in each sub-dimension, rating second in the region in public research system and business-academia collaboration, and third in STI system.

**Table 24.15. North Macedonia's scores for science, technology and innovation**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Science, technology and innovation dimension** | Sub-dimension 9.1: STI system | 2.6 | 2.4 |
| | Sub-dimension 9.2: Public research system | 2.5 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 2.1 | 1.6 |
| **North Macedonia's overall score** | | **2.4** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 9.1: STI system*

An economy-wide **STI strategy** has been in place since 2012, expiring in 2020. Developed within the framework of the OECD's Regional Competitiveness Initiative, the strategy aims to leverage knowledge and innovation to increase competitiveness, stimulate economic development and produce high-value employment opportunities. It includes measures to address major societal challenges such as climate change, mobility and brain drain through emigration. In line with its Action Plan 2019-20, the strategy is being implemented by the Fund for Innovation and Technology and Development (FITD), which was established in 2013 and closely co-operates with relevant ministries. Specifically, the plan is designed to enhance private sector innovation, strengthen human resources for innovation, cultivate a regulatory environment conducive to innovation and increase the flow of knowledge and expertise between sectors and firms. Some elements of the innovation policy are also included in the national Economic Reform Programme 2019-21.

While the STI framework does not address emerging areas of STI such as artificial intelligence, digitalisation or Industry 4.0, this is largely intentional and reflects the economy's current state of development. However, with the support of the European Commission's Joint Research Centre, efforts are currently underway to develop a new smart specialisation strategy that is expected to be adopted in 2021. The smart specialisation strategy is being developed by a working group comprising government institutions, public universities and chambers of commerce. It represents a continuation of the previous innovation strategy, with a focus on enabling economic growth through innovation, collaboration and knowledge sharing.

The **institutional framework** for STI remains relatively complex, with three government institutions overseeing the development and implementation of STI policy and no unified co-ordination mechanism in place:

- The National Committee for Innovation and Entrepreneurship is based in the Prime Minister's office and comprises members of key government ministries as well as experts from academia and the business sector. It primarily supports the implementation of STI policy in a co-ordinated fashion. In addition, the Working Group for Innovation is an advisory body established in 2012 to co-ordinate the implementation of innovation policies, namely the innovation strategy and action plan. The body consists of representatives from relevant ministries, state institutions, national agencies and the private sector.

- The Ministry of Education and Science is another important institution overseeing STI policy and is responsible for implementing and monitoring the innovation strategy. Within the ministry, the Department for Science and Innovation organises, finances, and promotes scientific research, technical development and innovation.
- The FITD acts as North Macedonia's dedicated innovation agency mandated to stimulate innovation activities, particularly within the private sector. Its budget has grown substantially since the previous assessment cycle and, despite the significant slowdown in 2020 amid the COVID-19 pandemic, it is projected to reach around EUR 16 million in 2021. Its operational capacity remains somewhat below potential, but financial and human resource capacity development is being supported by the World Bank and is expected to grow further in the medium term.

The **regulatory framework** for research, development and innovation practices has made moderate progress since the previous assessment cycle. North Macedonia co-ordinates its oversight of industrial property rights with the EU Intellectual Property Office, the European Patent Office, and the World Intellectual Property Office, although its actions are largely limited to awareness raising. Proposed activities to disseminate data among law enforcement agencies have not been implemented, which has limited North Macedonia's enforcement capacity.

North Macedonia engages in extensive **international collaboration** on research, development and innovation through its participation in Horizon 2020,[114] Western Balkans Enterprise Development and Innovation Facility (WBEDIF), Eureka,[115] European Cooperation in Science and Technology (COST)[116] and the International Atomic Energy Agency (IAEA) Agreement on Technical Co-operation. There is evidence of successful participation in these initiatives as well as the implementation of its associated objectives and commitments. In the period up to 2019, 95 Macedonian entities engaged under the Horizon 2020 framework, receiving EUR 10.6 million. More recently, however, activities to promote Horizon 2020 have been limited. Five Macedonian early stage companies have received financing under the WBEDIF Enterprise Innovation Fund (ENIF). However, institutional weakness and limited national scientific capacity pose obstacles to achieving strategic objectives for international STI collaboration. Budgetary and managerial limitations also inhibit the relevant government institutions from fully executing their responsibilities for international collaboration.

North Macedonia has made progress in increasing its **alignment with EU STI policies**, which it considers to be a national STI priority. Its national STI statistics are fully aligned with Eurostat methodology and best practice. The economy has adopted the European Research Area (ERA) Roadmap and participated in a 2018 ERA progress report and has committed to furthering ERA policy objectives, namely gender equality in the STI sector (EC, 2019[162]). It also participates in the European Strategy Forum on Research Infrastructures (ESFRI). Since 2020, North Macedonia has participated in two ESFRI Landmarks and in two developing research infrastructure projects. In early 2020 North Macedonia became a member of the European Open Science Cloud (EOSC) Governance Board and nominated two delegates, one from the MES and the other from the Faculty of Computer Science and Engineering. With the recent restructuring of EOSC governance under Horizon Europe, the Faculty of Computer Science and Engineering became a member of the EOSC Association. North Macedonia is currently drafting a national Research Infrastructure Roadmap that is expected to be formally adopted in early 2021. One higher education institution (HEI) – Ohrid University for Information Science and Technology – has endorsed the Charter and Code, while the South East European University is a participant in EURAXESS's Human Resources Strategy for Researchers.[117]

### *Sub-dimension 9.2: Public research system*

The **institutional structure of the public research system** has remained largely unchanged since the previous assessment cycle. While new policy initiatives have been made to support structural changes in the public research system, there have been no significant measures to increase the overall quality of

public research. The Law on Scientific and Research Activities outlines regulations to ensure the quality of research while the Law on Higher Education requires public HEIs and research and development institutions (RDIs) to regularly undergo mandatory self-evaluations. HEIs and RDIs also face external evaluation by the Board for Accreditation to verify the quality of their teaching and research practices.

North Macedonia has recognised the need to harmonise the Law on Scientific and Research Activities with the Law on Higher Education, redefining certain provisions, and aligning them with the recommendations of the European Commission and international good practice. A working group of experts from the MES and relevant representatives of faculties and scientific institutes was established to draft the new law, which was expected to enter into force in 2021. The National Agency for Quality in Higher Education was also established in 2019, and may further enhance research quality going forward.

The public research system remains underfunded, with gross domestic expenditure on research and development (GERD) at 0.37% of GDP in 2018, down from 0.52% of GDP in 2014 (UIS, 2021[163]). North Macedonia's **public research funding** comprises a mix of institutional funding and competitive grants, but the authorities have not provided a breakdown of how the funds were distributed between the two. The Action Plan for Innovation 2019-20 allocated roughly EUR 169 million to support the implementation of the national STI strategy, with funding sourced from the national budget, World Bank loans and international donors.

While public financing for STI programmes has increased since the previous assessment, in particular for the FITD, further efforts are needed to decrease dependency on international donors to implement North Macedonia's STI policy framework in a sustainable way. While the FITD provides financing on a competitive basis to firms and researchers through multiple funding instruments, there is no formal framework for performance-based funding for public HEIs and RDIs and it is unclear whether fair and transparent criteria are being used to allocate performance-based funds. There have been few significant improvements to public research funding since the previous assessment cycle, with no actions taken to promote third-party funding of research, interdisciplinary research or high-risk research. Likewise, funding is not used to promote research integrity or promote national scientific objectives.

North Macedonia offers few non-financial incentives for research excellence. The capacity of its **human resources for research and innovation** remains limited. The number of full-time researchers (per million inhabitants) has increased by around 18% since 2013, but remains below the 2015 level (UIS, 2021[164]) and the number of patent applications is low compared to regional peers. The Innovation Strategy 2012-20 has a chapter dedicated to strengthening human resources in innovation. There are clear support mechanisms in place for researchers, such as the Challenge for Young Researchers competition that has provided grants to young researchers since 2017. School-age children are also given support to participate in international STEM competitions. There are successful policy initiatives in place to promote the participation of women and other under-represented groups in research and innovation activities. The MES also financially supports the publication of scientific papers in international peer-reviewed journals as part of its implementation of the EU Recommendation on Open Science and Open Data, and provides postgraduate and doctoral scholarships to support the public scientific base. These measures are expected to improve human resource capacity in scientific research in the medium term. However, there are few policy initiatives to support doctoral research and education, make research careers more attractive, or address challenges associated with brain drain. Still, agencies such as the FITD have made notable progress communicating with the general public using promotional events and investments in STI initiatives in primary and secondary schools.

### *Sub-dimension 9.3: Business-academia collaboration*

Collaboration between business and academia remains underdeveloped in North Macedonia, although important progress has been made in promoting collaboration since the previous assessment cycle. Business-academia collaboration is included in the national STI strategy and has been promoted by a

number of financial and non-financial initiatives, which collectively form the foundation of a solid **collaboration promotion framework**. Government promotion of such collaboration is primarily focused on communication and awareness raising alongside financial support in the form of innovation vouchers and competitive co-financing grants. In addition, the FITD has used consultation meetings to involve relevant stakeholders in the design and implementation of relevant policy initiatives.

**Financial incentives for collaboration** are predominately channelled through the FITD, which has developed a specialised system of public tenders and grants, targeting both innovative companies and researchers. Competitive co-financing grants have been used to support private sector technology development and innovation, increase business-academia collaboration, and improve access to finance for start-ups and innovative firms. As of December 2020, the FITD had allocated EUR 42 million to over 500 individual firms, with the total investment generated through co-financing grants amounting to EUR 75 million. In 2018, the FITD developed a new support instrument promoting technology extension services that has supported 11 companies so far and provides acceleration services, of which 44% was sourced via private sector co-financing. Annual allocations for competitive co-financing grants have increased considerably from nearly EUR 300 000 in 2017 to around EUR 10.5 million in 2019. The preparation of a co-operative grant instrument is ongoing and is expected to be piloted by the end of 2021. The FITD piloted innovation vouchers in October 2020, aimed at enhancing co-operation between firms and research organisations, to encourage firms to undertake innovative practices that would increase overall economic competitiveness. It received 71 applications, of which 34 were awarded an innovation voucher. The FITD also redirected some of its activities to counterbalance the impact of the COVID-19 pandemic. However, North Macedonia does not currently use public procurement or tax incentives for firms as incentives for business-academia collaboration.

There are few **non-financial incentives for collaboration** available to researchers and businesses. As part of the World Bank's regional EU4TECH project, which is designed to build capacity for technology transfer from public research organisations and invigorate regional innovation ecosystems, HEIs and RDIs are eligible to apply for technical assistance for proof-of-concept and prototyping services for potential commercial spin-offs. As part of Horizon 2020, North Macedonia participates in Marie Skłodowska-Curie Actions,[118] which facilitate international researcher mobility. Since 2014, 30 Macedonian researchers have participated in the programme and Macedonian organisations have received EUR 280 000 in funding (EC, 2020[165]). However, with no domestic programmes providing non-financial incentives for collaboration, overall incentives remain very few.

There has been good progress on **institutional support for business-academia collaboration** since the previous assessment cycle. Efforts to develop North Macedonia's first science and technology park continue, and a feasibility study has been completed. The park is intended to support the development of start-ups and innovative enterprises by facilitating technology transfers. INNOFEIT, the technology transfer and innovation centre of the Ss. Cyril and Methodius University, opened in 2018 with a mission to give academics the practical expertise and skills needed to overcome private sector challenges. It is a good example of a measure to stimulate collaboration between firms and academia and offers a number of services to firms interested in pursuing research, development and innovation-related activities including pairing academics and entrepreneurs, collaborative research, access to laboratories and technology, and co-working spaces. In 2019, a new business-technology accelerator, UKIM, was incorporated into the INNOFEIT structure (Box 24.14). Despite these important advances, this policy area is not approached systemically and remains under-represented in the national STI policy framework. As a result, value-added measures such as training, coaching, awareness raising and other means of promoting collaboration do not appear to be provided systematically at the institutional level.

### Box 24.14. The Business Technology Accelerator UKIM

The Business Technology Accelerator UKIM was established under the umbrella of INNOFEIT with the aim of identifying and supporting high-potential technology-focused firms and early-stage businesses in North Macedonia. It was founded in 2017, by Ss. Cyril and Methodius University in Skopje (UKIM), the Crimson Development Foundation, CEED Hub Skopje, RSM Macedonia, and Professor Dr Dimitar Stamboliev, and is co-financed by the Fund for Innovations and Technology Development.

It offers tailored pre-acceleration and acceleration programmes and support through international markets, networks and communities. The accelerator also provides early-stage seed financing valued from EUR 5 000 to EUR 33 000, and up to EUR 100 000 in follow-on financing for market development as well as sales and revenue growth.

This accelerator is the first of its kind in North Macedonia, combining the expertise of the economy's biggest and most technologically advanced university, an investment/lending firm, financial advisory organisations, and business support institutions.

Source: (UKIM, n.d.[166]), *Business Accelerator UKIM,* https://accelerator.ukim.mk/.

## *The way forward for science, technology and innovation*

North Macedonia has made progress towards achieving its national STI objectives and has improved its overall STI policy framework. However, insufficient institutional co-ordination, funding limitations, and inadequate support systems for researchers and innovators continue to limit its progress in this policy area. The ongoing development of a national smart specialisation strategy represents a unique opportunity to build on the successes of the current innovation strategy while addressing key shortcomings. The following recommendations can help keep up the momentum:

- **Complete the development of the smart specialisation strategy** in order to build on the important gains made under the innovation strategy. The FITD could play an important role in supporting the implementation of the strategy framework if its capacities are expanded and funding sustained. Strengthening inter-ministerial co-ordination would further increase effectiveness of policy making and smooth implementation.
- **Increase investments in the public research system.** The public research system remains underfunded and detached from national STI objectives, despite significant increases in funding in recent years. Investments in public sector research, coupled with targeted measures to support researchers, would make scientific research a more attractive profession. This could be an important tool to counter ongoing brain drain within the sector, and is likely to increase overall research quality in the medium term.
- **Increase participation in Horizon 2020** and associated international research and development programmes. Efforts to promote involvement in European scientific research programmes should be revamped to include measures such as targeted awareness raising, increasing networking opportunities and international mobility for Macedonian researchers, including through the Marie Skłodowska-Curie Actions.
- **Promote business-academia collaboration through a systematic and targeted approach.** Targeted incentives, both financial and non-financial, could help raise awareness and stimulate interest in increased collaboration. North Macedonia's emerging institutional infrastructure will help to support integration between academia and the private sector, if it is designed with encouraging collaboration as a key objective.
- **Strengthen enforcement of industrial property rights.** Implementing the actions proposed in the 2016-18 strategy on industrial property rights will be essential to improving the enforcement

capacity in the economy. Likewise, increasing the number of investigations of infringements by improving institutional enforcement capacity would ensure stronger, more coherent enforcement.

## Digital society (Dimension 10)

### *Introduction*

North Macedonia is making steady progress with its broadband infrastructure development and has improved its legal and regulatory framework since 2018 to enable private sector investments in network infrastructure. The economy's above-average score in access indicators is reflected in Table 24.16, which shows North Macedonia's scores for the five digital society sub-dimensions and provides a comparison with the Western Balkan average. However, it is lagging behind regional champions in its digital government development. In April 2020, only 136 e-services were available on the central e-government portal and some of the most frequently used e-services for citizens and businesses are still at the second level of sophistication or lower, according to EU standards, meaning that they only support one-way interaction (Belcheva-Ristovska and Todevski, 2020[167]). For the e-services which are available, usage and satisfaction levels remain low, but North Macedonia lacks a database of digital government indicators to support data-driven evaluations and policy making.

North Macedonia scores below the WB6 average in digital society indicators on use and slightly below average in jobs. The adoption of ICT among SMEs has not been effectively promoted and continued delays in preparing and adopting a long-term vision for the ICT sector has led the industry to stagnate, demonstrating no improvement since the last assessment cycle in 2018. The indicators on society remain significantly below the WB6 average. More positively, North Macedonia has updated its policy framework for privacy protection and digital security risk management, reaching an average score on trust indicators, but the lack of human and financial resources to implement the new framework, harmonise legacy legislation, and promote capacity building to change mindsets is holding it back from reaching its full potential.

**Table 24.16. North Macedonia's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 3.3 | 2.9 |
| | Sub-dimension 10.2: Use | 2.0 | 2.4 |
| | Sub-dimension 10.3: Jobs | 2.2 | 2.3 |
| | Sub-dimension 10.4: Society | 1.5 | 2.1 |
| | Sub-dimension 10.5: Trust | 2.2 | 2.2 |
| **North Macedonia's overall score** | | **2.4** | **2.4** |

### *State of play and key developments*

#### *Sub-dimension 10.1: Access*

Broadband access remains uneven in North Macedonia, while infrastructure investments are mainly concentrated around urban areas. The National Operational Broadband Plan (NOBP), an ambitious plan to develop **broadband infrastructure** throughout North Macedonia, was adopted in 2019. It promised to connect every household and public institution to high or ultra-high-speed communications networks[119] by 2029. The NOBP targets the creation of a nationwide optical backhaul network, 5G infrastructure covering all cities and Next Generation Access (NGA) coverage of white zones.[120] The NOBP is aligned with the EU's 2016 Strategy Towards a European Gigabit Society for 2025 and also includes activities to co-ordinate with neighbouring Albania to avoid common obstacles to providing network coverage.

During the first year of its implementation, the plan has already shown positive results, especially in planning and accomplishing the prerequisites for developing connectivity in under-served areas. The key legal and regulatory improvements needed to ensure an enabling environment for private sector infrastructure investments, even in white and grey areas where interest and profit margin are low, have

been identified. These improvements include regulations on infrastructure sharing and re-use, co-ordination of civil works, and minimising restrictions on foreign investment in broadband infrastructure. State aid for white zones and other business models are being considered and consultations with network operators are ongoing over the selection of the most appropriate model in each area. The Law on State Aid Control (adopted in 2010) is in line with Articles 107, 108 and 109 of the Treaty on the Functioning of the European Union. However, to avoid market distortion, careful harmonisation of state aid rules with EU Guidelines for the application of State aid rules in relation to the rapid deployment of broadband networks (EU 2013/C 25/01) will be critical.

The construction, development, maintenance and management of the optical backhaul network in the white zones will fall under the responsibility of the Public Enterprise Macedonian Broadcasting (PE MKD). It will ensure that all operators have access to it and are motivated to develop NGA infrastructure in these areas. The government has secured EUR 600 000 funding from the Western Balkans Investment Framework to prepare a feasibility study for covering target areas with NGA access infrastructure. In an effort to improve co-ordination of broadband development activities, a national advisory board for broadband development was created in 2019, the Broadband Competence Office, to support and report on the progress of the implementation of the NOBP.

The second semi-annual report on NOBP implementation indicates that fixed broadband coverage was at nearly 98% in September 2020, higher than the EU average of 97% in 2019, while fixed broadband take-up was at almost 73%, approaching the EU average of 78%. However, the report also indicated that mobile broadband penetration in the first quarter of 2020 was almost 65%, against the EU average of 100% in 2019 and fast broadband take-up in September 2020 was slightly above 27%, lagging behind the EU average of 41% in 2018 (Broadband Competence Office, 2020[168]).

The ICT **regulatory policy framework** is generally aligned with the EU *acquis*. It is actively implemented and continuously improved to enhance the quality of services and to enable investments. EU Directive 2014/61/EU on measures to reduce the cost of deploying high-speed electronic communications networks has been transposed into the national framework. The electronic communications framework is aligned with the EU 2009 regulatory framework and in line with the WB6 economies' agendas. North Macedonia signed the West Balkans Regional Roaming Agreement in April 2019. Its national regulator, the Agency for Electronic Communications (AEK), is operationally and financially independent. It collects data regularly and publishes reports on the electronic communications market. The AEK is fully staffed and has the resources to perform its responsibilities, including carrying out regulatory impact assessments on every new regulatory proposal. However, the implementation of reviews of the stock of significant regulations against clearly defined policy goals is not yet a systematic practice.

North Macedonia is currently in the initial phase of developing data openness and transparency. Its **data accessibility** policy framework is based on the Transparency Strategy (2019-21) and the Open Data Strategy (2018-20). The framework supports the development of freely accessible online portals and open data access points to disseminate and allow the re-use of government data and public sector information. It facilitates public-private data exchanges for research and commercial purposes and data sharing within and across the public sector. These policies are also in line with North Macedonia's commitments under the Open Government Partnership (OGP) action plan for 2018-20. Data accessibility legislation is in place and aligned with the EU *acquis*, including the Law on Free Access to Public Information and the Law on the Use of Public Sector Data, which transposes the EU Directive (2013/37/EU). The framework regulates the format of data and their publication methods.

The government open data portal[121] has been improved and datasets are gradually being published by public institutions. However, although the portal had published 236 datasets from 52 public institutions by mid-2020, demand for open datasets is still low. An open data culture has yet to be instilled in the minds of both the public and the private sector in North Macedonia. Positively, a significant step forward was made to promote fiscal data transparency with a new open data portal[122] launched by the Ministry of

Finance in November 2019, publishing all state budget transactions. A number of online tools have been launched to foster fiscal transparency and public officials' accountability, publishing data on public spending and asset declaration tools. Regular monitoring of indicators for data accessibility and openness is weak, despite relevant provisions in the two strategies. A working group, comprising seven representatives from public institutions, academia and civil society, was planned to undertake this monitoring task but, as of 2020, no action had been taken to establish it.

*Sub-dimension 10.2: Use*

North Macedonia has made some positive advances in developing **digital government**, directly related to the reforms outlined in the Public Administration Reform Strategy (PARS) 2018-22 and its action plan. These are aligned with open government principles and North Macedonia's international digital government commitments. Some of the activities outlined in the PARS action plan are in the planning phase, some in the initiation phase and some of them are operational or even implemented (for example the alignment of the Law on e-Management and the Law on e-Identification with the Law on General Administrative Procedure). The PARS is being implemented either through non-budgeted activities undertaken by public sector employees or through donor-funded programmes.

The Law on Electronic Management and Electronic Services was adopted in 2019. It allows public institutions and private sector entities to communicate seamlessly through an interoperability platform to provide e-services. North Macedonia and Serbia signed an agreement in August 2019 on mutual acceptance of electronic documents. However, additional harmonisation of legacy legislation and regulatory improvements will be needed to remove the remaining obstacles to the delivery of efficient e-services for citizens and businesses in the field of e-identification and e-payments. The PARS action plan has already identified and planned some of these, for example regulating archiving and storing e-documents, and the transformation of an e-signed paper document for proving payment of administrative or other fees.

Horizontal governance is provided by the National ICT Council (established in 2018), which comprises representatives of relevant ministries and state agencies. The council provides guidance on procurement plans and technical specifications, serves as a focal point for digital government policy initiatives, and is expected to co-ordinate implementation with the National ICT Strategy, once it is adopted. The Ministry of Information Society and Administration publishes annual online reports on the implementation of the PARS that include some digital government indicators. However, there is no open and accessible database of indicators on digital government**,** which hampers effective data-driven evaluations of digital government policies.

The national e-government portal was providing a central point of access to approximately 136 digital government services is available by mid-2020.[123] However, a large number of these services are not directly available through the portal; instead, it only publishes information and links to the relevant portals. Several government portals have been developed, like the successful MojTermin portal for e-health services. Successful e-services include the eTax System that has simplified tax reporting, and mobile applications like eVAT that enables VAT returns for individual taxpayers. During the COVID-19 pandemic, the government received a private company donation for the StopKorona! contact-tracing app to prevent the spread of the virus. Progress has also been made in digitalising public registries. However, while the number of e-services for citizens and businesses is increasing, their use is much lower[124] than the EU average; EU penetration of e-government services in 2019 was 53% (EC, 2019[169]).

North Macedonia does not have a policy framework to directly support **private sector ICT adoption**. It has done little to promote the digital transformation of companies, while neither the Innovation Strategy and corresponding fund nor the other SME or industry policies and programmes have been designed to finance the adoption of ICT. Some tax incentives for purchasing software and hardware products exist, and small-scale voucher schemes have been implemented, but not sufficient to support widespread private

sector adoption of ICT. For example, only 13 companies were recorded as benefitting from a project implemented by MASIT, the Chamber of Commerce for ICT, which offered vouchers to SMEs to assess their ICT needs and plan their digitalisation. The Ministry of Economy funded the Support for Digital Transformation of SMEs project under the Programme for SMEs Competitiveness.

A national ICT strategy for 2021-25 is currently being drafted, which aims to deliver an overarching policy that embraces and aligns all other ICT-related policies, including government digitalisation. However, as the strategy is still in an early preparatory phase, it is not yet certain that it will address the digitalisation of SMEs effectively. The Digital Forum for ICT was created in February 2019 by MISA as a partnership and coalition forum for the exchange of ideas between institutions and other stakeholders, such as chambers of commerce and civil society organisations supporting digital partnership.

### *Sub-dimension 10.3: Jobs*

The development of **digital skills for students** is part of the current education policy framework, namely the Education Strategy and Action Plan for 2018-25. Relevant basic and more advanced subjects are integrated into the curriculum from the third grade and beyond in primary schools and throughout secondary education, either as compulsory or optional subjects. Digital skills curricula are co-ordinated across primary and secondary levels of education, providing a comprehensive continuum of skills development. The education policy framework is aligned with the principles of the European Digital Framework and promotes curriculum design tuned to the needs of the labour market through co-ordination with relevant market stakeholders. It recognises the importance of ICT tools for education and the urgency of equipping classrooms with computers. Legislation and regulations have also been adopted to delineate the use of ICT in teaching. All primary and secondary schools are required to incorporate computers with Internet access into their lessons.

However, outdated ICT equipment in schools and IT-shy teachers are an obstacle to delivering the promise of digital skills' development for students. During 2020, the Ministry of Education and Science reported that 80.7% of primary and lower secondary schools and 93.6% of secondary schools had a broadband connection (>10 Mbps), while 67.1% of primary and lower secondary schools and 69.7% of secondary schools were equipped with computers for students. The ratio of computers to students is around 1:20 in primary and lower secondary schools, and around 1:19 in secondary schools.

The recent COVID-19 experience has exposed disparities between private and public schools and urban and rural areas in the availability of functional computers and portable electronic devices (such as laptops and tablets) and teachers' digital competency and readiness to employ e-learning technology. It has also propelled developments in this field, such as the creation of a Learning Management System by the education ministry, which integrates existing school platforms and provides distance learning capabilities. It also delivered training to over 25 000 teachers on the platform. Over 90% of students attended online classes in autumn 2020. During the COVID-19 pandemic, the Ministry of Labour and Social Policy (MLSP), the Ministry of Information Society and Administration (MISA), the MES and Telecom MK provided free Internet access to 30 000 students from socially vulnerable categories. MRTV started broadcasting an educational programme called "TV Classroom".

In March 2020, a national platform to support distance learning for teachers and educators (www.eduino.gov.mk) was set up by the MES, the Bureau for Development of Education (BDE) and MLSP with the support of UNICEF. The platform offers webinars for training teachers and professional associates, video tutorials for professional development, activities and games for parents to use from home, and e-tests and class schedules. A working group was also established to develop a concept for a distance learning system for primary and secondary schools. The working group comprised representatives of the MES, MISA, BDE, the Vocational Education and Training Centre, the National Examination Centre, primary and secondary school teachers, university professors, international organisations (UNICEF and USAID),

and civil society. The concept focused on three aspects: pedagogy, technology and the design of e-learning systems. The minister adopted the concept on 21 July 2020 with Decision no. 08-4895/2.

During September 2020, the MES implemented a distance learning system that provides e-content and e-activities for all primary and secondary schools. The distance-learning platform is part of the Learning Management System, which is an integrated system that incorporates several existing systems and platforms developed by the MES, along with Office365 and Microsoft Teams tools for online collaboration and e-learning. User training for the platform was initially given to 30 teachers. They became national trainers who then conducted training for an additional 1 200 teacher trainers. Finally, the third level of training was rolled out to all 25 000 school teachers. The share of students attending online classes is currently over 90%. The government acquired Microsoft licences for these tools and provided them to all primary/secondary school students and teachers.

The development of **digital skills for adults** is weak, although related policies are being implemented by different actors, including the Adult Education Centre of the MES, and the National Employment Agency of the Ministry of Labour and Social Policy. There is no overarching framework that provides vision and co-ordination on implemented activities, however. On the positive side, programmes for the development of digital skills for adults have created a positive impact, including lifelong learning programmes, formal and non-formal (re)training programmes provided by private sector education providers (accredited, or not, by the Adult Education Centre). The Employment Agency provides public service programmes for unemployed young people, which include introductory and advanced IT skills in collaboration with private sector education centres. However, even though the ICT industry is generally consulted during curriculum design for these programmes, the amount of people trained and the quality of the training do not always meet the industry's demand for highly skilled ICT professionals. The digital skills gap is exacerbated by weak indicators for monitoring and reporting. Recently, under the pressure created by the COVID-19 pandemic, the use of distance learning platforms has been incorporated in some adult training programmes to increase their accessibility. It remains to be seen if these platforms will be permanently embedded in adult (re)training programmes to empower workers and people in rural or remote areas.

The outlook on **ICT sector promotion** has not improved since the last assessment cycle. Although the ICT sector is recognised in policy documents as a driver for economic growth in North Macedonia, there is no sector strategy that addresses the needs of the industry and co-ordinates the economy's digitalisation. ICT is one of the fastest growing sectors of the economy, employing over 200 000 highly paid people and bringing export revenue of EUR 160 million in 2018. The envisioned overarching National ICT Strategy, has been under preparation for years; it was ongoing during the Competitiveness Outlook assessment in 2018, if not before. The COVID-19 crisis has further postponed its drafting and the associated internal consultation processes, which are now scheduled for early 2021. In the absence of an overarching policy framework, the sector receives arbitrary support through horizontal policy documents and programmes for the development of broadband communications infrastructure, the creation of e-government services or to finance innovation in emerging ICT such as the Fund for Innovation. In the meantime, the ICT industry (mainly the IT sub-sector) suffers from poor retention of skilled staff, limited support for advanced ICT (re)training of employees and stagnation due to the industry's branding as an outsourcing destination.

### *Sub-dimension 10.4: Society*

**Digital inclusion** principles like social inclusion, non-discrimination, and accessibility of electronic systems and services, are included in strategic documents such has the Public Administration Reform Strategy and the National Operational Broadband Plan. However, the relevant activities in the PARS are not prioritised or budgeted in the action plan. Aspects of digital inclusion are covered by the ongoing activities for rural broadband infrastructure development that aim to close the digital gap and to provide affordable broadband connectivity to every household and citizen in North Macedonia, regardless of geography and financial capacity. A number of programmes by different actors, some donor-funded, promote equal opportunities

and narrowing gaps in ICT usage among disadvantaged or even marginalised groups of the population. Examples include ICT skills development programmes by the Employment Agency, Fund for Innovation grants for companies that minimise social exclusion through technological solutions or UNCTAD's eTrade for Women masterclass series programme. However, due to the low number of participants or beneficiaries, their impact is still limited.

The current framework guarantees the accessibility of public websites in accordance with international guidelines and standards such as the World Wide Web Consortium Web Accessibility Initiative Web Content Accessibility Guidelines. A comprehensive webpage has been set up to provide obligatory guidelines for the web presentation of public sector institutions.[125] However, the framework does not impose specific ICT accessibility standards and requirements for the procurement and certification of ICT products and services, which is particularly critical in sectors such as government and education. Monitoring of digital inclusion indicators is weak, basically extending no further than some basic ICT usage indicators gathered by the Agency for Electronic Communications or the National Statistics Agency.

### *Sub-dimension 10.5: Trust*

The digital **privacy protections** framework includes the Strategy for Personal Data Protection (PDP) 2017-22 and the new Law on PDP, adopted in February 2020, transposing the EU General Data Protection Regulation (GDPR) 2016/679. Under the new law, the former Directorate for Personal Data Protection will continue its work as the Personal Data Protection Agency. The law provides a transition period of 18 months for the PDP Agency, data controllers and data processors to align with its obligations. Encouragingly, all of the points on personal data protection and privacy which were raised by the European Commission in their 2019 country report had been addressed before this assessment took place, including amendments to legislation and alignment with the GDPR (EC, 2019[63]). The PDP Agency has significantly enhanced its international co-operation, although it is still understaffed. In its annual report for 2019, it reported that it remained without a director or deputy director for about six months after the resignation of the former director, which affected its ability to sign acts and perform inspections. In October 2020 the agency employed 23 staff members, which represents 36% of its proposed human resources plan. Its plan for 2021 prioritises hiring new staff and specific allocation within the state budget to ensure its financial independence, as prerequisites for addressing the challenges with the implementation of the new PDP Law.

North Macedonia leads the way in the Balkans when it comes to the development of a contact-tracing app. During the COVID-19 pandemic, the government received a private company donation for the StopKorona! app, which helps the Ministry of Health to track people who have been in close contact with an app user who tested positive for COVID-19, to warn them and prevent the spread of the virus.

Free Software Macedonia, a civil society organisation dealing with IT-related issues, raised concerns publicly about the StopKorona! contact-tracing app in relation to data protection. They demanded that the government make the app open source and publish the code for public scrutiny. Upon signing non-disclosure agreements, the Ministry of Health formed a working group in April 2020 consisting of volunteers to review the source code. After ensuring that the app collects and processes only the minimum data necessary, the working group acknowledged that there are no major data protection issues with the app, and made recommendations for further improvement. The Personal Data Protection Agency also conducted an emergency inspection to ensure compliance with personal data protection law. The Metamorphosis Foundation also analysed the privacy policy of the StopKorona! app, regarding data protection and concluded that it contains only the information needed to inform citizens, and thus respects the principles of privacy and transparency in personal data processing.

The Consumer Protection Programme 2019-20 is being implemented and includes some activities to raise consumer awareness and improve legislation to address **consumer protection in e-commerce**. For

example, it foresees the provision of student training in consumer protection that include topics on protection in e-commerce transactions. However, the implementation of public awareness campaigns on consumer protection in e-commerce has been weak. A draft consumer protection strategy is currently being prepared. A new draft of the Law on Consumer Protection was prepared in 2019, but its adoption is still pending at the time of writing. The Law on e-Commerce, based on the EU Electronic Commerce Directive (2000/31/EC), was updated in 2017. Market surveillance and inspection of e-traders is performed by the State Market Inspectorate of the Ministry of Economy, which offers an online form[126] for collecting consumer complaints alongside standard submission methods (in person or by phone). The statistical analysis of these complaints is announced publicly every year.

Although e-commerce is growing in North Macedonia, it is still relatively low, both in the numbers of local merchants selling and consumers shopping on line. A 2019 UNCTAD report measuring the business-to-consumer (B2C) e-commerce index of countries, ranked North Macedonia 48th out of 151 countries (UNCTAD, 2019[170]). Persistent barriers to e-commerce development include underdeveloped financial systems and a legal and regulatory framework that is not fully up to date. Moreover, many local consumers have poor digital literacy and insufficient understanding of their rights in e-commerce and how to exercise them. The Consumer Protection Programme has identified the legal and regulatory improvements needed and relevant activities are planned, especially regarding e-payment technologies and the development of reliable and secure online transactions. However, monitoring of indicators for consumer protection in e-commerce is weak.

The National Cyber Security Strategy and Action Plan 2018-22 provides a basic policy framework for **digital security risk management**, based on the EU Cybersecurity Strategy and the NATO Cyber Defence Pledge. The strategy promotes a complete digital risk management framework for the government, research and development, and the adoption of international standards in procurement and the recruitment of professionals. However, the government has not yet secured the budget needed to implement the action plan, except for the operation of the National Centre for Computer Incident Response (MKD-CIRT). The MKD-CIRT is still operationally challenged, since it has employed only two staff members since its establishment in 2016. Its limited financial and technical resources are provided by the Agency for Electronic Communications, its hosting organisation.

More positively, the new law on Networks and Information Systems Security is aligned with EU Directive 2016/1148, concerning measures for a high common level of security of network and information systems across the Union, but is still pending adoption.[127] The National Cyber Security Council was established in 2019 to provide horizontal co-ordination of digital security risk management and an inter-ministerial working group was set up to provide expert, operational and logistical support to the council. However, North Macedonia's critical information infrastructure has not yet been defined, and further legal and regulatory improvements are required to complete alignment of the legal framework on digital security risk management, ensuring clear roles, responsibilities and accountability for relevant government bodies and institutions. For example, competent public sector bodies have no obligation to regularly report on digital security risk incidents. Efforts to create other computer emergency response teams (CERTs) in the public or private domain are still at the initiation phase.

### *The way forward for digital society*

Despite having taken some important steps to improve its digital society policy framework, the government of North Macedonia should pay more attention to the following aspects:

- **Strengthen the demand for open data innovation by enabling private sector re-use of public sector data** through inclusive co-creation processes to deliver e-services to citizens**.** Although the legal and regulatory framework is advanced, the number of published datasets is only rising slowly, the general public are not widely engaged and the level of informed public debate on data-driven

issues remains low. The government will need to raise public awareness about open data, build the capacities of public officials and develop public-private partnerships for open data innovation.

- **Accelerate the reform and harmonisation of legacy legislation, particularly in the fields of e-identification and e-payments, and prioritise the digitalisation of the most frequently used services.** North Macedonia should prioritise the creation of e-services that are most relevant and useful for the entire population, and increase the sophistication level of services according to EU standards. It will need to create a publicly available dataset of e-government indicators and implement regular evaluations of the quality of available e-government services to facilitate their continuous improvement.
- **Prioritise policies supporting the digital transformation of private sector companies,** possibly under the umbrella of the forthcoming National ICT Strategy 2021-25. The Digital Forum for ICT and non-ICT sector chambers of commerce could help assess the type of support needed by businesses (particularly SMEs) and select appropriate financial schemes (like subsidies or tax reliefs) for purchasing software/hardware and staff IT training, while promoting business process transformation through e-commerce and e-business development. The strategy would also need to prioritise support measures for the ICT industry, to help retain highly skilled ICT professionals through favourable social security or taxation regimes, provide advanced ICT staff training, and strengthen exports and internationalisation, including re-branding the economy from an outsourcing destination to an innovation hub.
- **Adopt legal provisions to promote accessibility requirements in the public procurement of products and services** in the ICT domain and create corresponding certification schemes**.** Digital inclusion policies need to ensure that ICT products and services can be used by all their intended users, taking into account various physical, sensory, emotional or cognitive disabilities. Related policies need to ensure accessible ICT as a powerful enabler of peoples' ability to participate in every aspect of modern life.
- **Accelerate the adoption of the Consumer Protection Strategy** and ensure that it promotes realistic measures for educating consumers on their rights and how to exercise them, and for building trust in e-commerce**.** The strategy will need to address legal and regulatory shortcomings, especially related to e-payments, in order to increase e-commerce take-up. It will also need to ensure that consumer protection legislation addresses fraudulent or misleading practices, privacy issues, dispute resolution, and redress in e-commerce transactions. It should prescribe regular monitoring of indicators on consumer protection in e-commerce to verify or adjust programme implementation targets, as needed, to maximise their impact.
- **Ensure the National Centre for Computer Incident Response has sufficient human, technical and financial resources** and adopt the legal and regulatory provisions for defining North Macedonia's critical information infrastructure and the relevant digital security risk management. National CERTs play a key role in co-ordinating incident management with the relevant stakeholders at national level and are responsible for co-operating with their international counterparts. Definition and protection of the critical information infrastructure is essential for maintaining the vital social functions which ensure the health, safety, security, economic and social well-being of the population, the disruption or destruction of which would have serious national implications.

# Transport policy (Dimension 11)

## *Introduction*

Since the last Competitiveness Outlook assessment in 2018, the main transport improvements North Macedonia has made have been in implementation and procurement, and reforms in the aviation sector. The slowest progress has been in the fields of data collection, asset management and combined transport. North Macedonia's performance in this dimension is close to the WB6 regional average. Table 24.17 shows North Macedonia's scores for the three sub-dimensions, and compares them to the WB6 average. In the planning sub-dimension, North Macedonia scores in line with the WB6 average, in the governance and regulation sub-dimension it scores slightly above the WB6 average and in the sustainability sub-dimension it scores below the WB6 average, explained by its low score for the environmental sustainability strategy and combined transport strategy indicators (both among the lowest scoring in the WB6 economies).

### Table 24.17. North Macedonia's scores for transport policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 2.3 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 2.5 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 0.8 | 1.3 |
| **North Macedonia's overall score** | | **1.8** | **2.0** |

## *State of play and key developments*

### *Sub-dimension 11.1: Planning*

North Macedonia has developed its **transport vision** since the last assessment. It adopted the National Strategy for the Transport Sector (NSTS) for the period 2018-30 in December 2018, while the new National Aviation Development Strategy for 2021-30 is under preparation. The long-term NSTS presents a continuation of the transport vision in the previous strategy, which covered 2007-17. It covers all transport modes with very clear overall and specific objectives. During its development, the NSTS passed through the consultation processes with all relevant stakeholders as set out in the legislation. Strategic actions are presented with measures and indicators, so they can be monitored by the government body responsible, as prescribed within the strategy. The implementation timeline is set out for the short term (2021), medium term (2025), and long term (2030), while the budgets to meet the objectives were assessed for each measure.

The first monitoring report (which should be updated on an annual basis as set in the strategy) on the NSTS for the period 2018-20 is currently under the approval process in the government, but not yet publicly available. The monitoring report for the 2007-17 strategy is not available either, so the degree of progress could not be assessed. Therefore, it is not known if the new strategy includes measures to cover lagging activities left over from the old strategy. The new monitoring reports have to be used to report on lessons learned, and help define countermeasures against undesirable trends, as prescribed within the strategy. It remains to be seen to what extent they will be used to inform the update of the strategy in the future. Twelve years (2018 to 2030) is a long time to go without any update to the NSTS, and the strategy does not include plans for any updates before it expires.

While the planning framework and the transport vision are set out in the NSTS, some important areas need to be upgraded. For instance, the new/upgraded transport model has not been used in the prioritisation process at all. The measures and actions proposed in the national transport strategy should be assessed and evaluated through the outputs of the transport model as part of the strategy, otherwise the model will lose its purpose. Nor does the defined prioritisation methodology framework cover financial and economic

analysis or safety factors. The NSTS has not been aligned with the tourism policy and has not been designed in alignment with other strategies, showing a lack of holistic policy making. If the development and upgrade of transport policy and infrastructure was fully integrated and jointly implemented with tourism and other relevant strategies, it would improve the attractiveness of North Macedonia and the region, making it more competitive.

Public procurement rules applicable to road transport have been fully harmonised with the Transport Community Treaty (TCT). However no other fields relevant to transport have achieved a harmonisation level above 25%, showing the need to accelerate the process of bringing the framework for all transport modes closer to the EU *acquis*.

The last Competitiveness Outlook recommended co-operating and exchanging experiences with other WB6 economies. This has taken place, especially through the Transport Community Permanent Secretariat (TCPS) (Transport Community, n.d.[171]), cross-border co-operation programmes (EC, 2020[172]), and projects related to transport facilitation at border crossing points (BCPs) with Albania, Kosovo and Serbia. This co-operation and exchange of good practice needs to be regularly enhanced and intensified, as the proper development of a transport vision and planning can only take place through regular regional discussion, leading to a single and competitive regional transport market.

The funding for investment in road transport infrastructure has fallen since the last assessment, while it increased for rail infrastructure during the same period. The same trend applies for spending on road and rail maintenance.

The methodology applied for **transport project selection** is not clearly presented in the strategy. The government has provided a multi-criteria analysis tool for project prioritisation; however, it does not cover cost-benefit analysis (CBA) or safety criteria. There are no national CBA guidelines, so international practices and guidelines are used instead. National guidelines for transport projects, including all accompanying survey, analysis and technical instructions, need to be developed and updated every few years. The single project pipeline (SPP)[128] was developed to cover 2014-18, but it has only been updated once since the last assessment, in 2018 (Government of North Macedonia, n.d.[173]). The SPP should be monitored regularly, but the only report shared by the government is from 2015 (Government of North Macedonia, n.d.[174]). There was a proposal by the transport ministry for an update of the SPP in 2019 but it was not adopted by the National Investment Committee. The government does not have enough human capacity to select and prioritise transport projects in an effective and co-ordinated way. *Ex post* monitoring of the methodology and prioritisation processes needs to be developed and regularly applied (on an annual basis), and the prioritisation framework regularly adjusted accordingly.

In the area of **implementation and procurement**, the procurement rules applicable to the transport sector have been completely harmonised with the TCT, as mentioned above. Alternative procurement methods are allowed, but the national bodies in the transport sector do not have the capacity to execute their responsibilities for public procurement even though roles and responsibilities are clearly defined. The implementation strategy for transport projects is not complete: the processes of implementation from procurement to *ex post* monitoring are not defined, while only an overall action plan has been developed within the NSTS. Projects funded from the national budget are procured according to the Law for Public Procurement. Projects and grants funded by international financial institutions are also subject to the national public procurement law (Government of North Macedonia, 2019[175]).

Even though it was recommended in the previous Competitiveness Outlook in 2018, there is still no regional exchange of good practice and lessons learned from the implementation and procurement of public-private partnership (PPP) projects. National bodies have not been given oversight of procurement and monitoring of PPPs. There is no clear evidence of procurement procedures having been consistently monitored, or procurement procedures or project outputs being evaluated. However, there are regular internal audits of operations and audits related to the Instrument for Pre-Accession Assistance (IPA). The Central Financing and Contracting Department[129] develops annual reports on the lessons learned from

project procurement and implementation, for application in upcoming projects, but it remains to be seen how far they will inform future project procurement processes.

The key objective of a well-developed **asset management** system should be to provide justification for the maintenance budget, and to help direct limited funds towards those areas where the return on investment will be greatest. A soundly developed system is an integral component of the transport planning, identification, prioritisation, implementation and monitoring processes. The Government of North Macedonia is in the early stage of developing an asset management system for the transport sector. So far, only development of the road[130] and railway sectors have been started (Government of North Macedonia, 2019[176]). An asset management[131] system is still not mandatory for every transport mode, and has only been applied to a certain level in road transport. Public Enterprise State Roads and Public Enterprise Macedonian Railways Infrastructure are responsible for installing an asset management system for road and railways.

The Road Asset Management System (RAMS) is currently used as the road databank and road reference system. There is a portal offering a single point of entry into all RAMS components. Data collection has been conducted using ground penetration radar (for almost 4 400 km of state roads) and weight-in-motion measurements (for 20 locations). The results of the data analysis are presented in the global information system (GIS) application through visualisation. The rail sector has asset management software, but it is not being used due to lack of supporting facilities[132] and also because the Railway Infrastructure Management System (RIMS) needs to be updated. The newly developed bridge management system, subject of a recent tender in 2019 (Government of North Macedonia, 2019[176]), will be a component of the RAMS. It will need to be able to provide asset valuations, works programme monitoring, organisation and human resources, and budgets and use the outputs for reporting (annual report, key performance indicator, multi-annual programmes). The government needs to make greater efforts to follow and implement regional asset management plans.[133]

Investment in road infrastructure is considerably higher than other transport modes due to the current construction of new motorways and highways (Table 24.18). Investment in rail infrastructure needs to be multiplied to achieve a similar level as the EU rail infrastructure market. The current plan by the government is to invest 100-400% more annually in the period 2020-22 than in 2019. Maintenance of road infrastructure is slightly below the EU and OECD average, but maintenance spending saw a 30% increase from 2019 to 2020.

### Table 24.18. Trends in transport infrastructure investments and maintenance in North Macedonia (2017-19)

| | Investment costs | | | | | Maintenance costs | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Change over 2017-19 (%) | 2018 (road) 2019 (rail) (EUR mn) | Share of GDP (2019) (%) | OECD average (2018) (% GDP) | EU average (2018) (% GDP) | Change over 2017-19 (%) | 2018 (road) 2019 (rail) (EUR mn) | Share of GDP (2019) (%) | OECD average (2018) (% GDP) | EU average (2018) (% GDP) |
| **Road infrastructure** | -19.5 | 157 | 1.24 | 0.46 | 0.38 | -9.9 | 11.8 | 0.09 | 0.18 | 0.15 |
| **Rail infrastructure** | +125 | 12.65 | 0.1 | 0.17 | 0.31 | +6 | 14.96 | 0.001 | 0.16 | 0.16 |

Note: For road infrastructure, the comparison period is 2017-18 due to lack of data. OECD and EU average represents the average value for the counties with available data.

Source: (IMF, 2021[177]), *Republic of North Macedonia*, www.imf.org/en/Countries/MKD; (OECD/ITF, 2021[178]), *Transport infrastructure investment and maintenance spending*, https://stats.oecd.org/Index.aspx?DataSetCode=ITF_INV-MTN_DATA; (World Bank, n.d.[179]), *GDP (current US$)*, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&start=2018.

*Sub-dimension 11.2: Governance and regulation*

Reforms have continued[134] in the field of **aviation regulation**. The Single European Sky (SES) I package has been fully transposed into national law, bringing North Macedonia significantly closer to the EU *acquis*, but the SES II package provisions have only partially been transposed.[135] Safety Culture,[136] a programme covering safety risk assessment and safety assurance, has not yet been adopted. The State Safety Programme is currently being drafted by the Civil Aviation Authority (CAA).

The Airport Charges Directive is an important piece of EU legislation guiding the way charges should be set and monitored. They should be based on non-discrimination and transparency principles set by the EU, and quality standards related to the service-level agreements for services provided at the airport. The government has set a deadline for transposing it into national law (October 2021), but the process has not yet started. The market is not yet monitored in line with the Air Service Regulation, which provides the EU economic framework for the granting and oversight of operating licences of community air carriers, market access, airport registration and leasing, public service obligations, traffic distribution between airports, and pricing.

Bilateral co-operation in civil aviation has advanced since 2018, as the CAA has signed memorandums of understanding (MoUs) with Greece, Poland, Russia and Singapore. Many of these MoUs have been used for the exchange of experts and carrying out oversight and other activities as part of the aviation authorities' responsibilities.

Air traffic in North Macedonia is growing: the total number of passengers carried from all airports increased by approximately 30% in the period 2017-19, and amounts to 2.67 million passengers in 2019. In comparison, the global average increased by 11.7% over the same period (IATA, 2020[180]; Statista, n.d.[181]). Given the significant growth in aviation and its projected importance for the economy, it is important that North Macedonia continues regulatory reforms and brings the governance of the aviation sector closer to European standards and international best practice.

There has been a slight stagnation in progress in **rail regulation** since the last assessment. The dominant state-owned railway enterprise, Macedonian Railways, was separated into two state-owned companies in 2007: one managing infrastructure (Macedonian Railways and Railway Undertaking) and the other managing operations (Macedonian Railway Transport). Although the network monopoly was unbundled, the railway market is open only to national companies until North Macedonia joins the EU (For more information see: Sub-dimension 2.2: Services trade restrictiveness). Only 18% of the currently applicable railway legislation to North Macedonia prescribed in the TCT has been fully transposed and implemented, 5% is partially transposed and implemented, 75% is not transposed, and the rest remains unclear (only 10% of the total was not considered to be applicable). Progress has been made in the harmonisation of train driver licensing, passenger rights and transport of dangerous goods, while partial achievements have been made in the fields of rail safety and interoperability. Other fields such as market access, interoperability, railway safety, transportable pressure equipment and working time require further efforts to transpose and implement the TCT.

Several other key reforms in the railway sector remain outstanding. For instance, no more than 25% of the regional Rail Action Plan created by the TCPS has yet been implemented. The Rail Freight Corridor Regulation and Technical Specifications for Interoperability have not yet been transposed. The Network Statement (NS) for services facilities is incorporated in the NS for railway infrastructure. The National Investigation Body (NIB), charged with investigating accidents as a key input for the improvement of rail safety performance, has not been established yet. The Passenger's Rights and Obligations Directive has been transposed but will only come into force when the Republic of North Macedonia enters the EU.

On a positive note, North Macedonia has advanced bilateral co-operation in the railway sector, by signing agreements to facilitate border crossings with Serbia and Kosovo, and initiating an agreement with Greece for two additional BCPs. The utilisation of the railway network was almost unchanged between 2017 and

2019, amounting to 2 454-2 474 trains per km of track, which is only approximately 15% of the EU average in 2017 (EC, 2019[182]). Rail network utilisation measured using passengers and goods present a slightly positive trend for passengers and a positive trend for freight (Table 24.19).[137]

### Table 24.19. Trends in rail transport of passengers and goods in North Macedonia (2017 and 2019)

| Rail network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| **Passengers (passenger*km/km of track)** | +4.2 | 0.07 | 3.2 |
| **Freight (tonnes*km/km of track)** | +26.5% | 0.38 | 19.6 |

Source: (EC, 2019[182]), *Statistical Pocketbook 2019: EU Transport in Figures*, https://ec.europa.eu/transport/facts-fundings/statistics/pocketbook-2019_en; (MAKStat, 2021[183]), *Passenger and freight transport, by years*, http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__Transport__PatenTransport/560_Trans_MK_T39_en.px/.

The current investment levels (Table 24.18) show the dominance of investment in road transport. More investment in the railway sector will be needed to improve the quality of network and in turn increase demand by passengers and shippers. If North Macedonia succeeds in keeping its high mode share for rail freight (Table 24.19), and increases the rail passenger mode share, it will indicate sustainable growing demand. Such a growing and open market would lead to more efficient operation while also achieving lower prices. Even though there has been some increase in rail transport, there is still much to be done. In order to reach EU average levels of network utilisation, there will need to be a full opening of the market, incentives for shifting freight from road to rail, the development of rail freight corridors and the development of multimodal facilities. These will enable rail transport to dominate in North Macedonia, which will directly lead to much greater cost-effectiveness of its transport infrastructure assets.

In 2019, **road market regulation** was significantly improved with the establishment of the Integrated Border Crossing (one-stop-shop[138]) with Serbia. This was the outcome of the Agreement on the Establishment of Joint Controls at the Preševo-Tabanovce International Border Crossing, through which Serbian and North Macedonia customs and police officers work together in the same "office". The total number of bilateral international road transport agreements has increased since the last assessment to include one more country, Lithuania.[139] Based on information provided by the Ministry of Transport and Communications, 16% of the legislation prescribed by the TCT is fully transposed and implemented, 30% is partially transposed and implemented, 30% is not transposed, and the rest remains unclear. North Macedonia has continued to participate in the European Conference of Ministers of Transport multilateral quota system, which enables hauliers to undertake an unlimited number of multilateral freight operations in the 43 European countries participating in the system. The national legislation complies with the road haulage qualifications standards for companies, managers and drivers under the Quality Charter for Road Haulage.

The average age of passenger cars increased by 3% in the period 2017-19 to 19.3 years, which is almost double the EU 2018 average of 10.6 years (European Automobile Manufacturers Association, 2019[184]). Bearing in mind the environmental impact of old vehicles, incentives are needed to rejuvenate the vehicle fleet, similar to the recently implemented programme in Serbia for purchasing both new and electric vehicles.

Road transport has a significantly higher mode share than rail: 96.7% compared to 3.3%, while on average across the EU, road transport accounted for 75.3% and rail 18.3% in 2018. (Eurostat, 2020[185]). North Macedonia has a high road freight share, with a 86% heavier utilisation of roads than the EU average (Table 24.20). The negative effects of this on air pollution and climate change are obvious, so incentives to shift freight from road to rail could have a positive environmental impact.

### Table 24.20. Trends in road transport of passengers and goods in North Macedonia (2017 and 2019)

| Road network utilisation | Change over 2017-19 (%) | 2019 (million) | Share of the EU average (2017) (%) |
|---|---|---|---|
| **Passengers (passengers*km/km of road)** | -16.1 | 0.072 | 7.21 |
| **Freight (tonnes*km/km of road)** | +5.8% | 0.71 | 186 |

Source: (EC, 2019[182]), *Statistical Pocketbook 2019: EU Transport in Figures*, https://ec.europa.eu/transport/facts-fundings/statistics/pocketbook-2019_en; (MAKStat, 2021[183]), *Passenger and freight transport, by years*, http://makstat.stat.gov.mk/PXWeb/pxweb/en/MakStat/MakStat__Transport__PatenTransport/560_Trans_MK_T39_en.px/.

The COVID-19 outbreak is affecting the global transport market, and European transport and mobility (including the WB6 economies) are no exceptions. In the second quarter of 2020, North Macedonia introduced measures at its borders and customs controls to enable the provision of essential goods and medical equipment, contributing to a low number of infected individuals at the border crossing area. “Green lane” measures were introduced on the major corridors for the transport of emergency goods. It should take no longer than 15 minutes to pass through these “green lane” crossings, including any checks and screenings, so procedures have to be minimised and streamlined. This initiative has been endorsed and implemented by all regional economies and represents a good example on how good cooperation of the regional economies could generate benefits on the region (Transport Community/CEFTA, 2020[186]).

During the first quarter of 2020, North Macedonia had started developing technical documentation to pilot an electronic border queuing management system (e-QMS), as part of a joint project with four economies along the Corridor X (Croatia, Greece, Hungary and North Macedonia), inspired by the one installed in Baltic countries, but also endorsed by the Ministerial Council of the TCPS through the regional Transport Facilitation Action Plan (Transport Community, 2020[187]). Technical documentation is expected to be finalised during 2021 and the pilot system should start operation in 2022. This system will support the Connectivity Reforms Measure, aiming at the creation of more competitive, safe and reliable transport systems and network, to reduce waiting times at the border areas and replace physical queues with virtual ones. These measures could have a direct impact on how border crossing in the region could be treated in the future, by installing measures which minimise crossing time.

The only **inland waterways** (IWW) market in North Macedonia is for passenger transport on Ohrid Lake during the summer period. The national transport strategy does not include a budget for IWW transport. Currently, according to the government, 43% of the IWW legislation in the TCT is not currently applicable to North Macedonia, while of remaining legislation, 4% is fully transposed and implemented, 23% is partially transposed, and 54% is not transposed at all, with the remainder being unclear. The areas which are fully aligned are related to access to the profession, while the partially aligned areas are related to access to the market, the harmonisation of conditions for obtaining boatmasters’ certificates, and recognition of national boatmasters’ certificates for the carriage of goods and passengers. All other fields related to safety, transport of dangerous goods, environments, etc. have not yet been transposed and implemented.

Monitoring indicators to assess performance for all transport modes are either non-existent or not properly established. Some of the missing indicators include average user costs, travel time satisfaction levels, reliability, value of assets, market research and customer feedback, the quality of user information, and audit programmes. The government has not yet planned regular data surveys (for instance their purpose, and the level of data needed have still to be planned, and budgets allocated). Surveys have only been conducted for the purposes of specific projects and not for regular transport infrastructure assessment and planning. The government has confirmed that it intends to conduct the data surveys as one of its next projects, which will provide a base for future quality assessments of the transport network.

*Sub-dimension 11.3: Sustainability*

North Macedonia has taken some moderate steps to improve **road safety**, but overall its progress has stagnated since the last assessment. The National Strategy for Improving Road Safety (NSIRS) 2015-20 has expired and plans for an updated strategy have still not been presented. The government appointed a co-ordination body to follow up implementation of the strategy, and to develop annual implementation reports which should be approved by the Assembly, but in practice this body has not prepared any reports. There have been no monitoring reports on the implementation of the strategy; the only annual report in this field is on the work of the Road Traffic Safety Council. The NSIRS is not aligned with the TCT and also lacks any budget to carry out the measures and actions defined in the strategy.

The Regional Road Safety Action Plan (Transport Community, 2020[188]) was endorsed by the Ministerial Council of the TCPS in October 2020; North Macedonia needs to adapt its national plans to achieve the goals set out within this plan. The goal of the European Commission's Policy Orientation on Road Safety 2011-20 (EC, 2010[189]) was to reduce road fatalities by 50% between 2010 and 2020 as part of the Decade of Action for Road Safety, officially proclaimed by the United Nations (UN) General Assembly in March 2010. This goal would have been difficult to achieve given that North Macedonia has seen decreases of approximately 1.5% per year over the period 2010-19. Therefore, it will need to make significant additional efforts to reach the new zero deaths goal in the European "Vision Zero" strategy for 2050, with an intermediate goal of a 50% reduction in road fatalities during 2020-30 (EC, 2019[190]). As it has started the new decade without a strategy, expectations should not be high. In addition, the national goal of reducing the number of road fatalities by 30% during 2015-20 (Government of North Macedonia, 2021[191]) is also not expected to be achieved for the same reasons given above. The number of road fatalities per million inhabitants in North Macedonia was 63.6 in 2019, 24.7% higher than the EU average of 51 (Table 24.21).

### Table 24.21. Road safety trends in North Macedonia (2010-19)

| Road safety trends | North Macedonia | EU |
|---|---|---|
| Change in the number of fatalities 2010-19 (%) | -18.5 | -23 |
| Number of fatalities per million inhabitants (2019) | 63.6 | 51 |

Source: (EC, 2020[192]), *2019 road safety statistics: What is behind the figures?*, https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004; (Eurostat, 2021[193]), *Data browser: Victims in road accidents by NUTS 2 regions*, https://ec.europa.eu/eurostat/databrowser/view/tran_r_acci/default/table?lang=en.

The figures in Table 24.21 indicate some moderate progress, but it is not enough to reach the goals in the strategy or to match the achievements of the EU and regional economies. Much greater efforts are needed not only to harmonise the legislation with the TCT, but also in the fields of education, awareness campaigns, enforcement, etc. (Box 24.15).

### Box 24.15. Innovative ideas in road safety: Road safety social impact bonds in Montenegro

In 2018, the UNDP in Montenegro, in co-operation with the key national players in road safety, developed the new idea related to road safety social impact bonds. These are an innovative alternative performance-based public financial instrument, which shifts the policy framework from inputs and outputs to outcomes and value for money. The idea is to involve the private sector in investing in road safety improvements with the main aim of strengthening sustainability jointly with the public sector. The public partner commits to paying outcome payments to the investor if and only if the predefined and measurable social goals are met. This idea has great potential for other economies in the region (and beyond) to replicate and scale up the model.

Source: (UNDP, n.d.[194]), *Rethinking road safety in Montenegro*, www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

The **environmental sustainability** goals[140] for the transport sector are addressed through many different strategies, making them difficult to monitor. Therefore, it will be necessary to integrate a clear chapter dealing with sustainability in all transport modes into the national transport strategy or the transport sector strategies for each specific mode. There is no evidence that the government is preparing an overarching environmental sustainability strategy.

The only overview of the current situation is in the Study on the Transport Sector Analysis of Policies and Measures, developed by the United Nations Development Programme (RCESD, 2017[195]), which found that road transport was the dominant energy consumer out of road, rail and air transport, accounting for 97% of transport energy consumption, with 87% due to passenger cars. This is slightly higher than the EU road transport average of 94%. Transport contributed 13% of North Macedonia's total greenhouse gas (GHG) emissions in 2014, and 20.5% of the total emissions from the energy sector. North Macedonia levies environment-related taxes on buying and using passenger motor vehicles (e.g. importing and registering vehicles, and buying fuel). The study also assessed the impact of the new scenario of the environmental tax on vehicle registrations, imports and fuel, and found that if all the funds collected from these taxes were used directly to subsidise electric vehicles (e.g. at EUR 5 000/vehicle), they could cover subsidies for 870-4 340 vehicles per year.

**Combined transport**[141] of goods is the most cost efficient, reduces environmental pollution, and increases co-operation between the freight forwarding network companies. However, the legal and regulatory framework to support it still needs to be developed in North Macedonia. North Macedonia lacks a combined transport strategy and does not plan to develop one. The core activity in this area has been the preparation of the design documentation for the intermodal terminal Trubarevo near Skopje. The total tonnes of goods transported through combined transport increased by 30% in the period 2017-19, reaching 138.8 million tonnes-km. This represented 1.3% of the freight transport in North Macedonia, significantly below the EU average, where container transport was estimated in 2017 to make up 6.2% of total road freight transport (Eurostat, 2019[196]).

The World Bank's Logistics Performance Index (LPI) (World Bank, 2018[27]), is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation. In the last assessment in 2018, it ranked North Macedonia 81st out of 160 ranked countries, with an LPI score of 2.7. This is slightly below the world average (2.85) and far below the EU average (3.52). The best score achieved by North Macedonia was for the international shipments indicator,[142] where it was ranked 67th, and the worst for was for the tracking and tracing indicator,[143] where it ranked 100th.

Data collection, which is currently very weak, needs to be one of the key actions for assessing the performance of all sustainability areas. A strategy for data collection needs to be established to assess the transport sector, which will directly influence the prioritisation within transport policy in general.

### *The way forward for transport policy*

North Macedonia has taken some important steps towards developing a competitive transport sector, as presented above, but special attention should be paid to the following:

- **Develop a national centralised monitoring system** for the project development and project implementation process, covering each defined indicator and/or transport mode separately through independent monitoring departments**.** Such a system will help support follow up and updates in the following areas: implementation of strategies and legislation, project identification and selection, procurement processes, project implementation, and *ex post* monitoring, among others.
- **Update the national transport strategy every four years.** The existing strategy does not propose any periodic updates, which would need to be based on regular monitoring. Unfortunately, the monitoring report of the implementation of the past strategy (for 2007-17) was not used for the

latest strategy. The current monitoring report, which is in the process of being approved by the government, needs to be used to extract the lessons learned and use them to update the strategy.

- **Develop and tailor cost-benefit analysis guidelines specifically for North Macedonia.** It is very important for each economy to develop its own guidelines with accompanying national technical instructions needed for a proper CBA. The guidance needs to be updated often, as a maximum every two years. A good example is the United Kingdom's Transport Analysis Guidance,[144] which provides all the information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure consistency in the discount rates used for similar projects, economies need to develop their own benchmarks for all technical and economic parameters, including the financial and economic discount rate in the national guidance documents, and then apply them consistently in project appraisal at the national level. The empirical research needs to be conducted at a national level to generate input data for calculating externalities.
- **Develop a tool for project identification, selection, prioritisation and implementation.** This tool needs to be applied to all transport projects in North Macedonia. Albania and Serbia have both recently introduced well-developed systems, currently in the initial stage of implementation (Box 24.16). These could be used as a model.
- **Ensure that transport facilitation remains a key priority.** North Macedonia needs to implement more OSSs to simplify border crossing procedures and shorten crossing time, alongside other measures in the Regional Action Plan for Transport Facilitation (Transport Community, 2020[187]), which was endorsed in October 2020. These include: electronic queuing management systems, improving and upgrading of existing ICT infrastructure, constructing or modernising infrastructure to remove physical and technical barriers and increase existing capacities, and capacity building to improve performance efficiency. Implementing these measures will be a key part of integrating North Macedonia into the regional transport market, increasing the competitiveness and connectivity of the region, and driving deeper integration into the broader European transport market. It will directly improve the transit times of some key goods that depend on quick, cost-effective and timely delivery, but will also influence more investment in the transport infrastructure.
- **Implement asset management principles in the transport sector in line with the national inventory system.** Developing sound asset management practices[145] to enable economies to collect data (through annual data collection planning and budget allocation) and to manage and analyse conditions across all the transport modes. This information can then be used to optimise transport sector maintenance strategies and justify maintenance budgets, directing limited funds into those areas where the return on investment will be greatest. Performance-based maintenance contracts (PBMC), are already implemented, though not extensively, in some WB6 economies such as Albania, Bosnia and Herzegovina, and Serbia (Transport Community, n.d.[197]). They can be an essential component of the road asset management system and if well-developed, lead to good road conditions at relatively low cost. The quality of the transport infrastructure affects an economy's attractiveness for foreign direct investment.
- **Develop an integrated environment and transport action plan and a framework for environmental sustainability for the sector.** This plan needs to integrate the existing indicators and to include any missing ones in a framework for environmental sustainability in the transport sector. A good example was developed by the European Environmental Agency in the form of the Transport and Environment Reporting Mechanism (EEA, 2000[198]), which prescribes indicators for tracking of transport and environmental performance in the EU. Measures and indicators would then be applied in the strategies to which they belong, including the updated NSTS.

### Box 24.16. Tools for identifying, selecting, prioritising and implementing transport projects in Albania and Serbia

The only two economies in the region with a sound tool for transport project identification, selection, prioritisation and implementation are Albania and Serbia.

In 2018, **Albania** adopted the Decision on the Public Investment Management Procedures. For the purpose of budget planning on investment expenditure, projects are divided into two groups: 1) capital administrative expenditures related to equipment, furniture, computers, IT, etc.; and 2) expenditure on investment projects, including capital expenditure on infrastructure, such as new construction, reconstruction and rehabilitation with design costs, expropriation costs, purchase of larger technological equipment, implementation of works, supervision, etc.; and capital expenditure for capacity development, including research projects, technical assistance and capacity building.

Albania applies the following project management cycle: 1) project identification based on the analysis of public needs; 2) project evaluation and preparation with the evaluation of the economic and financial justification; 3) project approval and financing; 4) project implementation; 5) monitoring of the project implementation, which should ensure that the project activities are proceeding as planned; and 6) evaluation and audit, including reporting on the physical and financial implementation audit against the financial rules and the project performance indicators. Based on this project cycle, the following steps are used: 1) identification of the project idea; 2) review of the draft idea by the Project Management Team Leader; 3) review of the draft idea by the Secretary General; 4) detailed project preparation and evaluation, shortlist of alternatives; 5) submission of the investment project proposal to the ministry responsible for investment projects; 6) review of the proposal by the Council of Ministers; and 7) final approval after the approval of the investment projects within the annual budget.

As per Decision No 290 from 11 April 2020, a financial management information system has been installed in every spending unit, including all ministries, and it is integrated into various departments to be used for all steps in the project management cycle.

In **Serbia**, the procedure for project identification, analysis of relevance, pre-selection, funding, implementation and monitoring is clear and publicly available, and co-ordinated by the Ministry of Finance. This procedure was adopted in 2019 though the Rulebook on the Management of Capital Projects.

The prioritisation process, which is applied to all projects, applies, among other criteria, a CBA, environmental and social impact assessment, and a safety assessment.

Once the project is approved for financing through a very similar procedure to the one described above for Albania, there is a special procedure for the preparation of a plan for the project implementation.

During the project implementation, a specific procedure exists for the reporting. One type of report is the interim report for the presentation of the current project status, covering the activities carried out and the plan for the execution of the remaining project activities. At the end of the project a final report needs to be developed.

Projects are divided into three categories: 1) less than EUR 5 million; 2) EUR 5-25 million; and 3) over EUR 25 million. Those in the third category undergo *ex post* monitoring three years after the completion of works, which is a significant advance in the local legislation.

Source: (Government of Albania, 2018[199]), *Decision of the Council of Minsters No 185/2018: Public Investment Management Procedures*, http://80.78.70.231/pls/kuv/f?p=201:Vendim%20i%20KM:185:29.03.2018; (Government of Albania, 2020[200]), *Decision of the Council of Minsters No 209/2020*, https://qbz.gov.al/eli/vendim/2020/04/11/290; (Republic of Serbia, n.d.[201]), *Rulebook on the management of capital projects*, www.mfin.gov.rs/UserFiles/File/podzakonski%20akti/2019/Uredba%20o%20upravljanju%20kapitalnim%20projektima.pdf; (Republic of Serbia, 2021[202]), *Project cycle process: Forms*, www.mfin.gov.rs/dokumenti/saobracaj/.

## Energy policy (Dimension 12)

### *Introduction*

North Macedonia has shown tremendous progress since the last Competitiveness Outlook assessment in the area of energy policy. This progress is reflected in North Macedonia's score of 3.7, well above the previous score of 2.0, with improvements in every sub-dimension. While North Macedonia was lagging in the last CO, together with Albania it is leading the WB6 in almost every aspect this time around (Table 24.22). However, this progress does not mean that North Macedonia does not need to continue to improve. As the scores suggest, there is further room for improvement. This message is echoed by the Energy Community Secretariat, which concludes that up to 42% of the Third Energy Package (Box 24.17) still needs to be transposed, and 41% of additional implementation is required (Energy Community Secretariat, 2020[203]).

### Table 24.22. North Macedonia's scores for energy policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Energy policy dimension** | Sub-dimension 12.1: Governance and regulation | 3.7 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 3.6 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 3.7 | 3.0 |
| **North Macedonia's overall score** | | **3.7** | **3.0** |

### Box 24.17. The EU's Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Cooperation of Energy Regulators – ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies as members of the Energy Community, whose *acquis* reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude, the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

## *State of play and key developments*

Overall, North Macedonia consumed around 30 TWh of energy in 2018 (Table 24.23), down from nearly 32 TWh in 2017. Driving this decline in gross inland consumption[146] was a decline in consumption from the commercial and household sectors. Most of the energy was consumed in the form of coal and oil and petroleum products.

Meanwhile gross electricity production rose slightly by 0.1% in 2018 to just above 5.6 terawatt hours (TWh). This slight increase hides an interesting development, which is that coal-fired generation declined by nearly 16%, and was replaced by renewable generation which expanded by nearly 52% to generate nearly 2 TWh. This growth was driven by hydrogeneration, which expanded 61% to 1.8 TWh in 2018, though wind fell by 4% to just under 0.1 TWh (Figure 24.14).

## Table 24.23. North Macedonia's energy balance (2018)

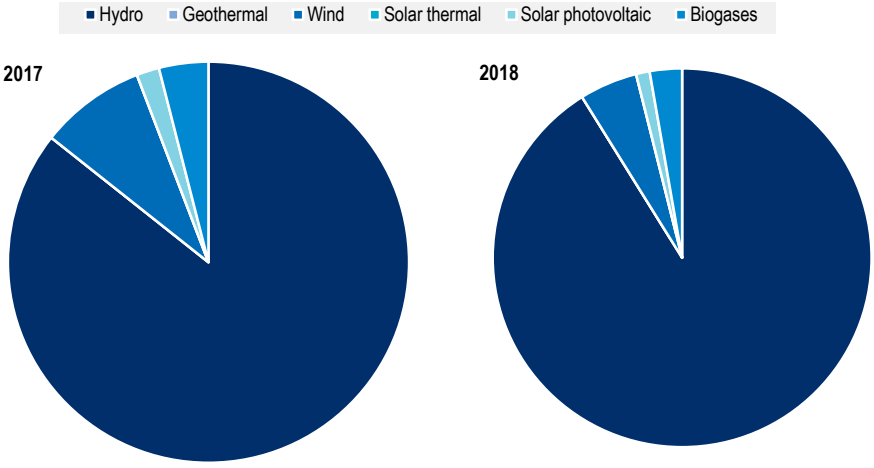
(GWh)

| | Total | Solid fossil fuels | Natural gas | Oil and petroleum products (excluding biofuel portion) | Renewables and biofuels | Electricity | Heat |
|---|---|---|---|---|---|---|---|
| **Primary production** | 13 180 | 9 305 | 0 | 0 | 3 875 | .. | 0 |
| **Imports** | 19 292 | 1 368 | 2 430 | 12 813 | 384 | 2 297 | 0 |
| **Exports** | 1 741 | 7 | 0 | 1 352 | 5 | 377 | 0 |
| **Gross available energy** | 29 910 | 9 743 | 2 429 | 11 556 | 4 263 | 1 920 | 0 |
| **Total energy supply** | 29 636 | 9 743 | 2 429 | 11 282 | 4 263 | 1 920 | 0 |
| **Gross inland consumption** | 29 910 | .. | .. | .. | .. | .. | .. |
| **Primary energy consumption** | 29 324 | .. | .. | .. | .. | .. | .. |
| **Final energy consumption** | 21 556 | .. | .. | .. | .. | .. | .. |
| **Transformation input - electricity and heat generation - energy use** | 12 776 | 8 739 | 1 918 | 151 | 1 967 | 0 | 0 |
| **Available for final consumption** | 21 547 | 1 004 | 504 | 11 108 | 2 285 | 6 105 | 541 |
| **Final consumption - non-energy use** | 586 | 0 | 0 | 586 | 0 | .. | .. |
| **Final consumption - energy use** | 21 282 | 1 324 | 504 | 10 522 | 2 285 | 6 105 | 541 |
| **Final consumption - industry sector - energy use** | 4 782 | 1 298 | 425 | 1 436 | 72 | 1 546 | 6 |
| **Final consumption - transport sector - energy use** | 8 182 | 0 | 8 | 8 161 | 1 | 12 | .. |
| **Final consumption - other sectors - energy use** | 8 317 | 26 | 71 | 924 | 2 212 | 4 548 | 535 |
| **Gross electricity production** | 5 607 | 2 848 | 746 | 47 | 1 966 | .. | .. |
| **Gross heat production** | 624 | 0 | 624 | 0 | 0 | 0 | .. |

Note: For general gross inland consumption please see Table 24.24 below.
Source: (Eurostat, 2021[204]), *Complete energy balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

## Figure 24.14. Gross renewable electricity generated by sources in North Macedonia (2017 and 2018)

(in %)




Source: (Eurostat, 2021[204]), *Complete energy balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

StatLink https://doi.org/10.1787/888934256159

### *Sub-dimension 12.1: Governance and regulation*

North Macedonia has made significant progress on its **energy policy and legislative framework** since the last Competitiveness Outlook assessment. With the adoption of the new Energy Law No. 08-3424/1 in May 2018, the economy has transposed a significant part of the Third Energy Package, and hence the Energy Community *acquis*. Some work remains to fully transpose and implement the package, including secondary legislation.[147] According to the Energy Community Secretariat, North Macedonia has transposed 58% of the Third Energy Package into national legislation, with a further 36% having been partially transposed. Implementation is only at 59% on average, although implementation in the power sector is well above 80% (Energy Community Secretariat, 2020[203]).

Most notably, North Macedonia adopted an energy strategy in December 2019 – the Energy Development Strategy 2040 (Ministry of Economy, 2019[205]). This provides clear guidance on the direction of the energy sector up to 2040, although an action plan for its implementation is still pending. North Macedonia was also the first contracting party of the Energy Community to finalise a draft National Energy and Climate Plan (NECP) and submit it to the secretariat for official review. The secretariat concluded that the draft provides a solid basis for the development of an ambitious final NECP. The adoption of the NECP is planned for the second half of 2021, which would pave the way for tackling the transposition of the Clean Energy Package, which reflects the EU's latest energy market improvements.

Furthermore, the relevant Network Codes are being or have been transposed.[148] Regardless of their national transposition status, Article 84(2) of the Energy Law does stipulate that the European Network of Transmission System Operators for Electricity (ENTSO-E) Network Code applies directly to North Macedonia.

North Macedonia's Energy Law and Electricity Supply Rules provide a clear approach to market opening and deregulation and all customers are free to select their suppliers at unregulated prices. More precisely, households and small consumers can freely choose their supplier with unregulated prices or opt to be supplied by the universal supplier at regulated prices.

In line with advanced energy policy, the **energy regulator**, the Energy Regulatory Commission (ERC), conforms with best practice in many areas. The regulator is designated by the 2018 Energy Law, in line with EU's Third Energy Package, as the sole national independent regulator. The independence of the regulator is enshrined in law. Moreover, the ERC has significant autonomy over its inner working and the

work packages it chooses to undertake. It has the power to start infringement procedures according to the provisions of the law, or other procedures in front of other competent state body, as well as to start a procedure for suspending or removing licences. ERC has extensive and clearly defined roles and responsibilities that are its exclusive purview. ERC also has extensive autonomy over the use of its financial resources, and the hiring and management of staff. The Energy Community Secretariat perceives ERC to be the best performing regulator among the WB6 regulators (Energy Community Secretariat, 2019[206]). In 2020, ERC maintained its place as the best-performing national regulatory authority in the Energy Community, together with the regulatory authority of Georgia.

Despite these positive findings, three issues affect the independence and the quality of work of the energy regulator:

1. **The selection of commissioners**[149] pursuant to Article 18 of the Energy Law. Although an independent board of experts preselects possible commissioner candidates, they are then filtered by the government before being presented to the parliament. This could lead to the selection of commissioners being politicised.
2. **The autonomy of the regulator over salaries**. Its staff salaries are tied to public salary conditions, which are subject to the influence of other agencies such as the State Audit Office. This could make it harder for the agency to offer a competitive salary for the sector, and hence retain employees.
3. **The human (and hence financial) resources at the disposal of the regulator**. Although ERC has sufficient resources to undertake its role today with great diligence and quality, it did highlight that it will need additional resources to maintain this quality as it takes on more roles and responsibilities.

North Macedonia has a clear vision and strategy for the **management of its energy infrastructure,** particularly with regard to its investment needs. This clear strategy arises from the existence of ten-year network development plans and the long-term strategy extending to 2040. In particular, the strategy considers the need for expansion in infrastructure subject to increasing integration of ever bigger volumes of renewable energy generation. There also appears to be extensive international donor community involvement in investment projects which could be seen as ensuring that investment projects are undertaken on the basis of international best practice. Moreover, there is a comprehensive collection of annual indicators.

The planned investment projects and studies seem to be on track, including the main transformer in substation Bitola 2, which connects MEC Bitola thermal power plant to the grid, the installation of optical ground wire on the transmission network, the strategy for the reconstruction/revitalisation of the transmission network, and the study into the effects of plug-in electric vehicles on the transmission grid. Some projects are experiencing delays, however, the delayed projects are clearly identified and information on delayed projects is publicly available in the Ten-Year Network Development Plan[150] of the Electricity Transmission System Operator of the Republic of North Macedonia (MEPSO). Indeed, the transparency extends to providing a detailed explanation for the delays and highlighting the adjustments to the 10-year plan. MEPSO states that “the rate of progress of the projects is on a satisfying level with certain delays, firstly because of the complex administrative procedures and adjustments to the local spatial and sociological conditions” (MEPSO, 2019[207]).

However, there are a few issues to consider. The first is that North Macedonia apparently does not fully comply with some of the Energy Community *acquis* (lack of transposition and implementation of regulations on guidelines for trans-European energy infrastructure[151]), although the adoption of the Law on Strategic Investments in 2020, and its amendment planned for 2021, aim to solve this issue. Second, there is no proper assets management system in place for infrastructure projects, as specified by the government. This lack of an appropriate system is particularly important given the age of the existing infrastructure, and thus the need for maintenance and modernisation.

*Sub-dimension 12.2: Security of energy supply*

When considering security of supply on the basis of a diversified energy mix and sources of supply, North Macedonia's **natural gas supply framework** has some way to go. Natural gas accounts for less than 10% of gross inland consumption – in line with the WB6 average but below the EU average – while coal accounts for around one-third of consumption – lower than the WB6 but well above the EU average (Table 24.24). This suggests there is still significant potential for gasification. Natural gas imports are still heavily reliant on just one source and are associated with oil index contract pricing, which implies that prices do not necessarily reflect the economic realities of the natural gas market (for a wider exposition, see the endnote[152]). However, efforts are underway to interconnect with Greece and thus to tap into the Trans-Adriatic Pipeline for natural gas supplied via the Shah Deniz project from Azerbaijan.

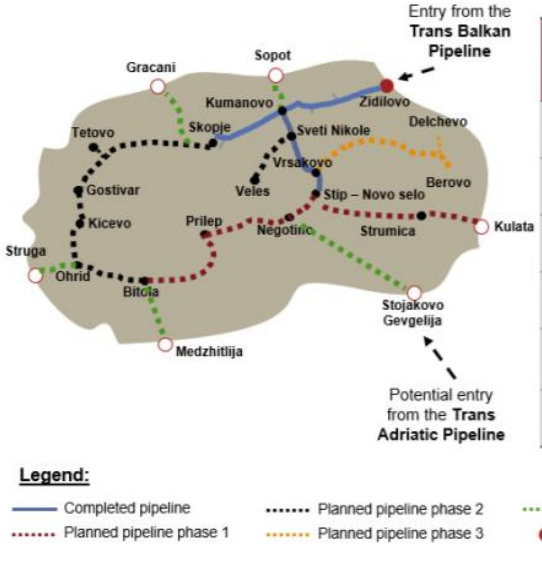
## Table 24.24. Energy consumption (2018)

| Gross inland consumption | North Macedonia | | Western Balkans | | European Union | |
|---|---|---|---|---|---|---|
| | TWh | % | TWh | % | TWh | % |
| Total | 29.9 | | 367.4 | | 17207.6 | |
| Solid fossil fuels | 9.7 | 33% | 170.2 | 46% | 2446.7 | 14% |
| Natural gas | 2.4 | 8% | 29.9 | 8% | 3777.3 | 22% |
| Oil and petroleum products (excluding biofuel portion) | 11.6 | 39% | 102.1 | 28% | 5859.8 | 34% |
| Renewables and biofuels | 4.3 | 14% | 68.7 | 19% | 2587.4 | 15% |

Note: TWh: terawatt hour.
Source: (Eurostat, 2021[204]), *Complete energy balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

Nonetheless, the natural gas supply framework is driven by the strategy to expand the natural gas infrastructure, gasification and ultimately the diversification of supply, as well as promoting regional interconnection. Figure 24.15 shows the planned natural gas infrastructure projects.

## Figure 24.15. Planned natural gas infrastructure projects in North Macedonia




| Interco-nnector | Section | Length (km) | Technical capacity (000 m³/h) | Expected completion | Value (mil. EUR) |
|---|---|---|---|---|---|
| MK - GR | Negotino - Stojakovo | 68-70 | 326 | 2022 | 51.2 |
| MK - GR | Bitola - Medzhitlija | - | - | - | - |
| MK - RS | Klechovce - Sopot | 23 | 160 | after 2022 | 16 |
| MK - KV | Matka - Gracani | 16 | 236 | after 2022 | 16 |
| MK - AL | Ohrid - Struga - Kafasan | 27 | 248 | - | - |
| MK - BG | Strumica - Kulata | - | - | - | - |

Source: (Ministry of Economy, 2019[205]), *Strategy for Energy Development of the Republic of North Macedonia up to 2040*, www.economy.gov.mk/Upload/Documents/Adopted%20Energy%20Development%20Strategy_EN.pdf.

The **electricity supply framework** is rapidly becoming advanced. North Macedonia intends to phase coal out of its electricity generation mix, supported by the intended introduction of a carbon market. Although North Macedonia does not have a current greenhouse gas pricing mechanism, its Energy Development Strategy 2040 foresees the "introduction of carbon price and its convergence to the ETS level" (Ministry of Economy, 2019[205]). North Macedonia plans to introduce this progressively: starting with direct taxation of

$CO_2$, then introducing requirements equivalent to the European Union Emission Trade Scheme (EU ETS), and finally joining the scheme on accession to the EU. So although North Macedonia cannot participate in the EU ETS at this stage, it does plan to undertake certain preparatory steps. These will include: mapping the installations that fall under the European Union Emission Trade Scheme and defining the scope of the scheme; arranging the allocation of allowances through designating authority and defining procedures; and designing auction platforms with built-in safeguard arrangements. It will also need to address the monitoring, reporting and verification of emissions both within the scope of deploying the tax and prior to joining the European Union Emission Trade Scheme.

However, there are some issues with regard to the electricity supply framework. Most importantly, there is some uncertainty about how far the supply framework is guided by action plans and strategies. The second key concern is that the EU regulation on risk-preparedness in the electricity sector[153] has not been transposed. Though it is not part of the Energy Community *acquis*, it offers benefits for planning and executing a safe and stable electricity framework. Finally, there is a need to raise public awareness of the purpose and need for greenhouse gas emission reductions and possibly pricing.

In the area of **renewable energy,** North Macedonia is in the process of deploying a system that reflects international best practice. One of the key pillars and strategic goals of the newly adopted Energy Development Strategy 2040 is to strongly increase the share of renewable energy sources to 35-45% of gross final energy consumption by 2040 from the current level in a sustainable manner. It is worth noting that this strategy was expected to be supplemented by the adoption of the National Energy and Climate (Action) Plan towards the end of 2020. According to the responses to the OECD questionnaire in 2020, this will provide a national renewable energy action plan, with targets and plans for its development. Moreover, the strategy is being supplemented by technical studies into renewable energy potential and the integration of renewable energy into the system. North Macedonia has also begun to use competitive renewable energy auctions for allocating commercial wind and solar projects, combined with a switch from feed-in tariffs (FiTs) to feed-in premiums (FiPs) (Box 24.18). Finally, it should be stressed that, in line with the latest developments in the European Union, North Macedonia promotes “prosumers”[154] through the guaranteed right to sell excess energy.[155]

### Box 24.18. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated independent of the electricity market price (Banja et al., 2017, p. 15[208]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (CEER, 2018, p. 12[209]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (EC, 2013, pp. 12-13[210]). The latter has been a problem especially as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (EC, 2013[210]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable

energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (EC, 2013, p. 8[210]).

The European Commission suggests using a feed-in premium scheme in combination with the following good practice recommendations (EC, 2013[210]):

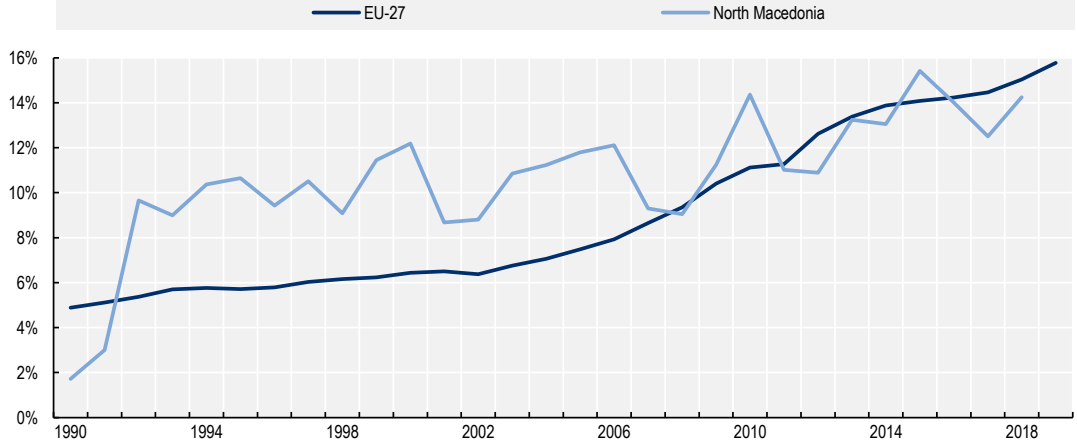
- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable project and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

However, the Council of European Energy Regulators reports that in 2016/17, 17 of the 27 European Union member countries still used some form of feed-in tariff, although mainly for small projects, while around 16 used feed-in premiums, including to complement feed-in tariffs (EUR-LEX, 2014[211]).

For further and more detailed exploration of renewable energy subsidies and best practice please see the sources below. Meanwhile, for more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.

Source: (Banja et al., 2017[212]), *Renewables in the EU: An Overview of Support Schemes and Measures*; CEER (2018[209]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017: Public Report*, www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (EC, 2013[210]), "European Commission guidance for the design of renewable support schemes", https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (EUR-LEX, 2014[211]), Communication from the Commission: Guidelines on State Aid for Environmental Protection and Energy 2014-2020, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

## Figure 24.16. Renewable energy as a share of gross inland consumption (1990-2018)




Source: (Eurostat, 2021[204]), *Complete energy balance*, https://ec.europa.eu/eurostat/web/energy/data/database.

StatLink https://doi.org/10.1787/888934256178

Despite this, renewable energy still only accounts for a small share of power generation; coal dominates, with a share of nearly 70% of the fuel mix. Overall, renewable energy accounts for about 15% of gross inland consumption, just marginally above the EU average of 14%. However, while the EU's share has been growing steadily by around 3.1% per annum since 2002, North Macedonia has shown only limited

growth (Figure 24.16). Most of its renewable energy is derived from hydrogeneration, which is subject to hydrological variations. Overall, renewable energy accounted for around 40% of North Macedonia's installed power generation capacity in 2018, with hydro accounting for 91%, at 674 MW. This is despite wind and solar offering substantial potential. Together they account for around 71% of the combined utility-scale wind, solar and hydro potential in North Macedonia. This is well above the WB6 average, where wind and solar account for around 66% of the potential (IRENA, 2019[213]).

Therefore, the most pressing issue for renewable energy in North Macedonia is promoting its attractiveness for renewable energy investment. First, although it has a FiP approach, to make it fully operational North Macedonia requires a functioning day-ahead market (DAM) to provide the appropriate baseline price. Second, while significant progress has been made in simplifying the administrative process for implementing renewable energy projects, a further reduction and simplification is possible,[156] which would support further investment in renewable energy by easing the administrative burden.

One consideration would be to transform its Guarantees of Origin (GOs).[157] While the current approach in North Macedonia to issuing GOs is compliant with the Third Energy Package, it does not conform with the Clean Energy Package.[158] Its restrictions on the issuing of GOs to renewable projects not receiving state aid limits the market value of renewable energy project that do and hence increases the burden on the government budget from subsidies.

The Law on Energy establishes the promotion of **energy efficiency** as one of the energy policy objectives for North Macedonia. However, the key legal act is the new Law on Energy Efficiency (adopted in February 2020), which transposes the relevant EU directives.[159] According to the Energy Community Secretariat, this law sets new best practice standards in the Energy Community (Energy Community Secretariat, 2019[206]). Meanwhile, the Energy Development Strategy 2040 is currently the main strategic document that outlines a vision for energy efficiency in North Macedonia.

Despite these positive steps, North Macedonia still needs to implement the secondary legislation arising from the newly adopted laws. This includes the government decree setting the energy efficiency targets, and the Fourth National Action Plan on Energy Efficiency, as well as secondary legislation on minimum energy performance requirements of buildings, the national calculation methodology, the energy performance certification of buildings, and the inspection of heating and air-conditioning systems. Finally, regarding energy labelling, the current by-law is aligned with EU Directive 2010/30/EU and so it will need to ensure compliance with EU Regulation 2017/1369 Setting a Framework for Energy Labelling and Repealing Directive 2010/30/EU.

The various state and local public entities with responsibility for energy efficiency have quite limited capacity; this urgently needs to be increased. The key authorities are the Ministry of Economy and the Energy Agency. These institutions are heavily under capacity in the number of employees and their expertise. According to the Energy Community Secretariat the significant deficiency in human resources has led to issues with the adoption and implementation of the relevant secondary legislation, despite the technical assistance available (Energy Community Secretariat, 2020[214]).

### *Sub-dimension 12.3: Energy markets*

Since the last Competitiveness Outlook, North Macedonia has made significant progress in creating an EU-style **energy market**. The positive steps include the liberalisation and price deregulation of the wholesale and retail markets, including the right to choose supplier and switching; and the integration of transparency and non-discrimination principles into the market. The universal supplier was chosen based on a competitive process, and the universal supplier is required to acquire the electricity it needs openly from the wholesale market. The balancing market is active with MEPSO procuring balancing services based on competitive principles.

However, there remain some key issues to tackle in order to complete the liberalisation of North Macedonia's energy market. The Law on Energy does stipulate a range of secondary legislation and regulatory acts. While most have been adopted, some of the acts remain outstanding. For example, the Energy Community Secretariat reported that the Rules for the Operation of Organized Markets, which are required under Article 90 Paragraph 2 of the Energy Law, have not yet been adopted[160] (Energy Community Secretariat, 2020[214]).

The other issue is the operational deployment of an organised electricity market. More precisely, Macedonian Electricity Market Operator (MEMO), a spin off from MEPSO, was licensed in 2019, pursuant to Article 68 and 88 of the Energy Law, to be the market operator, and, pursuant to Article 90 of the Energy Law, designated as the Organised Electricity Market Operator in 2020. However, the operational deployment of a day-ahead market is still pending subject to MEMO acquiring the associated DAM services, including a trading platform, internal clearing and settlement processes, organised electricity market rules (drafted by MEMO and approved by ERC), and relevant agreements with participants.

Similarly, there is no trading point for natural gas. Although the natural gas market is liberalised and prices are deregulated, the wholesale market lacks liquidity. This largely reflects North Macedonia's limited interconnectivity, and that its natural gas is exclusively sourced from Russia and imported via Ukraine, Moldova, Romania and Bulgaria.[161] Natural gas consumption is mainly driven by a few large customers, with negligible household consumption.[162] This largely reflects a lack of distribution network, although as discussed above, this is something North Macedonia is currently working on.

Finally, while North Macedonia does recognise licences issued by other Energy Community members, it does have a seat requirement for foreign traders and suppliers.[163] While not a major issue, the removal of such a seat requirement would lower the bar for new market entries from abroad and increase competition.

Meanwhile, when considering **unbundling** as per the Third Energy Package, North Macedonia is once again well advanced. The electricity transmission system operator (TSO) and distribution system operator (DSO) have been unbundled and compliance officers are active. However, the situation is less advanced in the natural gas sector, where the TSO is not unbundled.[164]

**Third party** access is enshrined in the legislation and regulation of both the electricity and the natural gas sectors, although some regulations need to be updated.

North Macedonia's **regional market integration** requires significant improvement. Interconnection capacity for electricity is allocated in conformity with Energy Community rules, whether bilaterally or using SEECAO, but North Macedonia has not implemented any market coupling with any of its neighbours, largely reflecting the lack of a day-ahead market. On the natural gas side, the sole interconnection point for natural gas is not being operated in conformity with the European Union Regulation 703/2015 Establishing a Network Code on Interoperability and Data Exchange Rules.[165] However, the greater issue is the lack of other interconnectors, although work to increase the number is ongoing, with North Macedonia working on building an interconnector with Greece.

Overall, these issues suggest that the potential for energy imports – and thus regional integration – is not being fully used, thus failing to reap the benefit it could offer in terms of liquidity and competitive pressures. More precisely, while the electricity interconnection capacity is efficiently allocated using competitive assignment, the lack of market coupling means that flows are not optimised based on efficient, transparent, and automatic matching algorithms between supply and demand in North Macedonia and its neighbours and thus the full benefit of trade flows is not being harnessed. In the case of natural gas, it is not just the lack of market coupling, but also the fact that interconnector capacity is not efficiently and transparently used based on best practice for the single interconnector in place.[166]

*Cross-cutting sub-dimension: Energy incentives – direct and indirect subsidies in the energy sector*[167]

Direct and indirect subsidies do not appear to be significant in North Macedonia's energy sector.

### *The way forward for energy policy*

While North Macedonia has made significant strides in energy policy, it should consider the following recommendations for improvements:

- **Finalise the transposition and implementation of the Third Energy Package**. This should help deploy international good practice and standards and provide clear and competitive policy guidance to the sector. Additionally, North Macedonia should consider starting to transpose the EU's Clean Energy Package, the latest attempt to improve the competitiveness and sustainability of the EU energy market.
- **Expand the human resources for key institutions**. Although the regulator is currently well staffed, as the market becomes increasingly competitive it will need the capacity to take on additional roles and tasks. These should also be accompanied by staffing increases in key institutions involved in governing and deploying energy efficiency, as this sector also needs to be strengthened. Significant aspects of the governance and implementation of energy efficiency measures remain outstanding, largely due to lack of staff (Energy Community Secretariat, 2020[203]). Energy efficiency has the potential to significantly reduce the impact of energy costs on the competitiveness of the economy by reducing the need for energy overall. For a more comprehensive analysis of the benefits of energy efficiency please see (IEA, 2019[215]).
- **Transform the Guarantee of Origin certification to allow more renewable energy generators to apply for it**. This should allow renewable generators to market their electricity to higher-paying customers and in turn make renewable energy investments more attractive. This could also provide financial support for the state budget by reducing subsidy costs and thus allow the state to support wider range of renewable projects. Good examples include France and Luxembourg, where auctions of GOs are performed on behalf of the state for renewable energy generated with state support. In the case of Luxembourg, the income flow is used to reduce the public cost of its renewable support scheme.
- **Deploy power exchanges for natural gas and electricity**. This should support the market coupling and integration of the natural gas and electricity sector. Both of these would allow the market prices to be used as benchmarks for renewable generation support schemes or to reduce the reliance on oil-index natural gas imports. For example, Albania, together with Kosovo, has deployed a power exchange which is expected to be operational soon.
- Moreover, North Macedonia, given the size of its market, should urgently **seek further market integration and market coupling** to ensure market liquidity and in turn robustness against market manipulation by key stakeholders. This will also improve the value-add optimisation of the energy market through increased international competition.

## Environment policy (Dimension 13)

### *Introduction*

North Macedonia has improved its performance in the environmental policy dimension, increasing its overall score from 1.8 in 2018 to 2.3 in the current assessment. This progress places North Macedonia in second place among the WB6 economies, with its scores for the resource productivity and environmental quality of life sub-dimensions matching the regional average, while it scores above average for the natural asset base sub-dimension, in particular thanks to important advances in its biodiversity and land-use frameworks (Table 24.25).

**Table 24.25. North Macedonia's scores for environment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 12.1: Resource productivity | 2.0 | 2.0 |
| | Sub-dimension 12.2: Natural asset base | 2.5 | 2.1 |
| | Sub-dimension 12.3: Environmental quality of life | 2.3 | 2.3 |
| **North Macedonia's overall score** | | **2.3** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 13.1: Resource productivity*

North Macedonia is a Non-Annex-I signatory to the United Nations Framework Convention on Climate Change (UNFCCC) and its Paris Agreement and is party to the Kyoto Protocol. As such it has been undertaking regular activities to reduce greenhouse gas emissions and limit global warming. It has set emission reduction targets (82% of 1990 emission levels by 2030) and has also determined emission objectives for the energy, industry, agriculture, forestry and waste sectors. It has a publicly available GHG inventory. Nevertheless, around 60% of total carbon dioxide ($CO_2$) emissions in North Macedonia in 2016 were as a result of electricity generation and heat production, while 21.5% came from transport (MEPP, 2020[216]).

North Macedonia has made some improvements since the last assessment to its **climate change mitigation and adaptation** legislative and policy frameworks. The new Law on Energy, adopted in May 2018; its by-laws on renewable energy sources; and a Law on Energy Efficiency, adopted in February 2020, all contain climate change mitigation measures – see Energy policy (Dimension 12) for more information. These measures mainly relate to the energy sector (the introduction of energy efficiency obligation schemes, an increase in solar rooftop power plants and biomass power plants installations, etc.) given its major contribution to the economy's $CO_2$ emissions. As a result of a slow transition to renewables, however, in 2017 the government had to revise down its renewable energy target, from 28% of gross final energy consumption in 2020 to 23.9% (UNECE, 2019[217]). Progress has been made in aligning legislation with the EU *acquis*, in particular establishing GHG monitoring and reporting mechanisms. The new Law on Climate Action was being prepared at the time of drafting, and is intended to harmonise the economy's legal framework with the EU Emissions Trading System (ETS).

North Macedonia was preparing a long-term strategy on climate action – up to 2050 – at the time of writing. This will consider introducing a carbon tax as a measure to reduce GHG emissions. The Energy Development Strategy (adopted in December 2019) and the draft National Integrated Energy and Climate Plan until 2030 (expected to be adopted in March 2021) represent the other main strategic documents in this area. North Macedonia is the first contracting party in the Energy Community to integrate the pillars of energy and climate in its national energy strategy (EC, 2020[46]). Its energy, transport and industrial strategies also all contain specific climate change mitigation actions. As a UNFCCC signatory, North

Macedonia prepares regular biennial update reports,[168] which are the only monitoring mechanisms in this area.

Some progress has been made in climate change mitigation since 2017. The major climate-related risks were identified in a study prepared in 2020. The revision of the methodology for the National Spatial Plan (2020-40), which started in 2020, aims to integrate climate aspects into spatial planning preparation. Measures such as flood and drought risk management are being implemented, mostly through international projects.[169] However, no flood hazard and flood risk maps (which represent the basis for flood risk management) have been created (UNECE, 2019[217]).

Limited progress has been made towards achieving a **circular economy** in North Macedonia. Recycling rates remain extremely low: less than 1% of solid waste is recycled and almost 99% goes to landfill (Eurostat, 2020[218]). On a positive note, recycling of packaging waste has been constantly increasing, from 27.08% in 2014 to 47.21% in 2018, despite limited economic incentives to promote recycling and waste prevention (MAKStat, 2020[219]). A number of bodies are responsible for waste management[170] and thus the circular economy but, according to the government, there are issues with communication, and efficient co-ordination mechanisms are largely lacking. Lack of staff and financial resources among these bodies impede the implementation of measures. These are recognised issues which the government intends to tackle in its revision of the National Waste Management Strategy (2016-20) in 2021.

On the legislative side, the new Law on Waste, which was being prepared at the time of writing, addresses the circular economy and secondary raw materials and is fully harmonised with the EU *acquis* in this area.[171] The new Law on Food Waste was also being prepared by the agriculture ministry, which represents a good step forward in acknowledging this particular issue. Since the last assessment, the government has drafted the National Waste Management Plan 2020-30 and the National Waste Prevention Plan 2020-26 (which was planned to be adopted at the time of drafting), which also contain measures related to the circular economy.

North Macedonia currently generates 456 kg of municipal waste per capita. While this is less than the EU average (492 kg per capita in 2018), the amount has been increasing constantly since 2014 (Eurostat, 2020[220]). According to the government, the overall **municipal solid waste management legislative framework** has gaps and contradictions compared to EU directives, although the majority of directive obligations have been transposed to some extent. The laws and regulations do not provide the required clear and concise regulatory framework, which results in poor and ineffective implementation. There have been no reports on the implementation of the previous National Waste Management Strategy, nor on the progress made towards its targets. The process of establishing an integrated regional system for waste management continues to face delays due to insufficient administrative and financial resources, and it suffers from lack of ownership (EC, 2020[46]).

Waste collection and treatment infrastructure remains heavily dependent on donor funds, which impedes regular maintenance. Waste collection and treatment services are funded from the waste collection fees. Only some municipalities sort waste, and then not in an effective manner. According to the government, measures to combat unregulated burning and illegal dumping of waste are the responsibility of local inspectorates. The law includes sanctions for unregulated burning and illegal dumping of waste and there is a mechanism for the citizens to report such actions. According to local stakeholders, enforcement can be rather sporadic and is limited due to few citizens knowing about the reporting mechanism.

### *Sub-dimension 13.2: Natural asset base*

North Macedonia has 3 040m$^3$ of available water per head per year, which makes it relatively rich in water.[172] Water demand from agriculture and industry tends to fluctuate over the years, while household demand has shown a constant increase (UNECE, 2019[217]; World Bank, 2020[221]). One significant pressure on the water supply relates to losses in the system, which range from 40% to 65% of the system input (UNECE, 2019[217]). Another key concern in this area is water pollution, as a result of an insufficiently

treated industrial and municipal wastewater – see Sub-dimension 13.3: Environmental quality of life for more information.

As in the previous assessment, the basic legal act in the field of **freshwater management** is the Law on Waters (2016). The main change that has taken place since 2017 relates to the adoption of the Law on Setting the Prices for Water Services, which takes into consideration not only the cost of water usage but also pollutants released into water, thus indirectly contributing to improving the quality standards and reducing water pollution. There is a system for prior regulation and/or specific authorisation for water extraction from ground water and/or from surface waters. A river basin management system has been developed and co-operation with neighbouring countries in this area has been established, although this co-operation needs to be renewed. There have not been any changes to strategies since the last assessment, except for the management plans of the Ohrid Basin watershed, Strumica river basin and the Vardar river basin, which have been prepared. In general, the implementation of the National Water Strategy (2012-42) remains quite limited: no implementation reports were ever prepared, although some reports (on the state of environment or parts of the sustainable development-related strategies) contain an overview of the situation relating to water. Data and projections on water demand from agriculture, industry (including energy) and households are not available and so cannot be used to guide decisions about handling competing uses now or in the future.

A number of bodies are responsible for water management in North Macedonia, but they lack financial and human resources to fulfil their roles and there have only been sporadic capacity-building activities to tackle this. The main vertical co-ordination tool is the National Water Council, a counselling body, whose three-year mandate is expected to start at the time of writing.

North Macedonia's **biodiversity and forest management framework** has advanced since the last assessment, with major change being the adoption of the National Strategy for Nature Protection and Action Plan (2017-27) and the National Biodiversity Strategy and Action Plan (2018-23). The new Law on Nature was also being prepared at the time of drafting, which aims to fully transpose the EU Habitats and Birds directives.

In terms of measures implemented, the first complete national red list of threatened species was adopted in 2019, identifying which native species are threatened by extinction. Management plans for three protected areas have been prepared and five natural rarities have been proclaimed since the last assessment. However, no implementation reports have been produced so far (except those stemming from the reporting on the Aichi biodiversity targets[173]), the methodology for monitoring the state of the natural environment has not been developed and no monitoring system has been established across the economy. According to the National Biodiversity Strategy, a monitoring system for biological diversity is planned for the period 2020-23. The Aichi Biodiversity Target 11, which stipulates 17% of total land area to be protected, is unlikely be attained. Even if the measures to extend the national protected area network contained in the spatial plan were fully implemented in 2020, protected areas would only account for 11.61% of North Macedonia's territory (UNECE, 2019[217]).

A number of government bodies regulate this field, but their human and financial resources remain inadequate to execute their main responsibilities. As a result of this deficiency, a National Biodiversity Information System, established in 2011 at the Ministry of Environment and Physical Planning, which includes a national biodiversity database, stopped operating in December 2018.

Forests make up around 40% of North Macedonia's total land area, which is the WB6 average (World Bank, 2020[221]). No national forest inventory has been carried out recently (the last one dates back to 1979) and there is no system in place for systematic monitoring of the forests. The Strategy for Sustainable Development of Forestry (2006-26) is incorporated in the new Law on Forests. This law regulates and foresees measures to prevent forest fires, as well as illegal logging, for which strict sanctions are envisaged (fines, imprisonment and confiscation of means and items). Although it is difficult to measure anthropogenic impact and pressures in the absence of forest inventories and biodiversity monitoring programmes, the

pressures on species and ecosystems from forestry operations and illegal logging do not seem to be significant in North Macedonia (UNECE, 2019[217]). In particular, no deforestation is occurring, as the total area of forest actually increased slightly from 2011 to 2019. What illegal logging there is usually takes place close to human settlements so the scope for the disturbance of forest habitats is possibly limited (UNECE, 2019[217]).

The **land-use management framework** in North Macedonia has further advanced since 2017. Major changes in the legislative framework relate to the adoption of the Law on Urban Planning at the start of 2020, and the draft Law on Spatial Planning (initially planned to be adopted until 2020, but postponed to 2021 due to the COVID-19 pandemic). The old National Spatial Plan (2004-20) was being updated and upgraded to the new National Spatial Plan (2020-40) at the time of drafting. Comprehensive annual implementation reports have been regularly prepared, based on the questionnaires submitted by local governments, public enterprises, organisations, institutions and other legal entities. An efficient inter-institutional co-ordination in this area has been noted, although all the responsible bodies lack staff and funds, impeding the implementation of plans. The key indicators related to land-use management are not collected regularly and they are neither georeferenced nor harmonised across government bodies such as property tax and forest management.

### *Sub-dimension 13.3: Environmental quality of life*

**Air quality** in North Macedonia seems to have improved over the last 10 years,[174] but the economy still has one of the highest concentrations of air pollution in Europe. In particular, there are high concentrations of particulate matter ($PM_{2.5}$) in winter months (widely exceeding national limits as well as those set by the WHO and the EU). Annual mean exposure to $PM_{2.5}$ is 33 micrograms per cubic metre (μg/m$^3$), which is more than three times the WHO recommended highest levels (10 μg/m$^3$). These are also much higher than the EU (13.1 μg/m$^3$) and OECD averages (12.5 μg/m$^3$) and the highest in the WB6 region (average of 25.77 μg/m$^3$) (World Bank, 2020[221]; OECD, 2020[222]). High concentrations of carbon monoxide (CO) indicate that burning of fuelwood presents a significant threat to air quality. Elevated concentrations of nitrogen oxides ($NO_x$) in the capital city Skopje, show that the city's traffic is another important issue for air quality (Government of North Macedonia, 2018[223]).

North Macedonia has continued its efforts to harmonise its national legislation with the EU *acquis*. In terms of strategies, the Plan for Clean Air (2019-20) and the 2019 and 2020 Programmes for Air Quality Improvements have been developed since the last assessment and have been regularly implemented. The main objectives of these programmes are to raise public awareness about the need for air quality improvement and to reduce PM emissions, primarily through the introduction of energy efficiency measures in households and public buildings. These are the most critical pollutants in North Macedonia according to the National Emission Inventory.[175]

The 2019 air quality programme was developed by the Ministry of Environment and Physical Planning (MoEPP) as part of the Plan for Clean Air. It had a budget of MKD 121 million (about EUR 1.95 million) to finance measures to reduce air pollution both locally and nationally. These included the replacement of existing heating systems in households, kindergartens, and primary and secondary schools; increases in energy efficiency; the procurement of air purifiers; and the expansion of kindergarten green areas. It also included the development of a web platform to monitor these measures. The programme for 2020, with a budget of MKD 100 million (around EUR 1.6 million), involved public calls for very similar activities to the 2019 programme. Although both programmes have been successful so far, further efforts are needed as insufficient co-ordination between central and local authorities and weak inter-sectoral co-operation are limiting the implementation of air quality measures (EC, 2020[46]). Few cities have prepared an air quality plan and the pace of their implementation should be increased (EC, 2020[46]).

Air quality is monitored regularly in North Macedonia with real-time data available on the national air quality web page. Air pollution emission monitoring is provided both continuously (through automatic all-day

monitoring systems set up for real-time data production) and periodically, and the type of monitoring is prescribed in the integrated environmental permits for each monitoring station. There are 17 permanent air quality monitoring stations across the territory. According to the government, active efforts are being undertaken to replace obsolete measuring instruments and assure the quality of monitoring. In the period 2018-20, North Macedonia replaced five measuring instruments and installed 24 new ones, the majority of which were still being tested at the time of drafting. The government plans to introduce a new monitoring station (Gevgelija), and replace more obsolete instruments in the next period. However, local stakeholders report a lack of regular maintenance of stations and note that they could be better positioned to measure the real impact of emissions and detect pollutants.

At the time of drafting, North Macedonia was working on establishing a national environmental information system to gather environmental data, including on air pollution, housed in one central database. The government reports that it ensures immediate action if the air pollution limit values ($PM_{10}$) are exceeded by setting alarm thresholds which trigger short-term measures, such as free public transport or more frequent inspections. However, this mechanism is rather ad hoc and there is an increased demand from the public for immediate and stricter measures against air pollution (EC, 2020[46]).

Management of the **water supply and sanitation system** remains undeveloped. Water pollution is one of the key challenges in this area, as a result of an insufficiently treated industrial and municipal wastewater. This has become of even greater concern during the COVID-19 pandemic as the deterioration of environmental health through poor water management and sanitation is expected to increase the vulnerability of communities to the virus (OECD, 2020[222]). Other than the regional sewerage systems to protect Lake Ohrid, Lake Prespa and Lake Dorjan, only 12 cities have constructed separate sewerage systems. There were only 24 wastewater treatment plants (WWTPs) operating in 2019, representing 24.5% of the required capacity (UNECE, 2019[217]). Appropriate wastewater treatment is lacking even in the sewerage systems in place for Lake Ohrid and Lake Prespa, both key tourism destinations (UNECE, 2019[217]). Skopje still lacks a WWTP and all wastewater is discharged untreated into the River Vardar. The government is planning to build a WWTP in the capital city – a donor-financed project was started in 2020, but has been delayed by the COVID-19 pandemic. Additional investments in WWTPs are planned, but the timeline is not yet established. The growing challenges related to water treatment, such as the need to treat contaminants of emerging concern, are still not taken into consideration when upgrading facilities.

According to the government, funds for water management and development are provided from the state and local budgets, fees[176] for water use, and international and European funds. Funds for the construction and maintenance of water supply and sewerage systems are provided from the water tariffs (for water supply and drainage service) as well as fees for connections to water supply and sewerage systems. There have not been any changes in the level of water tariffs since the last assessment.

As mentioned above, the legislative framework was amended in 2017 with the adoption of the Law on Setting the Prices for Water Services. This is represents the main legal act in this area and is almost fully aligned (95%) with the EU *acquis* for wastewater management. In 2017, the government conducted a National Water Study on the investment framework for implementing projects for water supply and wastewater treatment, in accordance with the requirements of the relevant EU directives. The results of the study were taken into account in the projections of IPA III projects related to water infrastructure.

Some measures have been taken to decrease water losses from the system (mostly through the changes in legislative framework) but it still represents one of the main concerns in this area, as the losses in general range from 40% to 65% of the system input (UNECE, 2019[217]).

No major changes have been recorded in the **industrial waste management** legislative and policy frameworks since the last assessment. At the time of drafting, the National Waste Management Plan 2009-15 was being replaced with the new National Waste Management Plan 2020-30 and the National Waste Management Strategy 2008-20 with the draft National Waste Management Strategy 2020-30. There is very limited information about the implementation of these past plans: according to information received through

the government's self assessment, only one contaminated "hot spot" site – the old industrial landfill around the smelter in the city of Veles – has been rehabilitated and the slag from the industrial landfill has been exported. No monitoring or evaluation has been conducted in this area.

There is an official register of chemicals that are on the market, as well as classification, packaging and labelling rules for chemicals. The Pollutant Release and Transfer Register protocol has been ratified. As regards managing and controlling industrial risks and accidents, the Seveso-III directive (Directive 2012/18/EU) has been fully transposed in the Law on Environment. No hazardous waste disposal facilities exist and toxic waste is being exported.

There is no policy or legislative basis for soil protection, but provisions for soil protection (identification and management of contaminated sites) will be set in the amendments to the Law of Environment, which was in the process of being adopted at the time of drafting.

### *The way forward for environment policy*

Since the last assessment, North Macedonia has made progress in several policy areas, such as climate change, biodiversity and forestry. It should now concentrate attention on the following points:

- **Involve all stakeholders in making the implementation of a circular economy a reality.** North Macedonia has made some progress in developing the legislative and policy framework for a circular economy. Effective implementation will require a whole-of-government approach with collaboration by the relevant ministries to steer the transition to a circular economy. The government should also establish a platform for wider co-operation among businesses, financial institutions and other stakeholders. North Macedonia should also consider encouraging best practice exchanges between municipalities by helping local government associations or environmental NGOs to develop guidelines, training and initiatives to recognise best practice (see Box 24.19).
- **Improve the wastewater system:**
  - **Increase the number of wastewater treatment plants**. Despite some newly constructed WWTPs, most wastewater in North Macedonia ends up untreated in rivers, resulting in high pollution levels. Only 25% of necessary WWTPs have been built and the existing ones are not maintained regularly. New investment in WWTPs is needed, financed mainly from the domestic budget and water tariffs.
  - **Apply the water-user and polluter-pays principles for all water users and dischargers**, paying attention to the vulnerable social groups in North Macedonia, and ensure regular maintenance of the existing water supply and sanitation network.

### Box 24.19. Building a circular economy in Hungary

Several non-government initiatives have addressed the circular economy in Hungary. The Hungarian Cleaner Production Centre of the Corvinus University of Budapest is involved in international and European projects to promote best practice on resource efficiency and cleaner production. The National Industrial Symbiosis project co-funded by the EU LIFE+ Environment programme helped Hungarian industries develop industrial symbiosis approaches where the waste or by-products from one industry become the raw materials for another. Over the period 2009-12, the Industrial Development Co-ordination Agency collaborated with a UK-based platform to encourage industrial symbiosis in the central region of Hungary. The three-year National Industrial Symbiosis project built capacity among Hungarian businesses and set up an industry network through a series of workshops and site visits. Thanks to the project, around 1 200 tonnes of industrial waste were diverted from landfill and used in various industrial processes. The following three-year project, Transition Regions towards Industrial Symbiosis (2016-19) aimed to integrate industrial symbiosis practices into regional policy instruments by disseminating good industry practice. As part of the project, the Hungarian company Clean Way developed an application for construction and demolition firms to gather information about emerging waste in construction and demolition sites, to facilitate their re-use and recycling.

The Circular Economy Foundation, founded in 2013, gathers business partners to promote the circular economy and provides a forum to share experiences and best practice. The Ablakon Bedeott Pénz programme encourages the dissemination of good practice in companies through an award for environmental performance, including waste management and resource efficiency. This initiative is led by KöVET, an association of environment-focused consulting companies.

Source: (OECD, 2018[224]), *OECD Environmental Performance Reviews: Hungary*, https://doi.org/10.1787/9789264298613-en.

## Agriculture policy (Dimension 14)

### *Introduction*

North Macedonia has slightly worsened its performance in the agriculture policy dimension. Its score has decreased from 2.9 to 2.8 in the 2021 Competitiveness Outlook assessment. However, North Macedonia's score is slightly above the WB6 regional average (Table 24.26).

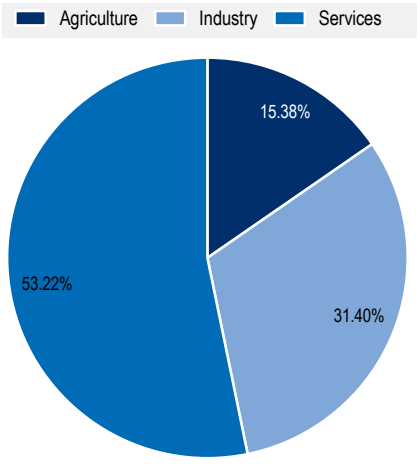
**Table 24.26. North Macedonia's scores for agriculture policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 3.1 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 3.3 | 2.9 |
| | Sub-dimension 14.3: Agricultural support system | 2.2 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 3.2 | 2.6 |
| **North Macedonia's overall score** | | **2.8** | **2.7** |

### *State of play and key developments*

Agriculture is the third largest sector by employment in North Macedonia, employing approximately 122 000 people, or around 15% of the total workforce (Figure 24.17) (MAKStat, 2019[225]). According to data from the Ministry of Agriculture, Forestry and Water Economy, almost one-quarter of the population receives some or all of their income from agricultural activity.[177] North Macedonia had 519 848 hectares of cultivated land in 2019 (MAKStat, 2019[226]), containing 178 125 registered agricultural households according to statistical data from 2016.

**Figure 24.17. Employment by economic sector (2019)**




Source: (MAKStat, 2019[225]), *Active Population in the Republic of North Macedonia, Labour Market - News Release*, www.stat.gov.mk/pdf/2020/2.1.20.06_mk.pdf.

The nominal gross value added in agriculture has increased by 18.9% in the period 2017-2019 (MAKStat, 2019[225]). Crop production, which represents 69.8% of total agriculture production, has increased by 22.9% in the period 2017-2019. Livestock production is 20.9% of total production, and has fallen by 1.1% in the period 2017-2019. In 2019, the nominal income in agriculture grew by 8.4%, while real income in agriculture grew by 9.5%.

Although there has been no change in the net value of the agricultural sector, its contribution to GDP has fallen about 1.2% in total for the last three years. The economic fallout of the COVID-19 pandemic reduced North Macedonia's GDP by 12.7% during the second quarter. However, agriculture and fisheries increased

by 4.5% during that period, pointing to the sector's relative resilience in the face of the pandemic. According to the State Statistical Office (MAKStat, 2020[227]) average net salaries overall increased by 8.1% over the period January 2019- October 2020, while agricultural salaries increased by 8.5%.

Agriculture was severely affected by the COVID-19 pandemic in 2020 by market constraints, lack of seasonal workers, movement restrictions and difficulties in organising transport and logistics. The uncertainty caused by the crisis, fear and the focus on health have greatly changed customer behaviour and demand towards increased level of food safety and standards. The crisis has been devastating, especially for those in the category of "underpaid workers", most of whom are farmers and women from rural areas, where the share of informal workers, who have limited access to adequate health and social care, is the biggest.

By April 2020, the Government of North Macedonia had provided a package of measures to support agriculture costing around EUR 76.1 million:

- **Support for the agricultural sector** of no-interest rate loans to a value of EUR 5 million through the Development Bank. The measure is aimed at supporting micro, small and medium-sized enterprises that produce primary products as well as processors and exporters of primary and processed agricultural products.
- **Payment cards to subsidise 50% of the cost of fuel for farm machinery**, an increase from 30% in the previous year. This measure will cover 50 000 farmers, and will cost EUR 4.6 million
- **Support for grape producers**. This measure provides financial support for grape growers and wineries to produce alcoholic distillate which will be used by domestic chemical companies, including for the production of disinfectants. In the next three years, this financial support will amount to EUR 3.5 million.

Since then, further measures have been developed:

- **In October 2020, further measures were developed to support the grape market**, with state subsidies of MKD 2/kg for purchased grapes. Additional incentives include supporting grape products and wine distillates with under 18% sugar subsidised with MKD 4/kg. Another new measure that is more directly related to the current situation is support for the transport costs of wine – 30% of the transport costs for bottled wine and 20% for bulk wine. The export of grapes is also supported with subsidy of MKD 2/kg for exports of up to 12 tonnes of grapes, MKD 3/kg for exports of 12-24 tonnes and MKD 4/kg for exports over 24 tonnes.
- **Public-private partnerships in the grape and tobacco sector** to support modernisation and make greater use of tobacco and grape product production capacities, two export-oriented agricultural sectors. This strategic commitment is expected to bring export benefits, primarily for grape and tobacco producers in North Macedonia, but also to the economy and gross domestic product. In the short term, investments are expected to reach EUR 10 million.
- **Long-term lease of pastures**, giving farmers access to about 500 000 ha of pastures for livestock grazing.
- **Support for cabbage producers**: growers were given a subsidy of MKD 3/kg for produce sold in the period from 5 April to 5 May 2020. The measure was aimed at stabilising the market for domestically produced cabbage and regulating the reduced demand and purchase price as a consequence of the state of emergency.
- **Postponing of various payments**: MAFWE postponed the deadline for rent payments of state-owned agricultural land paid by farmers and businessmen in the agro-sector to mitigate the effects of the crisis and maintain the profitability of agricultural production.
- **Support for lamb production**: through MAFWE, the government introduced support of MKD 2 500 per sheep to reduce the losses of sheep breeders due to reduced exports of lamb.

The crisis has made clear how important it was to have a stable food system that works in all circumstances and that can provide consumers with a sufficient and continuous supply of quality food at affordable prices. The pandemic also highlighted the role of farmers in the food supply chain. Small farmers are the most vulnerable, as they have to deal with both the economic and the health shock caused by the COVID-19 crisis at the same time. The global crisis has in fact deepened the problems farmers were facing anyway, especially those on the edge of sustainability.

### *Sub-dimension 14.1: Agro-food system capacity*

**The rural infrastructure policy framework** in North Macedonia is well developed and comprehensive. The current National Programme for Rural Development is compliant with the Instrument for Pre-Accession Assistance in Rural Development (IPARD) Programme 2014-20, clearly defining the policies and measures for further agricultural support. The implementation of policies on rural infrastructure has improved since 2018 and the number of budgeted activities continues to increase every year (60% annual utilisation of the budget on average between 2018 and 2020). However, deadlines still need to be extended and policies are still implemented late, illustrating an overall lack of administrative capacity in the government institutions responsible for implementation procedures. These include local governments and the Agency for Financial Support in Agriculture and Rural Development (AFSARD). AFSARD is still awaiting accreditation to implement the IPARD 2014-20 measure on investment in rural public infrastructure, limiting access to EU funds.

The current Agriculture Market Information System (AMIS) only provides limited data (weekly, monthly and annual reports) for interested users such as producers and suppliers. The system doesn't provide enough analyses or projections to guide producers. The government's attempt to digitalise agricultural markets through an Internet sales platform has not provided the expected results. Not only does the platform lack unified criteria on what information producers are required to provide to consumers about their products, but producers were not consulted during the establishment process, and nor have they been informed on how to successfully use the platform, minimising its effectiveness. According to the new National Strategy for Agriculture Production and Rural Development 2021-27, AMIS will be strengthened to provide more reliable data for more agriculture products on a regular basis. Meanwhile, according to MAFWE, there is an ongoing process to improve the sales platform through education of producers and traders.

The monitoring system used to check and review public procurement procedures before reimbursing investments is limited. While MAFWE has no monitoring unit to follow up on policy implementations, the ministry has made some progress in improving monitoring and evaluation since 2018. MAFWE has recently started a project with the EU on establishing a monitoring unit that will work on evidence-based policy measures. However, there is no system to publish regular evaluation and impact assessments and there are no concrete plans or a timeline to establish one. Impact assessments of regulations affecting agriculture occur irregularly and only in situations where there are pressing requests for one to be done. According to MAFWE, the current limitations in monitoring are due to limited human capacities, which is not being addressed.

The expansion and modernisation of **irrigation infrastructure** is considered a government priority, but lack of funds hinder implementation. The multi-annual Programme for Investments in Water Management Infrastructure for the period 2015-25 outlines North Macedonia's irrigation infrastructure plans and provides information on the objectives, priorities, project activities/investments, and the types and sizes of beneficiaries. As such, the programme offers a relevant and realistic basis for implementation, containing projections for the investment size and sources of funding. Most of the investments are co-funded by the state budget and long-term credits provided by international development banks or investment funds.

Management of the investments is under the public enterprise joint-stock company Water Economy of the Republic of North Macedonia. This public company is fully responsible for managing the primary irrigation network, as well as 95% of the secondary irrigation network. Only 5% of the secondary irrigation network

is operated by agriculture (water economy) co-operatives. Maintenance of irrigation systems is a critical part of water management, but not enough funding is dedicated to maintenance, leading to frequent system failures during the production season which significantly influences the quality and yield of agricultural produce. AFSARD manages the support for irrigation at a tertiary level , where the funding is provided both by the state budget and IPARD as part of the initiative to modernise agricultural households.

The **agricultural education system** remains unbalanced with a long-term strategy that does not reflect the needs of producers or the sector overall. The National Strategy for Agriculture and Rural Development 2014-20 envisages continuing training and informal education on agriculture aimed at improving the qualifications of agricultural producers, especially in the fields of farm management, introduction to new technologies, and the application of market standards for food safety and quality. However, its implementation is still pending due the lack of rules being set for the establishment and implementation of this measure.

The secondary school (14-18 year-olds) agriculture system is efficient and well-represented throughout the economy and its education curriculum is continuously improved and diversified. The vocational training system is well formalised in legislation, although in practice implementation does not always follow the regulatory framework.

Authority over agricultural education is split between MAFWE and the Ministry of Education and Science, but there is no co-ordination on training or lifelong learning. Collaboration with the private sector is usually based on personal links, which should be replaced by official programmes or measures.

For many agricultural sub-sectors, the education and training requirements to perform production activities remain unregulated, and general interest in education has declined. This has led to the Rural Development Programme's measures on education and training being ineffective. The number of students enrolling in the first year of university agricultural programmes has fallen by 35% in the last three years, with students instead choosing more market-oriented university programmes.

Monitoring and evaluation of the education process and performance are patchy and the results are not integrated to give an overall picture. The results of stakeholder consultations are rarely considered in developing measures in this area (especially when it comes to young farmers). Although mandated by the NARDS, no system for flexible movement of human capital between educational, research, advisory and occupational positions has been implemented. There is a pressing need to reorganise the current system using the resources available, and create sustainable links between the educational institutions and the labour market.

### *Sub-dimension 14.2: Agro-food system regulation*

North Macedonia's **regulations on natural resources** are harmonised with those of the EU and nearly all directives regarding the use of natural resources have been approved by the national parliament. However, realising the full potential of EU-driven regulations will take an implementation mechanism as well as additional resources. North Macedonia lacks a framework for natural resource management, which will be needed to lay the groundwork for any future plans to sustainably exploit its natural wealth.

Overall responsibility for legislation on natural resources lies with the Ministry of Environment and Physical Planning, while MAFWE has authority over the management of agricultural land, irrigation water, forestry and hunting. MAFWE uses a cross-conditionality system for the distribution of subsidies for the use of natural resources.

A number of institutions are involved in regulating natural resources but there are no permanent networking mechanisms. In 2015, the NARDS 2014-20 programme mandated an adequate legal regulatory system for the inter-institutional monitoring of the implementation of the cross-compliance system. However, this system remains in embryonic form and immediate efforts are needed to put it in place.

The existing **regulations on products** are fully harmonised with the EU, and the EU registries for seeds and propagation material are completely replicated within the national registries. The organisation and structure of this policy regulation is functional and fully operational, with a clear division of responsibilities and almost all protocols in practice are accredited according to EU standards. The existing regulations cover the registration, production, preparation for trade, certification, labelling, trade, import and export of seeds and propagation material for agricultural plants.

Monitoring and quality control of this policy area takes place regularly based on the Annual Programme for Monitoring. Consultations with stakeholders are also regularly undertaken within the Sectorial Working Group that acts as a consultative mechanism for defining policies, plans and programmes to support the process of communication among various stakeholders. Product regulations are monitored on a quarterly basis and revised regularly through updates to the Law on Seed and Propagation Material for Agricultural Plants and its by-laws, taking into account stakeholders' demands and the process of harmonisation with EU legislation.

### *Sub-dimension 14.3: Agricultural support system*

The planning period, support measures and the criteria for the **agricultural policy framework** in North Macedonia are in line with the procedures and support system envisaged in the EU Common Agriculture Policy The agriculture support framework is rather broad in its coverage, targeting more than 90 000 agricultural households, and its scope covers the agriculture sub-sectors equally. While its main objectives focus on increased productivity and improved competitiveness, they are only moderately reflected in the support measures. All agricultural activity in the economy above a minimum size of 0.2 ha is subsidised, with almost no additional requirements for the producers. The scale of support is rather high in comparison to the value of the agriculture sector as measured by the value of total sales of agricultural products (Table 24.27). Over the period 2016-18, total support to agriculture averaged around 50% of total agriculture sales, which illustrates how heavily subsidised it is by the state.

**Table 24.27. National budget support for agriculture (2016-18) in million EUR**

| | 2016 mln (EUR) | 2017 mln (EUR) | 2018 mlm (EUR) |
|---|---|---|---|
| Value of total purchases of agricultural products | 243 217 | 254 022 | 284 917 |
| Value of total budget support to agriculture | 140 318 | 140 975 | 140 416 |

Source: (MAKStat, 2019[225]), *Active Population in the Republic of North Macedonia, Labour Market - News Release*, www.stat.gov.mk/pdf/2020/2.1.20.06_mk.pdf.

Agricultural support comprises three programmes (direct subsidies, the Rural Development Programme and IPARD) in order of increasing competitiveness. Direct subsidies are available to most farmers who complete a simple form to request financial support; the main requirement is cadastral evidence of land holding, cross checked with data on land use from the Land Parcel Identification System and the registration number of the farm. In contrast, the Rural Development Programme is perceived to be more complicated to access as producers are required to provide project and/or business plans for their proposals. IPARD is unattainable for the majority of famers due to its strict criteria and the long application and implementation processes. However, the use of IPARD and rural development programme funds has been steadily increasing, with an increase of approximately 40% between 2018 and 2019.

As formalised in law, the planning of support measures involves long consultation processes and discussions through participatory mechanisms that involve all type of stakeholders, contributing to the definition of the measures.

The Rural Development Programme is quite wide and covers more than 50 measures, but annually only 17 or 18 are set. In practice, investments in rural infrastructure, including Water Economy investments, take more than 50% of the budget.

Monitoring and evaluation mechanisms are improving. For example, AFSARD has been preparing and sharing reports with the public on monitoring of this area since 2017. However, there is no fully enhanced co-ordination between AFSARD's and other institutions registries on a level of with the agency and unification of databases to provide a clear picture of sector support and indicators.

North Macedonia's **domestic producer support instruments** are well planned in legislation, with easy application procedures for subsidies and strong harmonisation with EU legislation, although the monitoring mechanisms to evaluate cross-compliance have not been implemented.

Direct payments are distributed by area under cultivation, head of breeding animal and agricultural produce sold. They are the main income support instruments for agricultural producers. Farmers, traders of agricultural products and food processors also receive credit support through the state-funded Macedonian Bank for Promotion of Development, facilitating their access to finance through a number of credit products with favourable interest rates. The only agricultural price support instrument used is tariff protection.

The direct payments largely determine the profitability of agriculture in most sub-sectors and represent an element of the decision-making process to increase agriculture as a professional occupation. The policy objective defined in the NARDS is to increase the share of investment-support instruments rather than direct payments, by increasing funding for rural development policies and modulating previous direct payment measures towards supporting rural development.

As mentioned above, only farms listed in the Farm Register can apply for direct payments. All land parcels in use have been graphically digitalised and are held within the Land Parcel Identification System. Direct payment beneficiaries are obliged by the Law on Agriculture and Rural Development and respective by-laws to adhere with cross-compliance measures, including good agricultural practice, animal welfare and sustainable land management. As part of the subsidy claim process they sign statements confirming their adherence to the cross-compliance requirements. In practice, while there is strict control of adherence to these principles for animal husbandry, for crops the monitoring of whether applicants meet these requirements is limited to the on-the-spot controls conducted by AFSARD on 1% of applicants.

Input subsidies are provided for fuel, *in vitro* insemination of cattle, and the production and use of certified seeds material and seedlings. Since 2020, MAFWE has also supported a system for climate control through airborne cloud seeding to achieve better protection of crops from hail. The budget for the measure is EUR 1 million per year and the operator is chosen through public procurement procedures.

Institutional co-ordination has not reached its full potential and the standards and criteria for the various support programmes are not fully harmonised. Some measures are not simplified enough or are still listed within a programme, even though they have been inactive for long periods. Monitoring and evaluation mechanisms are not as strong as they could be as MAFWE, AFSARD and the National Extension Agency (NEA) hold different registries and databases which are not yet integrated. In some cases, a lack of determination and capacity lies behind the failure to implement new polices (such as agriculture knowledge and innovation system and others).

When it comes to **agricultural trade policy**, North Macedonia has a few free trade agreements, which are predominantly multilateral (World Trade Organization, CEFTA, EFTA and the EU).[178] Some of the economy's agricultural products are characterised as sensitive or highly sensitive; tariff rates only apply to the latter. Tariff quotas on imports are only applied for wheat and there have been no export subsidies on any agricultural products since 2003. North Macedonia does not apply any export credit support or export prohibitions for agricultural production. Monitoring is improving while there is regular evaluation on performance on a multi-annual basis as part of the national agriculture strategy evaluation. Impact

assessments for import tariffs are carried out depending on the feedback received from businesses and on the market conditions analysis.

North Macedonia's **agricultural tax regime framework** does not include any specific tax legislation for farms or agricultural businesses. However, a taxpayer in the agriculture sector whose total annual income does not exceed EUR 21 140 (MKD 1.3 million) will be taxed on their lump-sum fixed income, which is still quite favourable for most small-scale farmers. The Law on Property Taxes also provides tax relief for agricultural land used for agricultural production, in an effort to stimulate agricultural production. The law also provides tax exemptions for activities that promote agricultural production such as facilities for protecting natural resources, investment in vocational training, employing disabled people and facilities for the primary processing of agriculture products.

The **sanitary and phytosanitary system (SPS) and measures** have a well-structured legal framework which enables a fully functional and operational system, and provides for a clear division of institutional responsibilities. SPS legislation in North Macedonia has been harmonised with EU legislation since 2005 and its compliance with international standards continues to improve. The Food Safety Law defines an integrated approach of policy implementation, official control and inter-institutional co-ordination in this area. A clear financing structure has been established, and the work of the phytosanitary sector is financed from the state budget and through paid services for private entities. National SPS legislation has been harmonised with the International Standards for Phytosanitary Measures which clearly defines the division of responsibilities between institutions and ensures the proper implementation of the phytosanitary policy of the International Plant Protection Convention and EU legislation.

The import of plants is regulated by the Plant Health Law, which aims to prevent the introduction and spread of harmful organisms as well as their eradication. Additional physical infrastructure needs to be established to provide facilities for phytosanitary controls at border crossings in accordance with EU practices. Standard operating procedures for border phytosanitary inspections and training for inspectors have been drafted and put forward for final endorsement by the government. These measures are regularly updated and consistently harmonised with EU directives.

Since 2013, the Phytosanitary Directorate has prepared an annual monitoring programme which includes visual inspection and sampling for testing all strategic agricultural crops (seed potatoes, grapes and other fruit, vegetables, and tobacco). The main objective of this programme is the interception and early detection and of quarantine of pests in places of production, storage, and import. The programme is implemented by phytosanitary inspectors and the State Phytosanitary Laboratory (SPL), who perform laboratory analyses. The pest risk assessment procedure includes relevant national expertise in the preparation of phytosanitary measures and preventative actions to be taken against certain pests.

The pest risk assessments are based on the available scientific evidence and monitoring plans and are undertaken in an independent, objective and transparent manner. Risk management takes into account the results of risk assessments, in particular the opinions of the European Food Safety Authority, and the opinions of the national food safety institutions. SPS risk assessments in the phytosanitary sector are in the early phases of implementation. However, there is currently no procedure or requirement in the national legislation for risk reassessment when updating regulations in this area. In 2018, the Phytosanitary Directorate prepared a first report on the phytosanitary situation in the economy which determined the presence/absence and prevalence of harmful organisms.

The Phytosanitary Information System (PIS) is in the early phases of development. MAFWE has provided funds to upgrade the data system on import, export, re-export and transit activities by including additional data to enable further risk analysis and the preparation of reports. The upgraded PIS for plant health and plant protection products will help to improve communication, co-ordination, transparency and the efficient functioning of all stakeholders involved in the phytosanitary sector. This upgrade was scheduled to take place in the second half of 2020.

Regional co-operation in the phytosanitary sector has improved since the last assessment. North Macedonia and the Republic of Serbia signed the Agreement for Phytosanitary Co-operation in September 2019. The two countries agreed to mutually recognise the results of laboratory analyses of samples taken from imports done by accredited or authorised laboratories. In 2020, North Macedonia concluded the same agreement with Albania.

### *Sub-dimension 14.4: Agricultural innovation system*

**Agricultural research and development** has been seriously neglected over the last two decades, in terms of permanent funding for maintenance of existing research infrastructure and facilities, as well as the development of new methodologies. The MES is responsible for the development of science and innovation and organises the national system of science, research and innovation. The NARDS 2014-20 prioritised support for scientific projects in applied agricultural research, specifying a sustainable system of selection, implementation and monitoring and evaluation of the effects of subsidised research projects. Nevertheless, progress on implementing this policy area has been weak thus far. As North Macedonia lacks a well-organised agricultural research and development framework, producers are not involved in priority setting, implementation or the funding of research and advisory services.

Some research and development activities are independently implemented by institutes and universities, with funding assistance from donors. Farmers are, to certain extent, involved in limited transfer of knowledge activities carried out by the public National Extension Agency. The Law on Agriculture and Rural Development set out a process for the selection for research projects and general transfer of knowledge, but it has not been implemented. While the working groups are consulted on many other agriculture policy issues, they have little impact on research projects despite having the right to do so by law.

Currently, the only financial support to research in the field of agriculture, forestry and water management is through the Fund for Innovation and Technological Development for pilot projects of up to 6 months, short-term studies lasting 12 months, and long-term research for up to 36 months. Financial support is defined in the technical measure for implementation of the programme but this measure has not yet been launched – see Science, technology and innovation (Dimension 9) for more details.

The current **agricultural extension services framework** offers farmers only limited services. The legislation on transfer of knowledge in this area is very well planned on paper, but lacks implementation due to budget constraints and limited human resources. The aims of NEA, the body responsible for extension services, are: the transfer of know-how and information between producers, ensuring the implementation of these services in agricultural holdings in order to improve the quality and quantity of economically viable and competitive agricultural production, sustaining the development of agriculture in rural areas, and supporting the development and implementation of agricultural policies.

Even though the general assessment by MAFWE is that the services provided by the NEA are inconsistent and limited in scope and quality, they are the only services currently offered to farmers by the state free of charge.

The financing and subsidy procedures in this area also need improvement. There is a draft law on the Farm Advisory System that has been prepared since 2018, and that underwent wide consultation processes at several levels during 2019 (dissemination and public hearing, intergovernmental services, comments from the World Bank and EU, etc.), but has not yet been adopted by the government.

Private advisors are excluded from delivering publicly supported advisory services. The state does not subsidise programme support that specifically targets certain groups of farmers or specific areas according to the policy goals.

### *The way forward for agriculture policy*

The Government of North Macedonia has made continued progress with reforms and improvements within the agriculture sector, but there are still important challenges to be considered and further efforts to be made:

- **Establish a monitoring and evaluation system**. Taking into account the sizeable investments in rural infrastructure, the agriculture support programme budget and the number of users involved, increasing monitoring and evaluation capacity, and improving the relevance of planned policy measures, are warranted. Creating a special unit within the MAFWE Department for Analysis of Agriculture Policies to handle monitoring and evaluation, while increasing inter-sectorial co-ordination by integrating the relevant databases and registries of different institutions, will allow all relevant information to be collected. In turn this will help plan realistic policy measures that reflect the needs of producers.
- **Review the agriculture support programmes**. Some of the existing policy measures suffer from low budgets and differing criteria between national and EU support programmes, and have had a limited impact on the main programme goals of improved competitiveness and productivity. Reviewing the content of support programmes would enable them to better reflect the needs of farmers and integrate measures that benefit producers and agriculture output. Support to agriculture should be continuously compared against number of social and economic indicators. Support should also be conditional and context compliant.
- **Strengthen institutional co-ordination and harmonise the standards and criteria for support measures**. Programme measures should be simplified or removed if inactive for long periods of time.
- **Improve farmers' access to information and channels of communication,** especially market information. The current Agriculture Market Information System should be upgraded into a functional and dynamic platform for the collection and dissemination of information. The legislation in place is broad enough to enable options such as outsourcing, public-private partnerships, or contracted public services implemented by private entities as part of this process.
- **Develop the education and training system, and increase the co-ordination between education entities in agriculture**. The continuous decline in interest in agriculture education and the pressing labour market demand create a large skills gap that risks damaging the performance of the agriculture sector. The NARDS programme already has a solid framework to cover this issue so North Macedonia should implement the planned activities and provide systems for flexible mobility and the transfer of human capital. In addition, greater clarification of the responsibilities between MAFWE and the MES, as well as better co-ordination, will be crucial to improving institutional performance and integrating all stakeholders in the system.
- **Enhance the policy framework supporting research and development**. Increasing investment in research and development and practical application projects is essential, as R&D is slowly declining and no value is being added to the agriculture sector. The current draft of the Law for a New Advisory System should be finalised and approved soon, and an integrated system between the NEA and private agriculture should be established.

## Tourism policy (Dimension 15)

### *Introduction*

Table 24.28 shows North Macedonia's scores for the five tourism sub-dimensions and compares them to the WB6 average. Since the 2018 assessment, North Macedonia has made slight progress in tourism by improving its scores in the availability of qualified workforce sub-dimension, driven by improvements in the VET framework indicator, as well as in the tourism branding and marketing sub-dimension. Progress is however limited and North Macedonia scores below the WB6 average in all sub-dimensions. Moreover, North Macedonia ranks last in the sustainable and competitive tourism sub-dimension. Overall, North Macedonia lags behind in tourism development, mainly due to inefficiencies related to the overall governance structure and the institutional set up at the national, regional and local levels. A more coherent and co-ordinated governance structure and institutional framework at both the national level and the destination level will be key to improving the competitiveness and successful future development of tourism. This is even more important in the context of the COVID-19 pandemic which significantly affected tourism in North Macedonia.

**Table 24.28. North Macedonia's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Governance and co-operation | 1.8 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 1.7 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 1.7 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 0.8 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 1.3 | 1.6 |
| **North Macedonia's overall score** | | **1.5** | **2.0** |

### *State of play and key developments*

North Macedonia considers tourism to be one of its six priority sectors for development. However, this prioritisation has not yet resulted in notable improvements in the sector's competitiveness. Although the number of international arrivals has been steadily growing over the last three years, the economy's standing on the 2019 Travel & Tourism Competitiveness Index has worsened from 82nd place in 2017 to 101st in 2019, with its position worsening in all sub-dimensions. The largest falls were in 1) the effectiveness of tourism marketing and branding (from 41st place in 2017 to 124th in 2019); 2) government prioritisation of travel and tourism (from 58th to 118th); and 3) the ease of finding skilled employees (from 76th to 129th). The unfavourable business environment and underdeveloped transport infrastructure also affect tourism competitiveness more widely (WEF, 2019[228]). In 2019, tourism's direct contribution to GDP was a mere 2%, and the direct contribution to employment was 1.8%, corresponding to 13 500 jobs in the tourism sector.

The new National Strategy for Sustainable Tourism Development (2016-21) sets new strategic and policy goals for the further growth of tourism in the economy. However, most of the policy measures have not yet been implemented. In addition, the strategy does not consider possible synergies between tourism, agriculture, food processing and the ICT sector, which are also considered strategic and high potential sectors for North Macedonia.

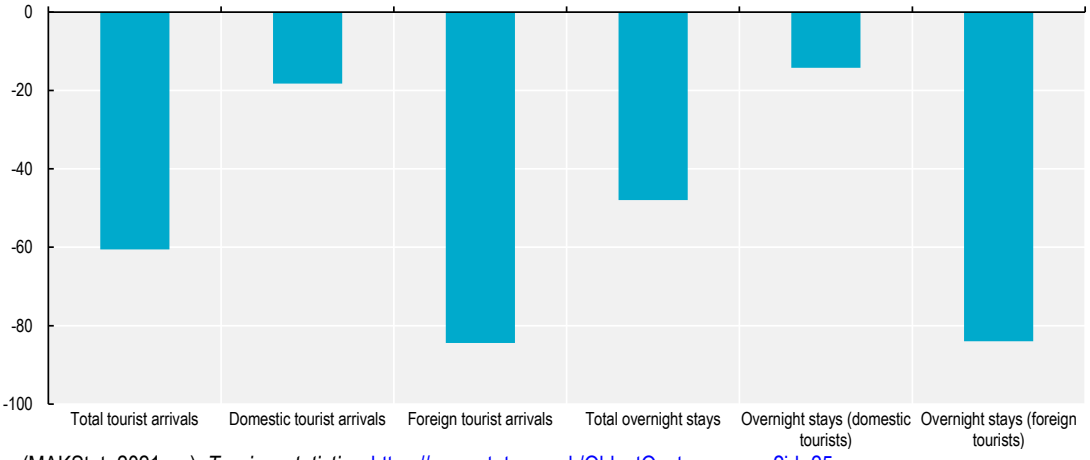
The main "accelerator" of tourism development in recent years has been the Local and Regional Competitiveness Project (LRCP), a four-year investment operation financed with a grant from the European Union (IPA II). It is based on a holistic approach to tourism development and destination management and provides investment funding and capacity building to support sector growth, investment in destinations and specific destination prosperity. According to the semi-annual report of the project, which

was reviewed together with representatives from the EU and the World Bank, 25 projects to improve tourism have been fully completed and 36 are under implementation (OECD, 2020[51]).

COVID-19 has left North Macedonia coping with its deepest recession since 2001. Robust GDP growth of 3.2% in 2019 was reversed by mid-2020 as the COVID-19 pandemic unfolded (World Bank, 2020[229]). Following the introduction of measures to contain the pandemic, hospitality, tourism and transport were the first sectors to experience lockdowns and major cuts in their revenues. In 2020, the number of tourists fell by 60.5% compared to the previous year: domestic tourists fell by 18.3% and foreign tourists fell by 84.4%. In the same period, the number of nights spent decreased overall by 48%: by 14.2% for domestic tourists and by 84% for foreign tourists (Figure 24.18) (MAKStat, 2021[230]).

### Figure 24.18. Tourist arrivals and overnight stays (2019-2020)

Change in %




Source: (MAKStat, 2021[230]), *Tourism statistics,* https://www.stat.gov.mk/OblastOpsto_en.aspx?id=25.

StatLink https://doi.org/10.1787/888934256197

In February 2020, the government set up a crisis committee to manage the crisis and the spillover effects on the tourism industry. The committee took 19 measures to prohibit large gatherings and outdoor events and to close catering facilities. The next stage aimed to provide the private sector and SMEs with financial support. The government established a Tourism Fund of MKD 74 million, of which MKD 30 million was dedicated to the Agency for Promotion and Support of Tourism. The government also asked the Musical Copyrights Society of Macedonia (ZAMP) to put a stop to claims for paying artists' copyright fees on restaurants and hotels and exempted them from monthly income tax advance payments. Companies in the tourism industry received subsidies to cover wages and social insurance contributions for eligible workers. The wage subsidy covered the net minimum wage (EUR 236 per month) and the social insurance contribution covered 50% of actually paid social security contributions up to a maximum amount of EUR 94 per month (World Bank, 2020[229]). The government also issued vouchers to be spent at local hotels which were given to citizens with incomes below EUR 150 per month to promote domestic tourism (OECD, 2020[231]).

The COVID-19 pandemic has put the brakes on the tourism industry. Accordingly, North Macedonia should carry on its efforts to develop new, high-quality and personalised tourist experiences around its natural and cultural sites. Moreover, it should prepare a marketing strategy and action plan to attract more domestic tourists and tourists from the neighbouring countries.

#### *Sub-dimension 15.1: Governance and co-operation*

In North Macedonia, **governance of the tourism sector** at the national level is relatively weak. This is reflected in how few of the policy measures defined in the tourism development strategy have been

implemented. The Ministry of Economy has the overall mandate for tourism development and is responsible for strategic planning. It also manages the Agency for Promotion and Support of Tourism, which is responsible implementing the policies developed by the ministry. However, there is no intra-governmental body (such as a tourism council or working group) to co-ordinate the work of the ministries responsible for the implementation of particular policy measures. Weak inter-ministerial co-operation also hinders the development of policy measures to promote synergies between tourism and other sectors, and the inclusion of tourism development needs in other national strategies (for instance for transport, environment or infrastructure development). Insufficient government commitment to tourism development translates into limited resources and capacity devoted to the implementation of tourism policy measures.

A working group to develop the tourism strategy has been established and is chaired by the senior tourism advisor. It provides a forum for **partnership with stakeholders** and co-ordinating tourism development at a national level and for **vertical co-operation** with regional authorities and local communities. The members of the working group are representatives of the Chamber of Commerce, the eight regions, the municipalities, the educational institutions, NGOs and other associations (such as the Mountaineering Association). The Chamber of Commerce also works in co-operation with the Ministry of Economy. However, the working group lacks substantial commitment from the government, which would contribute to a more efficient implementation of the tourism strategy. The working group does not meet regularly and proposals from private tourism stakeholders are rarely taken into account. The same applies to vertical co-operation, which is further hindered by limited financial resources and qualified staff at the local level. Although the tourism strategies for individual destinations are in line with the national tourism strategy, and developed in co-operation with the private sector, their implementation is lagging behind due to the overall inadequate co-ordination of strategic planning at the national, regional and local levels.

**Tourism data collection and dissemination** in North Macedonia is the responsibility of the State Statistical Office (SSO). The MakStat database is the core channel for data dissemination. Its user-friendly portal systems provide access to a wide range of statistical data in different formats and alert data users to new information. According to the SSO, the first Tourism Satellite Accounts (TSA) are in the process of being implemented and will be ready in 2021. This, combined with the harmonisation with EU regulations on statistics on domestic travel, are positive developments since 2017. Nevertheless, all the other recommendations made in the previous assessment are still valid (OECD, 2020[51]). These include the establishment of co-operation among relevant institutions, ensuring greater consistency of the definitions they use, updating and expanding survey evidence (such as visitor perceptions, spending, room occupancy, revenue per room and details by statistical region), and shifting to more frequent data collection, concerning foreign visitors and foreign tourists, rather than the current three-year collection system.

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

Since 2017, North Macedonia has made modest progress in improving its accessibility for tourists. In 2019, the number of countries on the visa requirement list was 115, which is the same as four years ago. Bilateral agreements with neighbouring Serbia and Albania enable border crossings with only an identity card. However, there has been no improvement in the intermodal **connectivity framework** over this period. Moreover, gaps in transport connectivity are impeding trade, including tourism. The quality of transport infrastructure and trade logistics remains low, and there are delays at borders (EC, 2020[46]).

When it comes to **accommodation capacity and the quality of the tourism offer**, an accommodation quality standard framework is in place and a register of accommodation has been established. The categorisation of accommodation facilities is in line with Eurostar standards and is mandatory for all types, and the rulebook for implementing the categorisation has been prepared. However, it is not clear how efficient the framework is, as no monitoring or evaluation of the categorisation system has yet been done. Inspections are still weak due to a lack of human resources and competencies at the Market Inspectorate,

which is responsible for the inspection of accommodation. According to the information available, no progress has been made in this area since 2017.

The tourism strategy includes measures to facilitate investment in new high-quality private accommodation as well as the renovation and upgrading of old facilities. The LRCP has co-financed 16 projects to renovate and build private tourist infrastructure (LRCP, 2020[232]). However, the number of tourist beds has grown only slowly in the last two years. According to private investors, one of the significant constraints on investments in accommodation is the lack of co-operation between municipalities and private investors over strategic planning at the destination level. Better co-operation would allow their investment proposals to be included in strategic papers at an early stage of preparation. This would not only contribute to better tourism strategies, which would be in line with the needs and ambitions of the private tourism stakeholders, but it would also contribute to integrating tourism investments into the urban planning for municipalities, which is currently one of the major bottlenecks for investments in tourist infrastructure.

**Tourist information is available** on tourist destinations and the accommodation, attractiveness and tourist services of those destinations. Information is provided via websites, road signs and in tourist information centres, etc. Information is available in multiple foreign languages. The Agency for Promotion and Support of Tourism, local communities, and the departments dealing with tourism regularly update the information. However, improvement in this area has been limited and there is no tourism information system framework that would connect current individual tourist information systems into a comprehensive national tourist information framework.

### *Sub-dimension 15.3: Availability of a qualified workforce*

A well-qualified workforce is one of the main success factors for the development of tourism. However, limited progress has been made in this field since 2017. The tourism strategy only recommends improving the attractiveness of tourism studies to students, with no concrete policy measures. There is no evidence of any progress in the **skills supply framework** since 2017 – in fact, North Macedonia worsened its ranking on the 2019 WEF Travel and Tourism Competitiveness Index for the ease of finding skilled employees from 76th place in 2017 to 129th in 2019 (WEF, 2019[228]). Co-operation between the public and private sector has not yet been established. The number of students in tourism and hospitality VET and higher education programmes has declined in the last two years, and no new educational programmes have been developed recently.

The **VET framework for tourism** is part of the National Qualifications Framework (NQF), defined in 2013. A VET quality assurance and accreditation body has been established in the form of a sectoral commission within the NQF that determines the quality of permanent and new qualifications. The VET teaching institutions (schools) are well equipped. The budget for the VET framework is increasing from year to year but, according to the VET representatives, it has not yet reached the level that would cover the investment needed in new technologies, modern equipment and teacher training to follow new technological advances in tourism. The development of the overall VET framework in North Macedonia appears to depend substantially on several donor projects in the economy and in the region. The latest regional project, Towards Regionally-Based Occupational Standards (TO REGOS), led by the Education Reform Initiative of South-Eastern Europe started in 2019. It looks promising as a way to improve the VET framework in tourism because of its focus on strengthening partnerships between VET institutions and businesses to define skills relevant to the labour market.

The **higher education framework** is also a part of the NQF. Tourism studies are available in some higher education institutions. The most prominent seems to be the private University of Tourism and Management in Skopje (UTMS), which offers tourism-related courses and programmes. Its curricula are in compliance with the European standards for 3+2 module of studies. UTMS is an affiliate member of the UN World Tourism Organization (UNWTO), giving students the opportunity to go on internships abroad. The courses include mandatory practical training, which is not the case in public educational institutions. Upgrading

higher education in tourism to include mandatory practical training could be the next step towards increasing the quality of higher education for the sector.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

The **natural and cultural heritage enhancement framework** for tourism is in the early stages of development. The tourism strategy includes natural and cultural heritage and represents a source for nature-related and cultural tourism products development. The cultural heritage strategy is still under development. In 2018, progress was made on raising awareness of the importance of natural and cultural heritage among young people through a range of events held all over North Macedonia. The Ministry of Culture, the Directorate for the Protection of Cultural Heritage, municipalities, and other institutions and organisations co-operated to bring this about, which was implemented within the framework of the European Year of Cultural Heritage 2018. However, North Macedonia still has improvements to make in this area, such as involving private tourism stakeholders and NGOs in the development of the cultural heritage strategy, preparing an action plan with clear policy measures, and putting in place actions to integrate the most valuable cultural and natural heritage into the tourism offer. This action plan should contain measurable indicators that would allow regular monitoring and evaluation of implemented policy measures, and especially their efficiency and impact on tourism development.

There is no policy framework for **promoting sustainable development within the tourism sector,** including clear measures to support stakeholders to develop sustainable tourism. According to private stakeholders, some lending is available on favourable terms for investment in energy efficiency and the increased use of renewable energy. However, there is no systematic approach covering all aspects of sustainable development such as environmental protection, respecting socio-cultural authenticity and ensuring socio-economic benefits reach the local population. The national tourism strategy or annual tourism action plan should be strengthened to include concrete policy measures to promote sustainable tourism development. Best practice from other countries, such as Slovenia's Green Scheme (Box 24.20), could be considered and adjusted to the context in North Macedonia.

When it comes to **tourism investment and innovation**, as mentioned above, the government has selected tourism as a strategic focus for investment, job creation and increased competitiveness for the period 2016-20. Accordingly, it created a legal and regulatory framework favourable to foreign investors that provides incentives to attract new investments.[179] The four-year LRCP also includes actions to facilitate investment in tourism, not only through grants to MSMEs, NGOs and municipalities, but also actions to improve the capacity of public authorities to manage the grant provision processes in the future. This could be a good basis for improving the implementation of the policy measures regarding tourism investments, defined in the National Strategy for Sustainable Tourism Development. Unlike the tourism investment framework, the tourism innovation framework is not established yet.

### *Sub-dimension 15.5: Tourism branding and marketing*

The Agency for Promotion and Support of Tourism is responsible for **tourism branding and marketing**. The agency manages the "Macedonia Timeless" brand for promoting visits to North Macedonia. However, it has not adopted a marketing strategy of its own. It works on the basis of the annual tourism promotion programme adopted by the government. The agency has an advisory body with representatives from the private sector and universities. Since 2016, there has been a noticeable reduction in the budget for promotion and marketing (35% less in 2019 than in 2016), which is reflected in a reduction in the promotional and marketing activities carried out. To provide more stable conditions for its promotion and marketing work it would need to prepare a five-year marketing strategy with a clear budget allocation. These would empower the agency to implement a more comprehensive marketing strategy that extends beyond one fiscal year.

When it comes to **digital tourism marketing**, the Agency for Promotion and Support of Tourism has implemented digital marketing activities in 2019, which includes the promotion of all tourist destinations in the economy. In 2019, 70% of the total budget for marketing activities was allocated to digital marketing activities. However, as mentioned, to ensure more stable conditions for tourism marketing, a five-year digital marketing strategy should be prepared. This strategy should also include capacity building for private stakeholders on using digital marketing tools.

### *The way forward for tourism policy*

To ensure the successful development of tourism, policy makers should:

- **Improve the efficiency governance structure and institutional set up at the national level** to enhance policy decision making at the government level. Moreover, North Macedonia should establish an intra-governmental body which will help improve co-ordination among ministries and other public institutions, while actively involving private and public stakeholders in the process of developing and implementing tourism strategies.
- **Develop regional and local destination management organisations,** as defined in the National Strategy for Sustainable Tourism Development. These can take over managing tourism development within individual destinations and design and implement destination tourism master plans. If such organisations are to be successful they will need sufficient budget for the start-up phase and sound capacity building programmes for their destination management teams.
- **Develop a programme promoting investment in high-quality tourism infrastructure**, building on the destination tourism master plans. This should start by preparing a comprehensive analysis of existing investment (public and private) in close co-operation with private sector stakeholders. This will help focus the programme on the financial resources available and the different forms of incentives in line with Tourism Master Plan, and in accordance with the interests of private investors. It is also necessary to ensure that investment will be appropriately included in other municipal development documents, which form the basis for the preparation of spatial plans. Currently, inconsistency between strategic documents is hindering investments in tourism infrastructure in most municipalities. While North Macedonia should make use of LRCP project support, it should also prepare a long-term tourism investment framework to ensure continuity.
- **Develop a sector-specific human resource policy for tourism** to address the specific skills needs of the industry and ensure that tourism education will be more attractive to lecturers and students.
- **Develop a comprehensive framework for the promotion of sustainable development and operation** of the tourism sector that will include at a minimum the mandatory consideration of sustainability criteria in all investments in tourist infrastructure. The framework should be supported by public incentives, and provide awareness raising and training for tourism sector stakeholders in how to develop their businesses sustainably. Using best practice from other countries is recommended, including Slovenia's green tourism scheme (Box 24.20).

### Box 24.20. Slovenia's green tourism scheme: A comprehensive model for promoting sustainable tourism

Slovenia's green tourism scheme is a good example of how tourism companies can be encouraged to develop sustainable business models. Launched in 2015 by the Slovenian Tourist Board (STO) and supported by the Ministry of Economic Development and Technology, it provides a comprehensive framework for sustainable development in tourism. The core of the scheme is a certification programme that provides guidelines for tourist destinations and companies (accommodation providers, travel agencies and tourist attractions) and tools for monitoring progress on sustainability. Destinations and companies meeting the criteria are given a green label ("green destination", "green accommodation", "green travel agency", "green park", "green tourist attraction") and marketing support from the STO under the umbrella brand Slovenia Green, which raises their profile and makes them more competitive on the global market. The certification scheme is based on the European tourism indicators system for sustainable destination management and the green destination standards (GDS), thus ensuring international comparability. It provides an awareness-raising and capacity building tool for tourism sector stakeholders.

The green tourism scheme is recognised worldwide as a unique comprehensive national scheme that promotes the development of quality and innovative tourism products with high added value. It contributes to the conservation of the environment and cultural heritage and tradition, and also benefits the economic development on the local population.

Source: (Slovenian Tourist Board, n.d.[233]), *Green Scheme of Slovenian Tourism*. www.slovenia.info/en/business/green-scheme-of-slovenian-tourism.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 24.29 shows North Macedonia's scores for the anti-corruption policy dimension and compares them to the Western Balkans (WB) average. North Macedonia has the highest score (along with Montenegro and Serbia) of the WB6 economies for corruption proofing of legislation. The score for corruption risk assessment also exceeds the WB average. However, North Macedonia scores slightly below the WB6 average for awareness raising and education. The Law on Prevention of Corruption and Conflict of Interest of 2019 provides a new framework for several key anti-corruption areas, particularly the management of conflicts of interest and disclosure of assets and interests. Since the previous assessment, North Macedonia has strengthened the independence and performance of its specialised anti-corruption bodies.

**Table 24.29. North Macedonia's scores for anti-corruption policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 2.8 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 3.0 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 3.0 | 2.8 |
| **North Macedonia's overall score** | | **2.9** | **2.5** |

Note: For comparability with the previous assessment, two sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

#### *Sub-dimension 16.1: Anti-corruption policy framework*

The development **of anti-corruption policy documents, co-ordination and implementation** is in progress. The State Commission for Prevention of Corruption (SCPC) submitted the draft National Strategy for Combatting Corruption and Conflict of Interest 2020-24 to the Assembly of North Macedonia in January 2020. The assembly did not adopt the strategy, reportedly due to the early elections of July 2020, and the SCPC resubmitted a revised version of the document in December 2020. The strategy identifies key problems in 2 horizontal areas (public procurement and employment in the public sector) and 12 sectors (including the political system, judiciary, law enforcement bodies, healthcare, and education). The accompanying action plan defines measures aimed at tackling the problems identified, the responsible institutions, deadlines and simple indicators focused almost exclusively on outputs rather than outcomes and impact. The strategy and action plan do not envisage the amount of funding needed to implement the measures, or the sources. Within the individual sectors, the Ministry of Interior and the Customs Administration have their own anti-corruption planning documents. At a local level, 47 municipalities have adopted anti-corruption statements or commitments to undertake certain actions such as forming working groups on integrity.

The Law on Prevention of Corruption and Conflict of Interest prescribes the key actions and stages for developing the national strategy. The preparation of the strategy is to be based on corruption risk analysis and carried out with the participation of representatives of state bodies, institutions, associations, foundations, the private sector and the media. The SCPC carried out and published the risk analysis, formed a broad working group including governmental and non-governmental stakeholders, and held several workshops. In December 2019, the SCPC published the draft strategy with an open call for comments and proposals. The consultation period was rather short (27 December to 8 January) with two

public holidays within the period. The SCPC did not publish an overview of the proposals it had received, accepted and rejected (DKSK, 2021[234]). This makes it hard to assess the impact of the consultation.

The SCPC monitors the implementation of the anti-corruption policy and has been publishing the state anti-corruption programmes (for 2011-15 and 2016-19) and annual implementation reports on its website. By July 2019, 56 of 74 activities in the 2016-19 programme had been or were being implemented (DKSK, 2019[235]). The SCPC will continue to monitor the implementation of the national strategy. Monitoring will rely on respondents (focal points) from each implementing institution who will be responsible for submitting information about the level of implementation twice a year through a web application, which is to be developed.

Legislation governing risk assessments has been adopted, but **corruption risk assessments** and management generally take place within the framework of internal financial control. Risk assessments are carried out in public institutions on a systematic basis. According to the government, by the end of 2019, 68% of central-level institutions and entities had adopted risk management strategies and 56% had adopted risk registers. At the local level, the shares were 43% for risk management strategies and 37% for risk registers. The accepted by the Ministry of Finance typology of risks includes risks related to employees and the organisation, and areas to be considered include ethics and conduct (the tone from the top, fraud, conflict of interest, etc.). In 2017, Guidelines for the Management of Fraud and Corruption Risk and Guidelines for Determining Critical Job Positions were published. In 2019, the SCPC conducted a corruption risk analysis for the strategic plan of combatting corruption and conflict of interest (DKSK, 2019[236]). The Law on Prevention of Corruption and Conflict of Interest includes the preparation of corruption risks analyses for the different sectors in the remit of the SCPC, but it has not yet developed a systematic practice in this area.

The SCPC is responsible for **corruption proofing of legislation**. In 2015, it adopted the Methodology on Anti-Corruption Proofing of Legislation (DKSK, 2015[237]), later revised in November 2020. To implement the methodology, a unit for corruption proofing legislation was formed within the Secretariat of the SCPC in 2016. The SCPC has published 15 reports of corruption proofing of laws and draft laws on its website. In 2019 it analysed five laws, acting on its own initiative. It has also been included in working groups for the elaboration of four draft acts (DKSK, 2020[238]). At the request of the SCPC, and with support from the Embassy of the Netherlands and Transparency International, North Macedonia carried out an assessment of vulnerability to corruption in employment policies and procedures in 2020, with special focus on nepotism, cronyism and clientelism. No concrete evidence is available on the implementation of recommendations made during corruption proofing processes.

### *Sub-dimension 16.2: Prevention of corruption*

The SCPC is the main **corruption prevention body**. It is legally autonomous and independent, and accountable to the Assembly. Originally established in 2002, the current SCPC operates based on the Law on Prevention of Corruption and Conflict of Interest adopted in 2019. It has multiple responsibilities such as developing anti-corruption policy, monitoring the implementation of the policy and compliance with legal requirements in several areas, exercising oversight regarding conflicts of interest and declarations of public officials, probing corruption-related acts, instigating initiatives for determining the liability of officials as well as for criminal prosecution, etc. With the new law, the SCPC has gained the competency to conduct misdemeanour procedures.

Several elements of the legal framework aim to safeguard the independence of the SCPC. These include a transparent procedure for the selection and appointment of its president and six members. The Assembly's Committee on Election and Appointment Matters (CEAM) conducts the appointments, which start with the publication of a public announcement. The committee establishes a separate selection committee, comprising seven members, including two representatives of civil society organisations (CSOs). Additional stakeholders from the public are invited to participate in interviews held by the selection

committee with candidates who fulfil formal conditions and broadcast on television. The selection committee determines a ranked list of the candidates, and the CEAM proposes the best-ranked candidates to the Assembly to be appointed for a period of five years, without a right to reappointment. When specific grounds exist, the law authorises the Assembly to dismiss the president and members of the SCPC before their terms have elapsed.

The law does not guarantee any particular level of funding for the SCPC but does determine the salaries of the president and members. The SCPC prepares its own budget proposal, and its president (or his/her deputy) participates in discussions about the budget in working bodies of the Assembly. The annual budget of the SCPC has been increased recently, from MKD 27 million in 2018 to MKD 55 million in 2020 (around EUR 0.9 million). Nevertheless, it remains significantly understaffed with only 24 out of 51 administrative positions filled as of mid-2020. It has had to handle a large amount of cases. In February 2020 alone, the SCPC had to make more than 100 decisions (Blaževski and Rizaov, 2020[239]).

Although there are no special mechanisms for civil society oversight, several CSOs have monitored the work of the SCPC. These assessments and their conclusions have focused on a range of aspects. For example, it has been argued that in 2019 the SCPC was more effective at handling cases of conflict of interest than cases of corruption, that its key focus has been on abuse of employment in the public sector, and that the share of cases it has initiated on its own initiative only amounted to 8-15% (Fakik, 2020[240]). Despite identifying specific weaknesses, these independent assessments have not doubted the generally positive role played by the commission. The SCPC has been found to be proactive in preventing corruption and launching cases against, among others, high-level officials (EC, 2020[46]). The legal requirement to publish its decisions facilitates such public oversight.

When it comes to **conflicts of interest**, the Law on Prevention of Corruption and Conflict of Interest determines the rules for official persons, defined comprehensively as all elected or appointed persons and public sector employees. Other laws, regulations and codes of conduct contain rules on conflicts of interest specifically for members of parliament, members of the government, judges, public prosecutors, etc. The law defines an actual and potential conflict of interest, and clearly requires official persons to be cautious of potential conflicts of interest and take steps to avoid them. The notion of private interest is described in an indirect and general manner as “personal, family, religious, political party and ethnic interests, pressures and promises from superiors or another person”. The SCPC should provide explanations regarding such general provisions and revise the published guidelines before the adoption of the current law (SCPC, 2016[241]).

International experts have identified ambiguity over the ad hoc disclosure and management of conflicts of interest (GRECO, 2019[242]). There do not seem to be consistent procedures using an unequivocal algorithm for reporting ad hoc conflicts of interest or requesting opinions from the SCPC, or for the officials concerned or the head of their institution to take steps to resolve the conflict. A new version of the code of ethics was adopted by the government on 22 September 2020, while the SCPC adopted a guide in November 2020 which aims to clarify the rules and the general management of conflicts of interest for members of the government and other executive officials (SCPC, 2020[243]). It would be necessary to analyse what happens in practice to determine whether the guide – and the officials responsible for advising on integrity matters – manage to ensure smooth compliance with the rules in practice.

When the SCPC determines the existence of a conflict of interest, it should request that the official in question resolves the conflict. If the request is not complied with and the SCPC notified then, depending on the category of the official, the SCPC can demand that a disciplinary procedure is initiated, or the official dismissed, or it can impose a public warning and start a misdemeanour procedure. The law envisages misdemeanour sanctions (fines) for several categories of officials for violations of rules on incompatibilities, post-employment restrictions, management of conflicts of interest, etc. In practice, the number of imposed sanctions has been low: seven public reprimands in 2017, one in 2018 and two in 2019. Only one fine was imposed in 2019 – for violating post-employment restrictions.

Numerous training courses have been held on the topic of conflict of interest. For example, representatives of the SCPC participated as lecturers in training courses for administrative staff organised by the Ministry of Information Society and Administration (MISA) in 2017-19.

The obligation to **disclose assets and interests** applies to high-level functionaries, higher (category A) civil servants, and to notaries, enforcement agents and people employed in the cabinets of the President of the Republic, the President and the Vice-Presidents of the Assembly, the President of the Government (Prime Minister), deputy prime ministers, ministers and the Secretary General. The SCPC may also request an official person not covered by this obligation to submit a declaration of assets and interests when acting on a case in which the person is involved. The Group of States against Corruption (GRECO) has raised the concern that only one official in the Public Security Bureau is subject to the disclosure obligation (GRECO, 2019[242]). Officials have to provide data about themselves and their family members on taking up an official position and after the termination of their function or employment. Officials also have to report increases in property that exceed 20 times the average net salary as well as any changes of interests. According to the SCPC, it would be preferable if they made annual declarations, regardless of changes.

The scope of the disclosure of assets appears rather comprehensive although it is defined in general terms. Salaries for performing official functions do not need to be declared. According to the government, cash savings outside financial institutions and virtual assets such cryptocurrencies are covered under the miscellaneous category, but this opens up the possibility some declarants may not clearly understand the obligation to disclose these types of assets. As of November 2020, it was not possible to precisely assess the scope of declarable information because the new declaration form and relevant by-laws had not yet been adopted. Due to a delay in developing a software solution, the implementation of the system in line with the new law has been delayed, and printed declarations using the previous format remained in use. The public procurement procedure for acquiring the software solution for electronic submission was underway at the time of the assessment.

The SCPC checks officials' property status and interests according to its established annual plan, as well as upon reports or cases formed *ex officio*. However, its capacity to carry out this task is very limited; according to its own data it has only three dedicated employees for this work. The law guarantees the SCPC has access to data from banks and other financial institutions on request as well as direct electronic access to the databases of 17 institutions (although the systems were not yet fully linked as of November 2020; full access is expected with the implementation of the new software solution).

The SCPC imposes misdemeanour sanctions for failures to submit or late submission of declarations (it applied 35 sanctions for non-submission of declarations of interest within the legal deadline, and 74 sanctions for non-submission of declarations of assets in 2019). In 2020, 67 misdemeanour payment orders were issued for non-submission of declarations of assets/interests and 13 for not reporting changes in the property status. According to the government, the amounts of fines have fallen since the 2019 law was adopted because of the general mitigation of misdemeanour sanctions policy. The current law stipulates fines of EUR 300-500 for failing to disclose assets or interests, while previously the range was EUR 500-1 000. In cases of suspected unjustified increase of property, the SCPC submits an initiative to the Public Revenue Office for the verification of undeclared and untaxed assets. It submitted 18 cases in 2017, 8 in 2018 and none in 2019. Since 2016, however, no personal income tax debt settlement decisions have followed such verifications. According to information provided by the SCPC in consultations in November 2020, one practical challenge it faces is individuals paying misdemeanour fines but failing to rectify the underlying violations.

**Whistle-blowers are protected** by the Law on Protection of Whistle-blowers, which was adopted in 2015 and extends to both the private and public sectors. Whistleblowing can be internal, external (to a competent authority) or public. However, protection of external and public whistleblowing is subject to conditions. External whistleblowing is possible, for example if whistle-blowers suspect that no remedying measures will be undertaken if they are reported internally or if internal reporting will cause them or people close to

them harmful consequences. The conditions for public disclosure do not encompass all circumstances envisaged in the EU Directive 2019/1937 on the protection of persons who report breaches of EU law, for example, when the breach reported may constitute an imminent or manifest danger to the public interest.

The law contains multiple provisions to protect whistle-blowers. These include: an obligation for the officer authorised to receive disclosures to protect data about whistle-blowers; protection against any type of violation of the rights of whistle-blowers and any detrimental activity or threat thereof; court protection, which includes possibilities to request finding that a harmful activity has been undertaken or a right has been violated due to the protected disclosure; imposing a ban on the harmful activity or the violation of the right; annulling the harmful act or violation; and awarding compensation for damage. Any provisions of contracts or acts that prohibit whistle-blower disclosure shall be considered null and void.

In any dispute regarding a violation of the right of whistle-blowers and people close to them the burden of proof lies with the institution. However, the definition of persons close to a whistle-blower does not explicitly comprise legal entities connected with the reporting person as envisaged in the EU directive. Legally guaranteed support for whistle-blowers is limited: there are no explicitly envisaged channels of counselling, no access to free legal aid apart from that based on the general rules regarding such aid, and no rules regarding provisional judicial protection before the review of the case is completed.

It has been argued that citizens generally do not understand what it means to be a whistle-blower and competent institutions are not fully prepared to receive whistle-blower reports. Internal whistleblowing is, at best, rare, and as late as in 2019, several major institutions with several thousands of employees and regional units across the economy allegedly had only one or no person designated to receive reports from whistle-blowers (Pisarev, 2019[244]).

The SCPC received 19 whistle-blower reports in 2019 and 6 in 2020. No reports were received in 2016-18. According to the SCPC, as of November 2020, only one of the reports had resulted in a misdemeanour procedure, and 15 remained under review, which is an indication of the relatively low effectiveness of whistleblowing and/or subsequent follow-ups. The SCPC received two requests for whistle-blower protection in 2019, and in both cases court proceedings were ongoing as of November 2020. According to the government, the increase in the number of whistle-blower reports is a sign of increased trust in the SCPC. It appears to be a favourable trend, which requires further strengthening.

The government has carried out some **anti-corruption public awareness-raising campaigns and education** activities. For example, the Customs Administration launched the Report Corruption campaign in 2018, which included dissemination of promotional materials. In co-operation with the Institute for Democracy *Societas Civilis*, the SCPC developed the Anticorruption Education for High School Students project. In 2019, the project resulted in completed research on students' knowledge, a manual for teachers, a manual for students and training for teachers in pilot schools. Further training activities within the project took place in 2020. Nevertheless, the efforts to raise awareness and strengthen the anti-corruption attitudes of the general public appear fragmented.

Various training activities have taken place. For example, in co-operation with MISA, representatives of the SCPC participated in state-funded training for civil servants on anti-corruption, conflict of interest, integrity and whistle-blower protection in 2017-19. Anti-corruption training for representatives of the judicial system has been done as part of the annual training plan of the Academy for Judges and Public Prosecutors. Development of e-learning is envisaged within an IPA project started in January 2020.

In 2019, employees of the SCPC themselves received training funded by USAID on ethics, codes of conduct, etc. North Macedonia provided information on numerous other professional development activities for members of the SCPC and administrative staff employed in its secretariat.

Education activities have been funded from both international sources and the national budget. However, information on the total amount of national funding for anti-corruption awareness raising and education is

not available since it is not centrally defined. There is no evidence that the effectiveness of the awareness-raising activities is being monitored, nor any corrective action based on such monitoring.

### *Sub-dimension 16.3: Independence of the judiciary*

According to the constitution, the courts are autonomous and independent. The Judicial Council (JC) appoints judges with no restriction on the duration of their term of office. The rules for the selection of judges comprise competitive elements, define criteria and ensure transparency. The JC selects a judge of a basic court from a list of applicants submitted by the Academy for Judges and Public Prosecutors, taking into account the year they completed their training and the achieved success, as well as the results of the interview conducted by the JC. Judges for higher courts are selected from among the candidates who responded to a public announcement and who meet the set requirements and criteria. Applicants are ranked according to the specialisation needed the positions to be filled. The JC also elects the presidents of courts from among candidates who have responded to a public announcement. It announces vacancies and decisions on the selection and promotion of judges on its website (Judicial Council of North Macedonia, n.d.[245]).

The JC is an independent and autonomous institution, and its institutional set up is generally adequate for its mandate. It has 15 members, with judges forming a majority (8 of the members are elected by judges from among their ranks, and the President of the Supreme Court as an *ex officio* member). The Minister of Justice is also an *ex officio* member, although without voting rights, which has been the subject of criticism (GRECO, 2020[246]). The JC has broad powers. In addition to appointing and dismissing judges, lay judges and presidents of courts, the JC monitors and assesses the work of judges, decides on the disciplinary accountability and revoking the immunity of judges, proposes two judges for the Constitutional Court, etc. By default, its sessions are held in public. It has been recognised as being increasingly proactive in its role as the guardian of the independence and impartiality of judges (EC, 2020[46]).

The Law on Courts and the Law on the Judicial Council set the grounds and procedures for the disciplinary liability of judges. The judges against whom the proceedings are conducted have the right to a fair trial, including the right to be heard and the right of appeal. Disciplinary decisions have to be published on the JC website. The number of sanctioned judges has fluctuated: one judge was dismissed in 2017, no disciplinary sanctions were made in 2018, and four decisions to dismiss judges were made in 2019 (including final decisions and decisions subject to appeal). More decisions to dismiss judges were made in 2020. Altogether, according to the JC, from 2017 to mid-2020 eight judges were dismissed in cases involving allegations of corruption. This suggests an intensifying trend. In 2019, North Macedonia adopted a new code of ethics for judges and lay judges.

Court cases are distributed among judges through an automated electronic system. This court case management information system has been subject to interference, and in August 2020 the former president of the Skopje Criminal Court was convicted of manipulating it (EC, 2020[46]). It will therefore be essential to monitor the reliability of safeguards to the system in line with the Law on Management of the Movement of Cases in Courts (adopted in February 2020). Courts have to publish decisions within seven days of the day of their coming into force, and the judicial portal provides access to a searchable database of court decisions (Judicial Council of North Macedonia, n.d.[247]).

### *Sub-dimension 16.4: Business integrity and corporate liability*

The formal framework for promoting **business integrity** is limited. For example, according to the Company Law the supervisory body of a joint-stock company is obliged to organise an independent internal audit service, which should, among other things, assess the adequacy and efficiency of internal control systems as well as the implementation of risk management policies, but there are no specific requirements concerning corruption risks.

There have been several public initiatives to support business integrity. One of them is a web platform for business integrity (Bezkorupcija, 2021[248]), which contains resource materials on principles and good practices, including a handbook for companies on systems for preventing corruption (Kusinikova and Cvetkovik, 2019[249]). The Business Confederation of Macedonia has developed principles of business ethics. In October 2020, the newly appointed Deputy Prime Minister in charge of the fight against corruption and crime, sustainable development, and human resources became the chairman of the Anti-Corruption Business Coalition, which aims to promote an attractive business climate through good governance, advocacy of best practices for integrity, co-operation and capacity building in public institutions and private entities.

According to the Law on Prevention of Money Laundering and Financing of Terrorism, the Central Registry shall establish, maintain and manage a register of beneficial owners. The definition of beneficial owner is generally in line with EU anti-money laundering directives. The name, date of birth, citizenship and country of residence of a beneficial owner, as well as their ownership share or other form and type of ownership or control are to be publicly available. This meets the requirement to provide public access established by the 5th Anti-Money Laundering Directive (2018/843). In January 2021, the register became operational. Both financial institutions and designated non-financial businesses and professions have to identify beneficial owners as part of their customer due diligence.

No designated institution such as a business ombudsman is responsible for receiving complaints from companies about corruption-related matters apart from the SCPC and law enforcement bodies.

The Criminal Code prescribes criminal **liability of legal persons** for all offences. A legal entity shall be liable for crime committed by a responsible person within the legal entity, or on behalf, for the account and for the benefit of the legal entity. Under certain conditions, an entity shall also be liable for crime committed by its employee or representative where a significant property benefit has been acquired or significant damage has been caused to a third person. The conditions link the commission of crime to actions or failure to act by a governing, managing or supervising body of the entity. The element of significant benefit or damage limits the application of liability in corruption cases where no such benefit or damage is found, for example if a bribe has only been offered.

The liability of legal persons is autonomous, i.e. an entity shall be liable for a crime even when there are obstacles to determining the criminal liability of the natural person as offender. Fines are the main sanctions for legal entities. The general upper limit of fines is MKD 30 million (around EUR 485 000) with the possibility of increasing the amount for crimes committed out of covetousness and crimes which lead to a greater benefit or damage. Provisions on the calculation of fines link the maximum amount of fines to ranges of prison sanctions. For offences which would lead to imprisonment of less than five years, fines would be many times lower. Even given the possibility of applying greater sanctions when damage has been caused or benefit acquired, as well as imposing confiscation, fines are low relative to the possible scale of large corruption transactions. The law also envisages several types of secondary sanctions ranging from prohibitions of certain types of activities to the termination of the legal entity. The law does not explicitly envisage due diligence, compliance, internal control, or other internal anti-corruption policies as mitigating circumstances, nor is it possible to defer the application of sanctions due to such circumstances. Thus, there is a room to consider introducing new incentives for compliance in the criminal law.

There are few convictions of legal persons for corruption offences. According to the government, no sanctions were applied in 2017-18, and four sanctions in 2019. The legal framework for corporate liability would benefit from guidance on anti-corruption compliance that legal entities have to ensure.

### *Sub-dimension 16.5: Investigation and prosecution*

The statistical data available are somewhat equivocal, but they confirm that North Macedonia has established a track record of prosecutions and convictions in cases of **high-level corruption**. According

to the government, there were two such convictions in 2017, four in 2018 and seven in 2019. Three convictions were final. During 2017-19, more than 50% of the sentences were real imprisonment. The Criminal Law prescribes mandatory imposition of a prohibition to carry out a profession, activity or duty for bribery and passive trading of influence. The European Commission has noted final convictions in three cases, including a sentence of six years of imprisonment for a former interior minister and the conviction of a businessman and his associate for forging documentation to win a tender. In June 2020, the former Chief Special Prosecutor was convicted for alleged extortion and abuse of office in the first instance. The number of new investigations and involved individuals show a sustainable trend in 2019-20 (EC, 2020[46]). Between 2017 and mid-2020, there have been no high-level corruption cases recorded where proceeds located abroad have been recovered.

The Prosecutor's Office for Organized Crime and Corruption (POOCC, originally established in 2004) serves as a **specialised anti-corruption prosecutorial body.** Its activities are currently based on the Law on Public Prosecution (adopted in February 2020). The POOCC has several special safeguards of its autonomy. For instance, the Chief Public Prosecutor of the POOCC is appointed by the Council of Public Prosecutors following a vote by all public prosecutors. The selection process starts with publication of a public announcement. Without the consent of the Chief Public Prosecutor of the POOCC, the Public Prosecutor of the Republic cannot undertake criminal prosecution or perform certain activities for which the POOCC is competent or authorise another prosecutor's office to conduct proceedings or to perform activities within the competence of the POOCC, except when the function has not been performed within legal deadlines. Public prosecutors of the POOCC are dismissed by a two-thirds majority of members of the Council of Public Prosecutors.

The budget of the POOCC is based on a proposal of the Chief Public Prosecutor of the POOCC submitted to the Public Prosecutor of the Republic. Its annual budget increased in 2018 and 2019 and was around MKD 24 million in 2020 (approximately EUR 390 000). The POOCC has 10 public prosecutors with prosecutorial work experience ranging from 7 to 23 years as well as 10 assistant advisors. In terms of the number of prosecutors and budget, the POOCC is a small institution, but its capacity is backed up with the ability to engage judicial police officers. Several experts have been temporarily engaged by the POOCC such as inspectors working on financial analysis, financial investigations and analysts in the field of cybercrime.

Several units operate as **specialised anti-corruption investigative bodies**. There are three entities within the Ministry of Interior: the Economic Crime and Corruption Department, the Unit for Corruption in the Organised Crime Division, and the Unit for Corruption and Counterfeits in the Skopje Regional Department of Interior Affairs. There are two further anti-corruption units within the Financial Police (the Unit for Detection of Abuse of Official Position and the Unit for Detection of Corruption in Public Procurement).

The specialised units in the interior ministry have no special safeguards of their autonomy. The selection of heads of the units takes place following an internal announcement. An internal commission interviews candidates and may conduct written examinations. The heads of the anti-corruption units of the Financial Police are selected based on a procedure that starts with a public announcement or through internal promotion.

According to the government, there are a total of 30 officers in the Ministry of Interior's specialised anti-corruption units. In the Financial Police, there are 12 officers in the specialised units. The units' budgets are not available as separate budget lines, complicating the assessment of their capacities. Employees of the specialised units have attended numerous training and education events, the majority of which have been organised by international actors. North Macedonia has taken steps to strengthen police support for anti-corruption investigations led by public prosecutors, but further investment into the capacity of these small police units appears necessary.

### *The way forward for anti-corruption policy*

North Macedonia should bring its anti-corruption policy further by strengthening several institutions, practices and laws. While positive reforms have been made regarding several aspects of preventing and repressing corruption, especially the relevant capacities and implementation measures require further development. Policy makers should:

- **Ensure full staffing of the SCPC with qualified personnel**, and make sure that the financial capacity of the institution is sufficient to maintain adequate staff capacity under the labour market conditions of North Macedonia. At the time of this assessment, the staffing level of the administrative apparatus of the SCPC was less than half of the envisaged strength and starkly inadequate for the various crucial functions of the SCPC in preventing corruption. The United Nations Convention against Corruption requires that states provide the necessary material resources and specialised staff for preventive anti-corruption bodies (Article 6, Paragraph 2) (United Nations, 2004[250]). More in-depth analysis would be needed to determine specific solutions in the case of North Macedonia, but generally the government should strive to ensure competitive remuneration and other service conditions in order to attract sufficient numbers of qualified personnel to the SCPC.
- **Develop and launch the electronic system of asset and interest disclosure** as soon as possible to ensure full implementation of the relevant provisions of the Law on Prevention of Corruption and Conflict of Interest. An electronic system is crucial for the effective implementation of many aspects of a system of asset and interest disclosure. Such a system should ensure a user-friendly submission of declarations, provide a comprehensive overview for the oversight body regarding compliance with the obligation to submit declarations fully and in time, include analytical tools for statistical analysis and detection of risk signs revealed by declarations, and ensure connection and data exchange with other public databases as well as swift and complete public disclosure as stipulated by law, etc.
- **Continue to disseminate information for potential whistle-blowers** in order to promote whistleblowing over acts of corruption and increase the usefulness of whistle-blowers' reports for detecting corruption. Explore the possibility of speeding up reviews of whistle-blowers' reports to ensure that they see the outcomes of their actions as soon as possible. North Macedonia should strive to implement, among other things, the support measures for whistle-blowers envisaged as mandatory or optional by the EU directive: comprehensive and independent information and advice, which is easily accessible to the public and free of charge, on procedures and remedies available, on protection against retaliation, and on the rights of the person concerned; effective assistance from competent authorities before any relevant authority involved in their protection against retaliation; legal aid, counselling or other legal assistance; and financial assistance and support measures, including psychological support, for reporting persons in the framework of legal proceedings, etc.
- **Implement the registration of beneficial owners of legal entities** and ensure oversight of compliance with the disclosure requirements. The EU Anti Money Laundering Directive requires that the information held in the central register of beneficial ownership information is adequate, accurate and current, and that states put in place mechanisms to this effect, e.g. the requirement that obliged entities and competent authorities report any discrepancies they find between the beneficial ownership information available in the central registers and the beneficial ownership information available to them. However, note that a full assessment of North Macedonia's level of compliance with requirements of the EU directives in this area is beyond the scope of this analysis.
- **Strengthen corporate liability** by ensuring that the applicable fines for all corruption offences conform with the standard of effective, proportionate and dissuasive sanctions. International standards do not define the sufficiency of the sanctions in specific terms, but the OECD Working

Group on Bribery in International Business Transactions has adhered to the standard that monetary sanctions should be sufficiently severe to impact large multinational corporations. In certain economies, statutory ceilings of sanctions even up to a few million euros have been found to be insufficient (OECD, 2015[251]). Even though such levels of fines may appear beyond relevance relative to the limited size of most companies in North Macedonia, the law should provide the possibility to apply adequate sanctions also in a possibly rare case of a large business player engaging in corruption.

- **Strengthen the practice of financial probes alongside corruption investigations** to increase the amounts of corruption proceeds that are detected and confiscated, especially those located abroad. This recommendation echoes the findings of the European Commission that law enforcement and prosecution bodies should boost operational capacity to carry out financial investigations; confiscation of illicit assets should become a strategic priority in fighting organised crime, terrorism and high-level corruption; and the authorities should use confiscation or extended confiscation systematically for certain offences. Corruption crime is mostly perpetrated for obtaining pecuniary benefit, and its recovery for the public is presumably one of the most effective remedies. Therefore, North Macedonia's authorities should make maximum effort to ensure that these benefits are identified, seized and confiscated when law enforcement bodies detect large-scale corruption and the judiciary convicts the involved persons.
- **Consider how to strengthen the independence of specialised anti-corruption law-enforcement units**. The United Nations Convention against Corruption sets the standard that a body or bodies or persons specialised in combating corruption through law enforcement shall be granted the necessary independence, in accordance with the fundamental principles of the legal system of the State Party, to be able to carry out their functions effectively and without any undue influence (Article 36) (United Nations, 2004[250]). This assessment did not evaluate in-depth the practice of the specialised anti-corruption investigative bodies of the Ministry of Interior and the Financial Police, and hence cannot argue whether or not there has been any undue influence on their activities. However, North Macedonia should consider potentially introducing additional means to safeguard the independence of these bodies such as more public and competitive selection of management and strengthened guarantees and transparency of dedicated budget funding. Box 24.21 gives an example of how the independence and accountability of Austria's body is safeguarded.

### Box 24.21. Independence and accountability of the Austrian Federal Office for Prevention and Fight against Corruption

The Federal Office for Prevention and Fight against Corruption (Bundesamt zur Korruptionsprävention und Korruptionsbekämpfung, BAK) was established in 2010 as an organisational entity of the Federal Ministry of Interior. The BAK is competent for security and criminal police matters related to corruption offences and several other kinds of crime.

Even though the BAK belongs to the system of the Ministry of Interior, the law provides it with certain special safeguards of independence and public accountability:

- The Federal Minister of Interior appoints the director of the BAK and his/her deputy for a term of five years after hearing the presidents of the Constitutional Court, the Administrative Court and the Supreme Court (re-appointments are permitted).
- Only those who have special knowledge and national and international experience in the field of corruption prevention and the fight against corruption can be appointed.
- The Legal Protection Commission consisting of the Legal Protection Officer envisaged by the Security Police Law and two other members is set up with the Federal Minister of Interior. The two other members are appointed by the Federal President upon proposal by the Federal Government after hearing the presidents of the Constitutional Court, the Administrative Court and the Supreme Court.
- The Commission reviews allegations against the activities of the BAK that are not manifestly unfounded, insofar as no legal remedy is available to those affected.
- The Commission may at any time report on its examinations to the Federal Minister of Interior and, as far as it appears necessary, to the public. The Commission submits a report on the performance of its duties to the Federal Minister of Interior annually. The Minister must make this report available to the Standing Subcommittee of the Committee on Internal Affairs of the Parliament upon request.

Source: (RIS, 2021[252]), *The Law on the Federal Office for Prevention and Fight Against Corruption*, https://www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=20006390.

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## Notes

[1] For more information, please see: OECD COVID-19 Notes - https://www.oecd.org/south-east-europe/

[2] A person from the Cabinet of the Deputy President of the Government of the Republic of North Macedonia who co-ordinates the whole assessment in the economy.

[3]https://nbstat.nbrm.mk/pxweb/en/Eksterni%20statistiki/Eksterni%20statistiki__Direktni%20investicii__Direktni%20investicii%20-%20Dvizenja/4_DIRMPoZemjiGodisniEN.px/

[4] Other key laws include: the Securities Law; the Profit Tax Law; the Customs Law; the Value-Added Tax (VAT) Law; the Law on Acquiring Shareholding Companies; the Foreign Exchange Operations Law; the Payment Operations Law; the Law on Foreign Loan Relations; the Law on Privatization of State-owned Capital; the Law on Investment Funds; the Banking Law; the Labour Law; and the law on Financial Discipline.

[5] www.ener.gov.mk

[6] The RIA process was started in 2010 and is managed by the Ministry for Information Society and Administration (MISA).

[7] Article 30 of the Constitution provides that no person may be deprived of his/her property or of the rights deriving from it, except in cases concerning the public interest determined by law. If property is expropriated or restricted, rightful compensation not lower than its market value is guaranteed.

[8] The Law on Expropriation predicts condition of expropriation of land in private property for public interest predicted by law.

[9] https://jpacademy.gov.mk

[10] North Macedonia has signed 19 international agreements and conventions including the Patent Cooperation Treaty, European Patent Convention, Paris Convention, Nice Agreement and Locarno Agreement.

[11] North Macedonia has been a member of the World Trade Organization since 2003 and accepted the Protocol Amending the Agreement on Trade-Related Aspects of Intellectual Property Rights in March 2010.

[12] IPR legislation is available on the SOIP website (SOIP, n.d.[327]).

[13] SOIP participated in awareness-raising activities as part of World Intellectual Property Day (April 26 2020 - Innovate for a Green Future).

[14] Both names are used for the agency.

[15] Articles 17, 18 and 19 of the Law on Financial Support for Investments.

[16] This initiative was initiated in 2015 and has run about 700 visits per year since.

[17] Machine and automotive components, ICT, healthcare sector, medical devices and pharmaceuticals, agribusiness, and food processing are the sectors with the biggest potential for investments according to the Programme for Stimulating Investment in the Republic of Macedonia (2007-10) as well as the Industrial Policy (2009-20). The energy sector, textiles and tourism are regarded as the next tier of promising sectors for investments.

[18] The FIC consists of more than 130 companies with foreign capital in the economy. It was established with the goal to make the economy more attractive for investment through simplified rules and increased predictability. Promoting solid business ethics and strong corporate governance principles is also high on the FIC's agenda. It gives foreign investors the opportunity to engage in direct dialogue with the highest political/executive level of government.

[19] DTIDZ aftercare services include: 1) support with relevant tax and customs issues; 2) assistance in acquiring visas/work permits for foreign investors; 3) dealing with other state and local authorities; 4) design and infrastructure approvals; 5) issuing building and operational permits; 6) customs outpost services in the zone; 7) zone infrastructure maintenance and upgrade; 8) services for creating linkages with universities; 9) company and recruitment agencies linkages; and 10) identification of suppliers.

[20] In 2018 and 2019, its main export partners were Germany, which alone accounted for almost half of total exports (47%); Serbia (7.9%); and Bulgaria (5.2%); the main sources of imports were Germany (11.6%), the United Kingdom (9.5%) and Greece (8.5%) (World Bank).

[21] There are several bodies established by the government:

- The Co-ordinative Body for WTO Accession, responsible for the accession process and processes after accession to the WTO. The three Economic Chambers are also included in this body. It is co-ordinated by the Ministry of Economy.
- The working group responsible for trade issues within Stabilisation and Association Agreement (SAA). It is co-ordinated by the Ministry of Economy and the Secretariat for European Affairs.
- The Advisory Council responsible for custom matters, withing the Custom Administration.
- The Economic Council within the government, chaired by the Prime Minister.

Inter-institutional co-ordination is implemented through a "sectoral approach" and sectoral working groups responsible for the development and managing of sectoral strategies and implementation. There are five sectoral working groups, including one for competitiveness and innovation.

[22] All proposals to Cabinet Sessions must pass internal government consultations (ministries and involved agencies) and external consultations (civil and business community entities). The General Secretariat of the Government co-ordinates pre-Cabinet Sessions with all ministries' state secretaries to assess the compliance of proposals with individual ministries' interests and regulations.

[23] These include the Ministry of Finance, Customs Administration, the Ministry of Foreign Affairs, the Secretariat for European Affairs, the Ministry of Agriculture, Forestry and Water Management, the Food and Veterinary Agency, the Ministry of Justice, the Ministry of Health and other institutions depending on the subject matter.

[24] The regulatory development process is covered by the regulatory impact assessment methodology. However, due to the overload of new or updated regulations, RIA is often carried out in a more formal way than with full understanding and compliance. RIA requires both internal government institutions and external stakeholders (citizens, companies). It should be noted, however, that the effectiveness and efficiency of RIA, and respect for the need to consult stakeholders, seems to be improving. Finally, a form of legal compliance assessment exists through the obligation to obtain the approval of the Secretariat for Legal Affairs for any new regulation.

[25] ENER (https://ener.gov.mk/Default.aspx) was created in 2009 to act as the official repository of all regulations under development and consultation.

[26] Evidence shows that the chambers are active in this area and proactively engage in a process of "pre-drafting" legislation for general government strategies. Training programmes were delivered to the chambers on how to participate in RIA processes, ENER training and complaint management. Chambers are able to submit comments, complaints and unsolicited proposals directly to the secretariats of the Prime Minister and the Vice Prime Minister for Economic Affairs. In recent years chambers have begun submitting “white papers” to the government on emerging economic issues.

[27] OECD member states and partner economies: Brazil, the People’s Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

[28] The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member states and partners states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.

[29] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[30] Law on Trade Companies, Закон за трговските друштва.

[31] In order to facilitate comparison with OECD members that have undergone the STRI exercise, the paragraphs below have been drafted in accordance with the methodology of the STRI project publications. The OECD Country Notes, as well as the Sector Notes, are available on the STRI web page https://www.oecd.org/trade/topics/services-trade/.

[32] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has been agreed internationally and aims for a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks’ risk management.

[33] Basel II is an international business standard developed prior to the 2008/09 crisis by the BCBS. It requires financial institutions to maintain enough cash reserves to cover risks incurred by operations.

[34] Directive 2011/61/ EU on alternative investment fund managers and the Regulation on venture capital funds 345/2013.

[35] "Letsfundit - This platform support three forms of crowdfunding: donation based, reward based and equity based http://www.letsfundit.mk/.

[36] Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts.

[37] The amount is MKD 2 000 for employees with an average monthly salary of up to MKD 10 000; MKD 1 500 for employees with a salary between MKD 10 001 and MKD 10 500; MKD 1 000 for employees with a salary between MKD 10 501 and MKD 11 000; and MKD 500 for employees with a salary between MKD 11 001 and MKD 11 500.

[38] The threshold for this rate is MKD 1.08 million annually (EUR 17 500).

[39] For income from intellectual property, the allowance varied between 25% and 60%. For rental income, allowances in the range of 25-30% were granted. An allowance of 35% was granted for income qualifying as "other income".

[40] This does not include the return on "games of chance" which are taxed at 15%.

[41] Employee contributions are remitted by the employer.

[42] The OECD Database on General Competition Statistics (OECD CompStats) is a database with general statistics about competition agencies, including data on enforcement and information on advocacy initiatives. In 2020, it included data from competition agencies in 56 jurisdictions, including 37 OECD countries (36 OECD countries and the European Union), i.e. Argentina, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas): Australia, Brazil, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other) (OECD, 2020[295]).

[43] The reported total number of SOEs in North Macedonia held by central and sub-national governments, and their total number of employees, is based on OECD calculations aggregating the sectoral figures provided by North Macedonia's authorities. The figures provided by the authorities excluded primary-sector SOEs.

[44] No corporate valuation figures for SOEs were provided.

[45] The primary sector is understood to include all activities related to the extraction of raw materials, including agriculture, forestry, fishing and mining activities.

[46] The three SOEs nominally listed on the stock exchange undertake the following activities: 1) invest, build, sell and maintain private apartments; 2) invest, build and maintain government properties (government buildings, sport arenas, schools and other government properties); and 3) operate the state lottery.

[47] All of the WB6 economies except Montenegro were included in the IMF analysis of SOEs' share of national economic activity. It is difficult to arrive at conclusive regional (or international) comparisons regarding SOEs' employment share, owing to limitations in data availability or differences in methodology. The IMF study found that SOE employees accounted for approximately 4% of national employment in

North Macedonia, which is lower than the 6.4% estimate of the current OECD assessment. The employment data used in the IMF study applied to a significantly smaller portfolio of SOEs than the current assessment, which likely explains the lower estimated employment share.

[48] While the Government of Macedonia is legally the shareholder of SOEs, it is commonly agreed – and asserted in the OECD *Guidelines on Corporate Governance of State-Owned Enterprises* – that the state exercises ownership on behalf of the general public, who are considered the ultimate shareholders of SOEs.

[49] This conclusion is based on the fact that an independent study of SOEs' financial performance was undertaken by the Balkan Investigative Reporting Network in 2014, using information from financial statements available for 101 enterprises through the Central Registry (BIRN, 2014[92]).

[50] According to stakeholders interviewed for this assessment, 14 SOEs operate under the separate legal form of "public enterprise".

[51] This is based on an unofficial translation of the 1996 version of the Law on Public Enterprises.

[52] For example, a government might establish heightened requirements for independent directors on boards (bringing rules in line with good practice), but then use the awarding of independent directorship positions as tools for political patronage.

[53] Although the latest state ownership report for Finland dates from 2016, its contents can still serve as a useful reference point. The report is available online (Ownership Steering Department, 2017[297]).

[54] Data for Kosovo and Japan not available.

[55] For the purpose of this profile, the instructional system refers to teaching and learning processes that takes place in school education. It generally consists of the curriculum, standards for schools and student learning, assessment and evaluation frameworks, and other elements that support instruction.

[56] Learning standards in North Macedonia vary by subject and grade level. For example, standards from the Cambridge curriculum are used for Grade 9 mathematics but these differ from the national mathematics standards used in Grades 10+, see Table 2.2 in (OECD, 2019[70]).

[57] The National Examinations Centre expects to start implementing the new national assessment in 2021 to monitor student achievement of the curriculum in Grades 3 and 5.

[58] North Macedonia requires schools to conduct self-evaluations biannually.

[59] Article 113 of the 2019 Law on Primary Education lists the tasks under the responsibility of school principals, including monitoring and promoting educational work – and deciding on educational measures.

[60] The share of early school leavers is defined as the percentage of 18-24 year-olds with at most lower secondary education (ISCED 2) who were not in further education or training.

[61] According to national data received for this assessment, nearly 99% of teachers in North Macedonia had attained at least a bachelor's degree as of 2018.

[62] Pedagogical-psychological and methodological preparation consists of attending classes and taking exams, as well as performing at least 45 days of practical teaching in primary or secondary schools.

[63] The Law on Higher Educational Institutions for Teaching Education Staff in Preschool Education,

Primary and Secondary Education, has undergone several amendments.

[64] Selection into initial teacher education programmes is based on candidate results in the State Matura.

[65] North Macedonia does not offer additional compensation to attract candidates or address teacher shortages in rural areas or academic subjects.

[66] Law on Teachers and Professional Associates in Primary and Secondary Education (Official Gazette of the Republic of North Macedonia no.161/19).

[67] Of the 60 professional development hours in a 3-year cycle, 40 must be from accredited programmes and 20 must cover priority areas identified by the ministry.

[68] Vocational education programmes in North Macedonia are either two, three or four years long.

[69] Teachers may be pressured by parents to give students high marks so they can attend the best upper secondary schools, raising concerns about the integrity of teachers' classroom assessments (OECD et al., 2019[71]).

[70] This is the second largest difference in the region, after Serbia (64 score points).

[71] Laws relevant to the institutional framework of VET governance in North Macedonia include the Law on Vocational Education and Training, the Law on the Bureau for Development of Education, the Law on Adult Education, the Law on Secondary Education, and the Law on the Chamber of Commerce.

[72] Education Strategy for 2018-25 and Strategy for Vocational Education and Training in the Context of Lifelong Learning.

[73] Averages taken through the World Bank Open Data portal, based on UNESCO Institute for Statistics (UIS) data. Data for Kosovo not available.

[74] Selection into higher education requires successful completion of a four-year upper secondary education programme and passing the State Matura examination. Specific requirements are also set by individual higher education institutions, which publish selection criteria on their websites.

[75] North Macedonia was one of the first non-EU member countries to introduce a Youth Guarantee Scheme that commits to ensuring all young people receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within four months of becoming unemployed or leaving formal education (OECD, 2019[70]).

[76] In 2019, own calculations based on Labour Force Survey (LFS) data.

[77] Note, that among the EU-11 (all EU transition countries) the average activity rate was 73.7% in 2019, (own calculation based on LFS data).

[78] From 2015 to the second quarter of 2019Q2 (WIIW/World Bank, 2020[129]).

[79] They are stipulated in the Law on Labour Relations, the Law on Occupational Safety and Health, and the Law on Private Employment Agencies.

[80] The OHS Council is an expert advisory body that reviews and gives opinions and recommendations concerning occupational health and safety issues in North Macedonia (ILO, 2013[334]).

[81] Note that youth unemployment rate is on average slightly lower in in countries that joined the EU after

2004 than in the “old” member states (EU-15).

[82] Information provided by the government.

[83] According to a press release of the Minister of Information Society and Administracija, drafting by-laws is in progress.

[84] According to the government.

[85] Government’s response to questionnaire.

[86] According to the government.

[87] Indicators include: 1) unemployment rates by various dimensions; 2) proportions of unemployed people versus employed people; 3) young people not in employment, education, or training (NEET); 4) coefficient of variation of education; 5) variance of relative unemployment rates; 6) mismatch by occupation; 7) over- and under-education; and 8) relative wages (ETF, 2019[130]) see also the ETF report Skills Mismatch Measurement in ETF Partner Countries (ETF, 2019[328]).

[88] Based on the International Standard Classification of Education (ISCED 2011), the term low-educated refers to people with less than primary, primary and lower secondary education (levels 0-2), medium educated refers to people with upper secondary and post-secondary non-tertiary education (levels 3-4) and highly educated refers to people with tertiary education (levels 5-8). Between 2015 and the second quarter of 2019, the unemployment rate among low-educated adults decreased by 5.9 percentage points, among the medium-educated by 9.6 percentage points, and among the high-skilled by 7.6 percentage points (WIIW/World Bank, 2020[129]).

[89] Elementary occupations consist of simple and routine tasks which mainly require the use of hand-held tools and often some physical effort (ILO, 2004[332]).

[90] Tracer studies can be defined as retrospective analyses of graduates through a standardised survey, which takes place some time after graduation (normally between 6 months and 3 years) (ETF, 2017[333]).

[91] In 2016, according World Bank (2020) data analysis, nearly two-thirds of young people with primary education had a temporary contract.

[92] With the lowest range showing the greatest inequality.

[93] The male employment rate increased by 7.8 percentage points between 2015 and 2019.

[94] For comparison in the EU-11 countries, the activity rate of men was 15.9% percentage points above the activity rate of women in 2019.

[95] Information provided by the government

[96] Information provided by the government.

[97] Of the remaining staff, 23% are working on passive measures, 10% are working as managers and 6% as support staff.

[98] In France and Germany for example, caseloads of hard-to-place jobseekers are around 70 jobseekers per employment counsellor, while caseloads may vary in these countries between 100 and 350, depending

on how much individual guidance job seekers need and how autonomous they are in using self-help guidance tools. (OECD, 2015[300]; Manoudi et al., 2014[282]); (Pôle emploi, n.d.[314])

[99] The long-term unemployment incidence in the EU was 35% in that year.

[100] Information provided by the government and Eurostat, LFS database.

[101] As recommended by the OECD, countries should ensure access to welfare benefits, such as unemployment and disability benefits whilst reducing incentives for early retirement for those still able to work. This calls for supporting companies to retain older workers (OECD, 2019[293]).

[102] 50% of reference earnings for workers who have the right to benefits for up to 12 months, while for workers who are entitled to benefits for longer than 12 months it is 50% of reference earnings in the first year and 40% in the remaining time period.

[103] Information provided by the government.

[104] The poverty rate was reduced from 27% in 2010 to 22.2% in 2017 (Government of North Macedonia, 2019[121]).

[105] Study led by co-operation Eftheia, Icon Institut and Budapest Institute on behalf of the European Commission, DG Employment, Social Affairs and Inclusion.

[106] Unemployment rate among 15-24 year-olds.

[107] In the second quarter of 2019, the youth unemployment rate was 4.9 percentage points above the WB6 average.

[108] LFS data.

[109] Information provided by the government.

[110] Data provided through answers to the questionnaire.

[111] There are no comparable data for Bosnia and Herzegovina, Kosovo, and Montenegro available. Data from other sources suggest that informal employment is about 30.4% in Bosnia and Herzegovina; 20% in Montenegro (where in addition 10% of salaries are under-reported according to a 2014 survey (ILO, 2019[278]), based on Labour Force Survey data; (EC, 2019[305]); (Katnic, 2018[281]). According to a Eurobarometer survey, 10% of respondents in the EU report they have purchased goods or services in the past year that might have derived from undeclared work. A third of Europeans know somebody who works undeclared (EC, 2020[306]).

[112] According to data provided by the government.

[113] There is a clear link between female employment and access to high-quality and accessible childcare.

[114] Horizon 2020 is the biggest EU framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020).

[115] Eureka is the largest intergovernmental network for co-operation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and

innovation or offers advice through various programmes (such as EUREKA Clusters, Globalstars, InvestHorizon) (https://www.eurekanetwork.org/).

[116] European Cooperation in Science and Technology (COST) is an EU-funded, intergovernmental framework that currently gathers 38 Members and 1 Cooperating Member. It is a funding organisation for the creation of research networks (COST Actions), which offer an open space for collaboration among scientists across economies. COST funding is intended for collaboration activities and complements national research funds (https://www.cost.eu/who-we-are/about-cost/).

[117] EURAXESS – Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated economies. It supports researcher mobility and career development and enhances scientific collaboration (https://euraxess.ec.europa.eu/).

[118] Marie Skłodowska-Curie Actions (MSCA) is an EU programme that provides grants to support research careers and encourages transnational, intersectoral and interdisciplinary mobility. (https://ec.europa.eu/programmes/horizon2020/en/h2020-section/marie-sklodowska-curie-actions; https://ec.europa.eu/research/mariecurieactions/msca-actions_en).

[119] The National Operational Broadband Plan includes a specific timeline for each action and tangible targets. For example, all towns in the country will have uninterrupted 5G coverage by the end of 2027, or at least 50% of the total number of household subscriber contracts across the country will provide internet access of at least 100 Mbps by the end of 2029, and all public bodies will have internet access speeds above 1Gbps by the end of 2029. (Ministry of Information Society and Administration, 2019[284]).

[120] White zones are those in which there is no broadband infrastructure and it is unlikely to be developed in the near future. A basic broadband infrastructure mapping web application was created in 2018 by the Agency for Electronic Communications, the national electronic communications regulator, indicating white, grey and black zones, based on the availability of internet access speeds higher than 30Mbps (AEK, 2021[255]).

[121] The Open Data Portal of the Government of North Macedonia (http://data.gov.mk/).

[122] The Open Finance Portal was developed with support from USAID and IRI and participation of the civil society (https://open.finance.gov.mk).

[123] National e-government portal (https://uslugi.gov.mk/).

[124] Country report and roadmap for Digital Agenda advancement in North Macedonia, project “Increasing Citizen Participation in the Digital Agenda – ICEDA”, co-funded by the European Union and implemented by the Metamorphosis Foundation (North Macedonia), Academy for e- Government (Estonia), Levizja Mjaft! (Albania), CRTA - Center for Research, Transparency and Accountability (Serbia), NGO 35mm (Montenegro) and ODK - Open Data Kosovo (Kosovo). (Jashari and Josifovska Danilovska, 2020[280]).

[125] Guidelines for Accessibility to Web Content describing the application of WCAG v2.0 standards for the web presentation of public sector bodies and institutions (http://wcag.mioa.gov.mk/).

[126] State Market Inspectorate, online form for collecting consumer complaints (https://www.dpi.gov.mk/index.php/mk/contact).

[127] The draft Law on Networks and Information Systems Security was under a consultation process at the time of writing this text.

[128] A single project pipeline (SPP) is a list of projects developed based on a strategic tool for project planning to avoid an ad hoc approach to planning preparation and implementation of investment projects. The SPP helps to ensure strong project prioritisation, to enable systematic and timely planning of resources, to provide a reliable basis for defining the proper sequencing of the priority axis and actions per sector, and to help link investment planning and programme budgeting.

[129] Department within the Ministry of Finance of the Republic of North Macedonia.

[130] For more information, please see: World Bank, Regional and Local Roads Program Support Project, https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ppar_macedoniaroads.pdf.

[131] An appropriate definition of "asset management" for the roads sector is the one proposed by the OECD in 2001: "A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organised and flexible approach to making the decisions necessary to achieve the public's expectations." (OECD, 2001[330]).

[132] Public Enterprise Macedonian Railways Infrastructure (PEMRI, owned by the Republic of North Macedonia) possesses the Railway Infrastructure Management System (RIMS) software, but unfortunately PEMRI does not have the measurement car needed to use the software as planned.

[133] Draft Regional Road Asset Management Plan developed by the Transport Community Permanent Secretariat, (currently under the endorsement process but the implementation level is already monitored by the TCPS); Draft Action Plan for developing a regional rail strategy in the Western Balkans developed by the Transport Community Permanent Secretariat, (currently under the endorsement process but the implementation level is already monitored by the TCPS); Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6. For more information, please see: https://www.transport-community.org/library/reports/.

[134] Important regulations include: Regulation on procedure, rules and special requirements for inspection and special requirements to be met by a person to carry out inspection of provision of air navigation services; Regulation on method of provision of Air Navigation Services and special requirements in respect of required staff, equipment and other special requirements necessary for safe and regular work; Decision on Level Charge for Air Navigation Services; Regulation on the organization and use of the airspace; Regulation on rules and requirements in respect of systems interoperability, their components and related procedures for provision of air navigation services with the European ATM network.

[135] According to the last Local Single Sky Implementation document, issued on 30 March 2020, the legal system of the Republic of North Macedonia is in compliance only with the ATM legislation of SES Package 1 but the transposition of SES II was initialised on the basis of the amendments of the Aviation Act enacted in 2016 and is ongoing (Eurocontrol, 2020[329]).

[136] Safety culture is civil aviation safety programme. The State Safety Programme is an integrated set of regulations and activities aiming to improve safety (e.g. Safety Risk Management, Safety Assurance).

[137] Information provided though the quantitative questionnaire by the government.

[138] A one-stop shop is a business or office where multiple services are offered; i.e., customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one

location, instead of having to "drive all over town" to attain related services at different stores. One-stop shop is a way of facilitating trade.

[139] On 28 January 2019, the Agreement on international transport of passengers and goods between the Republic of Macedonia and the Republic of Lithuania was signed by the Ministers of Foreign Affairs of both countries. It was ratified on 12.12.2019, and published in the Official Gazette of the Republic of North Macedonia no. 259/19 on 18 December 2019.

[140] Modal shift from road, standards for energy efficiency, standards for noise emission, reduction of GHG emissions, vehicle labelling for emissions and fuel efficiency, introduction of carbon footprint calculators, eco-driving and speed limits, ITS applications, co-modality in transport, urban mobility solutions, etc.

[141] As per the Combined Transport Directive 92/106EC, amended by the Directive 2013/22/EU, “combined transport” means the transport of goods between Member States where the lorry, trailer, semi-trailer, with or without tractor unit, swap body or container of 20 feet or more uses the road on the initial or final leg of the journey and, on the other leg, rail or inland waterway or maritime services where this section exceeds 100 km as the crow flies and make the initial or final road transport leg of the journey.

[142] Ease of arranging competitively price shipments.

[143] Ability to track and trace consignments.

[144] For more information please see the UK Transport Analysis Guidance (UK Government, 2019[323]), Special attention should be paid to the TAG unit A1-1 transport analysis guidance on the principles of cost-benefit analysis and how they should be applied in the context of transport appraisals.

[145] Periodical and regular measurements to monitor infrastructure assets’ conditions, assessment of the value of assets and costs for non-maintained assets, adoption of the asset management strategies, consistent approach in the identification of the mix and timing of asset operation and construction strategies, etc.

[146] Gross inland consumption is, in this case, the total energy demand of North Macedonia excluding international marine bunker. For further explanation of statistical energy terms please see https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Category:Energy_glossary.

[147] For a list of outstanding secondary legislation and regulations please see (Energy Community Secretariat, 2020[265])

[148] Network codes are a set of rules drafted by ENTSO-E, with guidance from the Agency for the Cooperation of Energy Regulators (ACER), to facilitate the harmonisation, integration and efficiency of the European electricity market. See more details at: https://www.entsoe.eu/network_codes/

[149] Commissioner in this context means, pursuant to and in compliance with Chapter III of the Energy Law No. 08-3424/1 from the 21st of May 2018, member of the governing council of ERC—including but not exhaustively the President and Deputy President.

[150] See Ten Year Network Development Plan (TYNDP) (MEPSO, 2019[207]).

[151] EU Regulation (EU) 347/2013.

[152] Oil indexation had been once the dominant pricing format for natural gas in Europe. This largely reflected that at the times, natural gas spot markets were not liquid enough to provide good price signals.

Moreover, at the times natural gas was competing with oil consumption in power generation and heating and oil indexation was a good approach to assure that natural gas was competitive versus main alternative fuel. Furthermore, with often oil indexation is also justified due to natural gas being partially produced as a by-product from oil exploration or as natural gas investment cost being associated with alternative investment into oil. However, oil indexation implies that in the current market situation that the natural gas price is not reflective of the supply and demand realities which are largely now disconnected from oil both in terms of alternative demand and on the production side. Furthermore, Europe has a variety of liquid natural gas spot markets that offer good pricing and indexation points, especially considering the interconnected natura of the European natural gas pipeline network. However it should be stressed that there is an extensive literature discussing benefit and drawbacks of natural gas being priced on oil indexation and this endnote only scratches the surface of the debate. Some examples of the literature are: (Dubreuil, Gergely Molnar and Jeon, 2020[262]), (EC, 2015[302])—with regard to legality of oil indexation, (Melling, A.J. (2010), Natural gas pricing and its future- Europe as the battleground, 2010[301]), (IEA, 2020[277])—for current split in pricing approach in Europe, (Stern, 2007[331]).

[153] European Union Regulation 2019/941 On risk-preparedness in the electricity sector and repealing Directive 2005/89/EC.

[154] "The term 'prosumers' broadly refers to energy consumers who also produce their own energy from a range of different onsite generators," (EC, 2017[303]) but "mainly through solar photovoltaic panels on their rooftops, citizen-led energy cooperatives or housing associations, commercial prosumers whose main business activity is not electricity production, and public institutions like schools or hospitals" (European Parliamentary Research Service, 2016[270]).

[155] The Energy Law establishes the possibilities of own consumption and stipulates in Article 38 Paragraph 2, Article 96 Paragraph 4, Article 185 Paragraph 2 and Article 186 Paragraph 1.7 that this activity does not require a licence and that rules for their accommodation should be included in support measures and the distribution network code. This is right is reaffirmed by the Rulebook For Renewable Energy Source.

[156] There are possible improvements with respect to establishing a single entity for a streamlined permit process which renewable energy projects need to approach, as well as establishing a electronic/online platform for aspects relating to permits and Guarantees of Origins.

[157] A Guarantee of Origin (GO) is a tracking instrument defined in Article 15 of the European Directive 2009/28/EC On the Promotion of the Use of Energy from Renewable Sources and Amending and Subsequently Repealing Directives 2001/77/EC and 2003/30/EC. GOs are certificates used to identify and certify that a certain consumed electricity was sourced from renewable energy. A certificate is issued per MWh generated from renewable energy and cancelled by consumers or suppliers who would like to certify that energy was generated renewably. For more information on GOs and their use and implementation please see (AIB, 2020[256]) or (Umwelt Bundesamt, 2020[324]).

[158] European Directive 2009/28/EC On the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, which is part of the Third Energy Package. Article 15 Paragraph 2 states that "Member States may provide that no support be granted to a producer when that producer receives a guarantee of origin for the same production of energy from renewable sources." In other words, countries have the option to limit the issuance of GOs to renewable projects not receiving state aid, an option that is currently used by North Macedonia. However, as part of the Clean Energy Package, this Article has been recast to state in Article 19 Paragraph 2 of the European Union Directive 2018/2001 On the promotion of the use of energy from renewable sources that "Member States shall ensure that when a producer receives financial support from a support scheme, the market value of the guarantee of origin for the same production is taken into account appropriately in the

relevant support scheme." In other words, countries can no longer exclude state funded project from receiving guarantees of origin. This change large reflects the realisation that guarantees of origin allows the owner to obtain additional financial flows for renewable generation as it separate the generated electricity and allows to capture consumer group willing to pay for the privilege of sating their consumption is derived from renewable generation. To this end, the Directive does prescribe that the additional income be used to ease the government associated support scheme cost.

[159] Energy Efficiency Directive 2012/27, the Energy Performance of Building Directive 2010/31, and the Directive of Eco-Design of Energy Related Products 2009/125.

[160] Please see the Energy Community Secretariat report (Energy Community Secretariat, 2020) for a list of all the secondary legislation which has yet to be adopted. Both the regulator and Ministry of Economy have an extensive list of energy sector legislation and regulations that have been adopted. (Energy Regulatory Commission, 2020[267]) (Ministry of Economy, 2020[283]) (Ministry of Economy, 2020[283]) However, the list in English is not as extensive as the list in the national language and so it is possible that some of the outstanding acts have been adopted .

[161] North Macedonia has no natural gas resources and is reliant on natural gas imports (Energy Regulatory Commission, 2019[266]).

[162] According to Energy Community Secretariat, there were roughly 437 consumers in North Macedonia in 2019, of which 389 were household consumers. Household consumption of 6 million cubic meters accounted for 2% of total consumption in 2019 (Energy Community Secretariat, 2020[203]).

[163] A seat requirement is "a provision of national law under which an undertaking established in another Member State must create a permanent establishment in the Member State in which it seeks" to be active (Energy Community Secretariat, 2018[264]). While this is not prohibited, it does add a barrier to entry and decreases the competitiveness of international market entries by imposing the additional cost of maintaining more than one establishment.

[164] Meanwhile, the DSO has fewer than 100 000 customers and thus, under EU Directive 2009/73/EC Article 26 Paragraph 4, does not need to be unbundled.

[165] For more on the natural gas network codes please see European Network of Transmission System Operators for Gas.

[166] For a comprehensive presentation of the benefit of trade and their mechanisms please see (Baker, Hogan and Kolokathis, 2018[257]); (Newbery et al., 2013[259]); and (Böckers, Haucap and Heimeshoff, 2013[258]).

[167] It should be clarified that this section is in relation to subsidies outside of support for renewable energy, energy efficiency, and social needs. All three are commonly applied policy areas that receive some form of financial support. It is common international practice to provide subsidies for renewable energy in order to support the investment and thus growth of renewable energy in the national energy mix. While at the beginning of the global deployment of renewable energy, source subsidies were needed as the cost of renewable energy was not competitive, as deployment has increased the cost has come down to a point where renewable energy sources are increasingly competitive with existing fossil fuel generation. However, renewable energy subsidisation continues to be the international norm in order to expedite the deployment and thus further the cost reduction of renewable energy. Meanwhile, international best practice also recognises social support as an acceptable form of protecting the most vulnerable consumers in society. It should be stressed that social support is sometime used as the basis to provide large section of

consumers with below market cost energy – including consumers who can afford to pay for their consumption. This use represents a cross-subsidy that is not considered international best practice. Lastly, energy efficiency is a common policy area and, much like renewable energy, it is international best practice to provide financial support to consumers to increase and accelerate the deployment of energy efficiency measures. This section concerns itself with direct or indirect subsidies that are not in any of these areas, but rather subsidisation that leads to a market distortion away from the competitive equilibrium.

[168] The third one was published in 2020 and the fourth one was being prepared at the time of writing,

[169] The project "Adaptation to Climate Change through Transboundary Flood Risk Management in the Western Balkans (2016-2020)" funded by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), focuses on the development of integrated water resource management and implementation of adaptation strategies in the Drin River Basin, covering Albania, Kosovo, Republic of North Macedonia and Montenegro. The main objective is to mitigate the impacts of climate change by focusing on flooding and drought risk management as well as strengthening regional co-operation as it pertains to the management of water resources. Moreover, the project "Improving Flood Resistance in the Polog Region" funded by the Swiss Agency for Development and Cooperation (SDC) and scheduled to run until 2023.

[170] Overall responsibility for waste management lies with the MoEPP. The Waste Management Department, established in 2010, is responsible for planning, adopting and implementing legislation, setting standards in waste management, monitoring, issuing permits for waste managers, as well as initiation and coordination of waste management projects. The Ministry of Economy (MoE), Ministry of Finance (MoF) and MoEPP are responsible for preparing regulations on Extended Producer Responsibility (packaging, WEEE, batteries). The Ministry of Finance (MoF) develops economic instruments and provides funds to encourage sustainable waste management. The Ministry of Health (MoH) and MoEPP prepare regulations on medical waste management. Responsibility for inspecting medical waste management is divided between State Sanitary Inspectorate (MoH) for the selection and storage of medical waste and State Environmental Inspectorate (SEI) for the transport and treatment of the medical waste. The competent authorities for inspection and enforcement tasks are the State Environmental Inspectorate (SEI) and the Local Inspection Authority (municipalities). Inter-Municipal Waste Management Boards (IMWMB) are established in all eight regions and have the responsibility of organising the implementation of waste management plans.

[171] EU Waste Framework Directive, Landfilling Directive, Packaging Waste Directive and Directives on end-of-life vehicles, on batteries and accumulators and waste batteries and accumulators, and on waste electrical and electronic equipment.

[172] Among the EU countries, Finland records the highest freshwater resources (with a long-term average of 19 950m³ per inhabitant) followed by Sweden (19 410m³). Freshwater abstraction by public water supply ranged across the EU from a high of 179m³ of water per inhabitant in Greece (2016 data) down to a low of 31m³ per inhabitant in Malta (OECD, 2020[51]).

[173] At the tenth meeting of the Conference of the Parties to Convention on Biological Diversity, held in October 2010, in Nagoya, Aichi Prefecture, Japan, a revised and updated Strategic Plan for Biodiversity was adopted, including the Aichi Biodiversity Targets, for the 2011-20 period. This plan provided an overarching framework on biodiversity, not only for the biodiversity-related conventions, but for the entire United Nations system and all other partners engaged in biodiversity management and policy development. Parties agreed to translate this overarching international framework into revised and updated national biodiversity strategies and action plans within two years, which are intended to define the current status of biodiversity, the threats leading to its degradation and the strategies and priority actions to ensure its conservation and sustainable use within the framework of the socio-economic development of the

country. There are 20 Aichi biodiversity targets grouped around 5 strategic goals: A) Address the underlying causes of biodiversity loss by mainstreaming biodiversity across government and society; B) Reduce the direct pressures on biodiversity and promote sustainable use; C) Improve the status of biodiversity by safeguarding ecosystems, species and genetic diversity; D) Enhance the benefits to all from biodiversity and ecosystem services; and E): Enhance implementation through participatory planning, knowledge management and capacity building (Convention on Biological Diversity, 2020[261]).

Draft VI National Report to the Convention on Biological Diversity in 2020 has been prepared. The report was submitted to the Secretariat of the Convention on Biological Diversity.

[174] Although six pollutants (SO2, NOx, $PM_{10}$, $PM_{2.5}$, CO and $O_3$) are continuously monitored, in many cases, the time coverage of the data is below 70%.

[175] In 2017, combustion in households and administrative capacities contributed 37% of $PM_{10}$, out of the national total of 16.2kt, and 62% of $PM_{2.5}$, out of the national total of 9.2kt.

[176] The following fees are set out in Article 213 of the Law on Water: fee for water use intended for human consumption; fee for use of irrigation water; fee for use of water for land drainage; fee for the use of water in the production of electric energy; fee for the use of water for thermal energy from geothermal waters; fee for the use of water for fish farming, in fishponds and in cages and waterfowl; fee for the use of water for washing and separation of sand, gravel and stone; fee for use of water for production and processing of food and beverages, industrial and technological needs; a fee for discharging water; and a fee for extracting sand, gravel and stone.

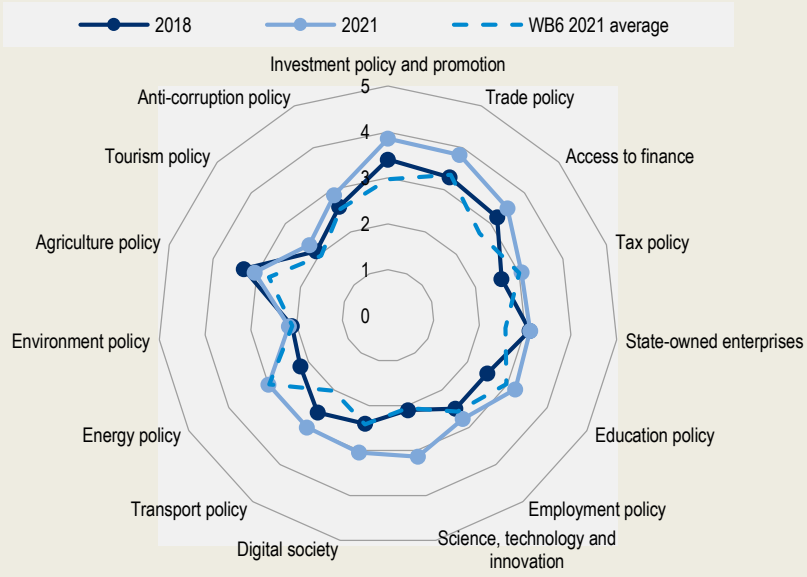
[177] According to the last agriculture census, more than 485 900 families declared at least 20% of the family income came from agriculture activity, State Statistical Office, 2019.

[178] After Brexit, North Macedonia and the United Kingdom concluded a new free trade agreement – Partnership, Trade and Cooperation Agreement between the United Kingdom of Great Britain and Northern Ireland and the Republic of North Macedonia. This agreement complies with the Stabilisation and Association Agreement between the European Union and the Republic of North Macedonia, in order to not disrupt the current trade relations between the two countries.

# 25 Serbia profile

# Key findings

## Figure 25.1. Scores for Serbia (2018 and 2021)




Note: Dimensions are scored on a scale of 0 to 5. Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See Scoring approach section for information on the assessment methodology. Scores for Dimension 5 Competition Policy are not included in the figure due to different scoring methodology (see Scoring approach).

Serbia has improved its performance since the publication of the Competitiveness Outlook 2018 report in 13 of the 15 policy dimensions[1] scored in the assessment (Figure 25.1). Although this clearly indicates progress in the design of policies to enhance its competitiveness, if these policies are to have a lasting impact then their effective and continuous implementation, monitoring and upgrading should remain a key priority. Serbia achieves its highest average scores in the investment policy and promotion; trade policy; access to finance; education policy; and science, technology and innovation dimensions, all with scores over 3.0. In these five policy dimensions, Serbia also outperforms the WB6 average. The main achievements in those policy dimensions since the last assessment are:

- **Serbia's investment policy is increasingly open and exceptions to national treatment are very limited**. Notably, Serbia's score in the OECD Foreign Direct Investment (FDI) Regulatory Restrictiveness Index, which assesses and benchmarks market access, was 0.05 in 2019, making its FDI regime less restrictive than the OECD average of 0.064. This indicates that its foreign investment rules do not constitute impediments to FDI. As a result, Serbia has been increasingly successful in attracting FDI over the last five years with net inflows increasing from USD 2.3 billion in 2015 to USD 4.3 billion in 2019. This makes it one of the best performers of the WB6 economies and the second largest recipient of FDI among all transition economies. This was also a better performance than the average for upper middle-income countries (2.0% of GDP) and OECD economies (2.4% of GDP) over the same period. Serbia has also adopted a strategic framework for intellectual property (IP) for 2018-22 that focuses on enforcement, and its new Law on Trademarks came into force in 2020, aligning its regulatory framework with the EU directives on trademarks. This marks significant progress in the reinforcement of its IP implementation and enforcement framework since the last assessment.

- **Trade policy is less restrictive, with greater transparency, improved consultations and an enhanced e-commerce policy framework.** All 12 services sectors analysed by the OECD Services Trade Restrictiveness Index methodology showed a greater degree of openness than in previous years. Serbia has carried out economy-wide policy changes to reduce restrictions applied to investors (such as amending its public procurement legislation in 2019). It has also eased services trade between Central European Free Trade Agreement (CEFTA) parties, spurred by the conclusion of the Additional Protocol 6 on Trade in Services to CEFTA in December 2019. It has made progress in strengthening public-private consultations and increasing business participation in the formulation of transparent trade policies, and has been very active in strengthening its digital trade framework. Serbia has revised its electronic commerce framework to align it with the European Commission's recommendations and the E-Commerce Directive 2000/31/EC, and has set up a programme to identify critical challenges to further develop e-commerce in the economy.
- **Alternatives to bank financing have increased.** In December 2020, the legislature broadened the scope of the legal framework by allowing financial leasing companies to be engaged in operating leasing. In addition, as of January 2021, the Financial Leasing Register, which centralises contracts of financial lease of movable and immovable assets, started to allow all types of registration applications to be submitted in electronic form, removing some of the administrative burden on enterprises. With the adoption of the Law on Alternative Investment Funds and by-laws enacted by the Securities Commission, private equity investment funds and venture capital have been able to operate in Serbia since 2020. In June 2021, Serbia and Albania will become the only WB6 economies to regulate the purchasing, selling or transferring of virtual currencies, making initial coin offerings based on blockchain technologies possible.
- **The education system has been strengthened with the introduction of dual education, and early school leaving rates have continued to fall.** In 2018, Serbia introduced a new competency-based curriculum that aims to update classroom practices so that all young people develop the competencies needed to succeed in the 21st century. It also revised its school quality standards in 2017-18 to ensure that all children and young people receive a good quality education by identifying schools where additional resources and support are needed. The early school leaving rate has declined slightly over the last decade and by 2019 it was 6.6%, lower than the EU average of 10.2%. In order to further reduce early school leaving, Serbia has implemented instruments to recognise students at risk of early abandonment, introduced targeted measures for vulnerable groups (e.g. Roma students or students with disabilities) and created individualised educational plans to retain young people in education and training. Serbia has also introduced a dual model for vocational education, mixing work-based and classroom learning, which is guided by curricula in line with the Law on Dual Education adopted in 2019. This should help students in vocational education and training (VET) to better develop their core literacy and numeracy skills, an area where they lag behind their peers in general programmes.
- **The policy framework and financial incentives for science, technology and innovation (STI) have improved**. Since the last assessment, Serbia has adopted two important strategic documents guiding the development of STI – the Smart Specialisation Strategy in 2020, and the Strategy for the Development of Artificial Intelligence. It also adopted the new Law on Science and Research in 2019. Serbia has expanded its support for STI with the establishment of the Science Fund, expected to become a key instrument for project-based research funding. It had a budget of EUR 4.2 million in 2019, rising to over EUR 7.5 million in 2020. Its aim is to provide funding and technical assistance to the research community, including support for young researchers and diaspora engagement, and promote international co-operation and business-academia linkages.

### Priority areas

While Serbia did not score below the WB6 average in any of the 15 scored policy dimensions, this assessment did find a number of priority areas that it should address to strengthen its competitiveness further. Serbia's lowest scores were in the environment, tourism and employment policy dimensions, all below 3.0 (Figure 25.1). Further, although Serbia scored just slightly over 3.0 in the state-owned enterprises dimension, at 3.1, its score has not improved since the previous assessment. To improve its performance in those four policy areas, Serbia should:

- **Improve environmental quality of life by reducing air and water pollution.** Although Serbia has a relatively well-developed legislative and policy air quality framework, the population is exposed to air pollutants like fine particulate matter ($PM_{2.5}$) at levels of 25 micrograms per cubic metre ($\mu g/m^3$), more than twice the maximum level set by the World Health Organization (10 $\mu g/m^3$). Serbia should step up its efforts to combat air pollution and climate change, primarily by reforming power generation, which remains the main source of pollution. Serbia will need to phase out coal subsidies and start implementing renewable support schemes. It could also consider subsidies for other forms of heating, such as solar space heating. Despite its abundant freshwater, Serbia also faces increasing water pollution, mostly as a result of continuing discharges of municipal and industrial wastewater into rivers. Around 58% of the population are connected to public sewerage systems, but only 10.5% are connected to public sewerage served by a wastewater treatment plant (compared to 86% on average in the EU). Serbia needs to invest in improving the water supply and sanitation system to treat more wastewater.
- **Empower local actors to manage tourism development**. Vertical co-operation in tourism development has been established and some municipalities and local tourist organisations have started developing tourism programmes. However, the lack of knowledge and skills among local public officials, weak public-private co-operation, and a lack of financial resources are hampering the efficient implementation of these programmes. Serbia should focus on providing co-ordinated expert support, designing tourism master plans, improving capacity building and allocating sufficient budget to implement policy measures at the destination level. It should also strengthen its dialogue and co-operation with private sector stakeholders, especially in discussions on the key challenges of tourism development, such as seasonality, the lack of new and high-quality tourist products, digitalisation and sustainability.
- **Increase efforts to implement employment activation policies effectively.** Although efforts have been made to increase the capacity of the National Employment Service (NES), the number of staff remains too low. The average caseload for each employment counsellor was 827, which is well above the average of EU countries such as France and Germany, where caseloads may vary between 100 and 350. Funding for active labour market programmes (ALMPs) is very low. In 2019 it amounted to 0.07% of GDP, compared to the OECD average of 0.37%. Participation in ALMPs is also very low, especially given the large share of registered unemployed facing severe employment barriers. Therefore, Serbia should strengthen the capacity of the NES and increase funding for ALMPs. In particular, to increase the employment rate of vulnerable groups, it should make more effort to develop integrated approaches and to allocate budget to improve the labour market integration of the most vulnerable groups (e.g. Roma communities, women in rural areas). This will require close co-operation with other key stakeholders at national and local levels.
- **Develop a comprehensive governance framework for all state-owned enterprises (SOEs).** Despite encouraging efforts and plans to reform the SOE sector, Serbia has significant room to align governance further with the OECD Guidelines on Corporate Governance of State-owned Enterprises and to improve SOE governance overall. Serbia should develop a comprehensive

state ownership policy that provides a rationale and expectations for all its SOEs. The 2016 Law on Public Enterprises currently only applies to companies engaged in activities in the public interest. The majority of SOEs (99 out of 156 according to the Ministry of Economy) engage in commercial activities and do not fall under the public ownership framework. A comprehensive state ownership policy is important as external assessments of the performance of Serbian SOEs suggest that these enterprises suffer from inefficiencies and provide low overall returns on the state's investment.

1: Please note that Dimension 5 (Competition policy) is excluded from the key findings section as it uses a different scoring model (See the Scoring approach section for information on the assessment methodology).

## Economic context

### *Key economic features*

Serbia is the largest and most diversified economy of the Western Balkan (WB) region. Like most economies in the region, it is also dominated by the services sector, which accounts for 51.1% of gross domestic product (GDP) and 57% of employment. Industry, including construction, accounts for 26% of GDP (roughly half of which is manufacturing) and 27.4% of employment. Even though the value added of the agriculture, forestry and fishing sector has declined considerably over the past decade, to only 6% of GDP in 2019, it still accounts for 15.6% of total formal employment and likely a significant share of informal employment (World Bank, 2021[1]).

Prior to the global financial crisis of 2008, Serbia's economy was driven by high growth in consumption fuelled by credit growth and expansionary fiscal policies. This resulted in high GDP growth, averaging 6.5% per year between 2000 and 2008, but also high imbalances including high current account deficits, which reached 20.2% of GDP in 2008. It also led to high inflation (ranging from 6% to 16% annually) and high and rising risks in the financial sectors, including high levels of foreign exchange-denominated lending and non-performing loans (NPLs) (World Bank, 2021[1]).

Over the past decade, the growth rate of Serbia's economy has moderated, but it has also become more balanced. The immediate aftermath of the crisis was accompanied by weak growth and heightened volatility reflecting large structural imbalances, imported shocks from trading partners in the Eurozone (i.e. the Eurozone crisis of 2011/21) as well as the devastating floods that impacted much of the region in 2014. However, since 2015, concerted efforts to restore macroeconomic and fiscal stability have started to pay off. Private investment has increased by more than 30% since 2014, on the back of declining and stabilising inflation, declining public debt, declining NPLs, etc. Investment was also supported by an increase in FDI, particularly in export-oriented manufacturing, which led to a significant boost in export performance. Manufacturing exports have risen by nearly 52% since 2015 and in 2019 they accounted for 65% of total exports. Service exports, driven by the information and communication technology (ICT) sector, grew by 16% per year between 2017 and 2019 and accounted for 30% of total exports in 2019 (SORS, 2020[2]).

However, despite this recent progress, many structural challenges continue to undermine the growth of the Serbian economy. Investment (as a share of GDP) remains lower than most of its peers as well as the OECD and European Union (EU) averages, and, with the exception of FDI, it is still mostly directed into low-productivity sectors. Moreover, even though FDI investments over the past decade have been concentrated in technology-intensive sectors like automotive and electronics, their impact on GDP growth and productivity has been moderated by their high import intensity and limited linkages with suppliers in the domestic economy. As a result, the growth in labour productivity has been relatively limited. In 2019, value added per worker in industry (including construction) and agriculture in Serbia was roughly one-

quarter of the EU average, while in services it was even weaker, at 20% of the EU average (World Bank, 2021[1]).

These challenges are also reflected in labour market outcomes. Even though unemployment has declined significantly to 9% in 2020, the high level of long-term unemployment is a concern. Likewise, the share of young people who are not in employment or education, at 15.1%, is higher than the EU and OECD averages, as well as aspirational peers in Central Europe and the Baltic states. More progress is also needed to boost the labour force participation of women and other vulnerable groups and achieve more inclusive growth – see Structural economic challenges.

Serbia has significant potential to boost its export-driven growth in the coming decade by maintaining macroeconomic stability and addressing key constraints to investment and growth in the tradable sector. These include increasing the transparency and predictability of regulations that affect business, reducing red tape and corruption, and levelling the playing field for all actors in the economy. In line with its aspirations to foster faster and more sustainable growth through smart specialisation, Serbia also needs to improve the skills of its workforce and strengthen the capacities of its small and medium-sized enterprises (SMEs) to innovate and adopt new technologies. These reforms will also be critical for fostering deeper linkages with Serbia's growing and increasingly diverse FDI sector and global value chains.

### Table 25.1. Serbia: Main macroeconomic indicators (2015-2020)

| Indicator | Unit of measurement | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|
| GDP growth[1] | % year-on-year | 1.8 | 3.3 | 2.1 | 4.5 | 4.2 | -1.0 |
| GDP per capita[2] | Current international $ | 14 928 | 15 858 | 16 611 | 17 736 | 18 930 | 19 231 |
| National GDP[2] | USD billion | 39.7 | 40.7 | 44.2 | 50.6 | 51.5 | .. |
| Inflation[1] | Consumer price index, annual % change | 1.4 | 1.1 | 3.1 | 2.0 | 1.8 | 1.6 |
| Current account balance[1] | % of GDP | -4.4 | -2.9 | -5.2 | -4.8 | -6.9 | -4.3 |
| Exports of goods and services[1] | % of GDP | 45.3 | 48.6 | 50.5 | 50.8 | 52.1 | 47.7 |
| Imports of goods and services[1] | % of GDP | 52.3 | 53.4 | 57.1 | 59.2 | 61.0 | 56.6 |
| Net FDI[1] | % of GDP | 5.1 | 5.2 | 6.2 | 7.4 | 7.8 | 6.2 |
| Public and publicly guaranteed debt[3] | % of GDP | 70.6 | 68.6 | 58.7 | 54.4 | 52.9 | 58.2* |
| External debt[4] | % of GDP | 73.5 | 72.0 | 65.1 | 62.2 | 61.9 | .. |
| Unemployment[1] | % of total labour force | 17.7 | 15.3 | 13.5 | 12.7 | 10.4 | 9.0 |
| Youth unemployment[2] | % of total labour force ages 15-24 | 42.6 | 34.5 | 31.5 | 29.4 | 27.1 | .. |
| International reserves[1] | In months of imports of G&S | 6.6 | 6.2 | 5.4 | 5.4 | 5.7 | 6.1 |
| Exchange rate (local currency/euro)[1] | Value | 120.7 | 123.1 | 121.4 | 118.3 | 117.9 | 117.6 |
| Remittance inflows[2] | % of GDP | 8.5 | 7.9 | 8.1 | 8.8 | 8.2 | 7.3 |
| Lending interest rate (BELIBOR)[5] | % annual average | .. | 3.4 | 3 | 2.5 | 1.2 | 1.2 |
| Stock markets (if applicable)[1] | Average index | 1 359 | 1 584 | 1 562 | 1 583 | 1 543 | 1 543 |

Note: G&S = goods and services. Belgrade Interbank Offered Rate (BELIBOR is the benchmark rate offered on dinar deposits by BELIBOR panel banks; * estimates for 2020.

1. (EC, 2021[3]), *EU Candidate Countries' and Potential Candidates' Economic Quarterly (CEEQ) Q1 2021*, https://ec.europa.eu/info/sites/default/files/economy-finance/tp048_en.pdf.
2. (World Bank, 2021[1]), *World Bank WDI data*, https://databank.worldbank.org/source/world-development-indicators.
3. (World Bank, 2020[4]), *World Bank Western Balkans Regular Economic Report*, https://www.worldbank.org/en/region/eca/publication/western-balkans-regular-economic-report.
4. (EBRD, 2020[5]) *Transition Report 2020-21*, https://2020.tr-ebrd.com/countries.
5. (IMF, n.d.[6]), *IMF Data*, https://data.imf.org/regular.aspx?key=61545855.

### *Sustainable development*

Over the past decade, Serbia has made progress in reaching the targets of the United Nations Agenda 2030 for Sustainable Development, but across most Sustainable Development Goals (SDGs) considerable challenges still remain (Table 25.2). Serbia has achieved the 2030 SDG target in two areas: 1 – poverty, where the headcount ratio[1] of those living on both USD 1.90 and USD 2.30 per day are lower than their respective targets and 4 – quality education, where the rates of net primary enrolment, lower secondary completion and literacy are above 97% and on track to reach the 100% SDG targets. In all other areas, moderate or significant progress will still be needed to reach the SDG targets by the end of this decade (Sachs, 2021[7]).

**Table 25.2. SDG Trends**

| SDG | Current Assessment | Trends |
|---|---|---|
| 1 - No poverty | SDG achieved | On track or maintaining SDG achievement |
| 2 - Zero hunger | Significant challenges remain | Moderately improving |
| 3 - Good health and well-being | Significant challenges remain | Moderately improving |
| 4 - Quality education | SDG achieved | On track or maintaining SDG achievement |
| 5 - Gender equality | Significant challenges remain | Moderately improving |
| 6 - Clean water and sanitation | Significant challenges remain | Moderately improving |
| 7 - Affordable and clean energy | Challenges remain | Moderately improving |
| 8 - Decent work and economic growth | Significant challenges remain | Moderately improving |
| 9 - Industry, innovation and infrastructure | Significant challenges remain | Moderately improving |
| 10 - Reduced Inequalities | Significant challenges remain | Information unavailable |
| 11 - Sustainable cities and communities | Significant challenges remain | Stagnating |
| 12 - Responsible consumption and production | Significant challenges remain | Information unavailable |
| 13 - Climate action | Challenges remain | Stagnating |
| 14 - Life below water | Information unavailable | Information unavailable |
| 15 - Life on land | Major challenges remain | Stagnating |
| 16 - Peace, justice and strong institutions | Significant challenges remain | Moderately improving |
| 17 - Partnerships for the goals | Challenges remain | Moderately improving |

Note: The order of progress (from greatest to least) is as follows: SDG achieved; challenges remain; significant challenges remain; major challenges remain.
Source: (Sachs, 2021[7]), *Sustainable Development Report 2021: The Decade of Action for the Sustainable Development Goals,* https://s3.amazonaws.com/sustainabledevelopment.report/2021/2021-sustainable-development-report.pdf.

The moderate challenges lie in two SDG areas: 7 and 13 – affordable and clean energy and climate action, as well as SDG 17; partnerships and financing to meet the goals. With respect to clean energy and climate action, Serbia still needs to make significant progress in reducing carbon dioxide ($CO_2$) emissions toward the ultimate goal of carbon neutrality. Some progress is also needed to improve the population's access to clean cooking fuels and technology (Sachs, 2021[7]).

There are significant gaps with regard to the SDG agenda targets in all other areas. These include SDG 3 – health and well-being, where greater progress is needed to reach universal health coverage from the current coverage ratio of 65%. With respect to SDG 6 – clean water and sanitation, the share of the population with access to clean drinking water has fallen, while progress needs to be made to improve the treatment of waste water. Reducing unemployment remains the most important challenge to meeting the SDG 8 – decent work and economic growth, while in the area of innovation (SDG 9), expenditure on research and development (R&D) remains well below the target. Significant reduction in air pollution and improved recycling can contribute to more sustainable cities and economies (SDG 11). Reducing corruption remains the biggest challenge for SDG 16 – peace, justice and strong. Last but not least, major efforts are needed to protect terrestrial and freshwater sites important to biodiversity (SDG 15) (Sachs, 2021[7]).

### *Structural economic challenges*

Serbia faces a number of key structural challenges that undermine its competitiveness, investment and integration into global value chains (GVCs).

#### *Strengthening education and skills is key to upgrading and building a knowledge economy*

Even though Serbia outperforms many regional peers with respect to student performance in standardised exams and other learning outcomes, it still lags behind the Central and Eastern Europe (CEE) region as well as the EU and OECD averages.

- **Spending on education lags behind aspirational peers**. At 3.6% of GDP in 2016, public spending on education is lower than the EU average of 4.7% of GDP and the OECD average of 5% (World Bank, 2021[1]). Financing per student has increased in recent years at the pre-primary and tertiary level, but has declined for primary and secondary education, and remains lower than in Serbia's WB6 peers as well as the EU economies. The low spending on secondary education partly reflects the limited practical training Serbian schools offer compared to CEEC countries. For example, vocational education and training (VET) schools require significant additional infrastructure and special equipment to enable practical learning for their students, but many Serbian schools focus on more theoretical knowledge, which limits the demand for such additional investment. Limited funding for the professional development of teachers further exacerbates the challenge of improving the quality of education (Maghnouj et al., 2020[8]).
- **Education needs to be more relevant to labour market needs**. Serbia could do considerably more to align its education with the needs of the labour market. In the latest Skills Toward Employment and Productivity (STEP) survey of employers, skills were identified as the most significant constraint on hiring, followed by lack of experience, as identified by 50% of the firms surveyed (World Bank, 2018[9]). Firms have noted the lack of not just technical skills but also cognitive skills, which are not well integrated into the curricula of educational institutions. This is very important as these skills are highly relevant in more knowledge-based activities and thus critical for economic upgrading. Recent reforms in the VET education system to introduce dual education modelled on the systems in Austria, Switzerland and Germany is an important step in the right direction (Government of the Republic of Serbia, 2020[10]). Further investments in adult education and lifelong learning could also help to address the skills gaps through opportunities for upskilling and reskilling.

#### *Strengthening the institutional and business environment is critical for boosting domestic and foreign investment*

Over the past decade, Serbia has made significant progress in improving its investment environment. Thanks to reforms to streamline the process of issuing construction permits, the introduction of an e-permitting system and electronic value-added tax (VAT) returns and social security contributions, Serbia has facilitated the operations of businesses on its territory, which has resulted this has resulted in a strong increase in its overall ranking on the Doing Business assessment from 88$^{th}$ in 2010 to 44$^{th}$ in 2020 (World Bank, 2020[11]). However significant challenges still remain:

- **Bureaucracy and red tape** remain an important challenge in Serbia. In the latest Business Environment and Enterprise Performance Survey (BEEPS) survey, Serbian firms cited notable challenges in dealing with the administration, including obtaining licences and permits and dealing with the tax administration. For example, it takes on average 98 days to obtain an operating licence in Serbia, compared to 24 days in Eastern and Central Europe and 28 days globally (World Bank, 2019[12]). Tax administration also remains relatively cumbersome: Serbian firms have to make 33 tax payments per year, which is twice as many as the other WB6 economies. Nearly half of the

firms surveyed in BEEPS also noted that they had to meet with tax officials twice a year on average (World Bank, 2019[12]).

- **Corruption** remains an important cost and obstacle to doing business. In the latest BEEPS survey, a larger share of businesses in Serbia reported having to provide gifts to obtain licences than in regional and global peers. For example, the bribery incidence while obtaining operational licences was 18% in Serbia compared to 9% for the Eastern and Central Europe region (World Bank, 2019[12]). The latest Transparency International Index ranks Serbia 91st out of 191 economies (Transparency International, 2019[13]), which reflects not only bribery and petty corruption but also the continuing prevalence of high-level corruption. Stronger and more consistent prosecution and sanctioning of such corruption will be critical to strengthening investor confidence in the economy (European Commission, 2019[14]).
- **Contract enforcement** is slow, costly and unreliable. Contract enforcement takes on average 622 days, which is longer than the OECD and Eastern and Central Europe averages (590 and 497 days respectively) and is more protracted than in the global leaders in the Doing Business index (120 days) (World Bank, 2020[11]). Contract enforcement is also quite costly: at 39.6% of the claim value, it is nearly twice as expensive as the OECD average of 21.5%. Finally, there is a lack confidence in the judicial system to make fair and impartial decisions. In the latest, Regional Cooperation Council (RCC) barometer survey, 73% of respondents stated that they do not trust the court system and 76% that they do not believe that the judiciary is independent of political influence. Likewise, 67% of respondents do not believe that the law is applied equally to everyone (Regional Cooperation Council, 2019[15]).
- **Predictable regulatory environments and transparency** will also be critical for boosting investment. While Serbia has set up a regulatory and institutional framework for effective, inclusive, and evidence-based policy making, in practice, institutional co-ordination and implementation still require considerable improvement. For example, enterprises operating in Serbia note the lack of timely and regular consultation in the process of drafting legislation. Businesses also complain that there is a lack of clear instructions on the implementation of regulations, which adversely affects their operations (Foreign Investors Council, 2019[16]).

### *Access to finance could be further improved, particularly for micro and small enterprises and start-ups*

- **The banking sector** in Serbia is relatively well-developed and competitive and it is able to serve established enterprises well thanks to a wide range of financial products and the lowest interest rates in the region. Likewise, Serbian enterprises report lower shares of loans that require collateral (41% in Serbia compared to the 76% global average) and lower collateral requirements compared to many regional peers (101% in Serbia compared to the 200% global average) (World Bank, 2019[12]). That said, the lending environment for micro and small enterprises as well as newly established businesses is still relatively unfavourable, especially when compared to aspirational peers or the EU and OECD economies. This includes access to finance from banks, whose stringent requirements on turnover, years of operational history, etc. are difficult for SMEs to meet. It also reflects the relatively limited non-bank financing options – see Access to finance (Dimension 3).

### *Cross-cutting and sector-specific constraints undermine the growth of key sectors*

- **Agriculture** is an important sector in Serbia, accounting for 6% of GDP, 13% of exports and 15% of employment in 2019. Agriculture in the northern region of Vojvodina is relatively highly productive and its exports are competitive. However, the majority of the sector is not very productive, characterised by small-scale farming, and highly fragmented and uncertain land tenure.

Productivity growth is further hampered by generous agricultural subsidies, which are still highly important for supporting rural economies. Finally, state-owned land, which still accounts for a large share of agricultural land, is only available on short-term leases which discourages investment. According to recent estimates, about one-third of state-owned agricultural land is not used (World Bank, 2020[17]).

- **Manufacturing**: Over the past decade, Serbia has attracted considerable FDI in export-oriented manufacturing, particularly in the automotive and electronics industries. However, most of this investment has been in low-value-added, labour intensive industries. Upgrading to more technology- and knowledge-intensive activities will first and foremost require better knowledge and skills. Some other important considerations include reducing the infrastructure gaps compared to competitor economies. This includes hard infrastructure as well as customs and logistics services.
- **ICT services**: ICT is a fast-growing sector with considerable potential for growth in both value added and exports in Serbia. As a globally expanding industry, ICT could benefit from Serbia's relatively low cost but highly skilled ICT workforce. According to the latest Startup Genome, Serbia ranks in the top five countries for ICT talent in the world (Startup Genome, 2020[18]). This sector has shown robust growth over the past decade. Its share of service exports rose from 6.5% in 2008 to 20% in 2019. The sector also has considerable scope for improving the productivity of other sectors. The biggest constraints to its growth include continuing challenges in secondary and tertiary education and lifelong learning; regulation and taxation of the sector, including competitive safeguards and cybersecurity; and insufficient digital connectivity outside the main urban areas (World Bank, 2020[17]).

### *Better management of public finances is needed to support the long-term development of the economy*

- Serbia went into the COVID-19 pandemic with already relatively high levels of public debt and more limited fiscal space than many WB6 economies. Increased spending in the aftermath of the global financial crisis coupled with weaker revenue performance had led to higher fiscal deficits and public debt, which rose from 30% in 2009 to 70% in 2015 (Government of the Republic of Serbia, 2020[19]). Strong fiscal consolidation efforts took place during 2015-19, but the pandemic has added renewed fiscal pressure due to the need for significant support against the economic and social consequences of the crisis. Like many economies around the world, Serbia will need to build up stronger fiscal buffers in the post-recovery phase in order to strengthen its capacity to respond to future shocks. This will entail addressing significant outstanding structural constraints including broadening the tax base to improve revenue performance and better and more efficient public spending. It will also include reforming the state-owned enterprise (SOE) sector which remains relatively large compared to regional and global peers (IMF, 2019[20]).

### *Stronger environmental protection will be critical for long-term development and well-being*

- **Air pollution** is a major concern for cities across Serbia. The annual exposure to particulate matter pollution PM2.5 at 25.1 μg/m$^3$ 2017 is almost double the EU average of 13.1 μg/m$^3$ and the OECD average of 12.5 μg/m$^3$ (OECD, 2020[21]). It is also 2.5 times the World Health Organization (WHO) recommended maximum level of 10 μg/m$^3$. The pollution is caused mainly by the transport and energy sectors. Pollution is exacerbated in winter months when residential heating, including heating by solid fuels, adds to the pollution from other sources. In the latest Balkan Barometer survey, 67% of people surveyed in Serbia identified air pollution as a serious problem, half of whom considered it a very serious problem (Regional Cooperation Council, 2019[15]).
- **Climate change**: Serbia is vulnerable to the impacts of climate change due to its high exposure and low resilience to natural hazards, particularly floods. Yet its transition to low-carbon growth has

been slow and more efforts are needed to strengthen its resilience to these hazards. The economy is still highly dependent on lignite coal and its intensity of energy consumption is high. Strengthening environmental sustainability and acting on climate change will require significant investments in infrastructure especially in the areas of waste and wastewater management, pollution control, and clean energy. It will also require better environmental policies and strengthening the capacities of the relevant authorities (World Bank, 2020[22]).

*More inclusive growth is needed to improve the incomes and well-being outcomes for all citizens.*

- Even though incomes, as measured by GDP per capita, have improved substantially over the past decade, inequality remains an important challenge and has improved little over the past decade (Solt, 2019[23]). There is also considerable regional inequality. For example, the Belgrade region is home to about one-quarter of the Serbian population but it accounts for over 40% of GDP, while the region Južne i Istočne Srbije, in the southern and eastern parts of Serbia, also has one-quarter of the population but generates only 13% of GDP. The poverty rate in the latter region is also three times higher than in the Belgrade region and it also lags considerably behind on access to various services. For example, one-third of the population in the region do not have access to the water supply system (SORS/World Bank, 2016[24]).

*COVID-19 has exacerbated structural challenges*

The COVID-19 pandemic has had a significant impact on the Serbian economy over the past year. The brunt of the impact was felt in the second quarter (Q2) of 2020 when domestic and external demand were hit hard by COVID-related restrictions on movement and disruptions in value chains. However, significant fiscal support and some recovery in demand mitigated the decline in the second half of the year and GDP contracted by only 1.1% in 2020, well below the other economies in the region. Exports and investment were most strongly impacted, contracting by 3% and 2.8% respectively, while private consumption declined by 2.5%. The decline in imports (4%) and the boost in government consumption mitigated the fall in domestic and external demand (EC, 2021[3]).

The service and manufacturing sectors were most strongly affected by the crisis. Retail and wholesale trade, transport, and tourism and hospitality were most affected, declining by 16.7% y-o-y in Q2. Meanwhile, professional, scientific, technical, administrative and support activities declined by 20.6% y-o-y in the same period. Industrial output fell by 7.1% y-o-y. Some sectors saw an increase in output in this period, including the ICT sector (up 5.4% y-o-y) and agriculture (2.2% y-o-y) (EC, 2020[25]; EC, 2020[26]).

Serbia implemented the largest fiscal support package in the region to counter the impact of the crisis and this helped contain the fallout in the labour market as well as among the most vulnerable populations. The package included a wide range of measures to support enterprises including the deferment of labour tax and contribution payments as well as corporate income tax payments, wage subsidies, and a moratorium on enforcement and interest on tax debt. Serbia also introduced a state guarantee scheme for bank lending to SMEs in order to support their liquidity. The fiscal package also contained measures to reduce the impact on vulnerable citizens, including a one-off payment to all pensioners (OECD, 2021[27]).

These measures helped to reduce the impact of the crisis on the labour market. Unemployment continued to decline in 2020 (from 10.4% in 2019 to 9% in 2020), while the decline in employment was minimal at 0.2% compared to the previous year (EC, 2021[3]).

Many of the structural challenges discussed above have played a role in either amplifying the impact of the COVID-19 pandemic or limiting the scope of the policy responses to it. The crisis has, therefore, provided important lessons on how to build more resilient economies and institutions:

- **Fiscal policy:** Among its political and administrative responses to the COVID-19 pandemic, Serbia introduced a number of tax policies including:
  - Deferral of personal income tax (PIT), corporate income tax (CIT) and social security contributions (SSCs) from 1 April to 30 June 2020, and exceptionally until 31 July 2020. In July 2020, these measures were extended until January 2021.
  - A wage subsidy scheme paid directly to employers of three minimum net salaries per employee, strictly to be used for the payment of salaries. These payments are conditional on employers not reducing the number of employees by more than 10% and not paying dividends until the end of 2020.
  - VAT exemption on goods and services for public health institutions during the state of emergency.

  Serbia has implemented a relatively narrow set of responses to COVID-19 compared to other WB6 economies. For example, unlike some, Serbia did not introduce a public loan guarantee, direct cash transfers to households, or deferral of households' and businesses' fixed costs. Its fiscal response has been critical to preventing significant economic fallout from COVID-19 especially for labour market outcomes, but it has resulted in a significant narrowing of the fiscal space. With revenues likely to be weaker in the wake of the crisis, particularly if the recovery is slow, improving the efficiency of public spending will be critical over the coming months, as will prioritising expenditures that can support the recovery and promote productivity growth and structural transformation for stronger and more resilient long-term growth. This also includes increasing public investment which has suffered significantly due to high and rising current expenditure. The crisis also highlights the importance of rebuilding fiscal buffers in the post-crisis period. In addition to better management of expenditures, this will also require tackling some of the structural constraints that undermine revenue performance.
- **Innovation and technology adoption:** The COVID-19 crisis starkly demonstrated the importance for firms of being able to adapt to new challenges and changing circumstances. It also revealed the advantages that firms embracing digitalisation and modern practices have over others. The resilience of the recovery will therefore depend on addressing the structural issues limiting innovation and technology adoption among firms (see the Structural economic challenges section above) and to what extent digitalisation and digital skills become mainstream.
- **Access to finance:** The crisis has highlighted the significance of having a well-developed and diversified financial sector that can respond to the financing needs of enterprises not only during a crisis but also during the recovery phase. As in the rest of the region, the main instruments for providing additional liquidity for enterprises during the crisis came from government support through subsidised lending or lending guarantees. But a robust financial sector comprised of diversified financial institutions that can provide financing for riskier and innovative ventures and not just established enterprises will be very important during the recovery phase and beyond.
- **Informality:** The large informal sector – and significant levels of informal employment even within the formal sector – have limited the scope of measures aimed at protecting the income and employment of people in the most affected sectors. Informality is widespread in these sectors, including retail trade and tourism, and informal firms have not been able to benefit from government subsidies, favourable loan terms and loan guarantees, and other support measures. Developing a more resilient economy will also depend on enhancing the incentives for formalisation and improving the oversight and sanctioning of non-compliance.
- **Health sector**: The crisis highlighted the importance of building a strong and resilient health sector that can better cope with pandemics and other pressures. Even though health outcomes in Serbia are generally strong relative to its income level, the sector still faces some important challenges. First, preventative care is not as well developed as many advanced economies which means that unhealthy lifestyles and the continued rise in non-communicable diseases are likely to place a

significant burden to the health sector in the future. Second, the continued widespread evasion of health insurance contributions as well as corruption within the system limits the financing available for health care and increases the out-of-pocket expenditures for many people (European Social Policy Network, 2019[28]; World Bank, 2021[1]). A significant share of these expenses also goes to informal payments in return for better quality of care (Radošević and Filipović, 2019[29]).

### *EU accession process*

Serbia has advanced considerably on the path to EU accession since it submitted its EU membership application in December 2009. It became an EU candidate country in March 2012 and just over a year later, in June 2013 it began accession negotiations. As of May 2021, Serbia had opened 18 out of the 35 chapters of the accession negotiations and it has provisionally closed 2.

Advancing the socio-economic reform agenda remains a critical priority in Serbia's path to EU membership. As the government negotiates its accession to the EU, the findings in this Competitiveness Outlook 2021 provide the monitoring and guidance needed for the government in meeting the requirements related to a number of critical chapters of the *acquis* when negotiating its accession to the EU. It also provides a good basis for assessing the critical challenges that the economy faces as a starting point for the development of the Economic Reform Programmes (Box 25.1).

#### Box 25.1. Economic Reform Programmes

Since 2015, all EU candidate countries and potential candidates prepare Economic Reform Programmes (ERPs) which play a key role in improving economic policy planning and steering reforms to sustain macroeconomic stability, boost competitiveness, and improve conditions for inclusive growth and job creation. The ERPs contain medium-term macroeconomic projections (including for GDP growth, inflation, trade balance and capital flows), budgetary plans for the next three years and a structural reform agenda.

The structural reform agenda includes reforms to boost competitiveness and improve conditions for inclusive growth and job creation in the following areas:

1. Public Financial Management
2. Green transition
3. Digital transformation
4. Business environment and reduction of the informal economy
5. Research, development and innovation
6. Economic integration reforms
7. Energy market reforms
8. Transport market reforms
9. Agriculture, industry and services
10. Education and skills
11. Employment and labour market
12. Social protection and inclusion
13. Healthcare systems

The structural reforms part of the ERPs is organised in two parts:

- A first part identifies and analyses the three key challenges across those 13 areas. The identification and prioritisation of key challenges imply a clear political commitment at the highest level to address them and the ERPs should propose a relevant number of reform measures to decisively tackle each of them in the next three years.
- A second part provides an analysis of the remaining areas (not included as key challenges) and may propose additional reforms to address them.

The European Commission and the European Central Bank then assess these programmes, which form the basis for a multilateral economic policy dialogue involving the enlargement economies, EU Member States, the Commission and the European Central Bank. The dialogue culminates in a high-level meeting during which participants adopt joint conclusions that include economy-specific policy guidance reflecting the most pressing economic reform needs. The findings of the Competitiveness Outlook provide guidance to the six Western Balkans EU candidates and potential candidates in identifying the key obstacles to competitiveness and economic growth, and in developing structural reform measures to overcome them.

Source: (European Commission, 2021[30]), Guidance for the Economic Reform Programmes 2022-2024 of the Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/default/files/erp_2022-2024_guidance_note.pdf; (European Commission, 2018[31]), Economic Reform Programmes: Western Balkans and Turkey, https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20180417-erp-factsheet.pdf.

### *EU financial and development support*

The EU is the largest provider of external financial assistance to Serbia. Since 2007, the EU has provided EUR 2.79 billion in assistance aimed at strengthening democracy, governance and the rule of law; boosting competition, innovation, agriculture and rural development; improving environmental outcomes, etc. A further EUR 5.5 billion has been provided through lending from the European Investment Bank (EIB) since 1999. The Western Balkans Investment Framework (WBIF) has provided EUR 210.2 million in grants that have leveraged investments of an estimated EUR 5.4 billion. Finally, the EU has provided grant financing of EUR 162.2 million to support Serbia's reconstruction efforts in the aftermath of the devastating 2014 floods (European Commission, 2021[32]).

In addition to grant funding and lending, the EU also provides important support through guarantees that support public and private investment by reducing the risks and costs associated with those investments. The new Western Balkans Guarantee Facility is expected to mobilise up to EUR 20 billion in investment over the coming decade.

The Connectivity Agenda seeks to support investments in sustainable transport and clean energy. Set up under the WBIF, the latest package, which was presented at the Western Balkans Summit in Sofia on 10 November 2020, completes the delivery of the EU's 2015 pledge to finance EUR 1 billion of investment in support of better connectivity in the region. It also represents the first step in the implementation of the flagship projects under the Economic and Investment Plan for the region (European Commission, 2021[33]).

The EU has also been instrumental in supporting Serbia's response to the COVID-19 pandemic. It provided EUR 93.4 million in bilateral assistance from the Instrument for Pre-Accession Assistance (IPA) 2014-20 to cover the urgent needs of Serbia's health sector and to support the economic and social recovery in the aftermath of the crisis. Serbia and other Western Balkan economies have also been recipients of the EU's regional economic reactivation package of EUR 455 million, a EUR 70 million package to help the WB economies gain access to vaccines and a further EUR 7 million of EC/WHO joint assistance to support vaccination readiness and health sector resilience (European Commission, 2021[32]).

## Scope and methods

### *Process*

Following the first two Competitiveness Outlook assessments, published in 2016 and 2018, the third Competitiveness Outlook assessment cycle for the WB6 economies was launched virtually (due to the COVID-19 pandemic) on 3 April 2020. The OECD team introduced Serbia's Competitiveness Outlook Government and Statistical Office Co-ordinators[2] to the new digitalised assessment frameworks (see Assessment methodology and process chapter for details). The two primary documents for assessing each of the 16 policy dimensions – the qualitative questionnaire and statistical data sheet – were explained in depth, giving particular attention to new questions and indicators. The OECD team also explained digital solutions to be used to disseminate the material together with the detailed guidelines, tutorials and information on the assessment process, methodology and timeline.

Following the launch of the assessment, the Ministry of Finance of the Republic of Serbia and the Public Policy Secretariat of the Republic of Serbia disseminated the materials among all 16 Policy Dimension Co-ordinators and Statistical Office contact points in Serbia. Where additional guidance was needed, the OECD team held teleconferences with Dimension Co-ordinators and Statistical Office contact points in April and May 2020.

All 16 Dimension Co-ordinators and Statistical Office contact points completed the assessment between April and May 2020. They assigned a score (see Scoring approach) to each qualitative indicator used to assess the policy dimension in question, accompanied by a justification. The completed assessments (qualitative questionnaires and statistical data sheets) were returned to the OECD team between May and July 2020.

The OECD reviewed the inputs and, where necessary, requested additional information from the Ministry of Finance of the Republic of Serbia, the Public Policy Secretariat of the Republic of Serbia, Policy Dimension Co-ordinators and Statistical Office contact points. The updated assessment materials were sent back to the OECD between July and September 2020. In addition, the OECD organised policy roundtable meetings between October and November 2020 to fill in any remaining data gaps, to get a better understanding of the policy landscape, and to collect additional information for indicators where necessary.

Based on the inputs received, the OECD compiled the initial key findings for each of the 16 policy dimensions. It then held consultations on these findings with local non-government stakeholders (including chambers of commerce, academia and NGOs) in November 2020. As a follow up, the OECD presented the preliminary findings, recommendations and scores to the Competitiveness Outlook Government Co-ordinator,[3] Policy Dimension Co-ordinators and Statistical Office contact points at a virtual meeting on 4 February 2021. The draft Competitiveness Outlook economy profile of Serbia was made available to the Government of Serbia for their review and feedback from mid-January to mid-February 2021.

### *Scoring approach*

Each policy dimension and its constituent parts are assigned a numerical score ranging from 0 to 5 according to the level of policy development and implementation, so that performance can be compared across economies and over time. Level 0 is the weakest and Level 5 the strongest, indicating a level of development commensurate with OECD good practice (Table 25.3).

For further details on the Competitiveness Outlook methodology, as well as the changes in the last assessment cycle, please refer to the Assessment methodology and process chapter.

### Table 25.3. Competitiveness Outlook scoring system

| | |
|---|---|
| **Level 5** | Level 4 plus independent impact evaluation. Results of monitoring and impact evaluation inform policy framework design and implementation updates in line with OECD good practice |
| **Level 4** | Level 3 plus evidence that the framework is monitored and, if necessary, adjusted accordingly |
| **Level 3** | Level 2 plus some concrete indications that the policy framework is being implemented effectively |
| **Level 2** | Framework specifically addressing the policy area concerned is solidly in place, officially adopted by the government or parliament (where applicable). The framework includes policy features necessary for it to have an impact |
| **Level 1** | Existing draft or pilot policy framework with signs of government activity addressing the policy area concerned |
| **Level 0** | No framework (e.g. law, institution, project, initiative) exists for the policy topic concerned |

*Exceptions*

Unlike the other 15 policy dimensions, competition policy (Dimension 5) is assessed using yes/no answers to 71 questions in a dedicated questionnaire. A “yes” response (coded as 1) indicates that a criterion has been adopted, whereas a “no” (coded as 0) indicates the criterion has not been adopted. The overall score reflects the number of criteria adopted. Moreover, some qualitative indicators which have been added to this edition of the assessment for the first time, are not scored due to the recent character of the policy practice they capture and the unavailability of relevant data.

## Investment policy and promotion (Dimension 1)

### *Introduction*

Serbia has slightly improved its performance in the investment dimension. The economy's score has increased from 3.4 in the 2018 Competitiveness Outlook to 3.9 in the 2021 assessment, with notable progress in enhancing its investment policies and introducing stable green investment initiatives (Figure 25.1). Serbia is the best-performing economy among the Western Balkan six (WB6) economies regarding investment policy and promotion dimension, driven by its above-average ratings for each sub-dimension (Table 25.4)

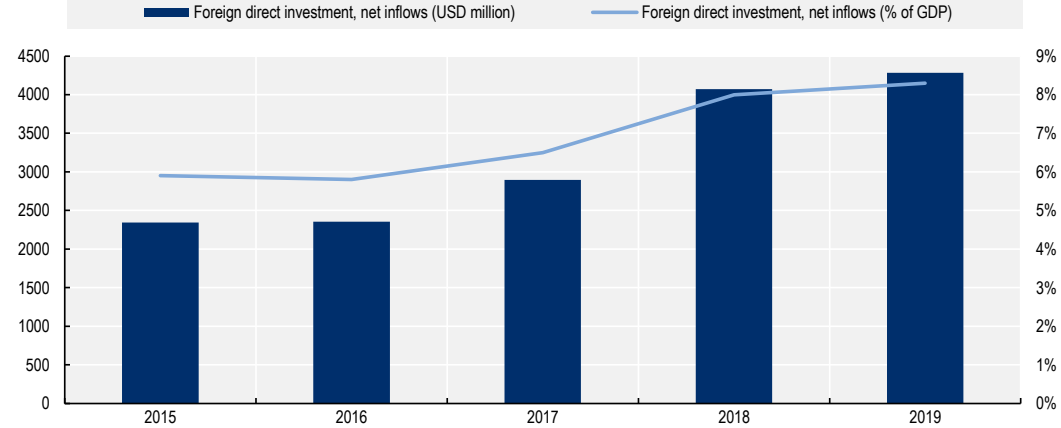
**Table 25.4. Serbia's scores for investment policy and promotion**

| Dimension | Sub-dimension | Serbia | WB6 average |
|---|---|---|---|
| **Investment policy and promotion dimension** | Sub-dimension 1.1: Investment policy framework | 4.1 | 3.2 |
| | Sub-dimension 1.2: Investment promotion and facilitation | 3.9 | 3.0 |
| | Sub-dimension 1.3: Investment for green growth | 3.0 | 2.0 |
| **Serbia's overall score** | | **3.9** | **3.0** |

### *State of play and key developments*

Overall, Serbia has been increasingly successful in attracting FDI over the last five years with net FDI inflows increasing from USD 2.3 billion in 2015 to USD 4.3 billion in 2019 (Figure 25.2). Net inflows averaged 6.9% of the economy's GDP over the last five years, making the Serbia one of the best performers in the WB6 and the second largest recipient of FDI among the transition economies after the Russian Federation. This is also a better performance than the average for upper middle-income countries (2.0% of GDP) and OECD economies (2.4% of GDP), over the same period. In 2019, the total stock of FDI stood at USD 44 billion. FDI is primarily concentrated in manufacturing, trade, real estate and logistics, and financial mediation, with the vast majority coming from the EU (70%) followed by the Russian Federation, Switzerland and Hong Kong, China.

**Figure 25.2. Net FDI inflows to Serbia (2015-19)**




Source: (World Bank, 2020[34]), Doing Business: Serbia 2020, https://www.doingbusiness.org/content/dam/doingBusiness/country/s/serbia/SRB.pdf.

StatLink https://doi.org/10.1787/888934256216

#### *Sub-dimension 1.1: Investment policy framework*

Overall, Serbia has a clear and comprehensive **legal framework for investment** activities and the conduct of business. The economy has a unified investment regime that covers both local and foreign investors

under the Law on Investment which was last amended in 2018. The law provides foreigners with the same treatment as nationals, imposes no restrictions on investment activities, allows foreign companies to own 100% of a domestic company, and permits the repatriation of profits and dividends without limitations or restrictions. Serbia's legal framework for investment also provides guarantees and safeguards for investors that are in accordance with EU standards. In addition, the Law on Investment is being revised to include additional protections for investors and is expected to be completed in 2021. However, there have been no significant changes to the legislative and regulatory framework recently as the pace of reform that made the economy successful in attracting FDI over the last decade has slowed.

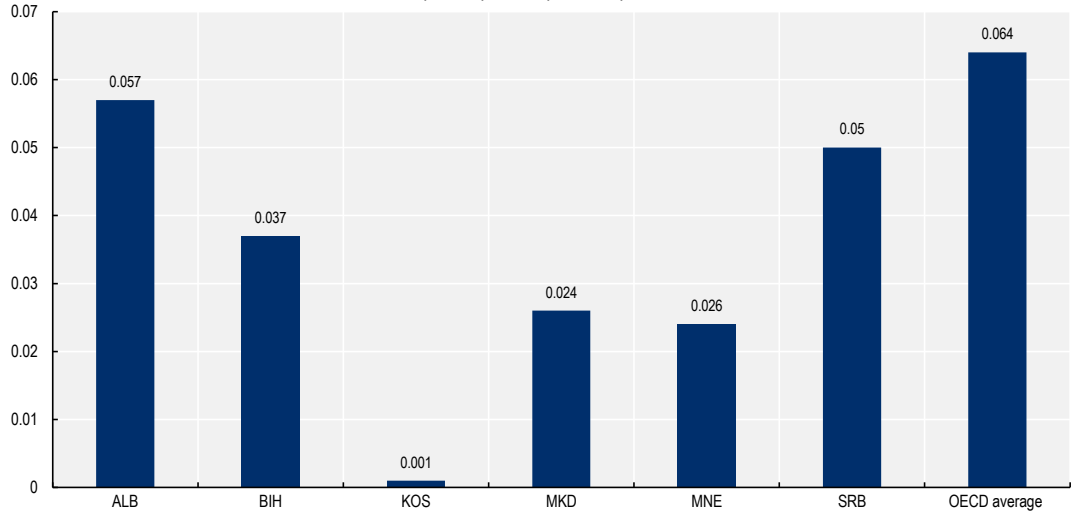
The government is endeavouring to ensure that the regulatory framework for investment is consistent, clear, transparent, readily accessible and does not impose undue burdens. The authorities publish a plan of changes to legislation and regulations including deadlines on line, while all proposed and adopted legislation are available on the Parliament's website (Parliament of the Republic of Serbia, n.d.[35]). Draft legislation that significantly affects the legal regime in a specific field or if the subject matter is an issue of a particular interest are made available on line for consultation as required by Serbian legislation.

In Serbia, investors report that public consultations are not consistently held in accordance with regulations. They report the following shortcomings: 1) limited time for inputs – although the Rules of Procedure require at least 15 days from the public call for submissions, and public hearings from the public call for submissions, investors report an average of 7 days, while the EU guidelines recommend 20 working days;[4] 2) consultations are held at a late stage of policy making; 3) the continued frequent use of the urgent procedure for adopting laws which deprives stakeholders from providing inputs; and 4) limited use of shareholders' contributions in the final texts. According to the EU, the regulatory framework for public consultations was improved with amendments to the Laws on State Administration and on Local Government and the Law on the Planning System, requiring that public consultations are organised early in the policy-making process (EC, 2020[36]).

In Serbia, the market is open and **exceptions to national treatment** are very limited. The economy's score in the OECD FDI Regulatory Restrictiveness Index, which assesses and benchmarks market access and exceptions to national treatment, was 0.05 in 2019 (Figure 25.3), making its FDI regime less restrictive than the average for OECD economies of 0.064, and indicating that foreign investment rules do not constitute impediments to FDI (OECD, 2020[37]). It is worth noting that the economy maintains some restrictions for services, notably in the media and transport sectors.

## Figure 25.3. FDI Regulatory Restrictiveness Index (2019)

Restrictions are evaluated on a scale of 0 (open) to 1 (closed)




Source: (OECD, 2020[37]), FDI Regulatory Restrictiveness Index (database), http://www.oecd.org/investment/fdiindex.htm.

Serbia also maintains licence requirements for investments in a number of activities for both local and foreign investors. Licensing obligations apply to the following sectors: finance, energy, mining, pharmaceuticals, medical devices, tobacco, arms and military equipment, road transportation, customs processing, land development, electronic communications, auditing, waste management, and production and trade of hazardous chemicals. However, there is no list of sectors where foreign investment is prohibited or where discriminatory conditions apply.

**Investor protection against expropriation** without fair compensation is enshrined in the Serbian Constitution and the Law on Investments, and its modalities are defined by the Law on Expropriation and the Law on General Administrative Procedure. The Law on Investments stipulates that expropriation can occur only when it is in the public's interest and in a non-discriminatory manner.

The Law on Expropriation stipulates the rules, procedures and competencies for determining the amount of compensation for expropriation. The evaluation is performed with the support of sectoral experts (forestry, agriculture, construction or economic) and indicates that compensations shall be paid to the investor without delay and shall include the legal default interest in case of delay, calculated from the date of expropriation until the date of payment. Decisions on expropriation by local self-government administrations are subject in the first instance to an appeal before the Ministry of Finance (MoF).

The Administrative Court decides the legality of the Ministry of Justice's final decision on expropriation. Once the decision has been made, parties to the expropriation may agree on the expropriation fee before the competent local self-government body. The local municipal court is authorised to intervene and decide the level of compensation if there is no mutually agreed resolution within two months of the expropriation order. However, although the law clearly defines direct expropriation and appropriate compensation measures, it does not recognise the concept of indirect expropriation, leaving unnecessary room for interpretation and difficulties in estimating the amount of compensation. Serbia has also signed a large network of bilateral investment treaties, which provide an additional layer of protection for foreign investors.

When it comes to **dispute settlement**, foreign investors have the same rights and remedies before the national court system as domestic investors. The justice system is continuing its reform efforts[5] to achieve the objectives included in the National Strategy for Judicial Reform and National Anti-Corruption Strategy. The judiciary is being reformed to reinforce its independence and efficiency and limit political interference. Overall, the court system is functioning well, and investors can generally rely on it to settle a wide range of disputes. However, it is still suffering from significant backlogs of cases despite improvements in recent years. Serbia also has commercial courts which have first instance jurisdiction in commercial matters. The economy's laws and regulations on commercial matters are consistent with international benchmarks, but the system suffers from the congestion of the commercial courts, uneven implementation of decisions and challenging contract enforcement (EC, 2020[36]).

As part of its efforts to reinforce make the judiciary more efficient, Serbia has improved its alternative dispute resolution mechanisms. There are opportunities for mediation to resolve disputes between private parties, including in commercial matters, regulated by the 2014 Law on Mediation. Serbia also ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) which mean it recognises foreign arbitral awards. The Law on Arbitration and the Law on Management of Courts regulate proceedings and jurisdiction over the recognition of foreign arbitral awards. However, the enforcement of an arbitration award can be a slow and difficult process due to a number of reasons including political motivation and limited enforcement capacity (US Department of State, 2020[38]).

Serbia has sound and modern[6] **intellectual property (IP) rights legal framework**, which are harmonised with EU legislation and meet the minimum requirements of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) even though Serbia is not yet a member of the World Trade Organization (WTO). It is a member of the World Intellectual Property Organization (WIPO) and adheres

to the main international treaties and conventions on IP rights including the Berne Convention and the Paris Convention.

Serbia is reinforcing its IP implementation and enforcement efforts**.** Recent positive progress includes the adoption of a strategic framework for intellectual property for 2018-22 that focuses on enforcement, as well as the new Law on Trademarks that came into force in 2020 which has aligned the economy with EU Directives 2015/2436 and 2004/48 on trademarks. The new law has also introduced an efficient opposition procedure in line with European standards, by extending opposition filing deadlines and publishing trademark applications before trademarks are granted, as well as developing new provisions to strengthen trademark protection and combat counterfeiting more effectively. Overall, the procedures for the registration of industrial property rights and deposit of works and authorship with the Serbian Intellectual Property Office are efficient and in line with EU standards (US Department of State, 2020[38]).

The Intellectual Property Office (IPO) is the main institution in charge of IP rights in Serbia. It is well staffed and efficient at registering trademarks (EC, 2020[36]). It offers online registration procedures for patents, trademarks and industrial designs. Its website includes all national databases for patents, trademarks, industrial designs and geographical indications of origin. The office has also issued several publications aimed at supporting SMEs dealing with IP rights. It co-operates with the following IP enforcement institutions: the customs administration, the market inspectorate, the tax administration, the Public Prosecutions Office, the Ministry of Health, the Ministry of Interior and Courts, the Agency for Medicines and Medical Devices, and the Tourist Inspectorate. However, co-ordination with other IP-related institutions should be reinforced.

While Serbia does not have specialised courts to hear IP-related cases, it has established several courts competent to hear civil intellectual property rights (IPR) cases. According to the Law on Organization of Courts and the Law on Seats and Territories of Courts and Prosecutor' s Office, the Commercial Court in Belgrade, the Higher Court in Belgrade, the Commercial Court of Appeal and the Court of Appeal in Belgrade may handle civil law IPR cases. While the judges in these courts who regularly handle civil IPR cases do not exclusively adjudicate IPR disputes, the judges of the Education and Information Centre (EIC), a special organisational unit of the IP office, regularly partake in IPO-organised seminars on IPR, most recently on harmonisation with EU Directive 2015/2436 on copyright and related rights as well as enforcement.

The government has also reinforced its **intellectual property rights awareness-raising efforts**, which are included in the National Intellectual Property Strategy for the Period 2018-2022. The 2019 EU Serbia report indicated that the government's new strategic framework on IPR, focusing on the enforcement of intellectual property rights is fully aligned with the relevant EU Directive (EC, 2020[36]). Development of a platform for exchanging data among the enforcement institutions is underway within the framework of the ongoing Twinning Project 2016, which brings together public administrative institutions of EU member states with pre-accession economies to share expertise on the protection and enforcement of intellectual property rights. Although the platform was expected to be finished by the end of 2021, many of the planned awareness-raising activities were postponed due to the COVID-19 pandemic. However, Serbia's IPR awareness-raising fair is currently still planned to take place during 2021 if the circumstances of COVID-19 permit.

### *Sub-dimension 1.2: Investment promotion and facilitation*

Serbia has a solid **investment promotion agency structure and strategy** for promotion and facilitation. According to the Law on Investments, the Development Agency of Serbia (RAS) is the sole agency in charge of promoting and facilitating investment projects at the national level. The agency has a wide scope of activities as its mandate encompasses export promotion and SME development as well as investment promotion. The agency is also involved in the design and implementation of all investment promotion policies, programmes and measures. These include the Strategy for Development of SMEs,

Entrepreneurship and Competitiveness 2015-20 and the Strategy and Policy of Industrial Development 2011-20, as well as preparing the new industrial development strategy and policy for 2021-30.

RAS is well funded by the state budget. It has a large staff (29 employees) in comparison to similar bodies in other WB6 economies, and they have regular training. The agency submits a work plan, financial plan and annual report to the government each year. Its performances are regularly benchmarked internationally and RAS usually takes part in benchmarking surveys and mystery shopper programmes performed by international organisations (Multilateral Investment Guarantee Agency, International Finance Corporation, World Bank, World Association of Investment Promotion Agencies, etc).

**Investment facilitation services and activities** include the development of free economic zones. Serbia has currently developed 15 free economic zones that host the majority of foreign investors. As of 2018, the zones have recorded investments amounting to EUR 3 billion (since 2008), attracted 204 multinational companies and created jobs for more than 35 000 employees. These zones accounted for 14% of Serbian exports, for a total turnover of EUR 5 billion. All 15 free zones are obliged to submit an annual report on their business activities. Based on those reports, the MoF provides consolidated reports to the government.

RAS has developed an investor targeting strategy based on its strategic framework for 2017-19. Key developments include a clear definition of the **investor targeting** function with expected values, follow-up activities and lessons learned. RAS is conducting targeted outreach campaigns followed by the follow-up mechanism and evaluating any lessons learned. This strategy has selected key sectors for attracting FDI based on Serbia's competitive advantages, giving priority to projects that have the potential to benefit SME development, export promotion and regional development. The agency is also striving to reinforce linkages between local firms and multinational companies by facilitating contacts between them and through the implementation of a supply chain support programme that relies primarily on working groups consisting of representatives from the public sector and companies.

Serbia also provides tax **investor incentives** targeting large projects, with no special groups or regions are benefitting more than others. According to the Law on Company Income Tax, any company that invests approximately EUR 8.5 million in fixed assets in Serbia and employs at least 100 additional employees throughout the investment period enjoys a 10-year corporate income tax incentive. These tax incentives are applicable for business entities registered in Serbia and operating under the Serbian Tax Administration. Serbia also provides a cost-based tax incentive scheme for qualifying R&D investment expenses as well as a 30% tax credit for investments in new companies performing innovative activities, provided the investor maintains less than 25% ownership. The free economic zones also offer exemption from VAT for income generated through commercial activities. All tax incentives are consolidated under the Tax Administration Office in the MoF.

Serbia has strongly reinforced its investment facilitation activities, as reflected by its improved ranking in the World Bank Doing Business Index from 91$^{st}$ in 2015 to 44$^{th}$ in 2020 (World Bank, 2020[34]). It has made significant procedural improvements in dealing with construction permits, trading across borders, protecting minority investors and resolving insolvency. RAS co-ordinates and facilitates activities on investment project development. According to the Law on Investment, for projects of national significance, project teams are formed with representatives from different levels of administration (local, central) with authority to collect mandatory documentation from other public offices on the investor's behalf. RAS is in charge of co-ordinating the work of project teams. The agency also acts as a one-stop-shop for both local and foreign investors. However, it is not entitled to approve any document on behalf of other institutions for the purpose of facilitating investment projects.

The official mandate of RAS extends to **aftercare activities** and this function has been defined as a permanent activity since the 2017-19 strategic framework. RAS has an aftercare unit that remains in continuous contact with foreign investors doing business in Serbia in order to get feedback on where it could better assist the company or how the business environment could be improved. The agency is also striving to develop and maintain strong collaborations with business associations such as the Chamber of

Commerce and Industry and the Foreign Investment Council as well as through the establishment of a working group consisting of representatives from the public and private sector.

### *Sub-dimension 1.3: Investment for green growth*

Serbia has begun developing a sound **investment policy for the promotion of green investment** and has established comprehensive legislation outlining its green growth priorities and objectives. As part of EU accession negotiations, Serbia adopted the Multi-annual Investment and Financing Plan (MIFP) for the environment in January 2020, further aligning its environmental priorities with Chapter 27 of the EU *acquis*. The MIFP includes an overview of investments needed for compliance, project cost estimates and assessment of potential sources of finance. It discusses the affordability of projects, defines priorities for investment and develops a financing strategy with investment needs, finance sources and the timing of individual projects. A priority investment plan was developed for projects to be started by 2029, based on detailed pipelines of required investments in waste, wastewater and drinking water infrastructure. However, no documents related to the 2020 MIFP are available to the public.

Serbia respects core investment principles such as investor protection, intellectual property rights protection and non-discrimination in areas inclined to attract green investment. These procedures are either part of individual institutional operational frameworks or part of multi-sectoral operational frameworks. For instance, the Ministry of Environmental Protection co-operates with Serbian Chamber of Commerce over regulatory frameworks, project implementation and matters relevant to EU integration. This inter-institutional co-operation between public and private institutions ensures lower costs cutting, simplified administrative procedures and a generally supportive environment for investment in new technologies, innovations, products and workplaces.

Serbia has shown commitment to creating predictable strategic and legal frameworks that are aligned at a national and sub-national level. In 2019, the economy adopted its National Strategy for Sustainable and Integrated Urban Development as well as a three-year action for its implementation. The strategy covers sustainable economic development, urban development and settlement management, social well-being, and environment quality, further aligning the economy with the European Union Urban Agenda. The strategy also addresses, among other things, climate change monitoring; air pollution; the protection of water resources and land, water, sewage and waste management infrastructure; and electricity infrastructure. It also covers the institutional framework needed to implement these areas of the strategy at local and national government levels.

Serbia has also developed a strong framework for making and implementing the choice of **public and private partnerships for green growth**. The economy's public-private partnership (PPP) framework is governed by the Law on Public Procurement and the Law on Public Private Partnership and Concessions, which was last amended in 2016 to account for PPP projects growing in both complexity and value. The law was amended with input from the European PPP Expertise Centre, an advisory service of the European Investment Bank.

Since 2012, Serbia's Public-Private Partnerships Commission has been providing professional support to PPP parties by overseeing concession proposals, holding consultations, giving advice, implementing best international practice and enforcing co-operation between government authorities and PPP parties. The commission is composed of nine government representatives, including those from the Ministry of Mining and Energy as well as the Ministry for Environmental Protection. Since 2017, Serbia has committed to several PPP projects in renewable energy or green growth areas, including four high-value wind farm PPPs[7] as well as a high-value PPP project for the Belgrade municipal waste-treatment facility.

### *The way forward for investment policy and promotion*

Serbia has an open economy and a clear pro-investment stance that has successfully attracted FDI over recent years. Yet improving its attractiveness as an FDI destination requires further policy adjustments and reforms in the following areas:

- **Accelerate reforms to the legal and regulatory investment framework**. In order to retain its competitiveness as a leading destination for FDI, Serbia should continue to improve its legal framework for investment, in particular by amending investment law to provide additional guarantees and protection for investors, and improving its public consultation processes by involving stakeholders earlier in the policy-making process and allowing them enough time to comment.
- **Reinforce the independence, resources and capacity of the courts, particularly for commercial disputes**. Improving the functioning of the commercial courts over the protection of property rights and the enforcement of contracts will be crucial to underpinning Serbia's economic performance and its ability to attract investors while reducing transactions costs. In the long run, a more efficient judiciary could encourage investments and promote the establishment of economic relationships while having a positive impact on competition and innovation.
- **Increase the take up of mediation mechanisms**. While Serbia has developed mediation mechanisms that are aligned with EU standards, their use remains limited, preventing them from alleviating the pressure on the courts. Raising public awareness of alternative dispute mechanisms could represent a first step towards this goal.
- **Reinforce efforts to implement the IPR framework and strengthen enforcement bodies**. Successful implementation of the strategic framework for intellectual property for 2018-22 will require solid governance, co-operation and co-ordination among the multiple actors involved in the implementation and enforcement of IPR rights, and increased resources and regular training on IPR matters.
- **Reinforce IPR awareness-raising efforts**. While the IPR strategic framework focuses on enforcement, it is also crucial to increase awareness about IP protection and management strategies among policy makers and in business communities. This could be done by improving access to information and regularly organising joint events with the private sector and the education system.
- **Continue to strengthen the capacity of RAS's staff**. While the national investment promotion agency has played an important role in attracting investors, it will be crucial to strengthen the capacity of its staff, notably in areas related to investor targeting and support for SMEs to enable RAS to reinforce linkages between local firms and multinational firms.
- **Reinforce the investment facilitation role of RAS through better co-ordination with other government bodies and agencies**. RAS acts as the main counterpart for investors but its role is hampered by its inability to facilitate its administrative procedures directly and effectively. Reinforcing its role of collecting and validating administrative procedures and/or strengthening its co-operation with the responsible government bodies and agencies will improve its ability to work alongside investors during the project definition and establishment phase, as well as to continue to assist investors once a project has been implemented.

## Trade policy (Dimension 2)

### *Introduction*

Serbia's performance on the trade policy dimension has improved since the last assessment. The economy's score has increased from 3.5 in the 2018 Competitiveness Outlook to 3.8 in the 2021 assessment (Table 25.4) with notable progress having been made on all sub-dimensions. Serbia improved the legal framework of its trade policy-making process through the implementation of a new trade facilitation body and expert groups. Its inter-institutional co-ordination mechanism has proved effective and the Ministry of Trade, Tourism and Telecommunications (MTTT) has established a National Co-ordination Body for Trade Facilitation which ensures co-operation between various government authorities, organisations, the business community and other foreign trade stakeholders. Public-private consultations have been strengthened and the business community have greater involvement in the formulation of trade policy. Serbia had made efforts to increase stakeholder participation in both the formation and implementation phases of policy making, as mandated by the amendments to the Law on State Administration. It has also significantly increased trade regulatory transparency by ensuring openness at all stages of the public consultation process through new obligations to publish relevant information, documents and assessments.

Serbia is integrated into the global network of international trade agreements. The economy extended its trade network by signing a free trade agreement (FTA) with the Eurasian Economic Union (EAEU) on 25 October 2019. Some challenges, however, remain unchanged since the last cycle of analysis. Very little progress has been made in accession to the WTO since the last review and a number of bilateral treaties are in the preparation phase.

Significant progress has been made in opening up trade with the conclusion of Additional Protocol 6 to the Central European Free Trade Agreement (CEFTA) in December 2019. Serbia continues to make progress in increasing the attractiveness of its economy by amending and adopting policies on trade in services. It has not reported any protectionist legal changes. This is particularly important in a context where regulations restricting services have tended to increase among OECD economies in 2020 (OECD, 2021[39]). By amending the new Public Procurement Law, Serbia has horizontally increased the attractiveness of all its sectors to trade in services since the last review round. The law is now fully harmonised with EU directives, including the abolition of preferential price conditions for domestic suppliers for the selection of tenders and the award of contracts. It has also taken major steps to open up the markets in certain specific service sectors, such as architecture, which has seen the most significant fall in restrictiveness among the sectors analysed. Further efforts could be made to improve company regulations and amend cumbersome procedures for obtaining business visas.

Serbia has a strong policy framework for e-commerce which has improved since the last assessment. The Law on Electronic Commerce has been amended to align it with the EU *acquis* and a working group has been set up to identify key challenges to e-commerce development. In October 2019, an action plan was created to improve e-commerce in Serbia.

### Table 25.5. Serbia's scores for trade policy

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Trade policy dimension** | Sub-dimension 2.1: Trade policy framework | 3.8 | 3.5 |
| | Sub-dimension 2.2: Services trade restrictiveness | n.a. | n.a. |
| | Sub-dimension 2.3: E-commerce and digitally enabled services | 4.0 | 3.1 |
| **Serbia's overall score** | | **3.8** | **3.4** |

### *State of play and key developments*

Serbia's exports of goods and services have been steadily growing since 2015. Overall trade increased from 115.8% of GDP in 2018 to 112% in 2019 in real terms, compared with 97.4% in 2015.

Exports of goods reached EUR 16.4 billion in 2019, while imports reached EUR 22.0 billion. The external deficit on trade in goods and services in 2019 amounted to 10% of the economy's GDP (official balance of payments statistics). In 2019, exports of goods and services were 50.8% of GDP while imports were 51%. Due to the pandemic, exports of goods and services as a share of GDP fell to 48.7% in 2020, while imports of goods and services fell to 56.7%. Serbia is a net exporter of commercial services, with commercial exports accounting for EUR 6.7 billion against EUR 2 billion in imports.

The introduction of a 100% customs duty by Kosovo on imports from Serbia and Bosnia and Herzegovina at the end of 2018 strongly affected Serbia's trade of goods and explains some of the variation in the main export and import destinations. Although it is difficult to establish the exact amount, the losses have been estimated at around EUR 400 million, or about 1% of GDP per year (European Commission, 2019[14]). These tariffs were lifted by Kosovo on 1 April 2020 and other non-tariff barriers for deliveries from Serbia were lifted in early June.

The EU is Serbia's main trade partner, followed by the CEFTA economies. In 2019, the EU accounted for 66.7% of Serbia's exports. Trade with CEFTA signatories accounted for 17.4% of total exports and 4.0% of total imports in 2019. Italy (12.2% of exports) and Germany (11.9%) were the main export destinations, followed by Bosnia and Herzegovina (7.9%). In 2019, Germany (12.9%) and Italy (8.7%) were also among Serbia's main suppliers, together with the Russian Federation (9.7%) and the People's Republic of China (9.4%).

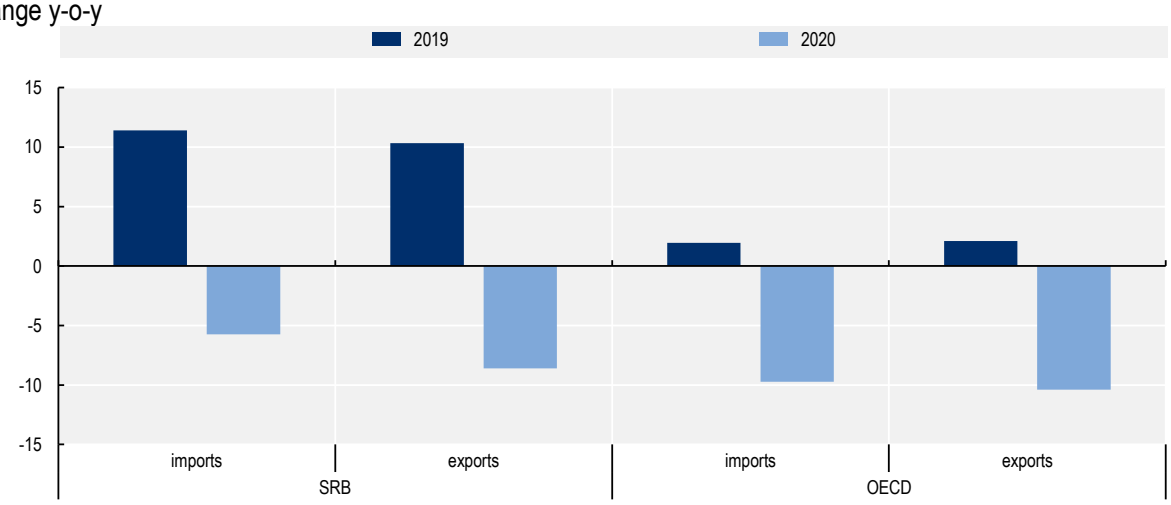
Like all economies, Serbia was affected by the COVID-19 pandemic. Containment-related export bans, restrictions on the movement of people, and closures of shops and services, which were in force from mid-March until the first week of May 2020, led to a decline in imports and exports in Q2-Q3 2020 compared to 2019 (Figure 25.4). The fall in GDP was more minimal (by 1% y-o-y). The COVID-19 outbreak means private consumption has plummeted, which was the largest contributor of the negative growth in the economy. Compared to other economies in the region and globally, Serbia was not the most severely affected; imports of goods and services declined by 5.8% and exports by 4.9% which was a smaller fall than the OECD average.

Exports of goods fell by 2.3% y-o-y in 2020, while imports declined by 3.5% leading to improvement of external goods trade balance by 7.1% (official balance of payments statistics). A geographical diversification of Serbia's export base resulted in increased exports to the United States (by 18.7% y-o-y), China (by 11.5% y-o-y) and Turkey (by 10.3% y-o-y), as well as Poland (by 16.2% y-o-y), Hungary (by 8.6% y-o-y), and Romania (by 8.0% y-o-y) in the EU. These helped compensate for a decline of exports to Italy (by 19.3% y-o-y) and CEFTA economies (by 8.5% y-o-y). Exports to Serbia's main trading partner, Germany, remained almost the same as in 2019 (decrease by only 0.7% y-o-y).

The largest reduction in goods imports in 2020 was from the Commonwealth of Independent States (CIS) (by 39.9% y-o-y) mainly due to low oil prices, and CEFTA economies (by 8.4% y-o-y). Imports increase from China (by 28.3% y-o-y), Hungary (by 11.7% y-o-y), and Slovenia (by 11.2% y-o-y).

## Figure 25.4. Impact of COVID-19 on trade, Serbia versus the OECD (2019-20)

% change y-o-y




Source: (IMF, 2020[40]), *World Economic Outlook* https://www.imf.org/en/Publications/WEO; (OECD, 2020[41]), *OECD Economic Outlook*, https://doi.org/10.1787/0d1d1e2e-en.

StatLink https://doi.org/10.1787/888934256235

Industries in the WB6 economies were affected by the supply shock caused by the COVID-19 pandemic and the resulting slowdown in trade flows. The decline in Serbia's exports was primarily due to the breakdown of global value chains. As one of the economies in the region with a higher level of integration into GVCs, and which has maintained its manufacturing base, it felt the immediate effects more severely but also saw its trade flows decline much less in the long run. The region's relatively low level of development and sophistication, has limited most WB6 economies to backwards linkages, mainly as assembly centres (World Bank, 2020[4]). Trade in intermediate industrial goods linked to global value chains accounts for about two-thirds of Serbia's exports (OECD, 2020[42]). The disruption in supply chains resulting from the combined slowdown of manufacturing production in China and reduced demand in the United States and the EU has brought some production and trade to a virtual standstill. This was the case for Serbia, where GVCs are concentrated in a few sectors (automotive, electrical equipment, machinery, chemicals and metals) and linked to a single European country (Germany). However, once the supply of raw materials was restored and demand from the EU stabilised, production and exports resumed to.

The closure of EU borders to non-EU citizens and other regulatory responses, combined with the existing logistical challenges of the Western Balkans, have particularly affected freight transport services. The WB6 set up the CEFTA co-ordinating body to exchange information on trade in goods at the beginning of the pandemic. They also set up priority "green lanes" with the EU and "green corridors" within the WB6 to facilitate the free movement of essential goods through priority "green" border/customs crossings (within the WB6 and with the EU). At the peak of the crisis (April to May 2020), most road transport in WB6 economies passed through these green lanes and corridors. These have helped to maintain a certain degree of international trade in goods in the region. In fact, only about 20% of the goods benefitting from the Green Lanes and Corridors regimes were basic necessities, the rest being regular trade. Such inclusive regional co-operation has proven to be very efficient in mitigating the consequences of the COVID-19 pandemic and helping the region's economies to recover.

### *Sub-dimension 2.1: Trade policy framework*

The Republic of Serbia boasts a comprehensive network of **inter-institutional co-ordination** mechanisms to formulate trade policies and regulations with the co-operation of expert groups, co-ordination bodies and civil society, under the direction of the MTTT. In addition to its existing trade policy mechanisms, Serbia

established the National Co-ordination Body for Trade Facilitation (NTFB) in 2017, which meets at least twice a year and ensures the effective facilitation of foreign trade and co-ordination efforts through the co-operation of various government authorities, organisations, the business community and other foreign trade stakeholders.[8] Four expert working groups have been established under the auspices of the NTFB and meet whenever necessary.[9] The NTFB formulates action plans for each group (currently for period 2020-21), in close co-operation with representatives of the business community in order to address the most relevant issues of trade facilitation for the private sector, and evaluate the previous action plan outcomes.

Serbia has significantly strengthened and formalised its **public-private consultation** process on regulatory issues, including trade issues, since the last assessment. The Law on the Planning System (2018) obliges the government to conduct public consultation processes at all stages in the development of public policy legislation. A 2018 amendment to the Law on State Administration required the authorities to conduct consultations and ensure public participation early in the preparation of draft laws, regulations and other acts including regulations on trade issues. The rulebook governing the Guidelines of Good Practice for the Realisation of Public Participation in the Preparation of the Draft Laws and Other Regulations and Acts, was adopted in 2019, further defining the process and methods of consultation. In January 2020, the government adopted guidelines on the inclusion of the civil society in working groups for drafting regulations and public policies.

The business community regularly engages with the NTFB and its expert groups through a platform where companies and interested parties can easily ask questions and submit proposals. Private sector organisations are members of each expert working group, so business community representatives are included from the start of the drafting process. As a result, many of the activities that are formalised in the action plans are proposed by private stakeholders and accepted by public institutions, members of the NTFB. In line with the Law on Planning Systems, the competent authorities are required to publish the findings of regulatory impact assessments conducted in the process of preparing legislation.

Since the assessment in 2018, Serbia has made progress in developing new bodies to strengthen public-private partnerships and improve business community involvement in the formulation of trade policy. The government has made strides in increasing stakeholder participation among non-governmental organisations (NGOs), academia, the private sector and chambers of commerce[10] in both the formation and implementation phases of policy making, as mandated by the amendments to the Law on State Administration.

Serbia has also significantly improved the transparency of its regulation by making consultation with all relevant entities mandatory in order to ensure openness, while obliging the competent authorities to inform the public at an early stage of the preparation of draft laws and relevant regulations. The new legislation in force has put in place a system that limits the use of shortened procedures for the adoption of regulations, including those affecting trade. As part of the consultation process, the authorities need to publish information on the options being considered and call on the public to submit proposals and written comments. The e-government portal[11] has dedicated applications redirecting to all ongoing consultation processes that are being conducted by the line ministries. When a public debate is required, the competent authority is obliged to publish on public websites and on the e-government portal the draft law, the presentation of the problem in a specific area, its causes, the objectives and the expected effect of the adoption of the law, and the rights and obligations of the entities covered by the law.

However, Serbia has not yet fully established a dedicated operational website that can act as a hub for all public-private consultations. A website is envisaged and the authorities are very active in implementing it in order to provide the public and all interested parties with an overview of all phases of the preparation of laws and other regulations. The portal should be operational by the end of the first quarter of 2021. As the site is not yet fully operational, the positive effects of the regulation on PPCs have yet to be quantified. There are very limited concrete data on the number of regulations affecting trade adopted under simplified

procedures in the current regulatory context[12] and reporting on the effectiveness of consultations is still limited. The Public Policy Secretariat (PPS) collects statistics on the number of legislative projects that have gone through public consultation, but this reporting is still done on an ad hoc basis. Furthermore, a number of local private sector stakeholders reported that the time allocated for public consultations was sometimes too limited. In addition, the implementation of comments in draft regulations does not always seem to be carried out in a fully harmonised way.

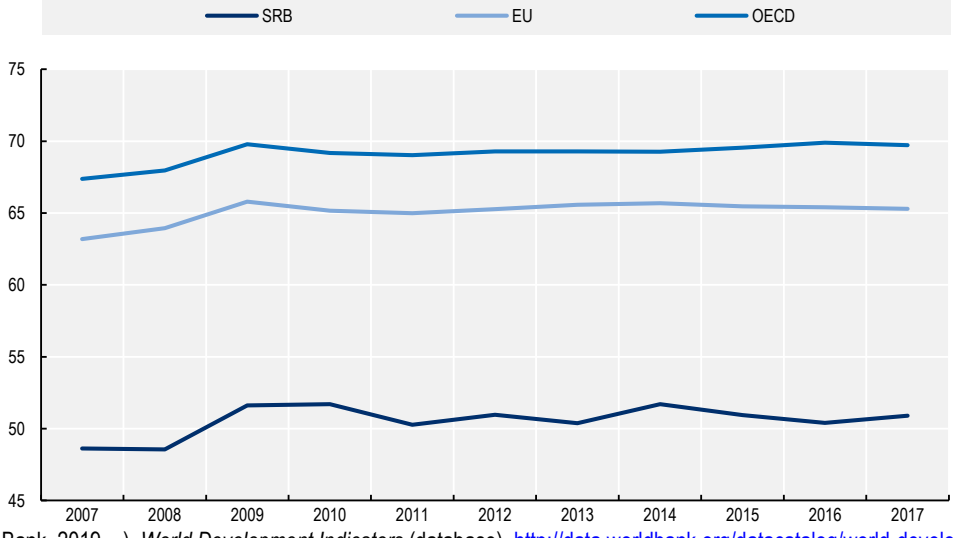
In the area of bilateral and multilateral **free trade agreements**, no progress has been made in Serbia's accession to the WTO since the last assessment. Serbia compensates for this through bilateral treaties and partnerships, notably by an FTA with the Eurasian Economic Union (EAEU) signed on 25 October 2019. The agreement was ratified in February 2020, but has not yet entered into force. This only extends the agreement to Armenia and Kyrgyzstan, as Serbia had already signed treaties with the other parties of the EAEU. Negotiations for a free trade agreement with Ukraine are ongoing. Since December 2018, negotiations are also underway on a bilateral investment treaty with South Korea. Discussions on a future trade agreement with the United Kingdom started in 2019. Serbia has also amended a series of existing treaties such as Protocol I and Protocol III on Trade in Services to the Agreement on Free Trade with Turkey, which entered into force on 1 June 2019. Similarly, Serbia supported the adoption of the Additional Protocol 5 (on trade facilitation) to the CEFTA on 26 May 2017, and the Additional Protocol 6 on Trade in Services to the CEFTA on 18 December 2019, which entered into force on 11 January 2021. Finally, Serbia has signed a limited, strategic partnership agreement signed in August 2009 with China.

Overall the integration of Serbia into international trade is half-hearted, with the economy having strong legal bases with major partners, in line with its regional integration policies and with the EU, but limiting trade outside this scope. This is particularly negative as Serbia is the largest economy in the WB6 region, and this status quo may hinder the benefits of a favourable regulatory regime for foreign direct investment in this economy (see investment chapter) and close the doors to third country investors.

### *Sub-dimension 2.2: Services trade restrictiveness*

Services contribute almost two-thirds of GDP in the WB6 economies, underlining how strongly economic growth, innovation and labour markets depend on effective policies on services that promote open and competitive service markets. In Serbia, services contribute to more than 50% of GDP (Figure 25.5) and account for more than 57.5% of employment.

**Figure 25.5. Contribution of services to Serbia's GDP (2007-17)**




Source: (World Bank, 2019[43]), *World Development Indicators* (database), http://data.worldbank.org/datacatalog/world-development-indicators.

StatLink https://doi.org/10.1787/888934256254

Enhancing openness of trade in services can improve domestic firms' efficiency and productivity. Trade in services allows countries to specialise according to their comparative advantages in services and skills.

The potential gains from liberalising services trade are significant because increased domestic and foreign competition, complemented by effective regulation, can enhance performance (OECD, 2018[44]) and lower trade costs related to regulatory barriers (Box 25.2).

### Box 25.2. The costs of regulatory barriers to trade in services

Recent OECD analysis has found that restrictions on trade in services significantly affect trade by increasing the costs for firms operating in the host economy (Rouzet and Spinelli, 2016[45]) Trade costs arise both from policies that explicitly target foreign suppliers, and more generally from domestic regulation that falls short of best practice in the area of competition and rule-making. The costs resulting from barriers to trade in services are much higher than those from trade in manufactured goods.

Trading services is costly. The studies show that policy-induced services trade costs are relatively high. Expressed as percentages of total trade value, average multilateral costs for cross-border services trade are around 57% for communication services and 54% for business services, around 60% for transport services, around 103% for insurance services, and around 255% for financial services. Even exporting to the most liberal countries still requires compliance with regulation at a cost that correspond to around 30% of the export value in most sectors and nearly 90% for financial services. Within the European Single Market, however, services trade costs are significantly lower – policy-induced costs of cross-border services trade are at around 10% in most sectors and around 32% for financial services.

Source: Benz and Jaax (2020[46]), "The costs of regulatory barriers to trade in services: New estimates of ad valorem tariff equivalents", http://dx.doi.org/10.1787/bae97f98-en.

The OECD Services Trade Restrictiveness Index (STRI) was used to **analyse barriers to trade for 12 services sectors** in Serbia. The OECD STRI project is a unique, evidence-based diagnostic tool that inventories trade restrictions in 48 economies,[13] allowing economies to benchmark their services regulations against global best practice, identify outlier restrictions, and prioritise reform efforts. For this CO assessment cycle, the 12 services sectors are grouped into four clusters: 1) transport and distribution supply chain (air transport, road transport, rail transport, courier); 2) market bridging and supporting services (commercial banking, insurance, legal services); 3) physical infrastructure services (construction, architecture, engineering); and 4) digital network services (computer services, telecommunications).

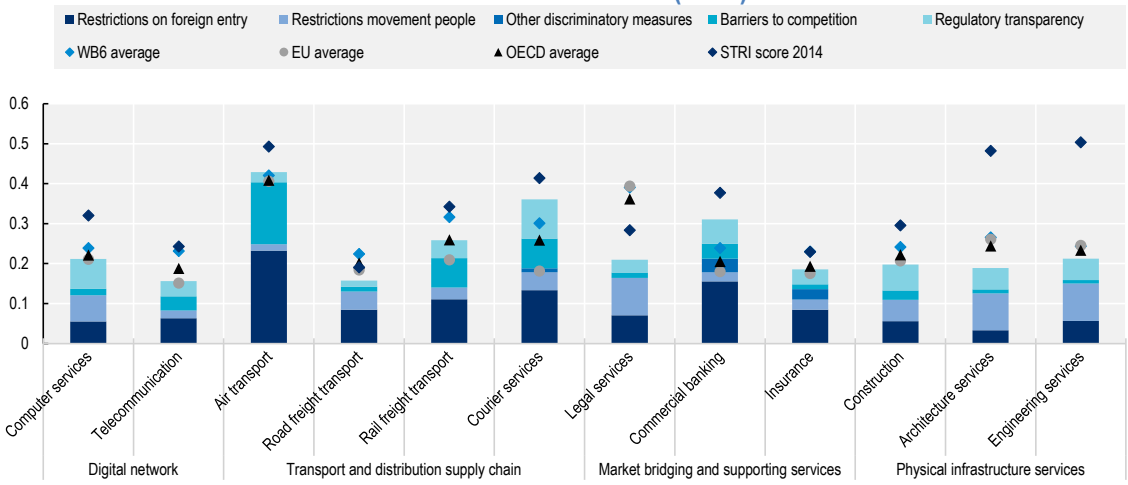
Information was collected from the WB6 economies' laws and regulations, and indices were calculated for seven years (2014-20). These composite indices quantify restrictions across five policy areas: foreign entry, movement of people, barriers to competition, regulatory transparency and other discriminatory measures. The indices quantify regulatory restrictions in each of the 5 policy areas for the 12 sectors by giving them a value between 0 and 1. Complete openness to trade in services gives a score of 0, while being completely closed to foreign service providers yields a score of 1.[14]

Each policy area is composed of a series of measures. These measures are called "horizontal" if they are present in all sectors, or "sector specific" if they only affect a particular sector.[15] The STRI measures the most-favoured-nation (MFN) restrictions and does not take into account any specific concessions, such as regional trade agreements or mutual recognition agreements (Geloso Grosso et al., 2015[47]).

Figure 25.6 shows Serbia's score in the 12 sectors covered by the STRI project along with the average and the lowest score among the WB6 economies. Serbia has a lower score on the STRI than the WB6 average in 8 out of 12 sectors. Compared to the STRI project member states, Serbia is in the low range for the restrictiveness of its service sectors. Legal services, architecture services and telecommunication

services are the three least restrictive sectors (those with the lowest STRI score). Commercial banking, courier services and air transport are the three relatively most restrictive sectors.

## Figure 25.6. Services trade restrictiveness index for Serbia (2020)



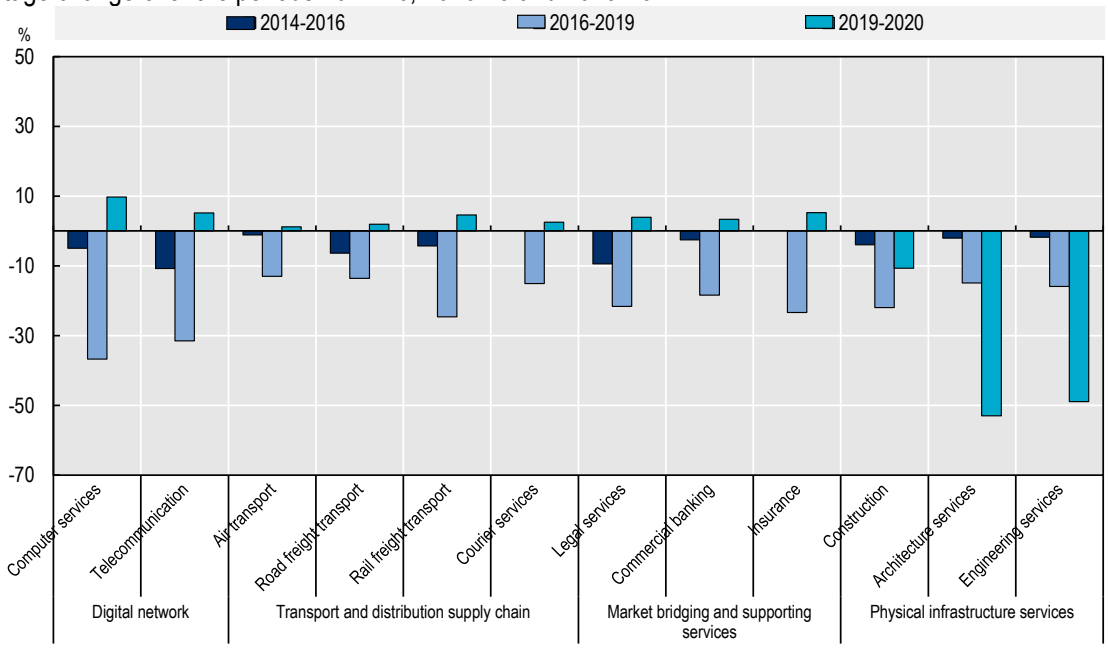

Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; Bulgaria, Croatia and Romania are not OECD members nor OECD STRI key partner economies and therefore are not covered by STRI indices; key partners to the STRI project are Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.
Source: (OECD, 2020[48]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256273

Serbia has demonstrated a continued willingness to lower restrictions affecting trade in services, as Figure 25.7 shows. The slowdown in reforms to open up services markets in 2019-20 is explained by the focus of all regulatory change in the economy on measures to safeguard public health and the economy in the context of the COVID-19 pandemic. It should be noted that there are no trends towards regulatory protectionism in the WB6 region, including Serbia, although some minor restrictive policy changes were introduced in 2020. Refraining from introducing disproportionate limitations on services is particularly important in a context where recent OECD studies of member states tend to show a growth in the number of protectionist regulations hindering services in 2020 (Banja et al., 2017[49]).

## Figure 25.7. Serbia's Services Trade Restrictiveness Index by sector (2014-20)

Percentage change over the periods 2014-16, 2016-19 and 2019-20




Note: Negative values indicate a reduction in the restrictiveness of the economy's trade regulatory environment.
Source: (OECD, 2020[48]). Services Trade Restrictiveness Index Regulatory Database, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256292

The following analysis starts with the horizontal measures that are included in all sectors and that typically hamper services trade in the economy as a whole. In particular, in the area of general business regulations, restrictions on the movement of service providers, standards for the cross-border transfer of personal data, the legal framework for public procurement and the screening of foreign investment. It then displays the STRI scores, explains sector by sector what drives the results, and provides a brief description of the most common restrictions and good practices. Box 25.3 presents the modes of supply of trade in services as defined by the General Agreement on Trade in Services (GATS) and used in the OECD STRI.

### Box 25.3. Examples of the four services supply modes

The definition of trade in services under the General Agreement on Trade in Services (GATS) has four components, depending on the territorial presence of the foreign service provider and the consumer at the time of the transaction. Pursuant to Article I:2, the GATS covers services supplied.

**Mode 1: Cross-border:** Services are provided from the territory of one member into the territory of any other member.

*Example*: A consumer in economy A receives services from abroad through its telecommunications or courier infrastructure. These supplies may include any type of consultancy, legal advice, architectural services, or computer related services.

**Mode 2: Consumption abroad:** Services are provided in the territory of one economy to the service consumer of any other economy.

*Example*: Nationals of economy A have moved abroad as tourists, students, or patients to use respective services.

**Mode 3: Commercial presence:** Services are provided by a supplier of one economy, through commercial presence, in the territory of any other economy.

*Example*: The service is provided within A by a locally-established subsidiary, or representative office of a foreign-owned and controlled company (bank or insurance company, air company, construction firm, etc.).

**Mode 4: Movement of natural persons:** Services are provided by a foreign supplier, through the presence of natural persons of an economy in the territory of any other economy.

*Example*: A foreign national provides a service within A as an independent supplier (e.g., IT consultant) or employee of a service supplier (e.g. IT consultancy firm).

Source: (WTO, GATS, 1995[50]), Article I:2 ; (WTO, n.d.[51]), Trade in services modes of supply, https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm.

**Cumbersome horizontal business regulations affect firms' ability to operate**

There are a number of areas where Serbia could improve its *general business regulations*. Foreigners are limited in their ability to acquire or use land and real estate.[16] The STRI methodology captures cases where economies have minimal capital requirements in their legislation. In order for a limited liability company to be established and registered in Serbia it must deposit a minimum amount of capital, which in theory affects the operating capacity of foreign companies. However, the effect of this measure is marginal in practice as, according to the Company Law, the minimum share capital for limited liability companies is 100 dinars, which is less than EUR 1. Moreover, the minimum capital does not have to be paid before or at the time of registration; shareholders are able to commit to fulfil this obligation in the foundation deeds within a predefined period of time.

General *restrictions on the movement of people* also limit trade in services in Serbia. Although significant progress has been made in easing movement between the CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA Agreement, nationals from non-CEFTA and EU economies are subject to restrictive requirements. Serbia does not apply quotas or labour market tests for foreigners from third countries, which has a positive impact on its STRI score. The length of stay of Independent service suppliers and intra-corporate transferees in Serbia is limited to 12 months. Contractual service suppliers can initially only stay up to 3 months. The 12-month duration is comparable with those observed in the EU Member States participating in the STRI project, but less than best practice elsewhere which is more than 36 months (OECD, 2020[48]). The length of stay for contractual service suppliers falls short of both EU and OECD best practice, however.

Finally, the STRI indices in the partner countries of this project are very often negatively impacted by the World Bank *Doing Business* indicators, particularly for registering a company (World Bank, 2020[52]). Serbia has made it much easier to start a business on its territory and is therefore very attractive. There are seven steps involved in starting a business in Serbia: 1) notarisation of the deed of incorporation; 2) opening a bank account and paying the registration fees; 3) obtaining a registration certificate, tax identification number, pension fund (PIO Fund) and health fund certificates, and the certification of signatures (three copies) for opening a bank account; 4) the affixing of a stamp and a seal; 5) registering employment contracts with the organisation / employment fund; 6) obtaining an electronic certificate; and 7) registering the ultimate beneficial owners (UBOs). This is below the maximum set as good practice by the STRI. Likewise, the procedure takes 5.5 days to completed and the total cost of all the official procedures needed to register a company is 2.4% of per capita income, also very competitive compared to other economies in the region.

*The legal framework for public procurement* has also improved. Serbia has reduced limitations in this area since the last review cycle. The new Law lifted the domestic prices preferences or conditions on foreign

contractors to source personnel and products locally when selecting tenders and awarding contracts that hindered the public procurement process. The new regime does not bias the conditions of competition in favour of local firms. Moreover, the regulations on public procurement explicitly prohibit discrimination against foreign suppliers,[17] which is relatively rare among the WB6 and has a highly positive impact on Serbia's STRI score. No procurement regime is applied to foreign suppliers below the value thresholds.[18]

Serbia's laws and regulations do not require the consideration of economic interests in the *screening of foreign investments* but nor is it explicitly excluded. The economy does not set a threshold above which a foreign investment project is subject to screening.

### Restrictions in specific services sectors[19]

Beyond the horizontal issues affecting Serbia's trade in services across all sectors, a number of sector-specific restrictions still remain in the 12 sectors analysed.

**Air transport services** are defined as passenger and freight air transport (code 51 under the International Standard Industrial Classification – ISIC Rev 4), carried domestically or internationally. The STRI for this sector only covers commercial establishments. In light of the range of air transport sub-sectors, the STRI's approach is to focus on measures affecting carriers' transport of passengers and goods between points. Airport management and other aviation services are only relevant where regulations enacted by relevant authorities could affect the ability of foreign carriers to transport passengers and goods between points. The other aviation services are covered more fully in the STRI for logistics services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.165 and 0.601. The WB6 average is 0.421, which is roughly in line with the EU average of 0.406 and the OECD average of 0.409 (where 0 signifies a completely open sector, and 1 a sector closed to foreign service providers). With a score of 0.429, Serbia is the second most-restrictive of the WB6 economies.

Due to the regulatory structure of the sector, which is largely driven by a multilateral approach, there is limited variation in STRI scores across the WB6 economies. Serbia is no exception, as its regulatory environment in this sector is largely aligned with EU regulations.

*Restrictions on foreign entry* play a prominent role in Serbia's STRI score for this sector. Like 40 other OECD and STRI key partners (OECD, 2020[53]), Serbia limits the equity share that foreign natural or juridical persons can hold in an air transport services company to 49%. This restriction is, however, in line with European Union legislation. Serbia follows a liberal approach in the leasing of foreign aircraft without crew (dry lease), which allowed subject to prior authorisation. In contrast, the lease of foreign aircrafts with crew (wet lease) is prohibited.

The other major category that influences Serbia's STRI score is *barriers to competition* due to the non-competitive allocation of slots. Like many economies, Serbia maintains public ownership of its national carrier Air Serbia. Slots at airports with high demand are allocated on the basis of historical rights, prohibiting the commercial exchange of slots. However, half of the slots remaining after the historical allocation go to new entrants, which reduces the degree of restrictiveness in the sector.

**Road freight transport** (ISIC Rev 4 code 4293) covers commercial road freight establishment only. Cross-border trade is governed by a system of bilateral and plurilateral agreements which provide for permits, quotas and other regulations.

The 2020 scores for all OECD member states and STRI partners in this sector range between a very low 0.124 and a high 0.624. The WB6 average is 0.225, demonstrating the region's open approach towards transport services, although still more restrictive than the averages for the OECD (0.201) and EU (0.184). Serbia is the second least restrictive of the WB6 economies with a score of 0.158. Due to the wide spread of scores in this sector, Serbia compares well against many OECD member states; against EU countries,

Serbia is only slightly more restrictive than the best performer (the Czech Republic) and less restrictive than the worst performer (Poland).

Serbia's score is worsened by cross-cutting factors affecting the whole economy, particularly those related to movement of people. Professional qualifications are paramount in this sector, particularly for truck drivers, who must obtain a special licence that demonstrates their professional competence. However, Serbia does not have procedures in place to recognise certificates gained abroad, meaning foreign licences are not recognised and imposing *restrictions on the movement of people*.

Sector-specific regulations also impose *restrictions on foreign entry* in Serbia. One such is the existence of a regime of discretionary authorisation. Within 15 days of receipt of a request, the transport ministry assesses whether Serbia has adequate transport capacities, i.e. a certain type and number of vehicles, and decides on the allocation of licences on a case by case basis. Serbia also applies an economic needs test before issuing a licence to transport freight within its borders. If Serbia has adequate transport capacity for the transport licence requested, the ministry will reject the request. In this sector, truck drivers providing cross-border road transport services (Mode 1) are highly dependent on visa measures. Thus, any regime that grants them adaptations to the general visa regime has positive effects on the fluidity of transport and thus the attractiveness of this activity within the host economy. Among the measures that can be found among the best STRI performers is the possibility to obtain a visa at the border or even a simple visa exemption for the entry/temporary transit of the crew. In that regard, Serbia do not grant any visa exemptions for third-country truck drivers. However, preferential treatment (in the form of a non-visa regime) is given to nationals from the WB6 and the EU economies.

**Rail transport** (ISIC Rev 4 code 4912) is provided over a dedicated network; the market structure may take different forms. The two most common are: 1) vertically integrated rail services firms owning and managing both the infrastructure and the operation of freight services; and 2) vertical separation between the infrastructure management and operations. Regardless of the market structure, there are well-established best practice regulations that also take into account competition from other modes of transport, particularly road transport.

The 2020 scores for all OECD member states and STRI partners in this sector range between a very open 0.129 and 1, indicating the sector is completely restricted, while the WB6 average is a relatively low 0.317. Serbia, with a score of 0.259, is the median WB6 economy, scoring higher than the EU average (0.259) and in line with the OECD (0.209). Serbia is also substantially in line with EU's worst performer (Poland).(See Trade policy (Dimension 2) regional chapter)

Serbia's score for this sector is negatively affected by the lack of grants of access rights, *restricting foreign entry*. Rail companies from neighbouring economies are granted access to Serbia's rail network to operate international and domestic cargo services.[20] Railway operators must also be established locally in order to provide services in Serbia and require an operating licence. The procedure for issuing railway licences and safety certificates is in accordance with the EU regulations (Directives 2012/34, 2004/49, 2016/798) governing this area. According to the rulebook on transport licences in railway traffic, operators must submit a business plan when applying for a licence to prove their financial capability.

On the issue of the *movement of people*, some professions in the sector, such as train drivers, need a licence in order to operate. This is in accordance with EU Directive 2007/59/EC on the certification of train drivers, and overall Serbia does not impose any additional burdens on foreign service providers.

Barriers to competition are an important contributor to the STRI score for this sector. Access fees are calculated by the infrastructure manager following certain predefined criteria. These fees must also be approved by the government. Prices for rail services are also regulated through formal government approval of the level of tariffs. The infrastructure manager regulates congested traffic and decides on requests to use congested tracks. Serbian Railways was split into subsidiaries responsible for cargo, passenger and infrastructure in 2015. Srbija Kargo is Serbia's main rail freight operator and it is state-

owned.[21] While the Railway Law stipulates that both public and private companies may participate in railway infrastructure, the state has a monopoly on this sector. The activity of infrastructure management is considered a natural monopoly and activity of public interest according to the Law on Railways, which is in accordance with EU Directive 2012/34.

**Courier services** (ISIC Rev 4 code 53) comprises postal and courier activities. While courier services have traditionally been an important means of communication, the rise of modern ICT means letters are less frequently used for communication. The STRI for courier services covers regulations that have an impact on the pick-up, transport and delivery (door-to-door) of letters and parcels, and express delivery services, regardless of who provides the service. These services include both addressed and unaddressed items.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.106 and 0.881, while the WB6 average is 0.301. With a score of 0.361, Serbia is in the median position among WB6 economies, and is more restrictive than the EU average of 0.181 and the OECD average of 0.259. Serbia's score has become less restrictive in this sector since 2014 but is still affected by two sector specific measures: the fact that the designated universal service provider is the state-owned Post of Serbia and preferential treatment of the designated postal operator .

A new law on postal services entered into force in November 2019. It replaced the Postal Act and harmonised the regulatory framework fully with the first and second EU postal services directives and partly with the third.

Serbia does not impose a commercial presence requirement, but cross-border services do require a local presence in Serbia, affecting foreign entry. Postal operators are able to provide postal services on the basis of a permit. As in many other economies, Serbia grants the designated postal operator two reserved areas: a monopoly on a subset of the range of universal services. Universal postal services in Serbia include collection, sorting, transport and delivery of letter-post items weighing up to 2kg as well as collection and delivery of letter-post items weighing up to 10kg in domestic and international postal traffic, and delivery of parcels up to 20kg in international postal traffic. As regards *barriers to competition,* Serbia's designated universal postal services operator is the public company Pošta Srbija (Post of Serbia), which could act as a barrier to competition. There is at least one other dominant provider in the courier services market. Postal operators in the economy are obliged to submit the price list of postal services to the designated Agency, RATEL no later than three days before its implementation begins. The postal operator is also obliged to apply the postage in accordance with the price list of postal services.

Sectoral *regulatory transparency* measures include customs and licensing procedures. Serbia requires postal operators to bear the costs of a licence fee. The operators must also pay an annual fee of 0.4% of the total revenue generated from the provision of postal services.

**Legal services** (ISIC Rev 4 code 691) cover advisory and representation services in both domestic and international law and, where relevant, measures are entered separately for each of them. International law includes advisory services in home-country law, third-country law, international law, and appearing in international commercial arbitration. Domestic law extends to advising and representing clients before a court or judicial body in the law of the host country.

The 2020 scores for all OECD member states and STRI partners in this sector range between a very open 0.141 and 1, while the WB6 average is 0.391. With a score of 0.209, Serbia is the least restrictive of the WB6 economies, and is also less restrictive than the averages for the EU (0.394) and OECD (0.362).

Serbia's score is negatively affected largely due to foreign entry restrictions and *restrictions on the movement of people*. There are relatively stringent procedures on foreign lawyers who wish to practise in Serbia. A licence is needed to provide legal services in Serbia. Foreign citizens registered in the Register A of the Directory of Lawyers, are limited to giving oral and written legal advice and opinions related to the application of the laws of their home country and international law. Foreign citizens registered in Register

B of the directory (i.e. to be permitted to provide advice on Serbian law as a foreign licensed lawyer), have the same advocacy rights as domestic lawyers, although for the first three years after registration, foreign lawyers can only act in Serbia via a partnership with a domestically licensed lawyer. In order for foreign professionals to enter Register B as a fully locally licensed practitioner, they must, in addition to other conditions, have passed the bar exam in the Republic of Serbia. Foreign lawyers are not able to obtain authorisation for temporary entry to carry out a specific project or to advise in some areas of legal services.

*Restrictions on foreign entry* are especially present in domestic law in Serbia. The law requires that equity shares of legal services firms may only be held by licensed lawyers or firms in Serbia. Registration with the establishment of a legal entity in Serbia indicating commercial presence is required to provide cross-border services (Mode 1 – see Box 25.3). A lawyer is required to have an office in Serbia, meaning that local presence is also required. The Bar Association is obliged to enable candidates to take a lawyer's oath, provided they have paid the costs of registration, and, if they are foreign citizens, provided they have submitted proof of a concluded contract of professional liability insurance in the Republic of Serbia.

Regarding *barriers to competition*, Serbian law does not permit lawyers, joint law firms or law firms to advertise.

**Commercial banking** (ISIC divisions 64-66) is defined as deposit-taking, lending and payment services. Commercial banking services are traded business to business, as well as business to consumer for retail banking. Efficient banking services are one of the backbones of a dynamic economy; they provide financing for investment and trade across productive activities, thus underlying all value chains.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.131 and 0.517, while the WB6 average is 0.239. With a score of 0.311, Serbia is the second most-restrictive of the WB6 economies in this services sector and is also more restrictive than the OECD average (0.205) and the EU average (0.180). However, it has made progress since 2014.

Serbia’s scores are mainly influence by three policy areas: restrictions on foreign entry, barriers to competition and regulatory transparency. These results reflect the particular characteristics of the sector as well as the policy environment in which it operates. As the banking sector plays a key role in each economy but can pose risks to financial stability, restrictions on entry and competition have sometimes been used as a means for authorities to maintain control over the operation of the sector in the absence of effective prudential regulation.

Regarding *foreign entry*, Serbia does not limit the share of foreign equity capital in local banks, nor does it restrict the establishment of foreign bank branches or the licensing of foreign-owned banks which is a positive outcome of the Banking Law. Furthermore, licensing is done according to objective and transparent principles applied in the same way as to domestic banks. Finally, Serbia’s regulation of cross-border mergers and acquisitions is non-discriminatory. Restrictions remain, however: foreign banks need to have a commercial presence in Serbia to provide services to residents. In the same logic, at least one of the members of the board of directors of a commercial bank must be a resident.

*In barriers to competition:* Serbia’s STRI scores are positively affected by its adequate regulation of financial products and the full operational, managerial and fiscal independence of its supervisory authority from the government. Finally, none of the largest commercial banks are state-owned. In consequence, this STRI category is up to speed with STRI best performers.

As regards *regulatory transparency* The authorities are obliged to provide reasons for rejecting an application for a licence within a maximum of 15 days, in line with OECD good practice on the matter. However, the time and cost required to resolve a debtor's insolvency contributes negatively to Serbia’s score in this area.

In *other discriminatory measures* Serbia's adherence to International Reporting Standards (IFRS) improves its STRI score in the area of other discriminatory measures. Its regulations are in line with Basel

II, while the implementation of Basel III recommendations is ongoing: Since December 2016, the National Bank of Serbia has adopted a set of regulations implementing Basel III standards[22] – see Access to finance (Dimension 3) – which also positively affects the openness of Serbia's commercial banking sector.

**Insurance services** (ISIC Rev 4 codes 651 and 652) comprise life insurance, property and casualty insurance, reinsurance and auxiliary services. Private health insurance and private pensions are not covered.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.104 and 0.565, while the WB6 average is 0.231. With a score of 0.185, Serbia is the third most-restrictive of the WB6 economies in this sector and lies between the EU average of 0.175 and the OECD average of 0.193. The relatively low spread of scores in this sector means that differences in rankings are dictated by measures with a limited impact on the trade in services. Thus, it is more relevant to note that Serbia maintains a very high level of attractiveness, including in comparison to EU and OECD states.[23]

Serbia's STRI scores in this sector are mainly influenced by two policy areas: foreign entry restrictions and regulatory transparency. These results reflect the particular characteristics of the sector as well as the wider policy environment. In general, as with the wider financial services sector, insurance relatively non-restrictive in Serbia. the main factors that make Serbia's banking sector relatively also apply for insurance. Serbia does not limit the share of foreign equity capital in local (re)insurance companies, nor does it restrict the licensing of foreign-owned (re)insurance companies. Licences are issued according to objective and transparent principles with no distinction made between foreign-owned and domestic companies. Serbia's regulation of cross-border mergers and acquisitions is non-discriminatory.

A few policies increase the *restrictions on foreign entry* in this sector, however. Foreign insurers need to have a local presence in Serbia to provide services to residents. Serbia also restricts the operation of branches of foreign insurance companies operating in its territory. At least one member of the board of directors of a foreign insurance company must be a resident. In addition, the Insurance Act sets a requirement for Serbian language proficiency as a prerequisite for obtaining a managerial position in a (re)insurance company.

Before 2019, *other discriminatory measures* affected the openness of the insurance sector because of Serbia's deviation from international standards on transparency and anti-money laundering (AML) and combatting the financing of terrorism (FATF 40). In 2019, as part of a major legal reform, Serbia introduced a new AML law as well as by-laws that regulate specific AML activities for the insurance industry. These measures have increased the openness of the sector.

**Construction services** (ISIC Rev 4 codes 41 and 42) cover the construction of buildings (residential and non-residential) as well as construction work for civil engineering. Construction has historically played an important role in the functioning of economies, providing the infrastructure for other industries. It accounts for a significant share of GDP and employment in most countries. There is a good deal of regulatory complementarity between the construction services sector and architectural and engineering services (below). The regulatory landscape of Serbia reflects these similarities, with all three sectors having very similar STRI scores.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.464, while the WB6 average is 0.242, the OECD average is 0.222 and the EU average is 0.207. Serbia is the second least-restrictive of the WB6 economies in this sector with a score of 0.198, placing it within the range of EU and CEEC scores. Serbia scores more liberally than the worst-performing CEEC country (Slovenia) but more restrictive than that region's best performer (the Czech Republic).

Serbia's score in the sector is mostly driven by horizontal measures such as restrictions on the acquisition and use of land and real estate by foreigners and local presence requirements for cross-border supply

Construction services is a labour-intensive sector (skilled and unskilled), which means it generally accounts for a higher share of employment than GDP in most economies. The potential for mechanisation and automation, and thus capital-intensive production, remains limited. *Restrictions on the movement of people* are applied across the board in Serbia and thus have a significant impact on this sector. Serbia's score is also affected by restrictions applied to architecture and engineering services, discussed below.

The movement of people is also restricted by licensing requirements to provide engineering services in Serbia. In 2018 an amendment to the law extended licensing requirements to all types of design and construction, whereas previously it only applied to specific sectors such as airports, railways, waste treatment plants and renewable energy facilities.

**Architecture services** (ISIC Rev 4 code 711) cover architectural services and related technical consultancy. These services form the backbone of the construction sector, with key roles in building design and urban planning. An important feature is the regulatory complementarity between architecture, engineering and construction services. Architectural and engineering activities are often combined into projects managed by a single company, and are sometimes subsumed in the building and construction sector. The STRI definition of architecture services includes several related activities, such as advisory and pre-design architectural services, architectural design, contract administration services, and urban planning and landscape architecture services.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.113 and 0.684, while the WB6 average is 0.265. With a score of 0.189, Serbia is the second least-restrictive of the WB6 economies in this sector and is also less restrictive than the EU (0.260) and OECD (0.244) averages. Its score is mostly affected by licensing requirements and the lack of temporary licensing system.

Serbia places restrictions on the *movement of people* in this sector with licence requirements with no temporary licensing system in place, meaning foreign architects cannot be granted temporary entry to carry out a specific project or provide advice in some area. Serbia has limited the negative impact of this by implementing a procedure for recognising foreign qualifications in 2020. Even so, applicants with a qualifying licence in their home country must take the general part of the professional exam and must fulfil the conditions prescribed in the law. However, some foreign licences are recognised on a reciprocal basis, mainly applying to CEFTA and EU licensed professionals.

As regards *restrictions on foreign entry*, Serbia restricts cross-border services. In consequence, services can only be supplied via some form of local presence in the economy, but there is no obligation to establish a commercial presence. Foreign authorised persons are only recognised in Serbia upon proving the conclusion of a professional liability insurance contract in the state in which they reside. Moreover, the contract if accepted in Serbia only if the insured is covered by a guarantee that is equivalent or comparable to the amount of insurance determined by the regulations governing professional liability insurance for performing activities in the field of spatial planning and construction in Serbia.

**Engineering services** (ISIC Rev 4 code 711) cover several related activities, such as engineering and integrated engineering services, and engineering-related scientific and technical consulting services. Engineering services are the backbone of construction and supply. Engineers are involved in the construction of key infrastructure, such as buildings and roads. They also play an important role in the development of production processes and the adoption of new technologies

The 2020 scores for all OECD member states and STRI partners range between 0.118 and 0.575, while the WB6 average is 0.243. Serbia, with a score of 0.212 is less restrictive than the averages for the EU (0.245) and the OECD (0.233). As in the architecture services sector, the engineering sector's score is mostly affected by licensing requirements and the lack of a temporary licensing system.

In engineering services, the results are mainly due *to restrictions on the movement of people.* A licence or permit is required to practise and there is no temporary licensing system, which means that foreign engineers cannot enter Serbia temporarily to carry out a specific project or to provide advice in certain

fields. On the positive side, Serbia implemented a procedure for recognising foreign qualifications in 2020. Even so, applicants with a qualifying licence in their home country must take the general part of the professional exam and must fulfil the conditions prescribed in the law.

**Computer services** (ISIC Rev 4 codes 62 and 63) are defined as computer programming, consultancy and related activities, and information service activities.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.123 and 0.448, while the WB6 average is 0.232. Serbia's score is 0.212, making it the second-best performer in the region, marginally more restrictive than the EU average of 0.211, but more open than the average for the OECD (0.221).

This sector is very rarely regulated by sectoral legislation and in Serbia computer services are only subject to the general laws that apply to the economy as a whole. Therefore, restrictions on the movement of people account for one-third of the total score in this sector. The need for skilled labour, combined with the complementarity between cross-border trade and movement of people explain why these restrictions feature prominently in this sector in Serbia.

**The telecommunication sector** (ISIC Rev 4 codes 611 and 612) comprises wired and wireless telecommunications activities. These services are at the core of the information society and provide the network over which other services including computer services, audio-visual services, and professional services are traded.

The 2020 scores for all OECD member states and STRI partners in this sector range between 0.108 and 0.682, while the WB6 average is 0.231. Serbia's score of 0.156 is in line with the EU average of 0.151, and it is a little more open than the OECD average of 0.188. The economy is the third most-restrictive of the WB6 economies.

Serbia' score in this sector depends on three policy areas: restrictions on foreign entry, barriers to competition and regulatory transparency.

In order to ensure fair competition in the telecommunications market, Serbia has an independent telecommunications regulator, RATEL, which is separate from stakeholders and the government. It operates without state intervention. RATEL has sufficient regulatory powers to regulate the sector effectively through ex-ante regulations applied in accordance with EU precepts to ensure that no single operator with significant market power in certain market segments (inevitable in certain cases) is bound by appropriate pro-competition regulation in place for operators that already have significant market power. Ex ante regulations are applied on the basis of a regularly conducted market analysis and readily available on the RATEL website. The government maintains the presence of an SOE as the majority shareholder in one of the main telecoms providers, *Telekom Srbija*. Serbia applies a "use-it-or-lose-it" policy to frequency bands – an important measure that prevents incumbent operators from over-holding valuable frequency licences as well as free tradable spectrum and telecom services.

In absolute terms, the regulatory framework of the telecommunication sector in Serbia is competitive and constrained only by horizontal measures that apply to the economy as a whole, most notably for the movement of people. Although telecommunications lend themselves easily to cross-border trade from a technical point of view, such restrictions account for a modest share of the total STRI score in this sector. Cumbersome procedures to obtain visas and register companies also negatively affect the sector to some extent.

### *Sub-dimension 2.3: E-commerce and digitally enabled services*

E-commerce can bring significant gains for businesses, driving firms' process innovation (Ferencz, 2019[54]). In can enlarge businesses' market scope, reduce the operational costs of various business activities and lower barriers to entry, thus intensifying competition (OECD, 2013[55]). E-commerce also

benefits consumers by providing information on goods and services, helping consumers identify sellers and compare prices, while offering convenient delivery and the ability to purchase easily via a computer or mobile device (OECD, 2013[55])

In the context of the COVID-19 pandemic, e-commerce has proved essential for maintaining trade flows despite restrictions put in place to preserve public health. Buying online rather than in person also reduces the risk of infection. Being able to keep selling in locked-down economies preserves jobs despite social distancing and movement restrictions. E-commerce also increases public acceptance of prolonged physical distancing and allows people to maintain a certain level of consumption. (World Bank, 2020[56])

It is clear that 2020 will prove to have been a turning point in e-commerce. This digital transformation underlines the importance of adopting a more holistic approach to policies as well as increasing international co-operation (Ferencz, 2019[54]).

This sub-dimension assesses policies which are implemented in parallel with those of the Digital society (Dimension 10). However, it focuses mainly on the trade in digitally enabled services given the rapid growth of trade in services in the region.

Serbia has a strong **e-commerce policy framework** and has made substantial changes since the last assessment cycle to meet the challenges of a growing trade sector.[24] The economy can boast of having the most complete e-commerce legal regime in the WB6 region. E-commerce policy falls under the remit of several institutions: the MTTT, the National Bank of Serbia, the Customs Administration, the MoF, and the Statistical Office of the Republic of Serbia (SORS). Serbia's institutional framework allows for effective institutional co-ordination between these ministries and agencies over e-commerce.

Serbia's e-commerce strategic framework was substantially updated in January 2019 after the MTTT set up a multi-stakeholder working group to identify the main obstacles to the development of e-commerce. In October 2019, following a proposal by this working group, the government adopted the Programme and Action Plan for the Development of E-Commerce for the period 2019-20. This action plan was prepared in cooperation with the United States Agency for International Development (USAID) Growth Cooperation Project.[25] The Action Plan' activities include the general removal of regulatory barriers to trade but also incentives for e-traders such as tax breaks or training, and activities related to promoting e-commerce and improving consumer confidence, logistics, and financial infrastructure. The ministry, in co-operation with relevant partners and stakeholders, implements these activities. The main purpose of the programme is to support the integration of SMEs selling online via social networks or other unregistered means into the registered online sales network – see Digital society (Dimension 10).

Modern e-commerce regulation needs to focus, among other things', on a number of key elements such as electronic documentation and signature, online consumer protection, data protection and privacy, cyber security, intellectual property rules and intermediary liability. While maintaining an attractive regulatory environment that refrains from creating disproportionate rules such as licensing requirements for e-commerce platforms, limitations on the type of goods that can be sold online (other than for generally accepted public policy considerations), and restrictions on cross-border data flows. In this respect, Serbia demonstrates an effective legal framework with only residual gaps remaining. These are well known to the Serbian authorities.

The Law on E-commerce, adopted in 2009, has been complemented by the recently adopted 2019 Law on Trade. Together they form the basis of Serbia's legal environment for e-commerce. Both have been successively updated in 2018 and 2019 to bring them into line with EU Electronic Commerce Directive 2000/31/EC. In order to close some of the remaining gaps, the government is working on improving the consumer protection rules through a new strategy and amendments to the above-mentioned laws and the Consumer Protection Act. The MTTT has also published a series of guides to inform consumers of their rights and to increase their confidence in the digital economy – see Digital society (Dimension 10).

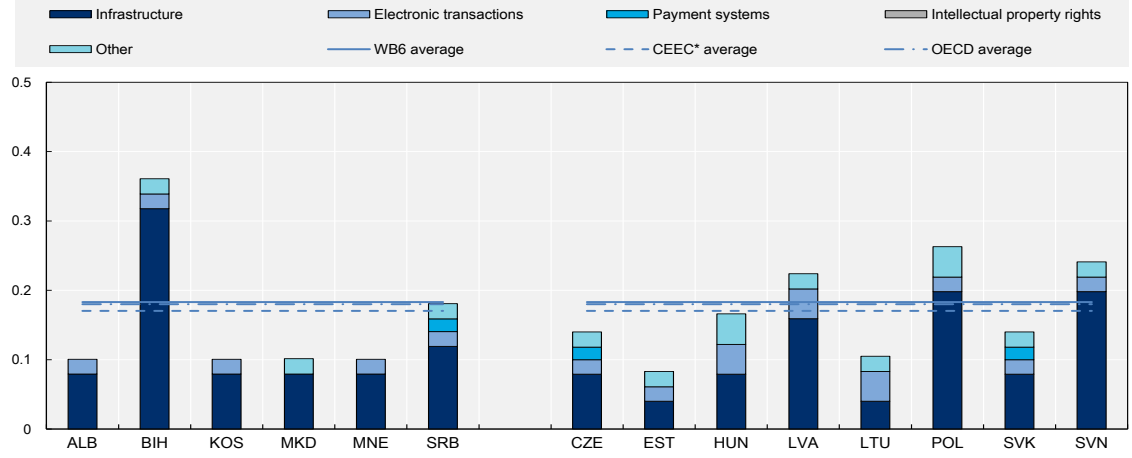
However, challenges remain; one missing element, which is also a restriction on the trade in services, is the lack of a proper online dispute resolution (ODR) mechanism in Serbian legislation.

In absolute terms, the regulatory environment is not an obstacle to the development of e-commerce in Serbia. The SORS publishes e-commerce performance indicators every year. The report covers statistics on the devices available in households, frequency of computer and Internet use and enterprises using computers or the Internet for business purposes.. The National Bank of Serbia also publishes data related to e-commerce, such as payment transactions for the purchase of goods and services via the Internet.

The OECD digital STRI captures the **restrictiveness of digital enabled services** due to cross-cutting barriers that inhibit or completely prohibit firms' ability to supply services electronically, irrespective of the sector. The regulatory data underlying the digital STRI were extracted from the existing OECD STRI database and data collected under public laws and regulations affecting digitally enabled services. The digital STRI aggregates the identified barriers to trade into a composite index. In accordance with the OECD STRI methodology, it uses a binary scoring system where 0 indicates there are no trade restrictions and 1 that restrictions are in place. The rating takes into account specific regulatory and market characteristics as well as the links and hierarchies between regulatory measures affecting digitally enabled services (López González and Ferencz, 2018[57]).

Serbia's score on the STRI index in the digital sector covered by the STRI project is shown in Figure 25.8.

## Figure 25.8. Digital services trade restrictiveness index: WB6 and CEEC economies




Note: (0=no restrictions, 1=fully restricted); average represents the WB6 average for 2020; *CEEC=Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia (Bulgaria, Croatia, and Romania are not OECD member states or OECD STRI Partner economies and therefore do not have calculated STRI indices); the absence of a category in the graph means that it is exempt from restrictions.
Source: (OECD, 2020[48]), *Services Trade Restrictiveness Index Regulatory Database*, http://oe.cd/stri-db.

StatLink https://doi.org/10.1787/888934256311

Globally the 2020 scores in this sector are moderate to high, ranging from 0.043 to 0.488, while the WB6 average is 0.183. Serbia's score is 0.181, which makes it the second most-restrictive of the WB6 economies. It should be noted, however, that the WB6 economies tend to be very open in this sector compared to the average for states participating in the digital STRI. In absolute terms, Serbia is therefore a very open economy for foreign digital service providers. Moreover, the variations in this sector in the region are very small, so the differences in scores are due to a limited number of regulatory measures.

The scores for most economies across OECD and partner states are driven by *infrastructure and connectivity* measures. This is usually the result of a lack of effective telecoms infrastructure regulations, especially in the area of interconnection. However, this is not the case in Serbia, where regulations are largely aligned with international good practice. Similarly, although Serbia has stricter rules than the OECD guidelines in this area, it does not impose excessive conditions on cross-border data flows beyond those

put in place to ensure the protection and security of personal data. Like 11 other participating economies, Serbia requires that some types of data be stored locally, but the transfer of copies abroad is allowed under terms specified in articles 63-71 of the Law on Personal Data Protection.

Businesses do not need any specific licences or authorisations for e-commerce activities on top of the ordinary commercial licences. However, Serbia des require a local presence in order to operate an e-commerce business.

Serbia has implemented international standards for electronic contracts and key electronic authentication measures such as the recognition of electronic signatures. However, as noted above, it lacks a proper dispute settlement mechanism to resolve litigations arising from cross-border digital trade which also affects its openness towards digitally enabled services.

Policy areas relating *to intellectual property rights* and payment systems account tend to be less important to states' STRI scores. Serbia is relatively open in this category from a regulatory point of view. There are no intellectual property protection regulations that treat foreigners less favourably than nationals.

### *The way forward for trade policy*

Despite having taken some significant steps to improve its trade policy framework, especially in the area of consultations, the government could improve its policy making in the following areas:

- **Enhance the quality of the public consultation process**. Although, from the regulatory point of view, Serbia has a theoretically flawless public-private consultation mechanism for its trade policy-making process, in practice its implementation has not been as effective as it could be. Serbia should continue to limit the adoption of laws affecting trade through shortened or exceptional procedures and should ensure longer deadlines for consultation procedures in order to respond to criticism from economic actors. Serbia should also raise awareness among the Serbian business community about their increased right to participate in legislative processes that affect them.
- **Expand the network of bilateral and multilateral FTAs**, as no progress has been made in Serbia's accession to the WTO since the last review round. A number of bilateral treaties are in an embryonic phase.
- **Broaden efforts to ease the trade in services and open markets beyond the commitments due to regional trade agreements**. Significant improvements have been made among the WB6 economies to open services trade through the conclusion of CEFTA Additional Protocol 6 in December 2019. Nonetheless, The STRI analysis of Serbia's regulatory environment affecting trade in services has provided some insights into where domestic reforms could help to attract new businesses from third countries and improve competitiveness:
    - **Relax the conditions for the temporary movement of people** for third-country service providers to further encourage innovation and knowledge transfer from third countries and contribute to economic growth. A starting point could be to extend the period intra-corporate transferees and independent service providers can stay from the current 12 months, and the very short period for contractual service providers (3 months). Although the current regulation is in line with the relevant EU legislation, the best practice prescribed by the OECD is 36 months for all categories of service providers (for the first permit).
    - **Reduce the remaining barriers to market entry and competition** in commercial banking, courier services and air transport by lifting some of the existing restrictions on services in trade. In the courier services sector, this would mean amending the preferential subsidy treatment available to the designated public postal provider, which is entitled to reimbursement of the net cost incurred in providing this service if it can prove that they are greater than the revenue generated in the previous year and represent an unfair burden on the postal operator's business. The restriction on foreign banks from operating in the economy through a branch

could be abolished. In the air transport services sector, “wet” leasing of foreign aircrafts could be allowed and the slot allocation process amended to no longer give priority to historic slots.

- **Strengthen the regulatory framework for e-commerce and digitally enabled services**. Some limitations remain in this area, in particular on settling disputes that may arise from e-commerce transactions. A first step should be the establishment of a national ODR platform based on the EU model (Box 25.4) The platform should be designed to resolve disputes over the online purchase of goods and services without the intervention of a national court. This process is known as alternative dispute resolution and is faster and cheaper than a court case. The ODR platform should net affiliated with any merchant but should provide an independent dispute resolution body that could be called upon at any time to deal with a complaint from any party to an e-commerce contract. The body should be an impartial organisation or person that helps consumers and online traders and is independent of, but approved by, the authorities and meets quality standards of fairness, transparency, efficiency and accessibility.

### Box 25.4. The European Online Dispute Resolution (ODR) platform

The European ODR platform was set up to make online shopping safer and fairer through access to high-quality dispute resolution tools. EU Regulation 524/2013 provides the framework, the creation of the EU ODR platform and required every e-shop in the European Union to provide a link to the platform enabling European consumers to electronically submit their complaints. From 9 January 2016, all online retailers and traders in the EU, Iceland, Liechtenstein and Norway have been obliged to provide an easily accessible link to the ODR platform and an email address for the platform to contact the consumers.

Consumers can use the EU ODR platform to solve any problem directly with the trader. The platform initially acts as an intermediary between the parties in the dispute by notifying the traders of the issue. If the trader is willing to discuss the dispute, the platform allows the exchange of messages directly via a dashboard which allows users to send attachments such as product photos and schedule online meetings. If the parties request it, or if the dispute cannot be resolved amicably within 90 days, the platform refers the dispute to a dispute resolution body. Although the model is mainly aimed at disputes initiated by a consumer, some European countries allow traders to also file complaints against consumer. However, the consumer must reside in Belgium, Germany, Luxembourg or Poland.

Source: Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR); The European Online Dispute Resolution (ODR) platform, https://ec.europa.eu/consumers/odr/main/?event=main.trader.register.

## Access to finance (Dimension 3)

### *Introduction*

Serbia has made further progress to enable businesses to access finance, improving its performance to a score of 3.3 well above the regional average of 2.6 (Table 25.6). Serbia scores the best in all the sub-dimension as well as being the best overall performer in the Western Balkan region.

**Table 25.6. Serbia' scores for access to finance**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Access to finance dimension** | Sub-dimension 3.1: Access to bank finance | 4.4 | 3.4 |
| | Sub-dimension 3.2: Access to alternative financing sources | 2.5 | 1.9 |
| | Sub-dimension 3.3: Mobilisation of long-term financing | 3.8 | 2.8 |
| **Serbia's overall score** | | **3.3** | **2.6** |

### *State of play and key developments*

#### *Sub-dimension 3.1: Access to bank finance*

Serbia's financial sector is bank dominated; the banking sector accounts for around 90% of the overall financial sector's assets which is considerably more than in the euro area (around 45%). As of end 2020, there were 26 banks operating in the economy. This is a relatively large number compared to similar economies – for example, there are 13 banks operating in Hungary, 16 in the Czech Republic and 17 in Bulgaria. The top three banks together hold 36.1% of the total banking assets, while the three state-owned banks had a combined market share of 7%. According to the regulations, a bank can only operate in Serbia if it is registered as a domestic legal entity, regardless of whether the owner of the bank is from a foreign country. Since 2010 five banks have had their licences revoked by the National Bank of Serbia (NBS), due to undercapitalisation and their inability to maintain the minimum required level of financial operability.

Serbia has a relatively well established regulatory framework for the **banking industry** which is in line with Basel II and Basel III recommendations (EC, 2019[58]). In December 2016, the National Bank of Serbia adopted a set of regulations implementing Basel III standards. The most significant changes these introduced were: new capital standards strengthening capital requirements, improvements to the risk management process to ensure proper coverage of all risks with capital, the introduction of capital buffers, leverage ratios, and the introduction of minimum standards for liquidity risk management and minimum liquidity ratios.

Under the Memorandum on Dinarisation Strategy adopted by the government and the NBS in 2012 and revised in 2018, the NBS implemented a set of measures to encourage local currency lending. This included loan-to-value ratios for foreign currency (FX) mortgage loans, but not for dinar mortgage loans and minimum mandatory down payment for FX household loans. In 2019, the NBS adopted two decisions[26] to reinforce dinar lending to businesses. The amended regulations establish new rules for banks, and created incentives for banks to exclusively lend in dinars to SMEs, entrepreneurs and farmers. Instead of all lending being treated in the same way, as before, dinar exposures are now given a more favourable regulatory treatment – banks will be able to allocate less capital to cover the risks arising from dinar exposures than from non-dinar and FX-indexed exposures.

Supported by these measures, and macroeconomic and exchange rate stability, Serbia has made progress in dinarisation. The main indicators have shown substantial improvement in the dinarisation of deposits of households and the corporate sector. Since the end of 2012, total household and corporate sector deposits in Serbian dinars (RSD) rose by 19.5 percentage points, reaching 38.8% by the end of January 2021; household deposits increased to 26.3%, and corporate deposits increased to 59.0%, both all-time highs.

The increase in household deposits is related to substantial growth of dinar savings:, which rose by 22% in 2018, 30% in 2019 and 17% in 2020, despite the pandemic. The growth of household savings has continued in 2021, by RSD 2.3 billion or 2.5% so far, reaching a peak of RSD 95.3 billion by 4 March 2021.

Dinarisation of receivables to households and the corporate sector combined increased by 9.5 percentage points also reaching an all-time high of 37.5% at the end of January 2021. Dinar receivables to households increased to 55.7%, while dinarisation of receivables to the corporate sector decreased to 21.5 per cent, despite the growth in 2020 (at end-2019 it equalled 14.0%), which is to a large extent driven by increase of corporate dinar lending within the state guarantee scheme. Moreover, interest rates for SME loans indexed to FX decreased to 4.2% in 2018 (from 4.6% in 2017 and 5.7% in 2016), while the interest rate spread between large companies and SMEs increased slightly to 1.9 percentage points (from 1.8 percentage points in 2017).

Serbia has had a **cadastre** and a **registration** system for pledges over movable assets since 2005, which are largely functional and actively used by the local banking system. The real estate cadastre covers the entire territory and is accessible on line; the online data are updated every week. The Register of Pledges is an integrated, centralised, electronic database of registered pledge rights, and it has full geographical coverage. Its data are public and accessible to all interested parties to search on line. In 2019 the registration of two additional types of security instruments on movable assets were introduced (RS Official Gazette, 2019[59]). These are contracts of sale with the retention of ownership rights, and pledge agreements instituting pledges by the transfer of the pledged item into the creditor's possession. According to the law, these contracts are subject to registration as of 1 January 2021.

**Collateral requirements** are among the lowest in the Western Balkan region, however they remain relatively important especially for smaller firms. In 2019 around 41% of loans required collateral (less than the OECD average of 58%), while on average 101.1% of the borrowed amount is required as collateral, higher than OECD average of 88% (World Bank, 2019[60]). There are no thresholds for loans below which collateral requirements are flexible for small businesses, which could limit smaller firms' access to loans. The NBS regulations only set the rules on the requirement of collateral from the perspective of risk-weighted asset calculations and classification of assets.[27] The regulations neither require nor ban flexibility over collateral for the bank's internal purposes.

Serbia has one credit bureau providing **credit information services,** an organisational part of the Association of Serbian Banks. Its work is regulated by the Law on Banks, the Law on Personal Data Protection, the Law on Information Security and other laws, by-laws and internal regulations. The retention periods for data used in credit reports are three years for individuals and five years for legal entities and entrepreneurs, as of the date of termination of the contractual obligation to the bank. The information collected by the credit bureau covers the entire adult population and is updated daily.

Under **credit enhancement and risk mitigation**, there are two national credit guarantee schemes in Serbia, one aimed at the banks and the second to support export-oriented firms. The Serbian Development Fund issues guarantees to commercial banks lending at subsidised interest rates to SMEs. Similarly, the Serbian Export and Insurance Agency (AOFI) issues guarantees and other forms of sureties for export businesses and investments abroad, such as bid guarantees, performance guarantees, advance payment guarantees, retention money guarantees and maintenance guarantees. The European Investment Fund (EIF) has selected five banks (Raiffeisen, UniCredit, Banca Intesa, ProCredit and Komercialna Bank) to implement the European Union's financing for the Serbian SME guarantee programme. The EIF provides a direct guarantee enabling these banks to support around 1 250 loans to SMEs on favourable terms, such as reduced pricing, lower collateral or longer maturities. Starting from 2020, the EU contribution of EUR 20 million over three years will mobilise up to EUR 180 million in the form of loans on favourable terms.

In addition to these guarantee schemes, in 2020 the government issued the Law Establishing a Guarantee Scheme to support to the economy and mitigate the consequences of the COVID-19 pandemic. It is

intended to provide EUR 2 billion of cut-rate funding to micro, small and medium-sized enterprises and entrepreneurs, for liquidity and financing of current assets. The NBS has made additional efforts to support dinar lending under this law. Where banks approving dinar loans under the scheme at interest rates at least 50 basis points lower than the maximum rate prescribed by the law (1M BELIBOR+2.5 pp), the NBS will pay a remuneration rate on dinar required reserves for the amount of these loans at a rate 50 basis points higher than the standard remuneration rate (currently 0.1%).

Since the COVID-19 outbreak, international financing institutions have made significant efforts to support the liquidity of Serbian firms. The European Bank for Reconstruction and Development (EBRD) provided a new credit line of EUR 210 million to Banca Intesa, Erste Bank, Eurobank, ProCredit Bank and UniCredit Bank with the aim of supporting SMEs. The EIB provided a total of EUR 67 million in credit lines to Banca Intesa and Erste Bank, focused on SMEs which commit to generating positive socio-economic impact and contribute towards strengthening economic resilience and sustainable growth in Serbia. The Council of Europe Development Bank (CEB) provided credit lines totalling EUR 50 million to ProCredit and Erste Bank to support urgent working capital requests following liquidity shortages brought on by the COVID-19 pandemic. In addition to these, and in line with the Washington Agreement signed on 4 September 2020, at the White House, the International Development Finance Corporation opened its overseas office in Belgrade, with the announcement of SME support projects worth USD 1 billion that are expected to be realised by the end of Q2 2021.

### *Sub-dimension 3.2: Access to alternative financing sources*

The **factoring** market is still in an early stage of development despite Serbia having had a dedicated law on factoring since 2013. Factoring is mainly driven by banks; as of December 2018 there were 18 factoring providers including 1 state-owned provider (AOFI). The factoring market has declined recent years in terms of total assets: the total volume of factoring assets fell from RSD 28 billion (around EUR 240 million or 0.57% of the GDP) in 2014 to RSD 21 billion (around EUR 180 million or 0.43% of GDP) in Q2 2020. Following recommendations made by the EBRD and the evaluation conducted by the MONEYVAL[28] Committee of the Council of Europe on Anti-Money Laundering requirements, in 2018 the government amended the law on factoring to align it with these requirements. Overall, the law regulates the conditions and manner of performing factoring, types of factoring, rights and obligations of participants in factoring, factoring agreements, reverse factoring, and supervision over factoring, however some additional components are still required such as the establishment of a proper invoice registry and the clarification on local providers' obligations to perform due diligence on customers (World Bank, 2019[61]; OECD, 2019[62]).

The financial **leasing** market in Serbia is relatively small, but has been growing since 2016. The total assets leased increased by 64.9% between 2016 and Q2 2020 to reach an approximate nominal value of RSD 109.3 billion (around EUR 929.7 million). As at the end of Q2 2020, 17 financial leasing companies were operating in Serbia. Seven lessors were 100% or majority owned by foreign legal entities, while 10 were 100% or majority-owned by domestic entities (of which 8 were owned by domestic banks with foreign capital). As of the end Q2 2020, financial leasing was primarily provided for freight vehicles, minibuses and buses (40.4%), followed by passenger cars (37.7%).[29] The Law on Financial Leasing of 2003, amended in 2011 under the supervision of the NBS, regulates financial leasing activities. In December 2020, following the adoption of a new decision,[30] the legislature broadened the scope of the legal framework by allowing financial leasing companies to be engaged in operating leasing. As of January 2021, the Financial Leasing Register, which centralises contracts of financial lease of movable and immovable assets, started to allow all types of registration applications to be submitted in electronic form.

**Private equity investment funds and venture capital** are regulated by the Law on Alternative Investment Funds and by-laws enacted by the Securities Commission which became effective on May 2020. As a result, the regulatory framework clearly details regulations governing the manner of investment and the

instruments in which private equity and venture capital alternative investment funds may invest; the restrictions, types, and timeframes for subscriptions by members or shareholders; the type and extent of restrictions on investment; the calculation of subscriptions; and the determination of the relevant costs. While no activity has been recorded, Serbian firms are more actively using the Enterprise Innovation Fund (ENIF; see Box 25.5)

There is no legal framework regulating the **business angel networks**. One network is operating: the Association of Business Angels of Serbia (ABAS) is a not-for-profit association of private investors which connects start-ups with investors. In 2019, Serbia recorded four business angel investments representing a total value of EUR 310 000, halting a trend of gradual increases between 2014 (EUR 1.8 million in investment) and 2018 (EUR 2.5 million) (EBAN, 2019[63]; EBAN, 2017[64]).

### Box 25.5. Enterprise Innovation Fund

The Enterprise Innovation Fund is an active fund managed by South Central Ventures, StartLabs, and Eleven Ventures, focusing on early stage high-growth companies mainly in the tech sector. South Central Ventures offers seed funding up to USD 100 000 per company while StartLabs goes up to USD 50 000 for an equity stake of 10-15%. Eleven Ventures is based in Bulgaria, but also invests in Serbia with pre-seed funding of up to EUR 100 000 for an equity stake of 10-12%. South Central Ventures also offers early stage and growth investments of up to EUR 3 million per company and Eleven Ventures can follow with additional funding as well. All companies offer mentorship to the companies they invest in and connections to boosters, angel investors and venture capital internationally. Eleven Ventures also acts as an accelerator. All funds also invest in other countries in the region. South Central Ventures had nine active investments in Serbia and StartLabs had about seven at the end of 2018. Eleven Ventures has invested in about more than 15 companies in Serbia. Demand for venture capital funding seems to be greater than the available supply, suggesting that there is space for more funds to come in.

Source: (World Bank, 2019[61]), *Serbia New Growth Agenda: Financing for Growth*, https://pubdocs.worldbank.org/en/358601577293558709/SRB-CEM-Financing-for-Growth-wq.pdf; (WB EDIF, 2019[65]), *WB EDIF Annual Report*, http://www.wbedif.eu/wp-content/uploads/2020/05/WB_Edif_AR_2019.pdf.

There are no **crowdfunding** activities in Serbia, nor any regulation of them although the National Bank of Serbia is in the process of drafting a law which will regulate the conditions and manner of providing group financial services. According to an official statement, the NBS will take into consideration provisions of the EU Regulation 2020/1503 on European crowdfunding service providers for business. However, the authorities have not announced a clear timeline for this.

In the area of **initial coin offerings based on blockchain technologies**, the Securities Commission of Serbia, in co-operation with the Prime Minister's office, issued a statement on the regulation of cryptocurrencies in March 2019. This qualified cryptocurrencies as one of the instruments included under the Capital Markets Act. The use of cryptocurrencies is also governed by the Law on the Prevention of Money Laundering and the Financing of Terrorism, amended in 2019. This regulates the services of purchasing, selling or transferring virtual currencies or exchanging such currencies for money or other property through Internet platform, devices in physical form or otherwise, and custody wallet service providers. Furthermore, in December 2020 the government adopted the Law on Digital Assets which will take effect on 29 June 2021. This law aims to govern the issuance and secondary trading in digital assets, provision of digital asset services, and pledge and fiduciary rights on digital assets, the competencies of the Securities Commission and the NBS, and supervision over its application. In theory, the law offers a comprehensive framework for the development of digital assets but its effect will be assessed in upcoming

cycles. It should also be noted that the law open the possibility to raise funds for businesses on crowdfunding platforms through digital currencies.

The NBS has also issued several public warnings on the risk of using cryptocurrencies on its website. According to the report published by Start-up Genome,[31] Serbia is one of the top five economies in the world for blockchain developers and has many product-oriented blockchain start-ups. The biggest initial coin offerings in Serbia include those by MobileGo (USD 56 million) and OriginTrail (USD 22 million).

### *Sub-dimension 3.3: Mobilisation of long-term financing*

**Public-private partnerships** (PPPs) are moderately well developed in Serbia. Between 2012 and 2019, the Commission for Public-Private Partnership approved 154 PPP proposals, mainly in the sectors of urban transport, highway concession, and sewage and solid waste management and treatment.[32] As of 2019, the total value of contracted PPPs and concessions exceeded EUR 2.5 billion (around 5.9% of GDP), with 10 projects accounting for 98% of the total (Jelena, 2020[66]). The majority of these projects involve the central government or the city of Belgrade.

The Law on Public-Private Partnership and Concessions was adopted in 2011 and amended twice in 2016. It allows for different types of co-operation between the public and private sectors. Projects can be implemented within the time frame of 5 years or up to 50 years. The selection of the private partner is governed under two laws: the law regulating public procurement if the partnership consists predominantly of public works, or by the law on PPPs and concessions if the PPP implies the granting of a concession, or the provision of services with the right to exploit the specific service and to collect payments. However, the reciprocity between both laws has not worked quite so well in practice; both laws have a number of ambiguities over deadlines and some of the procedural steps involved in a PPP that have remained a point of concern for a notable number of stakeholders on the market (CMS Law-Now, 2017[67]).

Serbia's domestic **institutional investor** base remain underdeveloped, limiting capital market development. At the end of 2019, of asset management firms were managing EUR 377.5 million of assets, about 0.9 % of GDP. The first investment funds were established in 2007, right after the adoption of the Law on Investment Funds. Initially, the investment fund industry grew rapidly but the investment fund industry collapsed during the 2008 financial crisis because of the fall in stock exchange prices. The Belgrade stock exchange 15 index (BELEX15[33]) plunged from a historical high at 3 335.2 in May 2007 to a historical low of 347.46 in March 2009. After suffering huge losses during the crisis, most of the funds that continued to operate were transformed from growth funds into money market funds (World Bank, 2019[68]). As of December 2019, five asset management firms were operating in Serbia managing 18 investment funds. Natural persons (93%) are the main categories of clients and of the remaining 7%, 89% are limited liability companies. As of March 2020, the main asset allocation preferences among pension funds were bonds (80.8%), stocks (9%) and private equity (3.3%), indicating limited diversification.

Serbia has **capital markets** but they are relatively underdeveloped. The only market segment that functions comparatively well is the government bond market. The contribution of capital markets to financing the economy is limited. In July 2020 the Belgrade stock exchange (BELEX) registered a total turnover of securities of RSD 2.8 billion (around EUR 23.7 million or 0.06% of GDP). Turnover of shares totalled RSD 133.9 million (around EUR1.1 million or 0.002% of GDP) while Republic of Serbia bonds (RS bonds) totalled RSD 2.7 billion (around EUR 22.9 million or 0.05% of GDP).

The private sector is not making use of the **stock market** for its financing needs. There has been only one initial public offering (IPO) since World War II. Shares of Fintel Energy a.d. were included on the Prime Listing and after the successfully completed IPO, they started trading on 20 November 2018, at an approximate total value of RSD 755 million. The lack of IPOs remains the biggest challenge for the Belgrade Stock Exchange and Serbian capital market. The government never used them as a privatisation model for state-owned enterprises, while companies from the private sector are very hesitant to raise capital through IPOs as there are no success stories. In addition, there are no clear and optimised

procedures, nor any prior experience or specific incentives that would encourage IPOs. All this, combined with financing dominated by bank lending has kept companies out of the capital market, leaving the IPO market effectively still in the testing stage.

In order to trade on the Belgrade Stock Exchange, an issuing company may apply for one of the three listing segments in Table 25.7. "Smart listing" was introduced in August 2016, with the aim of supporting the development of start-ups and SMEs, improve their business environment, and promote investment and growth. Yet, as of January 2020, no new businesses have used it to introduce their companies to the stock exchange. If the equity securities do not meet any of the listing standards described in Table 25.7 they may operate in the non-listed segment/open market which is a segment below. If the securities also do not meet the requirements for admission to the non-listed segment of the regulated market, they may be admitted to trading on the multilateral trading facility (MTF). It should be noted that only investment companies with a licence from the SEC may trade on a regulated market or MTF; other persons may only trade on these markets through such investment companies.

### Table 25.7. Listing segments of the regulated market in the Belgrade Stock Exchange

| | Prime listing | Standard listing | Smart listing |
|---|---|---|---|
| Length of business operations | Minimum 3 years | Minimum 3 years | New companies with up to 3 years of operations |
| Business results | Net profit | - | - |
| Opinion of the authorised auditor | Unqualified | Unqualified or qualified | Unqualified or qualified |
| Minimal amount of capital | EUR 3 million | EUR 2 million | At least 1 million EUR, and no less than EUR 500.000 under special conditions |
| General conditions during the period of listing | Auditor's report with expressed unqualified or qualified opinion | | |
| | Issuer's webpage – in both Serbian and English | | |
| Special conditions for shares and depository receipts on shares | • at least 25% of total number of issued shares<br>• shares of minimal capital of EUR 1 million which are owned by at least 250 shareholders<br>• shares which are in the ownership of at least 500 shareholders | • at least 25% of total number of issued shares<br>• shares of a minimal amount of capital of EUR 1 million, which are in the ownership of at least 150 shareholders<br>• shares which are in the ownership of at least 300 shareholders | At least 25% of the total number of shares, or shares of a minimal amount of EUR 150.000, under special conditions |
| | Average value of daily turnover of at least RSD 500 000 and an average daily number of at least five transactions calculated in the last six months, agreement on market making operations concluded, more than 1 000 shareholders, shares in the free float in the total amount of at least EUR 2 million. | | |

Source: Adapted from the inputs collected from the Government of Serbia.

In December 2016, BELEX joined the SEE Link network, enabling trading on multiple markets participations. SEE Link was set up by three regional stock exchanges with the support of the EBRD in 2014: the Bulgarian Stock Exchange, the Croatian Stock Exchange and the Macedonian Stock Exchange. It aims to integrate regional markets without mergers or acquisition, using only technology. It provides investors easier and more efficient access to those markets through a local broker. Since the launch of the network, five more stock exchanges have joined, including two from Bosnia and Herzegovina, the Ljubljana Stock Exchange from Slovenia, the Belgrade Stock Exchange, e and the Athens Stock Exchange. This

regional collaboration could enhance stock market liquidity in the participating economies, but the different legal and regulatory frameworks, the lack of central securities depository links, and different currencies create challenges for market operators which limit more intense trading activity on this platform.

Prior to the COVID-19 pandemic, Serbia was working on developing a comprehensive capital market development strategy. Together with domestic and international stakeholders, such as the World Bank, the EBRD, USAID and the United Nations Development Programme (UNDP), it aimed to assess the potential benefits of the capital market and instruments to boost the financing of both the state and the private sector. One of the most concrete measures foreseen was the inclusion of incentives in order to support and encourage companies to make an initial public offering, however, at the time of drafting this initiative was suspended due to competing priorities related to the pandemic response. In December 2020, Serbia continued the work on the Capital Markets Development Strategy with a new adoption date set for the end of Q2 2021. A number of activities envisioned by the initial strategy have also been adopted during the pandemic, primarily those relating to the efficiency of the corporate bond market.

The government **bond market** has made substantial progress in recent years but the non-government bond markets remain in their infancy. The bond market has a solid foundation in terms of its infrastructure, technology and regulation, but it has not been used extensively by the corporate sector, with private sector bonds only amounting to 0.06% of GDP. The main reason is that corporate bonds are considered to be more expensive than bank financing. In 2019 only one corporate bond was admitted to market, Erste bank a.d.

There are no subsidies to make the bond market more attractive, nor any specific incentives encouraging business to use it. However, in April 2020 the government introduced one simplification measure regarding the public offerings of debt securities to mitigate the impact of COVID-19 (Box 25.6). Investors can easily find information on the maturity, secure/unsecure, liquidation preferences, coupon rate, tax status and call provision in the prospectus but the SEC does not publish bond ratings. These measures resulted in a milestone event in terms of corporate bond market, with a landmark transaction, which saw a private sector company successfully completing a corporate bond issue, listed on the Belgrade Stock Exchange.

### Box 25.6. Emergency rules on the issuance of "Corona bonds" in Serbia

On 10 April 2020, the Government of Serbia adopted the emergency Decree on the Procedure for Issue of Debt Securities, which simplifies the current regime regarding public offerings of debt securities by Serbian companies in Serbia. This new simplified regime will be in force for a period of 180 days following the end of the state of emergency.

The decree releases prospective issuers from the obligation to prepare a short-form prospectus. It also cuts down the paperwork needed to obtain the SEC's approval. Businesses no longer have to submit documents that are publicly available and can be obtained from public registers to the SEC. This relates to current information on the issuer from the commercial registry, published financial statements, stock exchange information in case of public companies, share ownership structure available at the central registry, depository of securities, etc. Information about the issuer and its financial statements do not have to be included in the prospectus, but the prospectus may instead refer or link to publicly available or online information (e.g. the issuer's website, website of the commercial registry, the central register and depository of securities, or the register of financial statements). The issuer is required to list all referenced documents and webpages on which they can be found, and specify which relevant information can be found in which document and which section of the document.

When applying for the SEC's approval of the prospectus, if no more than 200 days have passed since the end of the relevant financial year and the date of the application for the SEC's approval, the issuer

is not required to additionally prepare and submit to SEC semi-annual financial statements for the current year.

The SEC is required to approve publication of the prospectus for the offering of debt securities within 10 days from the receipt of the issuer's application (provided that the application is complete).

Following the completion of the public offering, the bond issuer obtains the status of a public company, which triggers various reporting and other regulatory obligations. However, private joint-stock companies or limited liability companies are not required to apply for the listing of their shares at the regulated market.

Source: (SEC, 2020[69]), Republic of Serbia Securities Commission: The process of issuing debt securities in Serbia simplified, http://mail.sec.gov.rs/index.php/en/news/actual/650-the-process-of-issuing-debt-securities-in-serbia-simplified.

### *The way forward for access to finance*

To enhance the banking industry and support businesses' access to finances, policy makers should:

- **Continue efforts to implement crowdfunding legislation in line with EU norms**. In addition to the possibility of investing in these platforms through digital assets, the government should pay attention to facilitating FX investments to potentially attract investments from the diaspora.
- **Consider a business angel network review**. Despite increasing between 2014 and 2018, total business angel investments have only reached around EUR 2 million. A comprehensive assessment of existing investments could help the government to better understand the requirements of business angel networks. Additional policy tools could be deployed to promote further interest including tax incentives. Another option could be to provide support to the existing operator.
- **Promote access to equity capital through the stock market**. The low level of activity and liquidity in the stock market is a barrier for companies that could use it to raise new capital. To stimulate capital market development, the government could encourage the listing of state-owned enterprises which would help increase the size the stock market and its visibility among international institutional investors (see Box 25.7 for an example from Lithuania). To increase their attractiveness, the government could consider a tax credit system for costs related to initial listings and secondary equity offerings by already listed companies. Such a system would allow companies to deduct the listings costs, including any advisory service costs, against the corporate income tax payable up to a certain amount.

#### Box 25.7. Ignitis Group in Lithuania

Ignitis Group is a Lithuanian state-owned international energy company focusing on renewable energy transitions and one of the largest energy groups in the Baltic region. In October 2020, the previously fully state-owned group was listed on Nasdaq Vilnius and London Stock (LSE) exchanges. Ignitus group's IPO became the largest transaction in the Baltics in several decades, as a total of EUR 450 million of all primary capital was raised by offering 26.91% of the shares and global depository receipts (GDRs) to institutional and Baltic retail investors.

Ignitus group's IPO has already proved beneficial to Baltic capital markets with a 70% increase in Nasdaq Baltic turnover over 2020 and a doubled increase in turnover on the Nasdaq Vilnius market, making Ignitus shares the most traded and accounting for 35% of the total increase on the Vilnius stock exchange. Priority investments were given to high quality and local investors to allow for high-quality distribution among shareholders with approximately 9% of shares allocated to long-term investors while

retail and other hedge funds acquired the remaining shares. The group's IPO not only attracted strong interest from the Baltic states, but also by international Nordic, European and other international institutional investors, with the largest minority shareholder being the EBRD with 4% ownership.

According to a statement of the Lithuanian Ministry of Finance, the attracted funds will help with the implementation of the National Energy Independence Strategy by promoting green energy production and ensuring energy security and self-sufficiency. As the Bank of Lithuania requires a prospectus for listings on the Vilnius stock exchange, in line with international best practices, Ignitus group published a document containing risk factors, general information on the offering, payment policies, corporate government strategies and more.

Source: (EBRD, 2020[70]), EBRD Board Report: Ignitus Group IPO, https://www.ebrd.com/what-we-do/project-information/board-documents/1395294375006/Ignitis_Grupe_IPO.pdf?blobnocache=true; (Ignitis Group, 2020[71]), Press Release: Ignitis grupė completed the largest IPO in the Baltic States 2020, https://ignitisgrupe.lt/lt/ignitis-grupe-ivykde-didziausia-baltijos-salyse-ipo.

- **Facilitate market-based long-term debt financing for businesses**. Firms need access to fit-for-purpose financing that meets their needs at various stages of their growth trajectory and development. This will be even more important in the long run as the economy starts to recover from the COVID-19 crisis. Given businesses' dependence on bank financing, on top of the corona bond measures, more extensive use of corporate bond financing could help lengthen maturities, increase resilience and facilitate long-term investments in Serbia. One way to achieve this would be by creating an appropriate credit rating mechanism. The authorities could assess credible and reliable mechanisms, such as the model where central banks play a central role in providing rating services. Another way to increase the liquidity of the bond market could be to establish a special framework coupled with technology platforms such as crowdfunding for private bond placements by smaller companies. One recent and successful example of alternative financing options for SMEs is the Italian mini-bond market framework (see Box 25.8).

### Box 25.8. The Italian "Mini-bond" market

In 2012 the Italian Government introduced a series of laws[1] to initiate a mini-bond framework for unlisted companies to enable them to issue corporate bonds. The mini-bond framework provides a simplified process whereby unlisted companies with more than 10 employees and an annual turnover and/or assets in excess of EUR 2 million (except micro-enterprises and banks), can issue bonds that are available only to qualified investors. Firms are not required to publish a public prospectus – an admission document is sufficient.

In response to this new regulatory framework, Borsa Italiana introduced the ExtraMOT PRO segment in 2013, dedicated to the listing of bonds whose trading is only permitted to professional investors. Since its introduction, the mini-bond market has seen steady growth, with the number of issuances increasing from 16 in 2013 to 171 in 2018. The cumulated proceeds during this period amounted to EUR 10.6 billion, 25% of which was raised in 2018. Moreover, mini-bonds have also been securitised through special purpose vehicles which have created a diversified pool of mini-bond issuers available for institutional investors.

In 2019 the government introduced mini-bond placements on equity crowdfunding platforms. In October 2019, the operating rules for equity crowdfunding platforms willing to place mini-bonds were published by the competent authority (Consob). These include that the offers must be published on specific sections of the platforms; the issuers are limited to joint stock companies; and eligible investors are required to hold financial assets of at least EUR 250 000, invest at least EUR 100 000 in the mini-bond, or be client of an asset management company. The first offerings were published on crowdfunding platforms in January 2020.

1*:* Law Decree No.83/2012 and its subsequent amendments (Law Decree No. 179/2012; Law Decree No. 145/2013), Law Decree No: 91/2014; Law Decree No: 157/2019, (Fiscal Decree 2020) and Law Decree No: 160/2019 (Budget Law 2020) which created the possibility for unlisted companies to issue corporate bonds through the so-called mini-bond framework.
Source: (OECD, 2020[72]), *OECD Capital Market Review of Italy 2020*, www.oecd.org/corporate/OECD-Capital-Market-Review-Italy.htm.

## Tax policy (Dimension 4)

### *Introduction*

Table 25.8 provides Serbia's scores for two tax policy sub-dimensions, against the WB6 average. Serbia scores below the average for the tax policy framework as a result of its poor performance on the tax expenditure indicator, the lowest among the WB6 economies. However, Serbia scores above the WB6 average for tax administration as a result of its strong performance in the function and organisation and taxpayer services indicators: the highest rating possible for both indicators, and the highest among the WB6 economies.

**Table 25.8. Serbia's scores for tax policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tax policy dimension** | Sub-dimension 4.1: Tax policy framework | 2.0 | 2.6 |
| | Sub-dimension 4.2: Tax administration | 3.9 | 3.3 |
| | Sub-dimension 4.3: International co-operation | n.a. | n.a. |
| **Serbia's overall score** | | **3.1** | **3.0** |

Note: Sub-dimension 4.3 on international co-operation is analysed qualitatively and therefore remains unscored.

### *State of play and key developments*

#### *Sub-dimension 4.1: Tax policy framework*

Serbia's **tax revenues** as a share of GDP are relatively high. Its tax-to-GDP ratio was 36.8% in 2019, the highest of the WB6 economies, (compared to 30.6% WB6 average) (Table 25.9). This ratio is also above the average for OECD countries (33.8% in 2019). As with most WB6 economies, Serbia's tax-to-GDP ratio has risen since the last Competitiveness Outlook assessment in 2018, increasing from 36.2% in 2015. Serbia relies heavily on revenue from taxes on goods and services and social security contributions (SSCs) to fund its public spending programmes and healthcare system. These taxes accounted for 76.9% of total tax revenues in 2019, which broadly aligns with the 80.7% WB6 average but significantly diverges from the average in OECD countries (58.4%). Consequently, other taxes such as corporate income tax and personal income tax play a smaller role in the tax mix, accounting for only 16.6% of Serbia's total tax revenues (14.9% WB6 average; 33.5% OECD average).

The heavy reliance on SSCs supports the direct funding of the welfare system. It also prevents the need to fund social welfare from general tax revenues, which would create challenges from a budget perspective. However, Serbia could consider rebalancing its tax mix by shifting revenues away from SSCs and towards PIT (OECD, 2018[73]). The very high SSC rates may be having an adverse effect on the functioning of the labour market and comes at the cost of equity, as SSCs are mostly levied at flat rates, while PIT can be levied at progressive tax rates. With regards to taxes on goods and service, OECD research has found that consumption taxes, and particularly VAT, may have less of a distortionary effect on the decisions of households and firms and thus on GDP per capita than income taxes (Johansson et al., 2008[74]).

**Table 25.9. Serbia's tax revenues as a percentage of GDP**

| | CIT | PIT | SSCs | Goods and services | Tax/GDP ratio |
|---|---|---|---|---|---|
| Serbia | 2,3% | 3,8% | 12.5% | 15,8% | 36.8% |
| WB6 | 1.8% | 2.7% | 9.3% | 15.9% | 30.6% |
| OECD | 3.1% | 8.1% | 9.0% | 10.9% | 33.8% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions.
Source: (OECD, 2020[75]) OECD.Stat, https://stats.oecd.org/ (2019 for overall tax/GDP ratio, 2018 for specific tax/GDP ratio)

Serbia levies a standard CIT rate of 15%, which is, with Albania, the joint-highest rate among the WB6 economies (Table 25.10). This rate is higher than the WB6 average of 11.5% in 2020 but below the average rate in OECD countries (23.3% in 2020). Serbia's CIT revenues amounted to 2.3% of GDP, which sits between the WB6 average of 1.8% in 2019 and the OECD average of 3.1% in 2018. Serbia and Albania have the joint-highest reliance on CIT revenues among WB6 economies, relative to GDP. Dividend income is excluded from the CIT base of resident companies while capital gains are included. A 15% withholding tax is levied on dividend payments to non-residents, but tax treaties may result in a lower rate. Resident individuals receiving dividends are liable for a 15% PIT rate, also withheld at source. Serbia operates a worldwide taxation system whereby resident companies pay taxes on domestic and foreign-sourced income, while non-resident companies are liable for taxes on income originating from Serbia. All of the WB6 economies have adopted a worldwide taxation system, although, such systems are becoming increasingly less common among OECD countries, particularly for small open economies.

### Table 25.10. Selected tax rates in Serbia

| | CIT | PIT | SSCs | VAT |
|---|---|---|---|---|
| Serbia | 15.0% | 15.0% | 36.4% | 20.0% |
| WB6 | 11.5% | 12.8% | 28.6% | 19.0% |
| OECD | 23.3% | 42.8% | 26.9% | 19.3% |

Note: CIT= corporate income tax; PIT= personal income tax; SSCs= social security contributions; CIT and PIT averages are based on top statutory rates.
Source: (OECD, 2020[75]) OECD.Stat, https://stats.oecd.org/ (2020 for CIT and VAT, 2019 for PIT and SSCs)

As part of a tax reform in 2018, Serbia introduced a number of new **investment incentives** to its corporate taxes, many of which are cost-based incentives. Cost-based incentives lower the cost of investment and increase with the invested amount. For example, expenses directly related to qualifying research and development (R&D) in Serbia are eligible for a CIT deduction of twice the value of the investment undertaken. In addition, companies investing in the capital of a new company performing so-called "innovative activities" are entitled to a tax credit of 30% of the investment undertaken. To benefit from this tax incentive, the investing company should not own more than 25% of the shares of the newly established company. Another corporate tax incentive allows companies that invest over RSD 1 billion (around EUR 8.5 million) in fixed assets and employ at least 100 employees to be exempt from CIT for 10 years in proportion of the investment undertaken. This proportion is the value of the qualifying investment to the total value of the taxpayer's fixed assets for a period of 10 years. Research shows that cost-based incentives are preferable to profit-based incentives, which run the risk of a high redundancy of expenditure since the relevant investments may have proceeded anyway (UNCTAD, 2015[76]).

In Serbia, individual income is generally taxed at different rates for each category of income. The **personal income tax rate** on labour income is 10% for individuals with a taxable income of six times the average annual salary or less. When the aggregated net income exceeds this threshold, a "complementary income tax" with a 15% PIT rate applies to the portion of income above the threshold. For the self-employed, a flat 10% PIT rate applies. Serbia has the highest reliance on PIT revenues relative to GDP (3.8% compared to the WB6 average of 2.7%) and the second-highest top PIT rate (after Albania). However, PIT revenues remain significantly below the OECD average (8.1% in 2018). Serbia manages these relatively high PIT revenues despite low salaries, a relatively low rate for most taxpayers, informality and increases to the basic allowance in recent years. The monthly basic allowance for wages is currently RSD 16 300 (around EUR 139). It has increased by 38% since 2017, when it was RSD 11 790. A differentiated set of tax rates are levied in Serbia with regard to the taxation of personal capital income. Individuals' income from **dividends, capital gains and interests** are taxed at a rate of 15%. Rental income is taxed more heavily at 20%.

As mentioned above, Serbia raises significant revenues from **social security contributions**: 12.5% of GDP, which is significantly above the average for the WB6 economies (9.3%) or for OECD countries (9.0%). Its SSC rates are comprised of compulsory pension and disability insurance, compulsory health insurance, and unemployment insurance. Serbia has reformed its SSC rates modestly in recent years although the total rate remains high at 36.5%, which is the second highest rate among the WB6 economies (average 29.4% in 2020). In 2019, it reduced the rate of unemployment insurance from 1.5% to 0.75% and in 2020 it reduced the rate for pension and disability insurance from 26% to 25.5%, while health insurance stands at 10.3%. The employer SSC rate is 16.6% and the employee rate is 19.9%. Although the employee SSC rate aligns with the WB6 average of 19.9% in 2019, the employer SSC rate is significantly above the regional average of 9.5%. Serbia is also atypical by OECD standards in having a higher employee SSC rate than the employer rate, although this is common in the WB6 region.

These high SSC rates, combined with PIT, result in a high tax burden on labour income compared to capital income. This differentiated taxation creates an incentive for entrepreneurs to incorporate and receive income in the form of lowly taxed capital instead of highly tax salaries. OECD research shows that high SSC rates can place a significant tax burden on labour income, reducing incentives to work and making it expensive for employers to hire workers, especially low-paid and low-skilled ones. Serbia's large informal economy is likely related to the very high SSCs (OECD, 2018[77]). Moreover, SSCs are mostly levied at the same rate for all income levels,[34] and as such, they do not contribute to making the taxation of labour income more progressive (OECD, 2018[77]).

When it comes to the **design and functioning of the VAT system**, tax revenues from goods and services are relatively high in Serbia, as is common among WB6 economies. Revenues were 15.9% of GDP in 2019, the same as the WB6 average (15.9%) but significantly above the OECD average (10.9%). The standard VAT rate in Serbia is 20%, which is similar to the average rate of OECD countries (19.3% in 2020) and WB6 economies (19% in 2020). The VAT base is narrowed by a reduced rate of 10% which applies to a wide range of basic goods and services. These include food products, medicines and textbooks, as well as natural gas, transport and other services that are temporarily imported. OECD research has found that reduced rates are not an effective way to target those on low incomes, and can be regressive in some instances (OECD, 2018[77]). The combination of high SSCs, a high standard VAT rate and low PIT rates results in a tax system that is overall flat and very unlikely to play much of a role in reducing inequality.

The mandatory VAT registration threshold in Serbia in 2020 is RSD 8 million (around EUR 68 000). This threshold is relatively high compared OECD countries and WB6 economies. Reducing the VAT registration threshold could be investigated as a policy option as it would bring additional businesses in the tax base and increase tax revenues. Such a policy would likely need to be accompanied by a strengthening of the tax administration and VAT simplification measures.

Despite the wide range of corporate tax incentives in Serbia, the economy currently does not operate a regular **tax expenditure report,** unlike a number of other WB6 economies. For example, Albania implemented a tax expenditure report in 2019 and North Macedonia and Montenegro are currently in the process of doing so. Serbia should develop a regular tax expenditure report which would allow it to monitor the use and effectiveness of tax incentives and tax expenditures along with the tax revenue forgone (OECD, 2010[78]). The report should identify, measure and report on the cost of tax expenditures in a way that enables their cost to be compared with direct spending programmes (IMF, 2019[79]). The authorities could also conduct cost-benefit analyses to evaluate whether specific tax incentives are meeting their stated objectives and, if not, whether they should be abolished or replaced.

With regards to the **modelling and forecasting of tax revenues**, Serbia carries out projections and estimates of tax revenues for all major taxes using macroeconomic modelling. The MoF does not currently use micro-simulation modelling to analyse tax policy proposals. As a result, there may be scope for Serbia

to develop micro-simulation models using tax and survey data to estimate the cost and distributional outcomes of different policies.

### *Sub-dimension 4.2: Tax administration*

Serbia redesigned the **functions and organisation** of its tax administration in July 2019. The organisation is based around the different functions of a tax administration, with divisions such as audit, tax collection and taxpayer services. The tax administration carries out most classical tax administration functions, including tax fraud investigation. This function is usually the responsibility of a special police department in other WB6 economies. The tax administration collects all taxes, with the exception of taxes on immovable property, which are collected by local governments. Serbia follows OECD good practice in having a unified body that covers all taxes and all the core tax administration functions, which is an important factor in strengthening the efficiency of the tax administration (OECD, 2018[77]). Monitoring of the tax administration's performance is carried out by the State Audit Institution which issues an annual report. Similarly, regular assessments are carried out by the Fiscal Council, an independent body which reports to the National Assembly of Serbia. Serbia also took part in the Tax Administration Diagnostic Assessment Tool (TADAT), an international assessment programme for tax administrations.

Serbia's **compliance assessment** follows a risk-based approach. Each month, taxpayers are selected for audit on the basis of a wide range of risk criteria. The tax administration also carries out an annual audit plan. This plan includes a breakdown by types of taxpayer, activities, company type and company size. OECD research shows that risk-based selection is a key element of effective and efficient compliance programmes as it allows administrations to make effective trade-offs and make the best use of their resources (OECD, 2018[77]). It conducts several types of audits, ranging from general comprehensive audits to more targeted ones.

In terms of **independence and transparency**, a legal framework regulates the role of the Tax Administration. Serbia adopted the Tax Administration Transformation Programme 2015-20 in 2015. Among other objectives, this programme aims to improve the strategic management within the Tax Administration. As part of this initiative, an action plan was produced for the period 2018-23. It included the creation of several permanent committees such as an organisational transformation committee, a business oversight committee and a compliance committee. With regards to disciplinary sanctions, the administration has established rules and procedures against the abuse of tax collection. Their application is monitored by the Internal Control Department. This department also performs direct and indirect controls on the legality, timeliness, responsibility and efficiency of actions by the tax administration's employees. OECD research suggests that corruption among employees of a tax administration may deter individual taxpayers from paying taxes (OECD, 2018[80]).

In Serbia, electronic **tax filing** is mandatory for companies and entrepreneurs. Individuals may file tax returns either on paper or electronically. Tax returns for CIT and the personal business income of the self-employed are submitted annually. Payments are made monthly in the form of advance payments. Serbia's tax administration has a built-in system for the validation of reported data. It performs a variety of mathematic, logical and syntactic verification, and tax returns are corrected if necessary.

Various **taxpayer services** are at the public's disposal in Serbia, including online access to information, electronic communications with taxpayers, electronic submission of requests for reimbursement, and online tax payments and in-person inquiries. The Protector of Citizens is an independent state body that protects the rights of citizens and controls the work of administrative bodies. Taxpayers who believe they have been harmed by an act, action or omission of the tax administration, can turn to the Protector of Citizens. An assessment of the efficiency of the delivery of taxpayer services is conducted quarterly by the Ministry of Finance.

*Sub-dimension 4.3: International co-operation*

As with other WB6 economies, Serbia has become increasingly involved in dialogue and reforms related the **international tax framework** in recent years. As a member of the Inclusive Framework on BEPS (base erosion and profit shifting), it recently signed the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. This was implemented in January 2019. Serbia also joined the OECD Global Forum in March 2018 and implemented the Convention on Mutual Administrative Assistance in Tax Matters in December 2019. Serbia's assessment by the OECD Global Forum on exchange of information upon request (EOIR) was initially scheduled for the second half of 2021 but was postponed to the first half of 2022 because of COVID-19. The economy has yet to engage in initiatives in the field of automatic exchange of information (AEOI). It has transfer pricing rules in place, based on OECD transfer pricing guidelines. This involvement in the international taxation framework could help it to protect its domestic tax base from erosion due to tax avoidance and evasion.

Serbia is engaged in several initiatives in the field of **digital taxation**. With regards to VAT, it has not formally implemented the international guidelines on VAT/goods and services tax (GST). However, it levies VAT on cross-border digital services using a logic close to the "destination principle",[35] the cornerstone of the international VAT/GST guidelines. Serbia levies VAT in the place where the service recipient is established. Concerning taxation of individual income arising from digital platforms, the Strategic Risk Department of the Tax Administration carried out an analysis assessing tax compliance. This analysis found a poor reporting of revenues from digital platforms and a low rate of tax compliance among individual taxpayers. As a result, the Tax Administration requested data from commercial banks on payments received by individuals from digital platforms. It is currently developing a risk response plan to audit these taxpayers.

With regards to the OECD's Tax Challenges Arising from Digitalisation project, Serbia intends to actively participate in discussions on Pillar 1 and 2. Developments taking place at OECD level might have an impact on Serbia's taxation of corporate income, especially under Pillar 2. The GLOBE proposal intends to define a minimum taxation of corporate profits. Although Serbia has relatively high CIT rates compared to the other WB6 economies, it still may be affected by this proposal. Its comprehensive investment tax incentives regime lowers the effective tax rate of corporate profits. Depending on the minimum tax rate set, Serbia could be faced with the choice of either redesigning its tax incentives to increase the effective rate on corporate profits to the level of the minimum tax, or risk forgoing tax revenues to foreign jurisdictions. This topic will have a great importance in the near future and Serbia may wish to evaluate its position and prepare an action plan.

Serbia is engaged in moderate **regional co-operation** with other WB6 economies. In 2006, an Agreement on Co-operation and Mutual Assistance was concluded with Bosnia and Herzegovina, Bulgaria, North Macedonia, and Montenegro. Serbia would benefit from more regional tax co-ordination and tax co-operation. The intensification of co-operation efforts would help tackle tax avoidance and evasion in a coherent manner across the region. As Serbia faces similar challenges similar to other WB6 economies, it will benefit from intensifying information sharing and learning from its peers' experience.

### *The way forward for tax policy*

To enhance the tax policy framework and achieve their objectives, policy makers may wish to:

- **Strengthen its support to the economy and facilitate the economic recovery** in light of COVID-19 with targeted tax and subsidy measures. Serbia implemented a relatively narrow set of measures to mitigate the effects of COVID-19 on its economy and citizens. It may wish to strengthen existing efforts, while focusing on measures that could spark economic recovery.
- **Diversify the tax mix by strengthening the role of corporate and personal income taxes**. Serbia's tax revenues rely heavily on SSCs and taxes on goods and services. There is scope to

diversify the tax mix and focus on taxes that stimulate growth or make the tax system more progressive.

- **Instigate a regular report on tax expenditures**. Serbia recently implemented a diversified set of investment tax incentives. A regular tax expenditure report would help assess tax revenue forgone from all tax expenditure and would increase transparency on the revenue costs and, ideally, their distributional impact, which would result in better-informed tax policy making.
- **Weigh the advantages and disadvantages of its differentiated taxation of capital and labour income**. Taxing capital and labour income differently allows for more targeted tax policies. However, it may create distortionary spillover effects and encourage business owners to take advantage of this difference by incorporating and receiving income in the form of capital rather than labour income. Serbia may wish to assess its position on this issue.
- **Broaden the VAT base** by reducing the list of goods and services taxed at the reduced rate and, possibly, by lowering the VAT registration threshold. Broadening the VAT base could be accompanied by additional measures to strengthen the VAT administration.
- **Strengthen the design and progressivity of the PIT**. Revenues from the PIT are relatively high compared to regional average but low when compared to OECD countries. Several initiatives could strengthen its design and raise additional revenue. Serbia could also introduce a new progressive PIT rate schedule.
- **Rebalance the taxation of labour income away from high employer and employee SSCs**. This imbalance may affect labour market outcomes, especially for informal, low-skilled or low-income workers. There is scope to rebalance the tax mix away from SSCs and towards PITs.
- **Develop an action plan in case consensus is found on a possible global minimum tax** amongst members of the OECD/G20 Inclusive Framework on BEPS. Although a global minimum tax will very likely be lower than the current statutory CIT rate, Serbia could still face a choice of either redesigning its investment tax incentives or risking forgoing tax revenues. The government should evaluate its position on this issue and prepare an action plan
- **Implement micro-simulation models to analyse the impact of tax system changes**. Although Serbia implements models to forecast tax revenues it would benefit from implementing micro-simulation models to assess the impact of tax reforms.
- **Continue to strengthen the functioning of the tax administration**. Control of the tax administration is carried out by the State Audit Institution and the Fiscal Council. The economy is also engaged in the TADAT and the Tax Administration Transformation Program 2015-20. These initiatives are critical in building public scrutiny and Serbia is encouraged to continue these and other efforts to strengthen the functioning of its tax administration.
- **Continue to engage with the international tax community and implement international best practice**. Since the last assessment, Serbia has strengthened its involvement in international tax matters and this approach is very much welcomed.
- **Carry out a cost-benefit analysis on the merits of its worldwide taxation system for resident corporations**. For small open economies such as Serbia, worldwide taxation may entail high administrative costs without raising significant revenues.
- **Foster regional co-operation and co-ordination on common tax issues**. Serbia shares common challenges with other WB6 economies and enhanced collaboration might benefit all economies involved. Areas such as tax compliance, training of tax administration officials or exchange of information would greatly benefit from a co-ordinated regional approach.

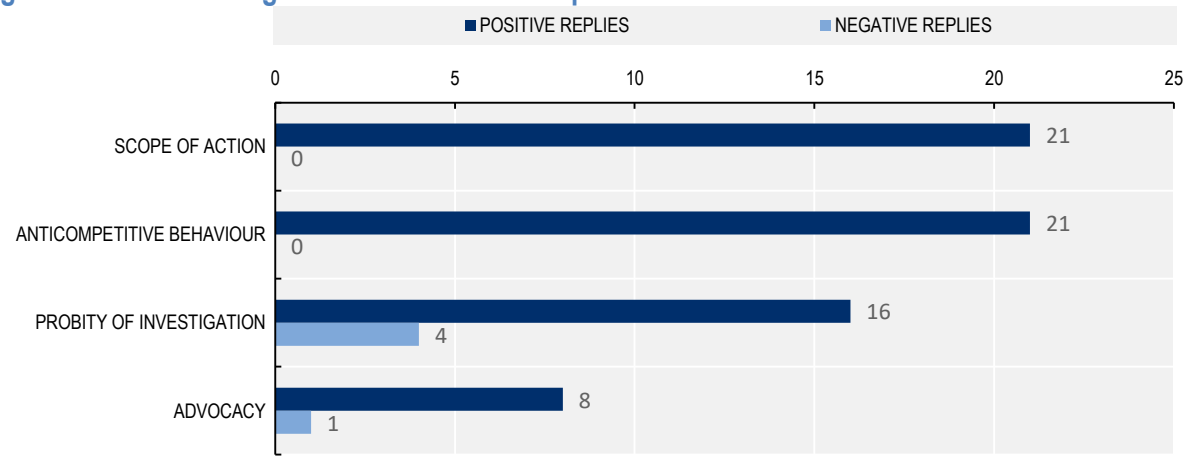
## Competition policy (Dimension 5)

### *Introduction*

Unlike the other dimensions, where indicators are allocated a score from one to five, the Competition policy dimension assesses four policy areas (i.e., scope of action, anticompetitive behaviour, probity of investigation and advocacy) is based on yes/no (coded as 1/0) answers to the 71 questions in the questionnaire administrated by the OECD. Where a response to a question is yes (coded as 1), then we refer to this as an adopted criterion. Each of the four policy areas has a different number of possible criteria that can be stated as having been adopted. Each policy areas is assessed though data collected from the questionnaire indicators and by measuring the number of criteria adopted. The new fifth policy area (implementation) is not scored, but is a quantitative analysis of how many competition decisions have been adopted by the competition authorities. The anti-competitive behaviour and implementation policy areas are discussed together below.

Figure 25.9 shows the number of positive (alignment to good practices) and negatives replies to the questionnaire administered by the OECD, with respect to each of the policy areas for this dimension. It is clear that Serbia is fully aligned to international best practice in the scope of action and its powers to fight anti-competitive behaviour. Some minor discrepancies persist in the probity of investigation and competition advocacy.

### Figure 25.9. Serbia's legal and institutional competition framework




Source: Based on the OECD assessment.

Serbia has not made substantial changes to its legislative framework on competition since the previous Competitiveness Outlook assessment. The legal provisions regarding anti-competitive agreements, abuse of dominance and merger review are closely aligned with those in the Treaty on the Functioning of the European Union and consistent with international standards.

The Commission for Protection of Competition (CPC), established in 2005, is the body responsible for implementing competition enforcement and advocacy in Serbia. It is an independent institution, provided with skilled and qualified staff. The CPC is a well-established competition authority in the context of the Western Balkan economies. After carrying out some significant cases in the last few years, it has the potential to make its competition enforcement even more impactful. In the area of advocacy, the CPC has endeavoured to embed competition principles in national laws and regulations and promote a competition culture.

## *State of play and key developments*

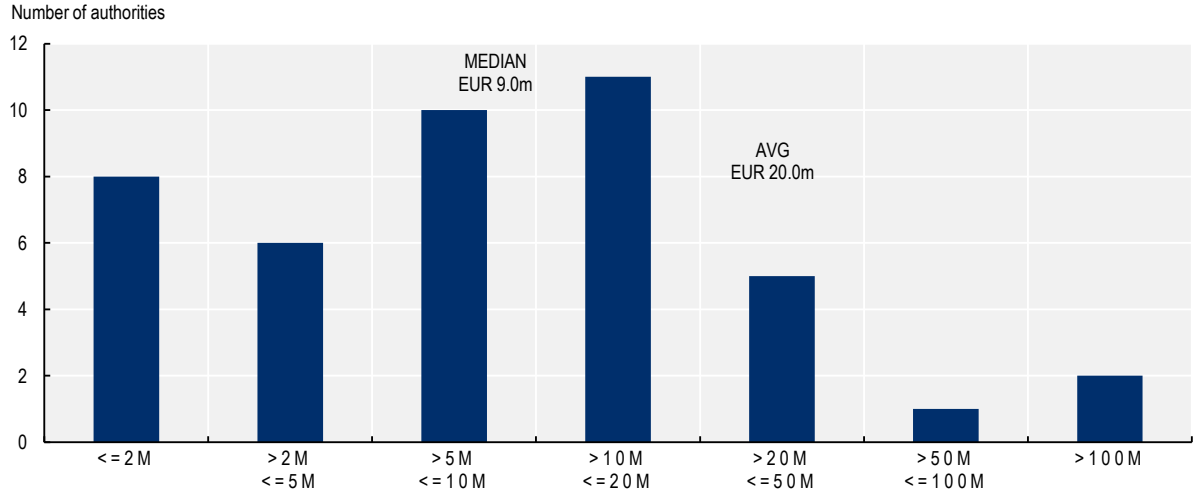
### *Sub-dimension 5.1: Scope of action*

The Council of the CPC consists of the President of the Commission and four members, elected from among eminent experts in the field of law and economics, particularly the field of competition protection. They are elected for a five-year term by the National Assembly, on being proposed by the committee in charge of trade operations, and they can be re-elected after serving their term. The candidates' interviews are streamed on line. The current council was appointed in 2019.

The total number of CPC staff has been steadily growing over the past few years, from 39 in 2015 to 49 in 2019. This figure is limited but reasonable compared with other OECD and non-OECD countries. In comparison, according to data from the OECD CompStats database,[36] the 15 competition authorities in small economies (with a population below 7.5 million) had an average of 114 staff in 2019, of whom 43 were working on competition.

The CPC's budget for competition law and policy has increased over the years. In 2015 it was EUR 2.7 million, rising to EUR 4 million in 2018 and EUR 4.4 million in 2019. Despite being high in comparison with WB6 economies, this budget is still small compared with foreign competition authorities. As Figure 25.10 shows, the CPC's budget places it well below the median of EUR 9 million. Its budget is small even when comparing it against the comparable budgets of the 15 competition authorities in small countries, which averaged EUR 5.4 million in 2019.

**Figure 25.10. Distribution of the budget of competition agencies participating in OECD CompStats 2020**




Note: Based upon the 43 authorities in the CompStats database that provided budget data for four years solely for competition activities.
Source: OECD CompStats Database.

In October 2019, the Republic of Serbia introduced a new Law on State Aid Control and established an independent authority, the Commission for State Aid Control (CSAC). The CSAC's mandate encompasses issuing opinions on alignment of laws and regulations with the rules on state aid control, as well as raising awareness about the significance of state aid control.

The provisions of the Law on Protection of Competition contribute to ensuring competitive neutrality, insofar as the **competencies** of the CPC encompass all legal and natural persons that directly or indirectly perform economic activities in Serbia, regardless of their legal status, ownership or state of origin. Competitive neutrality is likely to be key during the COVID-19 crisis, which may further increase the role that states play through SOEs.

The CPC has appropriate **powers to investigate and powers to sanction** and remedy possible anti-trust infringements, i.e. restrictive horizontal and vertical agreements and exclusionary or exploitative practices by dominant firms. The CPC can impose cease and desist orders, remedies, and sanctions on firms that have committed anti-trust infringements. It can also adopt interim measures if the alleged competition restriction could lead to irreversible damages. It can accept commitments offered by the parties to remove the competition concerns and close the investigation.

The CPC can compel investigated firms and third parties to provide relevant information and perform unannounced inspections on their premises. The assessment of alleged anti-competitive conduct follows a thorough scrutiny of the collected evidence, which includes an economic analysis of the competitive effects and of possible efficiencies. In 2015, the CPC introduced a leniency programme, which ensures partial or total immunity from sanctions to firms that reveal the existence of a cartel and/or bring evidence to support a cartel investigation. The programme is consistent with international best practices.

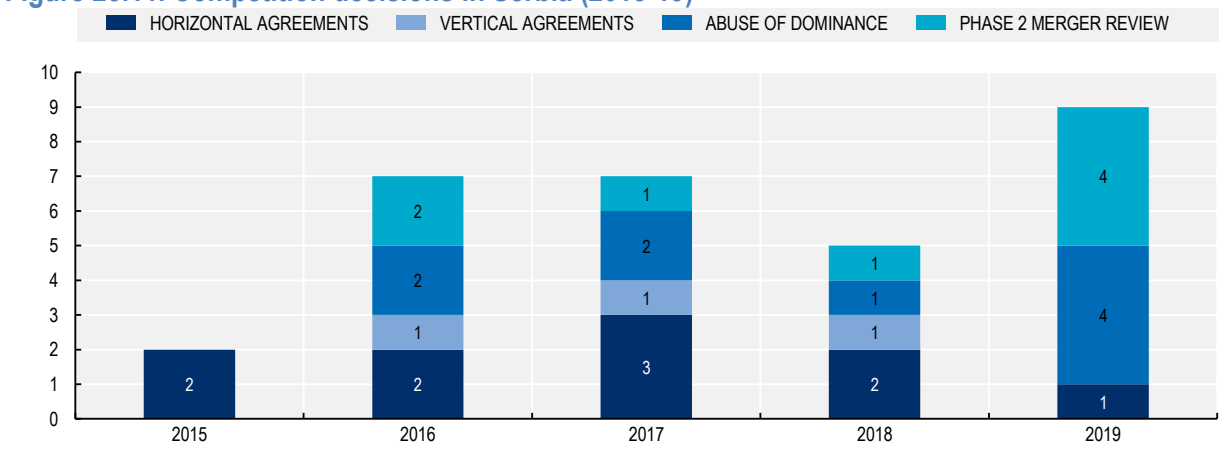
The Law on Protection of Competition provides for *ex ante* control of mergers, following the principles of the EU Merger Regulation. The CPC can compel merging firms and third parties to provide relevant information and can perform unannounced inspections on the premises of the parties in the course of in-depth (so called Phase II) investigations. The assessment of notified mergers must follow a thorough scrutiny of the evidence, which includes an economic analysis of the restrictive effects and of possible efficiencies stemming from the concentration. In cases of significant restriction, distortion or prevention of competition in the relevant markets, the CPC can prohibit the transaction. It can also accept remedies proposed by the merging parties to address possible competition concerns and clear the merger to go ahead. It can also issue conditional approvals, which require merging parties to implement specific conditions.

Regarding **private enforcement**, individuals, firms and consumers – either collectively or through consumer associations – can bring a legal action to seek damages from firms that have committed anti-trust infringements.

### *Sub-dimensions 5.2 and 5.5: Anti-competitive behaviour and implementation*

The anti-competitive behaviour and implementation policy areas together gauge the use of powers and resources in terms of decisions adopted and fines imposed for horizontal agreements, vertical agreements and exclusionary conduct. They also explore the actual activity of the competition authority on reviewing mergers. Serbia's record of competition enforcement is appreciable, particularly compared to the average among WB6 economies, but could still improve (Figure 25.11).

## Figure 25.11. Competition decisions in Serbia (2015-19)




Source: Data provided by the authorities.

In 2019, the CPC took only one decision concerning anti-competitive **horizontal agreements** (cartels). In previous four years, it had made nine cartel decisions in total, including a few cases of bid rigging in public procurement. The CPC also tackled three cases of **vertical agreements** (in 2016, 2017 and 2018), related to resale price maintenance. It should be noted that the investigation and collection of evidence was often supported by unannounced inspections on the premises of the parties. However, the leniency programme has not been effective to date: the CPC has received only one application in 2018, despite active promotion of the initiative.

The total amount of fines imposed on parties involved in anti-competitive agreements and abuse of dominance reached a peak of EUR 3.8 million in 2018 but then fell to EUR 857 000 in 2019.

The CompStats database can help place these figures in context. On average, the 15 competition authorities in smaller jurisdictions that participated in CompStats made decisions on 3.2 cartel cases per year in the period 2015-19, while the average fines levied on cartel infringers was EUR 2.7 million per year.

The data for 2020 seem to show that the CPC is continuing its enforcement actions on anti-competitive agreements. It issued infringement decisions and imposed fines on the parties in four cases: one related to horizontal price fixing, one to bid rigging and two concerning resale price maintenance.

The CPC also significantly increased the number of decisions on abuse of dominance (**exclusionary conduct**) in 2019, by adopting an infringement decision and closing three other cases with commitments imposed on the parties.

The number of **merger** notifications has almost doubled in four years, from 107 in 2015 to 197 in 2019. However, it should be noted that a significant share of mergers notified to the CPC concern extra-territorial transactions. In the period 2015-19, the CPC carried out eight Phase II investigations and two "gun-jumping" cases (i.e. failure to notify a merger to the competition authority, or implementing all or part of a merger during the mandatory waiting period). None of the transactions were prohibited, but remedies were imposed for five of them between 2016 and 2019. Three additional Phase II merger reviews and two gun-jumping cases were also conducted in 2020. In comparison, during 2015-19 the 15 competition authorities in smaller jurisdictions carried out 2.8 in-depth merger investigations per year on average, out of 30 notifications.

### *Sub-dimension 5.3: Probity of investigation*

The CPC is an **independent** organisation that performs its duties in accordance with the Law on Protection of Competition. The government has no legal right to interfere with its decisions. The CPC is **accountable** for its work before the National Assembly, to which it must submit an annual report.

In terms of **procedural fairness**, the decisions to open formal proceedings and the final decisions finding competition infringements, as well as decisions regarding mergers, are published in the Official Gazette of the Republic of Serbia and on the CPC website.

During the course of the proceedings, the parties under investigation for an anti-trust infringement can consult with the CPC with regard to significant legal, factual or procedural issues and have the right to be heard. Prior to the adoption of a final decision, the CPC must inform the party of the relevant facts, evidence and other elements on which the decision is based, and enable the party to submit its defence. Decisions can be appealed within 30 days before the Administrative Court.

The CPC has published procedural instructions and guidelines explaining its investigative procedures and its criteria for setting fines.

### *Sub-dimension 5.4: Advocacy*

The CPC has wide advocacy powers. It can monitor and analyse competition conditions in specific markets or sectors, issue opinions to the competent authorities on draft or existing regulations that affect competition, and co-operate with state entities to improve the implementation of competition rules. The Department for Legal Affairs is the CPC's specialised unit in charge of competition assessment, i.e. the scrutiny of laws and regulations aimed at identifying unnecessary restraints on market activities and developing alternative, less restrictive measures that still achieve government policy objectives. Even though public entities have no obligation to do so, they often submit draft laws and regulations to the CPC to seek its advice.

The CPC has engaged in a wide range of initiatives aimed at promoting compliance with competition principles in laws and regulations. The number of formal opinions addressed to the government or courts increased from 28 in 2015 to 70 in 2018. They include an opinion on the regulation of ride hailing services and an opinion on regulation impact assessment, both in 2018. In 2019, the CPC signed a memorandum of understanding with the Public Policy Secretariat to improve the competition assessment of legislation, on the basis of the OECD's Competition Assessment Toolkit.

The CPC has also conducted outreach activities to promote co-operation with other public authorities, including public procurement officials. Since November 2016 the CPC has been part of a tripartite co-operation agreement signed with the Serbian Anti-Corruption Agency and the Commission for Protection of Rights in Public Procurement Procedures. In October 2019, under the auspices of the EU Twinning project ("Further development of protection of competition in Serbia") with the Italian Competition Authority, the CPC held a five-day workshop on competition and public procurement. Several Serbian authorities in the field, including the Public Procurement Office, the Commission for Protection of Rights in Public Procurement Procedures, and representatives of large contractors, participated in the event. The CPC also issued Instructions for detecting rigged bids in public procurement procedures in 2011, based on the OECD's guidelines for fighting bid rigging in public procurement.

The CPC has performed a significant number of market studies over the last four years (at least three per year), which allowed it to gain a better understanding of several sectors, including retail, oil derivate retail and baby equipment.

It also performs activities aimed at developing competition culture: it regularly organises training and seminars, disseminates educational materials through dedicated social media accounts, and publishes a weekly newsletter on competition news. The number of advocacy events organised by the CPC has grown steadily over the years, reaching 25 in 2019.

### *The way forward for competition policy*

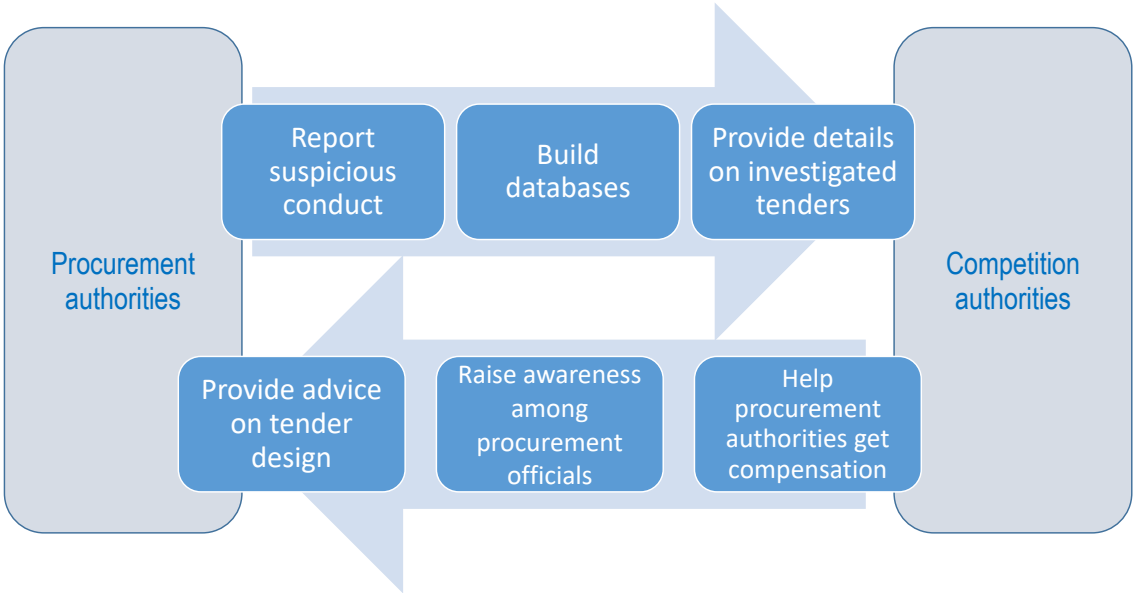
The CPC has been performing positively over the last few years, confirming its place as a leading competition authority in the region. Increasing the number of infringement decisions and the amount of fines levied against anti-competitive behaviour would further strengthen its reputation, thus fostering deterrence and competition compliance and making the leniency programme more effective.

The economic challenges brought about by the COVID-19 pandemic may suggest the CPC should focus its advocacy on the promotion of competitive neutrality, with a view to expanding the role that it can play in the rapid recovery of the national economy.

Policy makers and the CPC should focus on the following measures:

- **Prioritise boosting cartel enforcement and increasing fines**. Cartels are the most clear-cut and undisputedly harmful competition infringements and affect every economy. Although the CPC has successfully conducted some cartel cases over the last few years, it could make more effort to detect and sanction cartels, in order to deliver a strong message that firms that engage in collusion risk to be severely punished. Fines should be high to ensure deterrence and support the effectiveness of the leniency programme. Fines only act as a deterrent insofar as the risk of incurring in fines outweighs illicit gains. Concern over fines is also a key driver for leniency applications, thus fostering the effectiveness of the leniency programme – which has been barely productive in Serbia so far – and further boosting detection.
- **Pay specific attention to public procurement, particularly during the COVID-19 crisis**. Public procurement is a key sphere of action both for cartel enforcement and for competition advocacy. Bid rigging results in significant harm for public budget and taxpayers, dampening of innovation and inefficiencies. The CPC should further extend its co-operation with public procurement bodies to enhance cartel detection and foster bid rigging prevention through better tender design, using best practice guidelines such as those issued by the OECD. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012[81]) calls for governments to assess their public procurement laws and practices at all levels of government in order to promote more effective procurement and reduce the risk of bid rigging in public tenders. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009[82]), which form a part of the recommendation, are designed to reduce the risks of bid rigging through careful design of the procurement process and to detect bid-rigging conspiracies during the procurement process. Figure 25.12 shows how co-operation between competition and procurement authorities can help detect and avoid bid rigging. The OECD can also provide assistance through a project aimed at assessing the main rules governing procurement of public works as well as procurement practices of major public buyers and providing recommendations to design competitive procurement and fight bid rigging in accordance with international good practices, while offering training to both competition and public procurement officials based on the Guidelines on Fighting Bid Rigging in Public Procurement.

Figure 25.12. Example of co-operation between competition and procurement authorities




- **Advocate strongly for competitive neutrality** to ensure that all enterprises face the same set of rules, irrespective of their ownership or nationality. Competitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages. In other words, it is a framework within which all enterprises, irrespective of their ownership (state-owned or privately owned) or nationality (domestic or foreign). In most jurisdictions, the state has a dual role as policy maker/sector regulator and supplier or purchaser of goods and services. Consequently, in markets open to competition the state also acts as a market participant and interacts with private businesses, most often indirectly, through SOEs. Governments may be tempted to grant SOEs certain advantages, e.g. privileged market position, soft loans, outright subsidies, regulatory exemptions or tax benefits. Given the importance of SOEs in Serbia and the increased role of the state in the economy that is likely to result from the COVID-19 crisis, the CPC has a decisive role to play to promote competitive neutrality, in co-operation with the Commission for State Aid Control. It might need to discourage the government from granting selective aid to SOEs and resist political pressure to adopt a more lenient approach when investigating SOE conduct.
- **Expand international co-operation and training**. In the face of increasingly complex anti-trust issues and the frequent cross-border nature of competition infringements, the management and the staff of the CPC should have frequent opportunities to meet and participate in policy discussions. International organisations like the OECD, the International Competition Network (ICN) and the United Nations Conference on Trade and Development (UNCTAD) offer valuable opportunities to this end. The OECD-GVH Regional Centre for Competition in Budapest provides an ideal forum for capacity building and sharing of good practices with colleagues from other jurisdictions, focusing on the specific challenges of Eastern European and Central Asian countries. The CPC is already a regular participant in the centre's events and would benefit from actively continuing with this.

## State-owned enterprises (Dimension 6)

### *Introduction*

Serbia has made only limited reforms on state ownership since the 2018 edition of the *Competitiveness Outlook* (Figure 25.1). However, the Serbian authorities recently developed a state-ownership strategy document concerning future SOE reforms, which notably envisages a greater centralisation of state ownership responsibilities under the Ministry of Economy as well as the development of an ownership policy. This new policy can contribute to more professional ownership practices, supported by improved SOE performance monitoring.

Table 25.11 provides an overview of Serbia's scores for state ownership practices along with four broad sub-dimensions which are based on elements of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) (OECD, 2015[83]).

**Table 25.11. Serbia's scores for state-owned enterprises**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **State-owned enterprises dimension** | Sub-dimension 6.1: Efficiency and performance through improved governance | 2.8 | 2.2 |
| | Sub-dimension 6.2: Transparency and accountability practices | 3.5 | 3.0 |
| | Sub-dimension 6.3: Ensuring a level playing field | 3.3 | 2.8 |
| | Sub-dimension 6.4: Reforming and privatising state-owned enterprises | n.a. | n.a. |
| **Serbia's overall score** | | **3.1** | **2.6** |

Note: For comparability with the previous assessment, Sub-dimension 6.4 (reforming and privatising state-owned enterprises) has not been scored but is discussed in the text below.

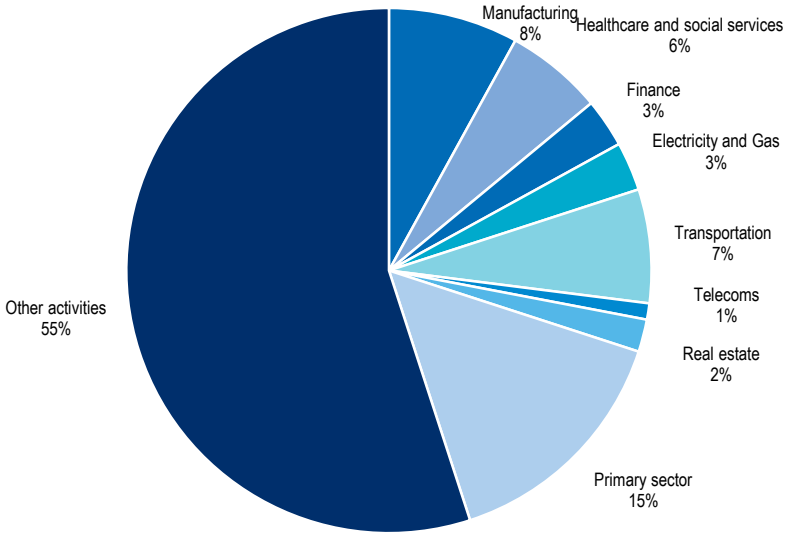
### *State of play and key developments*

#### *Sub-dimension 6.1: Efficiency and performance through improved governance*

According to the Ministry of Economy, Serbia has 156 state-owned enterprises (SOEs) and 38 state minority-owned companies. Approximately 57 SOEs fall under the scope of the Law on Public Enterprises by virtue of their involvement in performing public-interest activities.[37] The remaining SOEs operate primarily under the companies law and are not subject to a common state ownership policy.

State-owned enterprises play an important role in the Serbian economy. The SOE landscape is larger than most other economies in the Western Balkans and Central Eastern European region in terms of both employment and productivity (IMF, 2019[84]). State-owned companies are dominant or present in many structurally important sectors, including electricity and gas, transportation (railways, roads and postal services), telecoms, and finance. SOEs are also notably present in the primary sector, including mining and forestry.

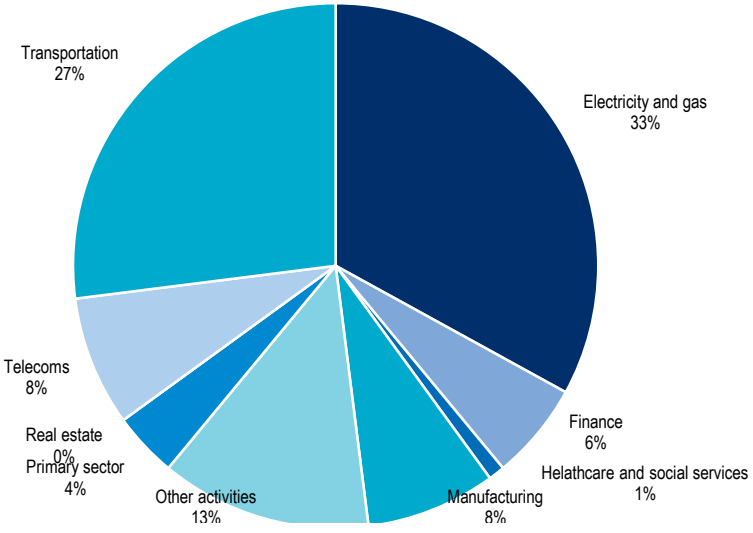
## Figure 25.13. Sectoral distribution of SOEs by number of enterprises




Note: Two water supply and sewage SOEs were not included because of their small employment share (29 employees).
Source: Calculations based on information provided by the Serbian authorities.

Figure 25.13 presents the sectoral distribution of SOEs by the number of enterprises. Prominent SOEs include the Public Enterprise Electric Power Industry (EPS), Serbian Railways, Srbijagas, Telekom Serbia and Air Serbia. Measured by their employment share, the majority of Serbian SOEs are concentrated in the electricity and gas sector (33% of all SOE employees), followed by transportation (27%), other activities (13%), manufacturing (8%) and telecoms (8%) (Figure 25.14). SOEs in Serbia employ almost 85 000 people, accounting for an estimated 2.9% of national employment.[38] This share of national employment is similar to the OECD average of 2-3%.

## Figure 25.14. Sectoral distribution of SOEs by employment

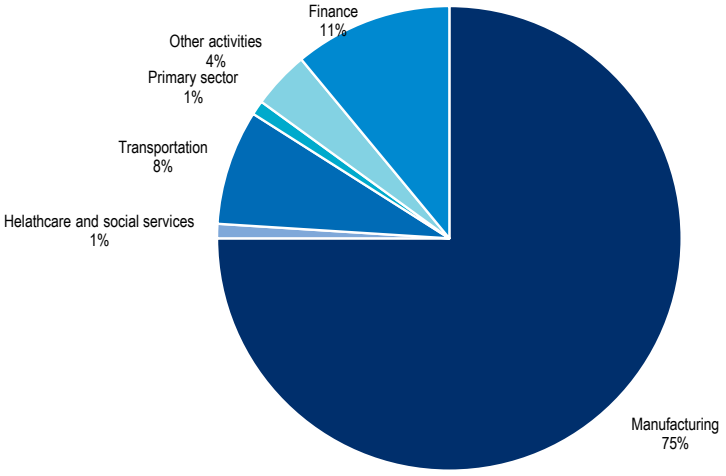



Note: There are two state-owned water supply and sewage enterprises that employ 29 people and are not included in the figure because of their very small employment share.
Source: Calculations based on information provided by the Serbian authorities.

The state also holds non-trivial minority shareholdings (over 10%) in 38 companies, together employing over 26 000 people and accounting for nearly 1% of total national employment. These companies are

highly concentrated in the manufacturing sector (75% of all employment in state minority-owned companies) (Figure 25.15).

### Figure 25.15. Sectoral distribution of state minority-owned companies by employment




Note: There is 1 state minority-owned company in the real estate sector, not included here because of its very small employment share.
Source: Calculations based on data provided by the Serbian authorities and the number of employed persons in Serbia (2 938 200) as reported in the national Labour Force Survey Quarter IV 2019 (SORS, 2019[85]).

External assessments of the performance of Serbian SOEs point to inefficiencies and low overall returns on the state's investment in these enterprises. For instance, a 2020 EBRD assessment of 25 emerging economies found Serbian SOEs had among the lowest returns on assets and the largest negative returns on equity (2014-16) (EBRD, 2020[86]).

Serbia has not yet developed a publicly available **ownership policy and rationale** that defines the state's overall ownership objectives, clarifies the main functions of various state bodies and specifies the state's expectations from SOEs. Some elements of an ownership policy can currently be gleaned within the existing legal framework covering SOEs, in particular within the Law on Public Enterprises, and certain strategic documents. However, the Serbian authorities recently developed an overall ownership policy document concerning future SOE reforms.

Serbia has not explicitly defined its rationale for state ownership for the majority of its SOEs. However, given that the Law on Public Enterprises applies only to enterprises that perform public-interest activities, it can be understood that performing public-interest activities ("activities of general interest" in national nomenclature) is one of the rationales for maintaining enterprises in state ownership.[39] In contrast, the rationale for state ownership of other SOEs, namely the companies that are primarily engaged in commercial activities and hence by definition not considered to be "public enterprises", has not been articulated. The authorities therefore need to clearly define and disclose the rationale behind state ownership of SOEs that are incorporated under other legal forms.

There is no co-ordinating body responsible for **professionalising state ownership** across the whole of the government. By law, the Government of Serbia has the ultimate responsibility for exercising ownership rights over SOEs which fall under the scope of the application of the Law on Public Enterprises. The Law on Ministries, the Law on Public Enterprises and the Government's Decision on the division of responsibilities of competent ministries define the roles and responsibilities of various ministries in the government. In accordance with these acts, the government is primarily responsible for exercising ownership rights in SOEs, including the right to appoint and dismiss SOE board members. However, a number of other important responsibilities (e.g. determination of strategic goals) are the responsibility of line ministries for many SOEs. For example, the Ministry of Mining and Energy oversees SOEs involved in the production and supply of electricity and gas. With the adoption of the Law on Public Enterprises in

2016, Serbia has taken some steps towards centralising ownership functions for a portfolio of SOEs under the responsibility of the Ministry of Economy. This is an important advance in its state ownership arrangements, as a more centralised model will help improve monitoring and professionalise and harmonise state ownership practices, which can ultimately lead to better performance and management of SOEs. The new state ownership strategy, currently under development, also foresees the establishment of a state ownership co-ordinating body.

Serbia has professionalised its **board nomination framework** for SOEs by introducing measures such as minimum qualification requirements (e.g. education and work experience) for board members and directors, and clarifying their responsibilities and competencies. The minimum qualifications for SOE board members go beyond what is established by law in most other WB6 economies. For example SOE board members are required to have at least three years of work experience related to the activities of the SOE in question, as well as knowledge of corporate management or finance. The related requirements do not apply to all SOEs, however, only those under the scope of the Law on Public Enterprises.

Although Serbia has made a significant effort to improve the board nomination process, unfortunately, there is still a lack of substantive information to assess if the process is robust in practice. The appointment process does not seem to be transparent and there is a perception that appointments are often influenced by political connections rather than purely based on professional merit. It should also be noted that these qualification requirement elements only apply to the subset of SOEs that operate under the Law on Public Enterprises. In view of the lack of clear facts on the implementation of the process there is still a risk that it will be politicised, especially since there is little evidence about the selection procedures or public tenders for board members.

Regarding the **promotion of independent and professional boards**, the Law on Public Enterprises requires that one member of every public enterprise board must be independent and that both the independent member and the company chief executive officer (CEO) cannot be a member of political party. However, this restriction does not apply to other board members, which, in practice, means that they can be politicians. The issue of political influence on SOE boards has been highlighted in external reviews: see, for example Transparency Serbia (Transparency Serbia, 2017[87]). The 2018 edition of the *Competitiveness Outlook* (OECD, 2018[80]) also raised concerns about politically affiliated persons serving on boards in the region. As no visible progress has been made in Serbia since then this remains highly problematic.

There are also some overarching issues which significantly weaken the corporate decision-making power of public enterprise boards. For instance, the government appoints the CEOs of public enterprises, leaving the board with no role in choosing CEOs. Normally, corporate boards responsible for monitoring their CEOs' activities should also have the power to appoint and dismiss them but in Serbia, the board of a public enterprise only has the authority to "monitor" the work of directors. Moreover, the Law on Public Enterprises means that several board responsibilities require the consent of the government.

On the positive side, it is worth noting that although there is no specific legal framework to enhance gender equality in SOE boards, the gender balance of the boards of the 10 largest listed companies in Serbia is among the best in the Western Balkans and Central Eastern European region. In total, 13 of the 63 board members were women in 2016 and the average female board representation within the largest listed companies was around 20% (EBRD, 2017[88]). Women accounted for 23% of top management positions in the country's largest employer Public Enterprise Electric Power Industry (EPS) in 2019. This statistics also stands out favourably when compared with the global average – according to Ernst & Young (2019[89]) only 15% of senior managers in power and utilities were women as of early 2019.

### *Sub-dimension 6.2: Transparency and accountability practices*

Legislation establishes multiple **financial and non-financial reporting** requirements for SOEs, including the requirement to publish audited financial statements and business plans on their websites. By law,

public enterprises are required to submit annual reports and financial statements to the Business Register Agency (BRA), which makes them publicly available. They are legally obliged to submit quarterly reports on the implementation of their annual and triennial business programmes to the Ministry of Economy and are required to report according to internationally recognised standards such as the International Financial Reporting Standards (IFRS). The Law on Public Enterprises also requires that SOEs publish quarterly reports on their websites. Nevertheless, according to stakeholders interviewed in the context of this assessment, in general, Serbia's SOEs are characterised by lack of transparency in their business and financial operations. The largest SOEs in Serbia do not necessarily implement good reporting practices that are not directly envisaged by the Law on Public Enterprises.[40] The law does not require them to publish sustainability reports, although some enterprises do it on their website within the framework of an internal act (i.e. enterprises which operate in energy sector).

Serbia appears to have established sound basic legislation to ensure high-quality **auditing practices** of SOEs. Their financial statements are audited by independent external providers and Serbia's SOE auditing standards compare favourably with the average OECD country (OECD, 2018[90]). SOEs with the status of "public-interest entities" are required to establish an audit committee, in line with the Law on Audit and other relevant legislation. This includes all SOEs that operate under the scope of the Law on Public Enterprises, as well as all SOEs that are considered "large" in accordance with criteria set forth in the Law on Accounting. SOE audit committees must be chaired by an independent member and include an audit professional or person with experience in the financial sector. The role of the audit committee includes proposing and controlling the implementation of accounting policies and standards in the preparation of financial reports, assessing the content of these reports and proposing candidates for auditors. SOEs are also obliged to establish internal audit and financial management control units.

Regarding the **protection of minority shareholders**, Serbia has established sound legislation to ensure the protection of basic minority shareholders' rights, which apply to the minority shareholders of SOEs. In practice, however, there are cases involving abuse of minority shareholders rights. For instance, the World Bank's 2020 *Doing Business* report gave Serbia a score of 5 out of 6 concerning the extent of shareholder rights (World Bank, 2020[11]). The 2018 *Competitiveness Outlook* found that some disputes between minority shareholders and the state had been brought to court, with minority shareholders claiming that their rights have not been respected (OECD, 2018[80]). Concerns have been also raised over the judicial system, which is sometimes biased in favour of SOEs, suggesting it is perhaps not fully equipped to protect minority rights in practice. The 2018 Company Law amendments strengthened minority shareholder rights, for instance reducing the ownership share required to request shareholder meetings and add agenda items. The protection of minority shareholders is a high-priority issue since 38 of Serbia's SOEs have non-state minority shareholders. Minority and state shareholders should both play an active role in shareholder decisions to ensure that SOEs create value for all shareholders.

### *Sub-dimension 6.3: Ensuring a level playing field*

Serbia has the basic elements are in place to ensure that SOEs' **legal and regulatory treatment** is broadly in line with that of private companies. A large proportion of SOEs are subject to the same company law that applies to private companies and SOEs are generally not formally exempt from the market regulations (e.g. competition rules) applicable to private companies. However, the existence of a subset of SOEs incorporated as "public enterprises" gives rise to concerns over the operational differences that may arise owing to their different legal treatment. A commonly occurring example is that some SOEs are exempt from bankruptcy procedures, removing a key incentive to undertake corporate improvements to avoid liquidation. There is also some evidence that SOEs are often expected to undertake non-commercial activities (such as sponsoring sports teams), which, in the absence of adequate and transparent compensation from the state, can prevent a level playing field with private companies.

In some sectors (e.g. electricity and gas), independent regulators have been established, thus mitigating the problematic mixing of objectives that can arise when the state bodies responsible for ownership are also responsible for sectoral regulation or policy. Nevertheless, this is only the case for some sectors and line ministries still play a role in the operational activities of SOEs, while also being responsible for sectoral policy. This means Serbia has not ensured a full separation of ownership and regulatory functions. The steps taken to centralise monitoring of SOEs and place some ownership responsibilities under the Ministry of Economy should help to separate these functions, but since line ministries still reportedly play an important role in SOE operational decision making, the separation is not complete. Streamlining SOEs' legal status, and eliminating any significant legislative differences that could distort fair competition, will be crucial to optimising their position in the marketplace.

Concerning **access to finance**, most SOEs obtain some financing on the marketplace, but not on market consistent terms due to explicit or implicit state guarantees. Serbia has committed to reducing the extent of state guarantees to SOEs and improving transparency surrounding them, mainly in the context of commitments made to the IMF (US Department of State, 2018[91]). As an EU candidate country, Serbia is expected to comply with EU rules on competition, which include state aid rules intended to ensure that state equity financing is provided on market-consistent terms and does not distort competition. Serbia has implemented the EU state aid regulations and its law is largely aligned with the EU, however, there are still implementation gaps.

In October 2019, Serbia introduced a new Law on State Aid Control and established an independent authority in this field – the Commission for State Aid Control (CSAC). Its mandate encompasses issuing opinions on alignment of laws and regulations with the rules on state aid control, as well as raising awareness about the significance of state aid control. Explicit state guarantees on SOEs' commercial debt are allowed, although recently the government has limited them to situations where the SOE is making capital investments; guarantees cannot be given for loans simply to finance ongoing operations. Many SOEs benefit from preferential financing and/or leniency over payments to the government or other SOEs, distorting the level playing field and leading to an inefficient allocation of resources. Examples highlighted in external assessments include direct state subsidies to state-owned railways and coal mines, explicit state guarantees on bank loans, tax arrears, and unpaid debts to the state-owned electricity company.

In terms of COVID-19 support measures to the SOEs, one of the most important measures was directed towards AirSerbia, Serbia's national carrier. Another significant injection was to Telekom Serbia. The National Bank of Serbia bought 50% (EUR 100 million) of Telekom's issued corporate bonds.

### *Sub-dimension 6.4: Reforming and privatising state-owned enterprises*

The privatisation process in Serbia is regulated by the Law on Privatisation which was adopted in 2014. The process is conducted by the Ministry of Economy. The legal framework defines three privatisation models 1) equity sales; 2) asset sales; and 3) strategic partnerships. Since the adoption of the law, the government has concluded 62 equity sales, 4 asset sales and 1 strategic partnership. Serbia continues to engage foreign investors in the privatisation process, inviting them to submit bids, participate in auctions, and purchase company shares. More than 310 enterprises, mostly with zero or a small number of employees have been put into bankruptcy since 2014. Other companies were privatised and non-EU investors acquired some of the largest firms in mining, metallurgy and agriculture (European Commission, 2019[14]). For instance, Chinese Hestil bought Serbia's steel plant in Smederevo. The copper mining complex RTB Bor was sold to China's Zijin Mining, and the agricultural corporation PKB to Al Dahra of the United Arab Emirates.

The government has also begun the process of restructuring of SOEs which is still ongoing, although at a slow pace. Restructuring of large SOEs, particularly in the sectors of mining, energy and transport, is supported by the IMF, World Bank and the EBRD. Among them are *Železnice Srbije* (Serbian Railways), *PE Srbijagas* (public enterprise activities for the transport, distribution and trade of natural gas), *PE*

*Elektrprivreda Srbije* (Public Enterprise Electric Power Industry; EPS) and *PE Putevi Srbijre* (Public Enterprise Roads of Serbia; PERS). The government has adopted the programmes for restructuring these enterprises, which include measures to improve the financial position of the enterprises (debt restructuring), and also improving organisational and management structure. The 2016 amendments to the Law on Public Enterprises aimed to strengthen the professionalism of SOEs' management, e.g. requiring directors to be appointed through public procedures. External assessments point to significant shortcomings in implementing the provisions of the law, including several cases where "acting directors" were still in place past the deadline for appointing directors according to the new procedures.

### *The way forward for state-owned enterprises*

SOEs operate at the nexus of the public and private sectors and, as such, their operations are affected by both the quality of public governance and the prevailing corporate and boardroom culture. As is the case in most economies in the Western Balkans, ensuring that SOEs in Serbia operate efficiently, transparently and on a level playing field with private companies will require reforms in multiple policy areas that cannot be done all at once. Choosing the appropriate sequencing of reforms is just as important as their content and depends in large part on the national political climate and current reform priorities. In short, identifying the most appropriate SOE reform priorities can only be done by the Serbian authorities.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises provide a guide for reforms that the Serbian authorities could use to inform their policy efforts in this domain (OECD, 2015[83]). Based on the state of play of SOE policy development in Serbia, the following priority reform areas – which are in line with the guidelines – could offer a basis for discussions with the authorities:

- **Further professionalise state ownership practices** by developing an ownership policy applicable to all SOEs, including those that undertake predominantly commercial activities. The ownership policy should clearly stipulate the rationales for state ownership, including for those SOEs that are not currently under the remit of the Ministry of Economy (see Box 25.9 for an overview of Lithuania's ownership co-ordination body). It should also clearly establish how the state expects SOEs to create value and detail the respective roles and responsibilities of state bodies responsible for exercising ownership rights in SOEs.
- **Strengthen the transparency and professionalism** of the SOE board nomination process. In line with OECD best practice, the board nomination process should be merit-based and fully transparent and it should result in boards with the requisite mix of experience, qualifications and independence to effectively oversee management decisions in the interest of corporate performance and value creation.
- **Improve SOE monitoring and disclosure practices**, including using the information that the Ministry of Economy already collects to produce a publicly available aggregate report on the activities and performance of SOEs or a selected portfolio of them. Making this information public (if indeed SOEs are complying with the reporting requirements) can be a good way to encourage ministries and SOEs to improve their management. Aggregate reports can also highlight weaknesses in SOEs' implementation of applicable reporting requirements, encouraging their improved compliance.
- **Streamline SOEs' legal forms**. The state should review the appropriateness of SOEs' legal forms, particularly for SOEs that are still incorporated as "public enterprises". Good practice calls for SOEs engaged in economic activities to be incorporated under the same legal form as privately owned companies.

### Box 25.9. Lithuania's state ownership co-ordination body

Lithuania has primarily decentralised its state ownership arrangements. For most of the country's 66 SOEs, the line ministries that are also responsible for sectoral policy and/or regulation in the relevant markets primarily exercise state ownership rights.

In the context of this decentralised system, Lithuania has taken significant steps to harmonise state ownership practices across the public administration through the development of SOE governance and disclosure standards and the establishment of a Governance Co-ordination Centre tasked with monitoring and reporting to the public on their implementation. It produces a detailed annual report on SOEs. Its main tasks include the following

- preparing aggregate reports on SOEs, with information on their financial performance and efficiency
- supporting SOE goal setting, including by calculating return-on-equity targets and evaluating the content and implementation of strategic goals
- participating in SOE board nomination processes
- contributing to SOE policy formulation, including by making methodological recommendations and initiating legislative reforms
- advising and consulting with the government, responsible line ministries and SOEs on matters like SOE governance practices, ownership decisions and dividend pay-outs.

Source: (Lithuania Governance Co-ordination Centre, 2018[92]), Governance Co-ordination Centre; (OECD, 2018[93]), Corporate Governance in Lithuania, https://doi.org/10.1787/9789264302617-en.

## Education policy (Dimension 7)

### *Introduction*

Table 25.12 shows Serbia's scores for the four education policy sub-dimensions and the cross-cutting sub-dimension on system governance, and compares them to the WB6 average. Serbia has the highest score (along with Kosovo) of the WB6 economies for the early childhood and school sub-dimension, driven by its above-average ratings for the indicators on the instruction system and early school leaving prevention. Moreover, except for the sub-dimension on tertiary education, Serbia scored above the WB6 average in all sub-dimensions.

### Table 25.12. Serbia's scores for education policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Education policy dimension** | Sub-dimension 7.1: Early childhood and school education | 3.5 | 3.0 |
| | Sub-dimension 7.2: Teachers | 3.3 | 2.7 |
| | Sub-dimension 7.3: Vocational education and training | 3.3 | 3.1 |
| | Sub-dimension 7.4: Tertiary education | 2.5 | 2.8 |
| | Cross-cutting sub-dimension: System governance | 3.5 | 3.3 |
| **Serbia's overall score** | | **3.2** | **3.0** |

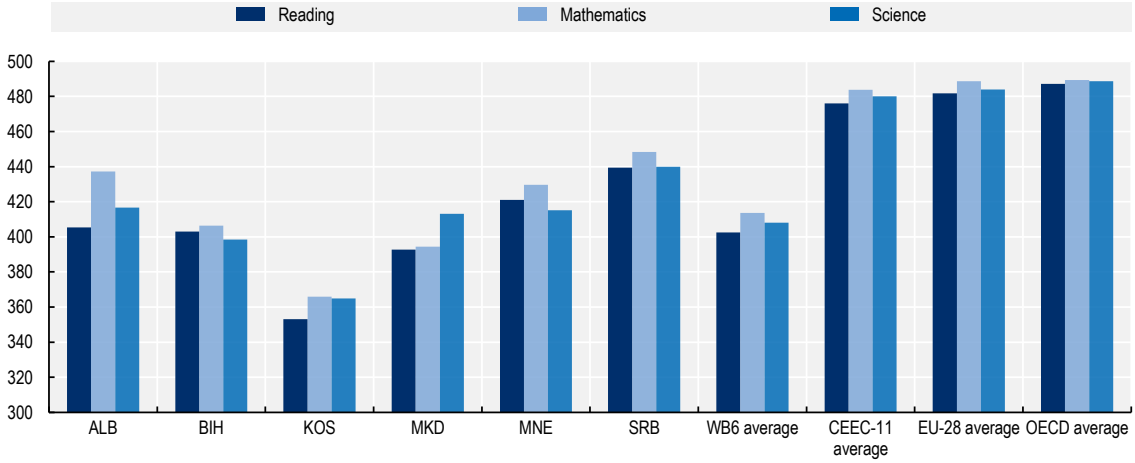
### *State of play and key developments*

Since the last assessment, Serbia has introduced reforms to further improve the quality and equity of the education system, such as the roll-out of a competency-based curriculum and learning standards. As of 2019, net enrolment in Serbia was 98.2% for primary education and 97.9% for lower secondary, meaning that compulsory education is nearly universal. Enrolment in upper secondary education (87.7%) is also high for the region (UIS, 2020[94]).

In terms of learning outcomes, Serbia's average scores in the Programme for International Student Assessment (PISA) are close to those of some countries in the European Union, such as Bulgaria, Greece and Romania. While students in Serbia perform better than their peers in other parts of the Western Balkans (Figure 25.16), many still do not achieve baseline levels of proficiency in reading (nearly 38%) and maths (nearly 40%), much higher shares than the OECD averages of 23% for reading and 22% for maths (OECD, 2020[95]). There has been a slight increase (by around 2%) in Serbia's share of high performers in reading since 2009 but the share of low performers has also increased (by around 4.9%), signalling widening educational inequities.

## Figure 25.16. Performance in reading, mathematics and science in Western Balkan education systems, 2018

PISA 2018 mean scores




Note: CEEC - Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia.
Source: (OECD, 2020[95]), PISA 2018 Database, https://www.oecd.org/pisa/data/.

StatLink https://doi.org/10.1787/888934256330

Similar to many countries around the world, Serbia closed its schools at the onset of the COVID-19 outbreak on 16 March 2020 (World Bank, 2020[96]). As part of the educational response to the pandemic, the government launched a Plan of Action for Inclusive Distance Learning that set out several recommendations for ensuring the continuity of education and providing support to children and families. For example, the plan called for the development of distance learning through television and other modalities, such as an online learning platform My School (*Moja škola*). It also emphasised communication among caregivers, teachers and school administers and the need for accountability at the school level to monitor the quality of distance learning and implications for equity (UNICEF, 2020[97]).

Primary schools in Serbia partially re-opened for the 2020/21 school year on 1 September 2020, with students in Grade 1 to Grade 4 returning to their classrooms. No more than 15 students were allowed in each classroom, lessons lasted 30 instead of the usual 45 minutes, and total number of students attending could not exceed 50% of total enrolment of the school. Students and teachers had to wear face masks and maintain a safe distance, and schools had to be disinfected after the first group of pupils finished their lessons. Students in Grades 5-8 attended schools either through a similar model, if their school has enough space and staff, or a combined model including both distance (through public TV) and in-school teaching (MPN, 2020[98]).

### *Sub-dimension 7.1: Early childhood and school education*

Serbia's performance in the **early childhood education (ECE)** indicator is relatively low for the region, despite having established a strong strategic and legal framework. It introduced a new Preschool Curriculum Framework in 2018 that aims to support the well-being of young children and promote continuity between preschool and primary education. There have also been a series of rulebooks designed to improve the quality and evaluation of Serbia's ECE institutions and workforce. For example, minimum education requirements for ECE staff have been in place since 2010 but a 2018 rulebook now outlines the professional competencies expected of ECE staff. Funding for ECE is mainly the responsibility of local authorities, with parents and families covering around 20% of costs, a regressive model that leaves poor municipalities struggling to create sufficient places for young children (World Bank, 2019[99]). Broad public initiatives to improve the quality and equity of ECE are still largely project based and donor funded, jeopardising the financial sustainability of recent improvement efforts. Serbia has made progress in

expanding access to ECE since the last assessment. Around 62% of children participated in pre-primary education in 2018 although, this share remains much lower than the EU average of 98% (UIS, 2020[94]). Despite good overall levels of participation, children from disadvantaged families and those who live in rural and remote areas continue to face barriers to educational access (Pešikan and Ivić, 2016[100]).

The Serbian **instruction system**[41] has one of the highest scores in the region for this indicator. The Strategy for Education Development in Serbia 2020 sets out a series of goals and targets to improve the quality and inclusiveness of teaching and learning, which the Ministry of Education, Science and Technological Development (MoESTD) evaluates in an annual report. Serbia also introduced a new competency-based curriculum in 2018 and is gradually updating learning standards for each grade and subject area, starting with the first year of each curriculum cycle (i.e. Grades 1, 5 and 9). This curriculum reforms aims to update classroom practices so that all young people develop the competencies needed to succeed in the 21st century. Serbia is working to align the new curriculum and learning standards with national examinations, which are used to certify the completion of basic education (in Grade 8) and upper secondary education (in Grades 11 and 12[42]). Serbia also plans to develop a new sample-based national assessment that will help measure the implementation of the curriculum and together with regular participation in international assessments, monitor the quality of learning outcomes to drive system improvement (Maghnouj et al., 2020[8]). Such information will be crucial to monitor student learning in light of school closures caused by the COVID-19 pandemic.

Serbia revised its school quality standards in 2017-18, to focus more on classroom instruction and ensure that all children and young people receive a good quality education by identifying schools where additional resources and support are needed. These standards are supported by a strong school evaluation framework that includes both self-evaluation and external evaluations modelled after inspection systems in other European countries. However, policies to provide additional support to low-performing schools (e.g. through expert assistance or small grants) remain in the pilot phase because of resource limitations. To further strengthen instruction in Serbian schools, principals participate in mandatory training and certification processes that aim to support them in becoming pedagogical leaders.

The **early school leaving** rate in Serbia has declined slightly over the last decade and, at 6.6% in 2019, is lower than the EU average of 10.2% (Eurostat, 2020[101]). While these rates are the same for young men and women, there are higher proportions of early leavers in rural areas (9.3%) compared to towns and suburbs (7.3%) and cities (3.2%) (Eurostat, 2020[101]). Despite this remaining challenge, Serbia has adopted several policies to help prevent early school leaving. For example, it has instruments to recognise students at risk of early leaving and individualised educational plans are used to retain young people in education and training. Moreover, Serbian schools are required to incorporate measures to prevent students dropping out into their development plans. Donor agencies continue to play an important role in reducing early school leaving in Serbia and have developed several programmes to help reduce it.[43] There are also been targeted policies to support Roma students and those with disabilities, for example Serbia's affirmative action programme for entry into secondary and tertiary education for Roma students.

### *Sub-dimension 7.2: Teachers*

Serbia's score in this sub-dimension is above the WB6 average. Compared to most European countries, teachers' salaries are relatively low (EC/EACEA/Eurydice, 2019[102]). While Serbian teachers have benefitted from salary increases since 2017, earnings continue to be lower than those of other tertiary-educated workers, partly because of the large share of teachers who work part time (MoSALSG, 2015[103]). The government has several policies and mechanisms to increase the attractiveness of the teaching profession and encourage teachers to develop their competencies. For example, there is a merit-based career structure that includes increasing levels of responsibility and a set of professional standards help to inform initial teacher education and professional development activities. Serbia now requires all primary

and secondary school teachers to complete a postgraduate degree (ISCED 7); however, national data suggests that only 85% of teachers had attained this level of education as of 2019.

There are no programme-specific accreditation criteria for **initial teacher education (ITE)** in Serbia; however, revisions to national accreditation standards in 2019 established a minimum duration for the initial practicum component.[44] This is an important development since the quality of ITE programmes and minimum entry requirements vary across the individual institutions. Serbia has some policies to attract and support students who wish to enter the teaching profession, such as offering scholarships to students in their second year of ITE and a mentoring programme for novice teachers. However, a general oversupply of teachers combined with a recent hiring freeze mean that many ITE graduates are not able to find employment (Maghnouj et al., 2020[8]). The number of teachers hired on part-time contracts in Serbia has also grown steadily in the last decade, from 28 380 teachers in 2010 to over 35 000 in 2019. This trend may discourage talented young people who are looking for more stable employment opportunities.

Serbia has a clear regulatory framework around the **professional development and management** of teachers. There is a specific institution, the Institute for Improvement of Education, responsible for accrediting professional development providers and a range of sources help determine professional development needs, namely self-assessment surveys, appraisals conducted by schools and external experts, and reports from schools. When the government identifies a teacher training priority area, this is paid for directly by the ministry but other activities are financed by local authorities, schools and donor agencies. While Serbia has a clear external appraisal process for promoting teachers, advancement is mainly based on years of experience, not performance or level of responsibility. Moreover, there is no progressive salary scale to reward teachers for moving to higher levels of the career structure. However, the ministry plans to develop such a scale, which will provide a powerful incentive for teachers to continue to develop their competencies.

### *Sub-dimension 7.3: Vocational education and training*

Serbia's score in the VET sub-dimension is similar to the Western Balkan average. Professionally oriented education starts at the upper secondary level, when students are allocated into either general, vocational or art programmes based on their academic performance in lower secondary school, results in a national exam and individual preferences. The majority of upper secondary students in Serbia (74% as of 2018) enrol in vocational upper secondary schools, much higher than the EU (48%) and OECD average (32%) (World Bank, 2020[104]).

However, evidence from PISA finds that learning outcomes across VET and general education tracks are not equal, as vocational students tend to have weaker literacy and numeracy skills than their peers in general education. While many education systems struggle with this challenge, Serbia has the widest gap in reading performance (85 score points) between vocational and general students (OECD, 2020[105]). Moreover, socio-economically disadvantaged students in Serbia are more than five times as likely to attend a vocational upper secondary school, suggesting that current sorting mechanisms may reflect students' background more than their capability (OECD, 2020[105]). These inequalities may limit Serbia's long-term competitiveness.

The **governance of VET** in Serbia is determined by a legal framework and strategic documents that regulate the sector and work-based learning (WBL). Several government agencies share responsibility for managing VET, with policy coherence ensured by MoESTD. To develop VET programmes and determine the number of study and/or training places, Serbia engages stakeholders through Sector Councils, whose main function is to determine the demand for qualifications through dialogue with representatives of labour unions and education sectors.

The Serbian government recently passed a set of by-laws to better plan and co-ordinate career guidance activities across the education system. It introduced a set of standards for career guidance practitioners in 2019 and Career Guidance and Counselling Teams were extended to vocational schools offering dual-

education (Government of Serbia, 2019[106]; EC, n.d.[107]). This is a positive development considering that data from the Ministry of Youth and Sports found that some 50% of youth report having never taken part in career guidance and counselling activities (CeSID, 2019[108]).

To inform career pathways and policy development, Serbia collects and disseminates data about the VET system, such as enrolment and completion rates. There is also some information about labour market outcomes. For example, at around 53.6%, the employment rate of VET graduates (20-34 year-olds) in Serbia is lower than the EU average of 76.8% (EC, 2020[36]). While this type of information can be useful, other labour market information about the WBL system is limited. For example, there is no information on the number of learners who are hired after completing an apprenticeship or WBL opportunity, nor are there any earnings data. Serbia plans to start collecting these data once its new education management information system (EMIS) is fully developed (see the Cross-cutting sub-dimension: System governance) but such mechanisms are not yet in place.

Serbia has started to move away from its previous theoretical model of vocational education towards more **work-based learning** (ETF, 2018[109]). The government started implementing a dual model for vocational education in 2019, whereby students attend regular classes in school and take part in work-based learning experiences outside of the classroom. The Law on Dual Education clearly defines all aspects of WBL and requires that curricula include a set of compulsory general, vocational and elective subjects. This could help ensure that all students develop the core literacy and numeracy skills needed to succeed in the workplace and adjust to changes in the labour market.

### *Sub-dimension 7.4: Tertiary education*

Serbia's score in this sub-dimension is lower than the WB6 average. While the EU has set a goal of having 15% of the population aged 25-64 participate in lifelong learning and adult education by 2020, Serbia's strategic commitment is to reach at least 7% (MoESTD, 2018[110]). The Serbian tertiary education sector is mostly public (66% in 2018), with a stable share of private institutions (Serbia Excel, n.d.[111]). The sector has expanded over the past decade and national data show that nearly 22% of adults (aged 25 and over) have attained some form of tertiary education (Serbia Excel, n.d.[111]). However, this is still behind the OECD average of 45% (OECD, 2020[112]) and access to tertiary education in Serbia remains a challenge for individuals from vulnerable social groups, especially Roma (MoESTD, 2018[110]).

To **improve equity in access to tertiary education**, the Serbian government has taken steps such as introducing affirmative action measures to increase the coverage of students from under-represented groups. Serbia is also acting to improve access by replacing university-led entrance exams with results from the new central Matura exam.[45] While this reform stands to improve the fairness and transparency of university admissions, Serbia's limited financial and human resources risk hindering the new Matura's implementation (Maghnouj et al., 2020[8]). A positive feature of Serbia's higher education system is the availability of financial aid for students, some of which specifically targets vulnerable groups (e.g. Roma and people with disabilities). However, the distribution of financial aid is mainly based on academic performance and only 10% of student loans and scholarships are granted to vulnerable students (MoESTD, 2019[113]). As a result, the cost of higher education remains a barrier to participation for many students.

The Serbian government collects some data to monitor equity in tertiary education, such as enrolment and completion rates by gender and minority background. However, no research has been conducted to better understand and address the individual factors that may hinder participation in higher education.

Serbia has taken several steps to improve the **labour market relevance of higher education** in recent years and this topic is expected to be a priority in the next education strategy. For example, the 2017 Law on Higher Education now requires higher education institutions to have a Council of Employers to help strengthen links between the labour market and education system. There have also been efforts to promote

the internationalisation of education, namely through Serbia's full participation in the European Union Erasmus+ Programme (European Commission, 2021[114]).

Several government agencies collect data to monitor the quality and labour market relevance of the tertiary sector, including employer surveys. The government also established a Qualifications Agency in 2019 that will be responsible for collecting data on labour market outcomes for each higher education institution and programme. Other measures to increase labour market relevance have included establishing a National Council for Higher Education to harmonise the higher education system's quality assurance and accreditation mechanisms with European and international standards.

Despite these efforts, there is evidence that skill shortages extend across most sectors of the economy (Reyes, Javier and Nguyen, 2020[115]) and Serbia's share of 15-24 year-olds who are not in employment, education or training is higher than the OECD and EU averages . Overall, Serbia's unemployment rate remains high – see Employment policy (Dimension 8) – especially among young adults and recent tertiary graduates (Eurostat, 2020[101]). This contributes to outgoing migration as skilled young people search for better opportunities abroad and when combined with Serbia's decreasing population, presents a risk to economic competitiveness.

### *Cross-cutting sub-dimension: System governance*

Serbia has several governance features that align with practices found in European and OECD education systems and economies; however, the score for this cross-cutting dimension is similar to the WB6 average. The National Qualifications Framework of Serbia (NQFS), for example, is harmonised with ISCED and has been linked to the European Qualifications Framework, which establishes the recognition of learning outcomes and qualifications within the economy and internationally. The Strategy for Education Development in Serbia 2020 sets out broad long-term objectives for the entire education system. The present education strategy was developed in consultation with a range of stakeholders and informed by an analytical review of the system. It is also accompanied by a set of action plans to support implementation. The ministry has written a draft for the new education strategy, which will outline Serbia's vision for education for 2021-30, as well as the corresponding action plan for 2021-23. Public consultations are currently underway.

The Serbian government evaluates its education strategy and action plans through annual progress reports using a variety of indicators. While system inputs and outputs are regularly monitored, indicators related to outcomes are relatively limited since Serbia does not have a regular national assessment of student learning. However, the government plans to develop a new national assessment building on a pilot instrument[46] that was conducted in 2018. This will address an important system governance gap, as the majority of EU and OECD countries already use some sort of national assessment to monitor student learning (OECD, 2013[116]). At present, Serbia must rely on international assessments (which are not specific to the Serbian context) and national examinations (which do not provide information on learning during the earlier years of schooling) in order to have comparable information about student learning. Such information is crucial to support system monitoring and inform education policy decisions.

In recent years, there have been some efforts to modernise Serbia's data collection and system evaluation efforts to help improve system governance. For example, the EMIS was connected to a new interface in 2016, called the *Dositej* platform, to collect school-level data more efficiently. However, the functionality of this platform is limited and does not link with Serbia's labour market data. While the government does not aggregate relevant and available data to produce a comprehensive report on the state of the education system, there are a range of thematic reports prepared by technical education agencies and donors.

### *The way forward for education policy*

In today's increasingly global and fast-changing world, achieving inclusive and quality education in Serbia could increase its regional competitiveness and create opportunities for more individuals to develop the competencies needed for sustainable development and social cohesion. Serbian officials will need to reflect on the economy's political, social and fiscal environment to determine how best to achieve their education goals. While the OECD review on evaluation and assessment in Serbia's education system (Maghnouj et al., 2020[8]) provides detailed recommendations on how to strengthen the equity and quality of the education sector, the following considerations in particular can provide insights for discussions on the way forward to enhancing education in Serbia:

- **Ensure the new education strategy has a clear set of priorities and a strong monitoring framework**. Serbia's next education strategy will cover a critical period for its national development and potential accession to the EU, highlighting the importance of directing the education sector towards supporting more students to achieve good and excellent outcomes. It will therefore be important to focus on clear and measurable priorities to help mobilise stakeholders across the system. Considering the low rate of enrolment in ECE, increasing coverage at this level of education should be considered a priority. This and other national priorities should be translated into action plans that are financially viable and can be measured through a monitoring framework. Box 25.10 shows the how Ireland included specific indicators in its Action Plan for Education 2018 to measure progress towards its national goals.
- **Provide teachers with stronger incentives to develop their practice**. Serbia has a merit-based career structure and has recently raised teacher salaries; however, the professional management system does not effectively reward performance or provide teachers with incentives to update their skills, knowledge and practice. Serbia should strengthen the link between teachers' performance and rewards. Current plans to introduce a salary increase for different levels of teaching careers will be an important step in this direction. However, it will also be important that the procedures for appraising and promoting teachers is fair and transparent.
- **Implement plans to strengthen the collection and management of data**. Serbia has already taken several significant steps towards modernising the collection and management of education data in recent years. However, it is important that current plans to link education and labour market databases are implemented so the system can more effectively analyse education inputs, processes and outcomes.

### Box 25.10. Ireland's indicator framework for the Action Plan for Education 2018

Ireland's Action Plan for Education 2018 accompanies the country's national education strategy for 2016-19, setting out priorities and actions that the Department of Education and Skills and its technical agencies should undertake during the year. The action plan clearly aligns each action and sub-action to the country's five main goals for improving the quality of its education system. Each goal is associated with a list of actions and a set of indicators that are used to measure progress. For example, the first goal, "improve the learning experience and the success of learners", identifies six objectives, followed by indicators, as in the table below:

#### Table 25.13. Objectives and indicators

| Objectives | Indicators |
|---|---|
| 1.2 Deliver a "step change" in the development of critical skills, knowledge and competencies to provide the foundations for participation in work and society | Increase the percentage of students taking higher-level maths at the end of Junior Cycle: 60% by 2020 |
| | Increase the proportion of students performing at Level 5 or above for reading in PISA: 12% by 2020 |
| | Decrease the proportion of students performing below Level 2 for science in PISA: < 10 by 2025 |
| | Increase the proportion of students performing at Level 5 or above for mathematics in PISA: 13% by 2020 |
| 1.6 Enable learners to communicate effectively and improve their standards of competency in languages | Percentage of candidates presenting a foreign language at the Junior Certificate/ Cycle Examination: 100% by 2026, 92% by 2022 |
| | Students studying a foreign language as part of their HE course: Support 20% of all HE students to study a foreign language as part of their course (2026) |
| | Students doing Erasmus +: 4 100 HE students (2018/19) |

Extracted from: (Maghnouj et al., 2020[8]) *OECD Reviews of Evaluation and Assessment in Education: Serbia,* https://www.oecd-ilibrary.org/education/oecd-reviews-of-evaluation-and-assessment-in-education-serbia_d8a85cfe-en
*Source*: Government of Ireland (2018[117]), *Action Plan for Education 2018*, www.gov.ie/en/collection/d3b2f1-action-plan-for-education-2018/.

## Employment policy (Dimension 8)

### *Introduction*

Serbia has strengthened its regulatory framework for the labour market since the last assessment but when it comes to implementing these regulations, improvements have been more limited. It has made no progress in strengthening the role of collective bargaining in the private sector, nor of Economic Social Councils. There have been some improvements in processes to detect informal employment and efforts have been made to reduce it. Some improvements have been made to skills matching, with a framework for improving training contents for initial VET training laid down, but few improvements to support continuing learning, and in particular to increase the skills of low-skilled adults. Although advances have been made in improving the capacity of the public employment service, caseloads remain too high and budgets for active labour market policies too low.

Table 25.14 shows Serbia's employment policy dimension scores, detailing them for each of the four employment sub-dimensions. Serbia scores above average for all sub-dimensions except for job quality. This is due to a lower score on the policies to promote female employment indicator, the second lowest in the region. However, Serbia's overall score remains above the WB6 average.

**Table 25.14. Serbia's scores for employment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Employment policy dimension** | Sub-dimension 8.1: Labour market governance | 2.9 | 2.6 |
| | Sub-dimension 8.2: Skills | 2.8 | 2.2 |
| | Sub-dimension 8.3: Job quality | 2.3 | 2.4 |
| | Sub-dimension 8.4: Activation policies | 3.0 | 2.9 |
| **Serbia's overall score** | | **2.8** | **2.6** |

### *State of play and key developments*

**Table 25.15. Key labour market indicators for Serbia (2015 and 2019)**

| | Serbia | | WB6 average | EU average |
|---|---|---|---|---|
| | 2015 | 2019 | 2019 | 2019 |
| **Activity rate (15-64)** | 63.7% | 68.1% | 61.0% | 74.1% |
| **Employment rate (15-64)** | 52.1% | 60.7% | 51.5% | 69.3% |
| **Unemployment rate (15-64)** | 18.2% | 10.9% | 16.3% | 6.4% |

Note: WB6 average rates are based on author's own calculations using simple averages.
Source: (Eurostat, n.d.[118]), Labour Force Survey data base, https://ec.europa.eu/eurostat/web/main/data/database.

As Table 25.15 shows, the activity rate of the population aged 15-64 increased by 4.4 percentage points from 2015 to 2019 reaching 68.1%, above the WB6 average, but still well below the EU average and also below the five EU countries that may serve as peer countries (Bulgaria, Croatia, Hungary, Romania and Slovenia), which average 71.2% (Eurostat, 2019[119]). A favourable economic climate has led to employment growth over this whole period. The number of people in employment increased by 10.6% between 2015 and 2019. The employment rate among 15-64 year-olds increased by 8.6 percentage points over the same period, reaching 60.7% in 2019, compared to the EU average of 69.3%. The unemployment rate for the same age group decreased steadily from 2015 to 2019 reaching 10.9%, which is one of the lowest rates in the region, but markedly above the EU unemployment rate and the average of the five peer countries mentioned above (4.1%).

The COVID-19 pandemic has had only a limited effect on the labour market so far. The main change has been an increase in inactivity rates and a slowing of the improving labour performance trend. Those in

informal employment have been hit by the crisis and informal employment fell. Since they were unable to search for a new job during the lockdown and COVID-19 outbreak they were classified as inactive (ILO, 2020[120]). An increase in unemployment among those formally employed was avoided, due to the introduction of a job preservation scheme by the Ministry of Finance. This took the form of a wage subsidy scheme (at the level of minimum wages from March to May, and half the minimum wage thereafter) for micro-enterprises and SMEs affected by the pandemic (CEVES, 2020[121]; Government of Serbia, 2020[122]).[47] Take up of this measure was very high, covering roughly half of those in employment. However, the most vulnerable workers – those in temporary or seasonal work contracts, service contracts, agency contracts, vocational training and advanced training contracts, and supplementary work contracts – are not covered by these measures (CEVES, 2020[121]; United Nations, 2020[123]). The labour market impact has been comparable to that in EU countries which introduced similar schemes (Duell, 2020[124]).

### *Sub-dimension 8.1: Labour market governance*

Most parts of the legislative **regulatory framework** for governing the labour market have been aligned with the EU *acquis* (EC, 2020[36]).[48] As a rule, draft labour laws are submitted to the European Commission for comments and alignment. The Law on Safety and Health at Work is, for the most part, harmonised with the relevant EU directive. By-laws in this area have transposed 24 individual EU directives to the greatest possible extent. A proposal of the Law on Safety and Health at Work was prepared, which will bring further harmonisation with the Framework Directive. Changes to the law on Temporary Work Agencies made in December 2019 will come into force in 2021. In line with EU legislation, this mainly concerns the principles of equal pay and equal working conditions. Recent changes in the legal framework also include the Law on Employment of Foreigners (further simplifying of the procedure for issuing work permits for foreigners) and the Law on Conditions for Sending Employees to Temporary Work Abroad (abolishing the legal obligation of employers to submit a notice and the Central Registry of Compulsory Social Insurance Certificate to the Ministry of Labour, Employment, Veterans and Social Affairs (MoLEVSA) with regards to the employees who shall be sent to work abroad). Other recent amendments to labour laws aim to promote formal employment by reducing the administrative burden (see the Cross-cutting sub-dimension: Informality below).

Serbia plans to harmonise its labour law with another 14 EU directives. The first step will be an analysis of the current gaps in the law. The areas being reviewed relate to collective redundancies, the protection of young and pregnant workers, employment conditions of workers with service contracts and non-standard contracts, and working hours. The labour law recognises certain non-standard contracts but it does not regulate in detail the labour and legal status of persons engaged via those contracts. Serbia adopted an action plan for aligning with the EU *acquis* in social policy and employment in May 2020.

The labour law does not regulate the term “self-employed” and their status, nor does it regulate temporary work contracts, or platform[49] and gig workers. In 2019Q2, about 23% of workers were self-employed (a slight increase on 2015 but a decrease since 2017), in line with the WB6 average, and well above the EU average of nearly 14% (WIIW and World Bank, 2020[125]; Eurostat, n.d.[126]). There were also 137 000 contributing family workers (usually unpaid workers, with no social benefits and labour rights), equivalent to 4.7% of total employment in 2019 .

In Serbia, a significant share of the self-employed are own-account workers,[50] nearly half of whom work in the informal sector. Generally, self-employment is linked to poor employment conditions (SORS, 2020[127]). Informal employment is particularly widespread in the agricultural sector.

The Strategy for Safety and Health at Work in the Republic of Serbia (2018-22) and its related action plan set the objectives of reducing injuries at work by 5%, making progress on the prevention of workplace injuries and occupational diseases, and improving the monitoring of injuries at work.[51] Advances are being made in monitoring; the authorities intend to start public procurement for the register of injuries at work, in order to establish an IT system and a database on key indicators related to injuries at work in line with the

European Statistics on Accidents at Work methodology (Eurostat, 2013[128]).[52] The introduction of this register should align the existing different monitoring systems, which are run by the Administration for Safety and Health at Work, the Labour Inspectorate, and the Republic Fund for Health Insurance.

Reducing and preventing accidents at work and improving working conditions requires that a strong implementation mechanism is in place. In 2015, around 38% of employers had elected representatives for safety and health at work (EU-OSHA, 2016[129]). More efforts could be made to encourage the establishment of representatives and support their work. A study on improvements since 2015 and the remaining challenges should be conducted.

The Strategy for Safety and Health at Work in the Republic of Serbia 2018-22, aims to strengthen the capacity of the **labour inspectorate** and a budget was allocated to this task. In particular, the Labour Inspectorate is expected to focus more of its work on preventive measures, in line with OECD good practice, by the end of 2022. The labour inspectors currently focus on controlling compliance with the regulatory framework in the field of safety and health at work and labour standards, detecting informal employment, and controlling temporary agency employment. Labour inspectors can impose fines and, in case of severe misconduct, file criminal charges. The effective implementation of preventive measures would require a substantial increase in capacity. Labour inspection lacks technical and human resources, and is not audited.[53] The number of inspectors fell by one-third between 2009 and 2019, leaving 243 inspectors operating in 2019. This means there are nearly 12 000 workers for every labour inspector, nearly 50% higher than the ratio in Montenegro and North Macedonia, and higher than that recommended by the International Labour Organization.[54]

The Labour Inspectorate plans inspections of employers in certain sectors and in certain territories on the basis of risks that are assessed according to previously completed inspections. It uses data from the Central Registry of Compulsory Social Insurance and the Agency for Business Registers, which it receives upon written request. It has also access to certain data entered into the unified IT system “eInspector” from other inspections. However, this system does not yet offer reporting and it has not been set up to meet the needs of labour inspectors. The inspectorate conducts unscheduled inspections, often applying the principle of “rotation” of inspectors. It is important that labour inspectorates are able to carry out on-the-spot visits right across Serbia.

Efforts have recently begun to increase the technical capacity of labour inspectors to tackle child labour and human trafficking through participation in the 'Engagement and Support at the National Level to Reduce Appearance of Child Labour'' project which started in 2016, and the 'Prevention and Fight against Human Trafficking in Serbia project which started in 2017.[55] These projects have developed special protocols and guidelines for detecting child labour and human trafficking, and trained inspectors in issues related to child labour. A total of 70% of inspectors have been trained in this area.

Despite some improvements in key labour market indicators, the main labour market challenges that remain are the low employment rates of older people and youth unemployment, long-term unemployment, the high inactivity rates, labour market integration of vulnerable groups, and wide regional disparities (WIIW and World Bank, 2020[125]; Government of Serbia, n.d.[130]),. Efforts have been made to base the **employment policy framework** on labour market analysis and on assessments of policies already in place. The National Employment Strategy 2021-26, which forms the basic employment policy document, is being developed on the basis of an *ex ante* evaluation, an *ex post* evaluation of the previous plan, a feasibility study into introducing a youth guarantee, and the barriers facing hard-to-employ groups in accessing jobs and active labour market programmes (ALMPs). However, these reports are not publicly available, which is against good practice for transparent policy making. The new strategy was adopted in February 2021.[56]

Employment policies are developed by a working group consisting of several ministries, the Standing Conference of Towns and Municipalities, the public employment service (PES), chambers of commerce and social partners. Specific objectives are encouraging employment in less developed regions and the

development of regional and local employment policies, the improvement of labour force skills and competencies with emphasis on hard-to-employ categories, strengthening the capacities of labour market institutions, and decreasing duality in the labour market.[57] With the support of the Project Youth Employment Promotion, an updated guidebook on drafting local employment action plans was developed, and an analysis of Roma integration conducted. More efforts need to be made to develop integrated approaches and to allocate suitable budgets to improve the labour market integration of vulnerable groups, including Roma and people with disabilities (see also Sub-dimension 8.4: Activation policies).

In 2016, the government adopted the Strategy for Social Inclusion of Roma in the Republic of Serbia 2016-25. According to the most recent 2017 Regional Roma Survey data, only 21% of Roma are employed compared to 40% of non-Roma living in close vicinity with them, and 55% nationally. At the same time 71% Roma are engaged in undeclared work, compared to only 17% non-Roma and the national average of 22% (RCC, 2019[131]). The strategy has specific objectives to increase the labour market participation rate and combat discrimination against Roma in the labour market, increasing the number of Roma employed in public authority bodies, and formalising the work of informally employed Roma men and women, (especially introducing individual collectors of secondary raw materials into the waste management system at local self-government level, without any results so far). The action plan for employment and social inclusion of Roma expired in 2018. Implementation has been followed up with less intensity than planned, planned actions were not fully implemented and there have been delays in the preparation of the new action plan (EC, 2020[36]).[58]

A framework for **social dialogue** is in place, but it lacks practicable procedures, mechanisms, rights and obligations for collective bargaining partners. Improvements have included the adoption and amendments of the Law on Peaceful Resolution of Labour Disputes[59]. Data from 2011 suggested that the unionisation rate in the private sector was around 20% (Arandarenko, 2012[132]; Ladjevac, 2017[133]). This would be comparatively high for the region, but it is not known whether the rate has increased or decreased since then. Major companies in the metal industry, banking sector and retail are not members of the Union of Serbian Employers (UPS) (Ladjevac, 2017[133]). Collective bargaining is conducted at sector level (mainly in the public sector) and company level in the private sector. While sector agreements are monitored by MoLEVSA, company level agreements do not need to be reported. It is estimated that only 30% of employees, probably largely in the public sector, fall within the scope of collective agreements in Serbia, compared with an EU average of 60% (Ladjevac, 2017[133]). Information on collective bargaining at all levels would need to be collected to assess collective bargaining coverage and monitor the level of wages agreed. The labour law stipulates that employees working for an employer with over 50 employees may establish a works council, but it is not known how many companies have a works council.

The Social and Economic Council (SEC) is a tripartite body composed of the representatives of the government, employer organisations and trade unions. There are also 21 local SECs. The SEC is consulted on draft labour regulations and is the main actor setting the minimum wage. In 2019, the SEC held 8 sessions, down from 11 sessions in 2018. The permanent SEC working groups held 23 meetings in 2019. However, the operations of SEC are not underpinned by the state budget and the secretariat is not in a position to pursue analytical activities from its own resource (Ladjevac, 2017[133]).

### *Sub-dimension 8.2: Skills*

Labour market outcomes are significantly determined by level of education. Low educational attainment is associated with a higher risk of being in informal employment. Employment growth has been driven by a rise in employment among both low and highly educated workers (WIIW and World Bank, 2020[125]). [60] The unemployment rates fell for workers with all levels of education each year between 2015 and 2018 (and 2019 Q2); among low-educated workers they fell from 15% in 2015 to 12.1% in 2018 (and 9.2% in Q2 2019), among medium-educated workers from 19.4% to 13.7% (11.4% in Q2 2019) and among highly-educate workers from 15.3% to 10.8% (8.5% in Q2 2019). The strongest percentage-point reduction in

unemployment was among the medium educated, followed by the highly educated (WIIW and World Bank, 2020[125]). The proportion of young people not in employment, education or training (NEET) stood at 15.3% in 2019, down from 19.9% in 2015 (SORS, 2020[127]).

Despite improvements in labour market outcomes, **skills mismatches** continue to be a major challenge. The employment rate among recent graduates (20-34 year-olds) was 56.9% in 2017, well below the EU average of around 80% (European Commission, 2019[134]). Employers name lack of work experience as one barrier to recruitment, and generally indicate they face shortages of candidates with the skills they need, according to a survey conducted by the National Employment Service (NES), Serbia's public employment service. Over-education is another pressing issue (ETF, 2019[135]). Over-education may result from an oversupply of university graduates and/or from skills gaps among young graduates if they are not acquiring the technical and soft skills employers need, and weaknesses in the education-to-work transition. Graduates' first work experience may thus be in jobs requiring a much lower formal education level.

The NES has set up a new programme, My First Salary, which started in the second half of 2020. The programme works with employers in the private or public sector, but prioritises private sector employers, especially those from disadvantaged municipalities in accordance with the Decree of the Government of the Republic of Serbia on the level of development of local self-government units. During the programme, the NES pays a monthly cash benefit to young people being employed through this scheme: RSD 20 000 dinars to those with secondary education, and RSD 24 000 to those with higher education, and it also pays a contribution in the case of injuries at work and occupational diseases for people included in this programme. The programme is expected to benefit 10 000 young people during 2020 and 2021 (Government of the Republic of Serbia, 2020[136]). Its implementation and outcomes should be closely monitored, including the types of private companies taking part and the employment outcomes for the participants after 6 and 12 months.

Research on graduates' transition to the labour market has so far been limited to periodic school-to-work transition studies. Efforts are needed to develop a regular monitoring system for education outcomes that would include information on graduate employment, use of skills in the workplace, and the difficulties encountered while searching for work and their strategies to find employment. A pilot graduate tracking study was implemented in 2018 with the aim to make this practice mainstream in future (ETF, 2019[135]). Difficult transitions from higher education to work may act as an additional push for young people to emigrate, aggravating skills shortages.

Further improvements have been made to the skills anticipation system. A survey on the skills needs of employers is used for one-year forecasting at occupational level. The results are used in the design and implementation of ALMPs as well as in the context of the National Qualification Framework. In 2020/21, with the support of the IPA 2014 (Project for the Development of an Integrated System of National Qualifications), MoESTD has been developing a methodology to establish sector profiles, for collecting and forecasting key indicators such as the number of employed/unemployed persons in the sector, relevant vocations, the qualifications structure, the supply of programmes for gaining relevant qualifications, economic parameters and strategic directions for sector development. These data should support the work of sector councils on required competencies, and the mapping of qualifications and updating of the existing list of vocations in line with the National Classification of Vocations.

Serbia has taken major steps towards improving its skills framework. It adopted the National Qualification Framework for Serbia in 2018, and established a link to the European Qualification Framework. The Council for the National Qualifications Framework is an advisory body appointed by the government, which makes recommendations on the process of planning and development of human potential in accordance with public policies in the area of lifelong learning, employment, career guidance and counselling. The council includes decision makers in the education, employment, youth, economy, local self-government and health sectors as well as representatives from social partners, the Chamber of Commerce and Industry of Serbia, the NES, associations of secondary schools and higher education institutions, and civil society

organisations. The council has the power to propose qualification standards for all levels of the NQFS. The government has decided to form 12 sector councils. It has also established the Qualifications Agency, which is in charge of developing qualifications standards, recognising foreign school and higher education documents, and accrediting adult education providers. Serbia therefore has a modern structure for skills governance to co-ordinate and take into account the different views and skills needs of employers, which in principle is the right way to reduce skills mismatches.

Efforts have been undertaken since 2016 to introduce work-based learning elements into VET and the corresponding legislative provisions were completed in 2018 – see Education policy (Dimension 7) for more information. The system is still in its pilot stage and the first evaluation results will become available in 2021 (European Commission, 2019[134]). Efforts should then be undertaken to introduce a quality assurance mechanisms.

Career guidance is being improved as part of the National Employment Action Plan. More efforts are needed to make career guidance gender sensitive in order to reduce gender imbalances in some professions, as well as to develop career guidance for adults.

Participation in **adult learning** is low (European Commission, 2019[134]). According to data from the Adult Education Survey of 2016, 19.8% of adults participated in some type of formal or non-formal education or training in 2016, an increase on 2011, but still well below the EU average of 45.1% (SORS, 2018[137]). Participation in Serbia was higher than in other economies in the region for which information is available (Albania, Bosnia and Herzegovina, and North Macedonia). The participation rate was highest among young adults (25-34), particularly among highly educated urban women. For the most part, training was work-related and performed at work, during working hours and paid for by employers.[61] Almost half of respondents (47%) wanted to participate in adult learning but could not due to the costs of education/ training, family reasons, scheduling (i.e. overlapping with working hours) and lack of suitable training. The Strategy for Education Development in Serbia, adopted in 2012, aimed to increasing the education offer for adults by 2020 (Government of Serbia, n.d.[138]). More efforts are needed to increase participation in continuing training of prime age and older workers, as well as among those who are medium and low-educated, vulnerable groups, and the self-employed. Adult education and lifelong learning opportunities and second chance education for adults are not enough to improve the labour market integration of vulnerable groups. There is little co-ordination between public and private institutions involved in implementing education and training policies for labour market integration and social inclusion (European Commission, 2019[134]).

### *Sub-dimension 8.3: Job quality*

To improve the **quality of earnings**, the Social and Economic Council regularly fixes the minimum wage for workers with standard working hours. Only when the SEC cannot come to an agreement on the level of the minimum wage does the government step in. This has happened in 2018, 2019 and 2020 and has led to an increase in the minimum wage (of 28% over the whole period). The minimum wage is decided on the basis of the social parameters, the minimum consumer basket, the unemployment rate, GDP, retail prices, productivity levels, and average salary trends. In 2019, Albania and Serbia had the highest minimum wage to average wage ratio in the region (WIIW, 2020[139]).[62] Based on information from the MoF and the tax administration, about 12.5% of workers receive the minimum wage. There are clear difference in wages between companies covered by collective agreements and those not covered, according to the government, but there is no statistical analysis or collection of data in this area. Efforts need to be undertaken to make a thorough analysis of wage structure and development and to make the results public. This would also require systematically collecting data on collectively agreed wages from sector- and company-level agreements.

The in-work poverty rate among the self-employed stood at 35.1% in 2017, lower than in 2015, but 12.9 percentage points above the EU average. The self-employed were at a significantly risk of poverty

than employees (6.8% in 2017). This gap may be over-reported, as around 38% of the self-employed worked in the informal sector (in 2016), but nevertheless it is substantially higher than the EU average and points to low earnings in the informal sector. The in-work poverty rate of workers with temporary contracts was 11.2% in 2017, nearly double the rate for those with a permanent contract (5.9%). (Pejin Stokić and Bajec, 2019[140]) (B92, 2018[141]).

There is no co-ordination between the MoF and MoLEVSA over policies on non-wage labour costs, in particular for social security contributions. However, these can have a significant impact on the quality of jobs (e.g. social protection of formal self-employed) and the promotion of formal employment among low earners (e.g. through a lower social security contribution rate). There is apparently also no co-ordination over addressing the tax wedge of low wage earners.[63]

On the **promotion of female employment**, in Serbia, as in Albania, the employment and activity rate gender gap is smaller than in other WB6 economies, but still higher than in EU peer countries (WIIW and World Bank, 2020[125]). Women's employment rates have grown faster than men's, increasing by 9.4 percentage points between 2015 and 2019 for women compared to 7.9 percentage points for men. Informal employment has also declined more among women than men, linked to a decline in employment in the agricultural sector. The employment rate among women aged 15-64 stood at 54.3% in 2019, well above the WB6 average of 42.5%, but still below the EU average of 63.3% (Eurostat, n.d.[118]). Young rural women, in particular from Roma communities, are the most disadvantaged groups in the area of education and access to decent work (World Bank, 2016[142]).

Young women are more likely to enrol in higher education than young men, but the subjects they choose tend to be segregated by gender. Men dominate the fields of informatics and communication technologies (74%) and engineering, manufacturing and civil engineering (63%). Nevertheless, women made up 43% of science, technology, engineering and mathematics (STEM) graduates in 2015 which is higher than the EU average of 33% for that year (Risteska, Memeti and Samardzic Jankova, 2020[143]). Women are over-represented in mathematics, often connected to the objective of becoming a teacher. Access to dual VET in technical fields among female students is promoted in a wide range of technical and mechanical professions but there is no breakdown of enrolment by gender for these courses. Middle-aged, and especially older women are more likely to have low educational attainment than their male peers, so on average women are still more likely not to have completed upper secondary education (35% of women and 23% of men in 2015) (European Commission, 2019[134]).[64]

Gender segregation also characterises the Serbian labour market with women over-represented in some occupational groups, particularly service and sales workers, clerical support workers, professionals and associated professionals, and elementary occupations. Men are significantly more likely than women to work in skilled blue collar jobs, as plant and machine operators and assemblers, as craft workers, and as managers. According to a study conducted by the Centre for Advanced Economic Studies, in Serbia women earn about 11% less than men working in jobs with the same characteristics (education, work experience, profession, industry sector, etc.) (CEVES, 2018[144]). In 2018 the gender gap in monthly average gross earnings was wider for working women with a university degree (19%) than the average for all workers (10%) (SORS, 2018[145]).[65]

Women are still greatly under-represented among entrepreneurs and managers (NALED, 2019[146]). Progress is being made to promote female entrepreneurship. In 2019, a Programme for Supporting and Promoting of Female Innovative Entrepreneurship was established. The programme awards grants, conducts mentoring, offers training in entrepreneurial knowledge and skills, organises lectures, and publicly promotes the experiences of successful female entrepreneurs. In 2019, another entrepreneurship programme was launched with the theme "Economic empowerment of women who have experienced violence in the process of self-employment", targeting vulnerable women.

Women are one of the target groups for Serbia's active labour market programmes and they tend to participate more often then men. However, no assessment has been made to determine which ALMPs work particularly well to address the employment barriers women face.

There was a National Strategy for Gender Equality 2016-20 with an action plan for 2016-18. The evaluation of the plan by UN Women found it had limited success. Based on the lessons from this evaluation, more efforts are needed to deliver gender sensitive formal education, increase public awareness of the significance of gender equality, ensure men and women play more equal roles in parenting and the economy of care and in the area of gender studies (UN Women, n.d.[147]). Childcare services are in short supply, and the number of preschool institutions should be increased (World Bank, 2016[142]).

The Gender Equality Administration was removed in 2014. The situation improved with the establishment of the Department for Antidiscrimination Policy and Promotion of Gender Equality in MoLEVSA on 1 July 2017, with immediate responsibility for monitoring the application of the Law on Equality of Sexes. Employers with more than 50 permanent employees are obliged by law to adopt a plan to remove or mitigate unbalanced gender representation and report on its implementation. These reports form the basis of the ministry's annual report.

While it is important to gather information on companies' activities and to monitor progress, it will also be important to conduct permanent awareness-raising campaigns aimed at reducing discrimination and to have a strategy of gender mainstreaming in all policy fields. MoLEVSA's budget does not allocate any funds to awareness-raising media campaigns, and nor were any donor funds secured for this purpose. However, UNICEF are implementing a project to address gender discrimination in kindergarten and schools. This also includes training of teachers.

### *Sub-dimension 8.4: Activation policies*

Efforts have recently been made to increase the capacity of Serbia's **public employment service,** the NES, by expanding the number of public employment agencies (20 of the 129 offices were established in 2019). However, the number of staff is still too low to effectively implement activation policies. Although most staff are certified employment advisors, in line with the World Bank methodology, each employment counsellor's average caseload was 827, which is well above OECD good practice guidelines and high for the WB6 region. A small caseload is particularly important when finding jobs for hard-to-place jobseekers. In France and Germany for example, employment counsellors have caseloads of around 70 hard-to-place jobseekers each, while caseloads of regular jobseekers may vary between 100 and 350, depending on how much individual guidance they need and how autonomous they are at using self-help tools (OECD, 2015[148]; Manoudi et al., 2014[149]; Pôle emploi, n.d.[150]).

A reform process for the NES was launched in 2015, starting with a feasibility analysis conducted in January 2015 . This recommended expanding the role of employment counsellors, and setting up an integrated IT system. The World Bank also performed a functional analysis of the NES and made a number of recommendations (World Bank, 2017[151]). Based on these assessments, an Action Plan for Optimization in Provision of Public Social Services was set up, including the NES. Its objectives include increasing the placement of unemployed workers in the formal sector, benchmarking and peer learning among employment service offices, and taking contextual factors into account when assessing employment outcomes. Improving the quality of services offered to employers has also been an integral part of NES reform. The amended Law on Employment and Insurance in Case of Unemployment of 2019 extends the coverage of activities of the PES to include employee training programmes.

In its work, the National Employment Service uses documents of the Integrated Management System which determine in detail the individual interviews with job seekers who are registered as unemployed. Individual interviews last between 20 and 60 minutes. An employability assessment is conducted and employability plans established. It is, however, not clear who benefits from a 60-minute interview given the very high caseload and the high incidence of long-term unemployment among registered jobseekers. The

yearly National Employment Action Plan determines the categories of hard-to-employ persons who have priority for participating in ALMPs. A new functional analysis of the NES is planned to prepare the new employment policy strategic framework for 2021-26.

Progress has been made in strengthening the analytical and planning capacities of the NES, particularly for planning training measures. As well as carrying out the skills needs survey (see Sub-dimension 8.2: Skills), the NES also communicates with local governments and uses their investment plans to determine which future skills will be needed. The NES also analyses unfilled vacancies, to understand the circumstances when it was not able to provide a suitable candidate for the job, and the education profiles included in the individual employment plans of the unemployed. Cross-referencing all this information, helps to define a catalogue of training for the unemployed to meet labour market needs.

Serbia has a **mutual obligation framework**. To be eligible for unemployment benefits, a worker must have paid insurance for a minimum of 12 months either continuously or intermittently during the last 18 months. Unemployment benefits are based on previous income and not a fixed amount, as in other WB6 economies. This aligns Serbia with EU good practice. The law prescribes the minimum and maximum amount per month. The payment period ranges from 3 to 12 months, and exceptionally 24 months for people who are less than 2 years from retirement although in principle unemployment benefit schemes should not be used as pre-retirement schemes. Unemployment benefit recipients need to register with the NES. They need to report in person, in accordance with their individual employment plan, at least once every three months and, if necessary, submit a job search diary to their employment counsellor. Unemployment benefit recipients are removed from the unemployment register if they do not comply with the job-search requirement. Monitoring job-search activities every three months is not frequent enough; in the United Kingdom and Australia, for example, fortnightly reporting is required. There seems to be no instrument for soft sanctioning, as implemented in a number of OECD countries.

The existing minimum income scheme does not provide sufficient coverage. Around 3-4% of the population receive social assistance of the equivalent of EUR 69 per month for adults, less for children. The vast majority of recipients are very poor (European Commission, 2019[134]). Recent reforms have strengthened the mutual obligation principle but have not changed benefit levels. Social assistance recipients are referred by Centres of Social Work (CSW) to the NES where the first interview is within 10 days. The CSW may conclude agreements with the beneficiaries of cash social assistance to take active steps to overcome their situation. These impose activities and obligations on the beneficiaries, and their right to social assistance can be reduced or revoked if they do not abide by these obligations without just cause.

Co-operation between the CSW and the NES has improved in recent years, including electronic co-operation and joint thematic meetings, during which all relevant information related to the treatment of people from this category are exchanged. According to the Report on NES Performance Agreement, during the period January-December 2019, 11 565 cash social assistance beneficiaries took part in some type of ALMP or NES activity. Of these, 549 were included in public works measures. In 2017, 105 051 families (257 354 people) received monetary social aid, (Government of Serbia, n.d.[152]). More progress is needed in fostering co-operation at the local level.

A significant number of local self-government units have formed local employment councils (LECs), which jointly, or with technical support provided by NES, implement ALMP measures. Their activities include the activation of social assistance recipients, reducing informal employment and combating discrimination so co-operation with the CSW and NES may become necessary. As LECs play a potentially important role for the labour market integration of vulnerable groups, an assessment of their functioning is recommended.

The number of registered unemployed has been well above the number of unemployed recorded in the Labour Force Survey (LFS).[66] This indicates that people have an incentive to be registered as unemployed or need to register as unemployed, although they may have small jobs (and thus are underemployed), are not searching for work, or have difficulty being available for work (e.g. due to care responsibilities or health issues). Another incentive may be to be covered by health insurance through registration with the NES. It

is therefore important to increase efforts to place vulnerable job seekers into formal employment and ALMPs, implement in-work benefits that would create incentives to move into formal employment, and to offer comprehensive and integrated social and employment services.

Funding for **active labour market programmes** is very low: in 2019 it amounted to 0.07% of GDP, compared to the OECD average of 0.37%, or 0.51% if PES administration and services are included, and thus also counselling (OECD, n.d.[153]; Government of Serbia, 2020, pp. 58, Table 30[154]), despite a significantly lower average unemployment rate. The budgets and number of participants of Serbia's ALMPs are very low, especially, given the high share of those facing severe employment barriers among the registered unemployed. About 28% of the unemployed registered with the NES benefitted from any type of support (EC, 2020[36]). Nearly one-third of the registered unemployed are aged 50 and over, one-third have no formal qualifications, and many have health problems (Government of Serbia, n.d.[130]). About 60% of those unemployed according to LFS data were long-term unemployed in 2019 Q2, below the WB6 average of 66%, but well above the share of long-term unemployment in peer countries such as Austria (26.4%) (WIIW and World Bank, 2020[125]).

The measures provided under the yearly National Action Plan on Employment are mostly one-day services such as job fairs and job-search training, covering around 120 000 participants per year. These measures may be useful but have limited impact on the job prospects for unemployed people. Only around 3% of registered unemployed people have been included in measures such as training, employment and self-employment subsidies or public works. Training measures are mostly for medium and highly educated jobseekers and there are no specific training measures for low-educated adults (European Commission, 2019[134]). A small training programme for low-educated jobseekers was planned for 2020, which would have included 200 participants, but could not be implemented due to the pandemic.

As a result of improved labour market conditions, the number of both registered and LFS unemployed fell by 30% between 2015 and 2019. Although the unemployment rate (10.9% in 2019) was below the regional average of 16.3%, it is nearly double the EU average (6.4%) and the incidence of long-term unemployment is 2.5 times the EU average (Eurostat, n.d.[118]).[67] The past reforms and activities of the NES are unlikely to have had a major impact on reducing unemployment, given counsellors' very high caseloads and the extremely low budget for ALMPs. However, around 32% of those who participated in any type of measure, including very short ones, were in employment six months after completing them, with variations regarding the level of employment barriers they face.

### *Cross-cutting sub-dimension: Informality*

In 2019, 18.2% of Serbia's workers were informally employed. Informal employment is especially pronounced in agriculture (64% of all informally employed).[68] Informally employed women mostly work as unpaid family members while informally employed men are predominantly self-employed. Within the private sector excluding agriculture, the share of informal employed is estimated to be 12%.[69] In recent years, there has been an increase in registered employment in Serbia (+6% between 2016 and 2018). The number of entrepreneurs and their employees and self-employed persons has also increased (12.7%), while the number of registered individual farmers fell by 11.9% (Government of Serbia, n.d.[130]).

Serbia has adopted a National Programme for Countering Grey Economy with an action plan for its implementation covering 2019-20. The objective was to decrease informal employment by 2 percentage points between 2018 and 2020, and to improve the monitoring of the informal economy. The other objectives include improving tax collection, reducing the administrative burden of formal employment, and raising awareness (Box 25.11).

### Box 25.11. Activities to combat informal employment in Serbia

The Law on Simplified Work Engagement for Seasonal Jobs in Certain Areas implemented since 2019 to simplify the employment of seasonal workers in certain activities (e.g. agriculture) introduces a new type of contract, which made it easier to register these workers for social insurance and tax payments. The objective is to reduce informal employment and first results from the labour inspectorates seem promising: Between 2017 and 2019, even though the number of inspections increased, the numbers of undeclared workers they detected decreased.

A "name and shame" approach has been used to raise awareness among employers. Two lists are published and updated weekly on MoLEVSA's website, of employers which have employed informal workers and of workers who have engaged in informal activity.

Source: Information received from the Government of Serbia.

Improvements have been made in the co-operation among agencies to detect informal employment. The Director of the Labour Inspectorate is the president of a working group for combating informal employment, involving a wide range of relevant actors. The working group meets regularly and conducts joint inspections. In 2019, 895 joint and co-ordinated inspections were conducted, mainly in co-operation with the tourist inspection, the tax administration and the Ministry of Interior. Co-operation with the Ministry of Interior over the administration for foreigners is necessary to tackle informal employment among foreigners. These joint inspections detected about 291 undeclared workers and 10 unregistered businesses. An external assessment of the performance of labour inspectorates is recommended. The labour inspectorate has also started a free helpline for citizens who wish to report informal work.

*Cross-cutting sub-dimension: Brain drain*

Emigration from Serbia has been high, although not as high as in some other WB6 economies. About 400 000 people (about 5.5% of the 2016 population) emigrated from Serbia to OECD countries between 2008 and 2016 (IMF, 2019[155]). This trend has continued and in 2018, an estimated 50-70 000 people left the country (WIIW and World Bank, 2020[125]; Bjelotomic, 2019[156]).

The working-age population (15-64 year-olds) has fallen by 10.3% since 2012, driven by population ageing and emigration; while the activity rate increased by 7 percentage points. Labour shortages in some sectors due to continued migration also put pressure on wages (WIIW and World Bank, 2020[125]). The share of young people wanting to emigrate is still high and has been increasing (Lavric, 2021[157]). Employment opportunities and higher earnings are by a long way the main reasons young people emigrate.

An estimation of the costs to the economy of the emigration of young people shows that directly and indirectly, the lost employment has generated an annual loss of gross value added of EUR 897.3 million, which was about 2.1% of Serbia's GDP in 2018 (Government of Serbia, n.d.[130]).

The World Bank LinkedIn Digital Data for Development show that in Serbia, skill losses due to brain drain have mainly affected Internet services, financial services, higher education, research, and international affairs. The five main skills that were lost were dentistry, genetic engineering, development tools, medicine and rehabilitation, and web development (World Bank Group & LinkedIn Corporation, n.d.[158]). In addition Serbia has lost management and cross-cutting skills such as problem solving, time management and oral communication, although less so than in Albania, Bosnia and Herzegovina and North Macedonia (WIIW and World Bank, 2020[125]). Skills shortages also affect a number of crafts and low-skilled activities.[70]

The NES has mediated finding employment abroad for some unemployed people (mainly to Croatia, Germany and Slovenia).[71] It has a bilateral agreement with the German PES. Serbian citizens were predominantly employed in construction, medicine, hospitality and manufacturing. Private employment

services also provide mediation abroad. Individual networks and other job search channels play a major role. In order to protect migrant workers, bilateral agreements on temporary employment have been concluded with a number of countries, including Belarus, Bosnia and Herzegovina, Hungary, Malta, the Russian Federation, and Slovakia.

Recently, the government has adopted a strategy to reduce brain drain. On 27 February 2020, it adopted the Strategy on Economic Migration of the Republic of Serbia 2021-27. The overall objectives are to create an economic and social environment that will slow down the departure of the working-age population, strengthening ties with the diaspora, encouraging returning and circular migration, and attracting foreigners with a variety of education profiles. A public debate on the related draft action plan 2021-23 was conducted in February 2021 (Government of Serbia, n.d.[159]). This strategy looks highly relevant but its impact may take some time to be felt.

### *The way forward for employment policy*

The main efforts needed to advance employment policy relate to strengthening the capacities of government and other actors at national and local level to effectively implement regulations, increase transparency in monitoring working conditions and wages, and deepening labour market analysis. In particular:

- **Increase the capacity of the labour inspectorate to detect informal employment,** including enhancing staff capacities. More efforts are needed to strengthen the role of inspectors to provide health and safety advice in order to prevent injuries and improve working conditions. An efficient monitoring system of the activities of the labour inspectorate is still under construction and it will be essential to implement and use it. The co-operation between various actors should continue to be fostered in order to detect informal employment.
- **Strengthen collective bargaining capacity at sector and company levels, and strengthen worker representation in companies.** The Social and Economic Council should be equipped with basic resources to conduct labour market and sector analysis, as in France (Arkwright et al., 2020[160]) and a number of other European countries. The council should evaluate the impact of minimum wage on poverty reduction and informal employment. A good example is the work of the minimum wage commission in Germany (Box 25.12).

#### Box 25.12. Germany's Minimum Wage Commission

The Minimum Wage Commission in Germany includes members from the scientific community in a consultative role. It has a mandate to constantly evaluate the impact of the minimum wage on the protection of workers, conditions of competition, employment in certain industries and regions, and productivity. The commission presents the results of its evaluation to the Federal Government in a report together with its resolution on adjusting the minimum wage every other year.

Source: (Minimum Wage Commission, n.d.[161]), website, www.mindestlohn-kommission.de/EN/Commission/Commission_node.html.

- **Foster links between universities and employers to ease the transition from universities to work**. Internships should be included in university curricula, in order to improve the employability of young people. Promoting a smooth school-to-work transition may also help to reduce the emigration of young skilled adults. Recent efforts to place young graduates into quality jobs should be continued. Skills development and reducing skill mismatches are also key strategies for reducing informal employment.

- **Promote adult education, especially for low-skilled adults**. This would include providing remedial education as well as linking upskilling measures to the recognition of prior learning (Box 25.13).

### Box 25.13. Adult learning in Portugal

Portugal has developed standards to recognise the skills acquired by adults outside of formal education that are equivalent to those required to obtain an upper secondary diploma. It has hundreds of adult-learning centres across the country with staff dedicated to helping adults undergo such a process. The 303 Qualifica Centres specialise in the provision of adult-learning services. They are operated by various types of institutions, public and private. Qualifica Centres offer information, vocational guidance, and the recognition, validation and certification of skills free of charge. The Qualifica programme promotes participation in training alongside the completion of prior learning and recognition processes.

Source: (OECD, 2019[162]), *OECD Skills Strategy 2019: Skills to Shape a Better Future*, https://doi.org/10.1787/9789264313835-en.

- **Encourage employers to promote continuing training at company level, particularly among middle-skilled employees, to adapt to technological change**. Other countries have provided subsidies to employers, financed study leave, and offered tax credits and individual learning accounts (OECD, 2019[163]). The strategy for adult learning should also include counselling activities for employees and employers, in particular for SMEs (e.g. as done in Portugal through the Qualifica Centres (OECD, 2019[162]). In France, every individual has the right to information, advice and career guidance support. To put this into practice, the Advice for Professional Evolution was launched in 2014, offering free and personalised services (OECD, 2019[162]).
- **Assess and expand the availability of affordable and quality childcare in order to enhance female employment**. More efforts are needed to adapt vocational guidance accordingly and to reduce gender discrimination in companies in order to attract women in non traditional career paths.
- Continue to strengthen the capacities of the NES:
  - **Significantly reduce the caseload of NES staff**, enhance the number of employment counsellors and increase the budget for active labour market programmes.
  - **Continue to strengthen the co-ordination and monitoring of local employment councils**. An assessment of their functioning should be carried out. More efforts should be made to develop integrated approaches and allocate relevant budgets to improve the labour market integration of the most vulnerable groups (e.g. Roma communities, women in rural areas). This would require close co-operation with other key stakeholders at national and local levels. More efforts will be needed beyond job fairs to develop services for employers and to proactively collate vacancies.
  - **Systematically differentiate outcomes (employment) by degree of disadvantage**. Thorough evaluations of ALMPs and their impact on different target groups should be conducted by an external evaluator.

## Science, technology and innovation (Dimension 9)

### *Introduction*

Serbia has made continuous progress in developing its science, technology and innovation (STI) policies, and continues to set the pace for the region. With an overall score of 3.1, it is outperforming its WB6 peers in all three sub-dimensions (Table 25.16) and has continued to improve in all areas, particularly its overall STI system and business-academia linkages.

**Table 25.16. Serbia's scores for science, technology and innovation**

| Dimension | Sub-dimension | Serbia | WB6 average |
|---|---|---|---|
| **Science, technology and innovation dimension** | Sub-dimension 9.1: STI system | 3.4 | 2.4 |
| | Sub-dimension 9.2: Public research system | 2.9 | 2.0 |
| | Sub-dimension 9.3: Business-academia collaboration | 3.0 | 1.6 |
| **Serbia's overall score** | | **3.1** | **2.1** |

### *State of play and key developments*

According to the 2020 European Innovation Scoreboard, Serbia continues to be categorised as a moderate innovator, despite significant improvements compared to 2019 (EIS, 2020[164]). The government recognises the development of STI as a key policy priority, and investment in R&D, albeit from low levels, has increased almost consistently in recent years to 0.89% of GDP in 2019 (RZS, 2021[165]). Since the previous assessment, several policy changes favourable to STI have been implemented. While the impact of the measures developed and implemented is not yet fully evident, they are expected to boost STI activity in the medium to long term.

#### *Sub-dimension 9.1: STI system*

Serbia has an **STI strategy** in the form of the Scientific and Technological Development of the Republic of Serbia – Research for Innovation strategy, adopted in 2016, and the Smart Specialisation Strategy Serbia (4S), adopted in 2020. The preparation of the 4S was aligned with the methodological guidance provided within the S3 Framework for the EU Enlargement and Neighbourhood Region, with the support of the Joint Research Centre. It was based on the identification of economic, innovation and scientific potential, and included the Entrepreneurial Discovery Process which brought together key stakeholders to jointly identify strategic priorities and measures. In 2019, Serbia also adopted a Strategy for the Development of Artificial Intelligence, following comprehensive analysis and stakeholder consultation.

The **institutional framework** for implementing STI policy is overseen by the Ministry of Education, Science and Technological Development, which is responsible for designing policies to support STI and in charge of budget allocations within this area. However, the lack of a fully adopted action plan to implement the strategic framework has somewhat hindered its full and comprehensive execution. MoESTD is supported by the National Council for Science and Technological Development, which provides assistance in inter-ministerial co-ordination and monitoring. Emphasising its commitment and strong focus on developing STI, the government further established a Ministerial Council on IT and innovative entrepreneurship, as well as a minister without portfolio for Innovation and Technological Development. Whilst these measures ensure that STI development remains a priority, overlapping mandates and unclear objectives of the various co-ordination mechanisms somewhat weaken the institutional framework.

The Serbian Innovation Fund remains the key vehicle for implementing the STI policy framework. Established in 2011, the fund now runs several programmes in support of innovation, entrepreneurship, technology transfer and business-academia collaboration, with a budget of EUR 5.5 million in 2019. In response to the unfolding COVID-19 pandemic, the Innovation Fund introduced a new programme aimed

at supporting innovative products and services to fight the pandemic (Box 25.14). The fund's activities are currently funded through both the state budget and donor support, further underlining the government's strong commitment to the innovation agenda.

### Box 25.14. The Innovation Fund at the forefront of Serbia's response to COVID-19

Amid the unfolding COVID-19 pandemic in March 2020, the Innovation Fund launched its own response to counter the crisis. In an ad hoc call for projects, it aimed to identify and support innovative ideas addressing the health and well-being of the population, which had the potential to be scalable and developed quickly and would contribute to combatting the pandemic.

Nearly 300 proposals were received. Given the urgency, the fund's independent panel of experts prioritised those solutions they assessed would be able to produce the most influential, rapid and strategically important response to specific problems. Overall, the fund identified 12 innovative projects, awarding a total amount of approximately EUR 500 000 in support.

Within one month, all 12 proposed solutions were developed and made available for use and the final products and services were donated to organisations and institutions of strategic importance throughout Serbia. These included the first Serbian ventilator, a new type of protective mask with a removable high efficiency particulate air (HEPA) filter for multiple and long-term use, disinfection booths intended for use in public places and locations of interest, a mobile counter for contactless use, temperature measurement and manual disinfection, and portable ozonisers for the fast and safe disinfection of critical objects.

Source: (Serbian Innovation Fund, 2020[166]), Results of the public call for suppression of the effects of the COVID-19 pandemic presented, http://www.inovacionifond.rs/news/results-of-the-public-call-for-suppression-of-the-effects-of-the-covid-19-pandemic-presented0; (Government of the Republic of Serbia, 2020[167]), Support for innovative projects for suppressing effects of COVID-19, https://www.srbija.gov.rs/vest/en/152532/support-for-innovative-projects-for-suppressing-effects-of-covid-19.php.

A key achievement since the last assessment in 2018 has been the establishment of a Science Fund in early 2019 to serve as a technology agency to scientific research. Within its first year of operation, the fund launched five programmes, providing both financing and technical assistance to the research community. These programmes include support to young researchers, artificial intelligence and better leverage of the Serbian diaspora to advance domestic scientific research activities.

The new Science Fund is regulated through the new Law on Science and Research and the Law on the Science Fund, which were both adopted in 2019 and complete Serbia's STI **regulatory framework**. The Patent Law has also been amended twice since the last assessment, in 2018 and 2019, in order to align with the EU *acquis* on intellectual property. The law now also reflects a more balanced approach between the interest of an employer and those of employees who may have created a patent during the course of their employment. This reform of the IPR legal framework is welcome but, amid weak law enforcement, further efforts are needed to protect intellectual property and incentivise the commercialisation of scientific research in line with the European Commission's most recent recommendations (EC, 2020[36]).

Serbia has expanded its engagement in international research activities as **international collaboration** is a key component of its STI policy framework. The new Science Fund is expected to be a key tool to reaching Serbia's diaspora, and Serbia has actively participated in the EU's Horizon2020 framework[72], with over 500 Serbian entities having benefitted, receiving over EUR 144 million in grants to date (EC, n.d.[168]). Equally, Serbia participates in Eureka,[73] and has been a main beneficiary of the Western Balkans Enterprise Development and Innovation Facility (WB EDIF), which has invested in 13 Serbian companies since its inauguration in 2012.

Serbia has continued its **alignment with European STI policies**: the priorities of the European Research Area[74] are reflected in the STI framework and the economy adopted the European Research Infrastructure roadmap in 2018. Serbia is a member of key European research networks and has also adopted EURAXESS's European Charter & Code for Researchers.[75] It facilitates open access initiatives, such as the Open Science Platform to promote science and enhanced access to publications and research data. Serbia has been participating in the EU Innovation Scoreboard since 2012.

### *Sub-dimension 9.2: Public research system*

The new Law on Science and Research establishes excellence in research as a key objective of Serbia's STI framework, while higher education institutes (HEIs) are governed through the Law on Higher Education. HEIs and research and development institutes (RDIs) across Serbia operate relatively autonomously, setting their own research priorities and requiring minimal co-ordination with MoESTD, resulting in a somewhat scattered **institutional structure of the public research system.** RDIs and HEIs undergo regular internal evaluations and some external ones to monitor their performance. However, there is no strategic approach to assessing the performance of public research institutes and it remains unclear whether the results affect public funding availability.

Overall, investment into research in Serbia remains very low at 0.92% of GDP, with only one-third provided by the private sector. Serbia is currently in the process of defining and establishing a new model of financing of research activities. Until recently, **public research funding** has mainly been project-based, but the allocation of funds has not always been transparent or implemented in line with a clear methodology. The Law on Science and Research has a strong focus on reforming the funding model for scientific research, envisaging a clear shift towards performance-based institutional funding in combination with highly competitive project-based financing through the Science Fund. As a result, the Science Fund has a transparent methodology for evaluating projects and follows a two-step review process including the National Council for Science and Technological Development, in line with best practice. However, as it is a relatively new institution, this methodology is yet to be fully tested and evaluated.

The Science Fund is expected to become a key instrument for project-based research funding, with a budget of EUR 4.2 million in 2019, rising to over EUR 7.5 million in 2020, to implement financial support programmes for research. It has already launched a number of programmes, including instruments incentivising closer collaboration between academia and industry (the IDEAS Programme and the Programme to Support the Development of Artificial Intelligence).

A further objective of Serbia's STI strategy is to strengthen **human resources for research and innovation**, amid low capacity of scientific research personnel. The number of full-time researchers has remained relatively constant in recent years (UIS, 2021[169]), while more encouragingly, the number of young people entering research has increased in recent years.

In line with the strategic goal to strengthen human resource capacity in the STI sector, the Science Fund has developed the PROMIS Programme which provides young researchers with financial support to initiate research programmes early in their careers, which has triggered high interest. A second programme is the Collaboration Programme with the Serbian Scientific Diaspora, which aims to foster mobility among researches and provides vouchers to facilitate short-term study visits and collaboration between Serbian research institutes and the diaspora. In addition to these programmes, MoESTD makes scholarships available for doctoral research, co-finances researchers to participate in conferences or professional training, and offers incentives to Serbian researchers returning to Serbia to continue their careers.

### *Sub-dimension 9.3: Business-academia collaboration*

Serbia's STI policies have identified the need for increased integration of scientific research with the private sector, and have put a number of mechanisms in place. The **collaboration promotion framework**

envisaged under the Science and Innovation Strategy encourages the commercialisation of IP, the introduction of technology transfer services, and an extended support infrastructure and financing programmes to encourage collaboration between businesses and academia. However, there is no evidence of a clear roadmap to implement a comprehensive framework. The measures predominately focus on building an STI-conducive infrastructure, awareness raising and visibility, and providing financial support to encourage more engagement of the private sector with RDIs through the Innovation Fund and Science Fund. Although support is extensive and covers a wide range of areas, there are currently no measures in place to encourage technology extension. As the new Law on Science and Research begins to address wide-ranging reform in the governance and funding of public research, more concrete steps to enhance public-private sector research may be expected. The revised intellectual property legislation also favours academia-industry collaboration, covering both research in RDIs, universities and in-company research, and guaranteeing an equal split of proceeds from commercialised IP between the organisation holding the IP and its creator. In 2019, the fees for patents or trademarks were also significantly reduced.

The Innovation Fund remains Serbia's key instrument offering **financial incentives for business-academia collaboration**. In 2016, the fund introduced a collaborative grant scheme, a dedicated finance programme to encourage businesses and RDIs to engage in joint technological projects with a promising business model and commercialisation strategy. Since 2017, the fund has also been offering innovation voucher to SMEs, financing up to 80% of technical research services provided by RDIs that they may need in order to develop or improve their products and services. The fund also runs a technology transfer facility, providing support to RDIs for commercialisation. Companies that evidently support research and development or hire qualified researchers are also eligible for tax relief.

While the focus on financial support has been strong, less attention has been paid to date to developing **non-financial incentives** for business-academia collaboration. To enhance exchanges between researchers and the private sector, the government actively encourages exchanges, sabbaticals or research leave, though there is no evidence of a systematic approach to facilitate these measures. Researchers continue to be primarily evaluated against publication in scientific journals, citations and patents. However, factors such as engagement with the private sector or the impact of research are increasingly being considered, thereby encouraging researchers to engage with businesses. The number of Serbian researchers' successfully participating in the Marie Skłodowska-Curie Actions[76] has increased steadily over recent years, reaching a total of 246 since 2014.

Lastly, Serbia has invested greatly in expanding its **institutional support for collaboration.** Serbia now has four science and technology parks, most notably the one in Belgrade, which has attracted a large number of start-ups since it started in 2016 and also hosts the Innovation Fund. Further efforts need to be made to boost the parks beyond their capacity as incubators. The number of Centres of Excellence has also increased in recent years. There are currently 21 centres, as well as a number of largely self-sufficient technology institutes operating out of Serbia's more urban areas. All major universities have established technology transfer offices, although, these remain largely under-resourced.

### *The way forward for science, technology and innovation*

Serbia continues to make good progress in developing its science, technology and innovation. It has built the momentum to introduce several key measures, in line with international best practice and often adequately funded. However, several challenges remain in building capacity of the public scientific research system and increasing overall investment in research and development, particularly through the private sector. Such challenges may be addressed by implementing the following measures:

- **Further strengthen the Science Fund**. Following its successful launch in 2019, the momentum should be maintained to further strengthen the agency's capacity and outreach. Political commitment will be needed to fully implement the reformed scientific research funding model. Close monitoring of the its activities and impact will help to optimise operations, where applicable.

- **Implement the action plan of the Smart Specialisation strategy**. Empowering the National Council for Science and Technological Development with a clear mandate to lead and oversee its implementation, in combination with the Strategy on Artificial Intelligence, will ensure comprehensive and well-timed execution.
- **Increase investment in R&D** .The continuing allocation of state budget to the Innovation Fund is an important signal of the government's commitment to the STI agenda. However, further investments are needed to strengthen capacity of the public scientific research sector and attract private sector participation.
- **Build capacity for better enforcement of intellectual property protection**. Building on initial efforts, Serbia should continue raising awareness about the importance and benefits of IP protection and strengthen the capacity of the IP Office to provide support in patent application. Judicial expertise in IP should be strengthened.
- **Stimulate more intense co-operation between industry and academia**, by transforming the existing institutional innovation ecosystem to become a genuine interlocutor for academic research and private sector needs.

## Digital society (Dimension 10)

### *Introduction*

Table 25.17 shows Serbia's scores for five digital society sub-dimensions and compares them to the Western Balkan average. The economy scores above average across all sub-dimensions and ranks first among the WB6 in use, jobs, society and trust. It, however, scores close to average for access, which mainly reflects the need for further efforts in improving the ICT regulatory policy framework. Digitalisation has been recognised as a powerful enabler of economic growth and, together with education, is a key priorities of the Serbian government. Serbia has adopted a strategy that promotes artificial intelligence as one of the areas with the greatest potential to contribute to these priorities. In the last three years, it has intensified its public administration reform efforts and digitalisation of government services, which is already reflected in increasing users' satisfaction. Serbia is ranked 59th out of 193 economies in the United Nations e-Government Survey 2020 (United Nations, 2020[170]). It has also made progress in aligning its education system with labour market needs, with special emphasis on digital skills development.

Serbia is the strongest of the WB6 economies in supporting the fastest growing sector in its economy, ICT. Information and communication technologies accounted for 4.9% of GDP in 2019 and generates international visibility for the Serbian economy (SORS, 2019[171]). During 2019, exports of ICT services grew by over 20% for the fifth consecutive year (Government of the Republic of Serbia, 2020[172]). Serbia also ranks 13th among 129 economies in the 2019 Global Innovation Index for the ICT services exports sub-index (Cornell University, INSEAD and WIPO, 2019[173]). However, although the government is readily adopting new digital society policies, regulatory impact assessments (RIAs) are not sufficiently systematised and the policy design process is not always informed by regular policy and programme reviews.

**Table 25.17. Serbia's scores for digital society**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Digital society dimension** | Sub-dimension 10.1: Access | 3.0 | 2.9 |
| | Sub-dimension 10.2: Use | 3.5 | 2.4 |
| | Sub-dimension 10.3: Jobs | 3.0 | 2.3 |
| | Sub-dimension 10.4: Society | 3.5 | 2.1 |
| | Sub-dimension 10.5: Trust | 2.7 | 2.2 |
| **Serbia's overall score** | | **3.0** | **2.4** |

### *State of play and key developments*

#### *Sub-dimension 10.1: Access*

During 2018, the Serbian government adopted the Strategy for the Development of New Generation Networks by 2023, as its economy-wide **broadband infrastructure** development framework, but a budgeted action plan was never adopted. The strategy is aligned with the overall digital strategy and prioritises the development of cloud computing, the "Internet of Things" and 5G mobile systems, but the lack of dedicated funding has limited its implementation. The Law on Broadband Development that would provide an effective ICT-sector investment framework is still being prepared. The existing framework provides weak incentives for private sector broadband infrastructure investments. Continuing obstacles include unregulated issues and the pending reform of the Law on Planning and Construction which would improve the investment environment for joint construction projects and reduce the costs of developing broadband network infrastructure. Although a Broadband Competence Office has been part of the Ministry of Trade, Tourism and Telecommunications since 2017, its direct effect on the co-ordination of different levels of the government is not yet evident.

Broadband connectivity and penetration are steadily rising. Fixed broadband penetration (i.e. number of subscriptions per 100 inhabitants) was 18.5% in 2019, up from 17.4% in 2018, but still lagging behind European countries and also some of neighbouring economies, like Montenegro (28.5%) and Bosnia and Herzegovina (23.6%) (ITU, 2019[174]). According to 2020 statistics, 81% of households in Serbia have some type of connection to the Internet, compared to 91% in the EU (Eurostat, 2021[175]). Revenues from electronic communications continue to rise, reaching 3.8% of GDP in 2019 (RATEL, 2020[176]). Despite market growth, new generation network (NGN) coverage in rural and remote areas has not been expanding.

In June 2020, the government announced the launch of a new programme for rural broadband development, promising to deliver high-speed affordable communications to more than half a million households in rural areas. The programme aims to use loans provided by the EBRD to support private sector investments in scarcely populated areas, where investment interest in the development of NGNs is limited. During the first phase of the project, in spring 2021, broadband infrastructure development will gradually enable access to high-speed Internet of 100 Mbps for 90 000 households in rural settlements. The project will support the deployment of mid-mile fibre broadband, connecting the existing fibre backbone to 600 schools in white zones[77] in rural areas (EBRD, 2020[177]). The project is part of a larger initiative; the second phase, targeting around 900 schools, is planned as a separate project for 2021/22.

Significant progress has also been made in completing Serbia's broadband mapping exercise. The national regulatory agency, the Regulatory Agency for Electronic Communications and Postal Services (RATEL) has implemented a structured, geo-referenced broadband infrastructure mapping application and database that includes cables, antennas and other electronic communications equipment. Its future plans include extending this map to reference all electronic communications infrastructure and to integrate information about infrastructure from other sectors, such as the power distribution network.

Serbia has made limited progress since 2018 in completing the alignment of its ICT **regulatory policy framework** with the EU *acquis*. The new Law on Electronic Communications, expected to partially align with the EU Directive 2018/1972 on Electronic Communications Code and to remove any remaining misalignments with the EU 2009 regulatory framework, has been under preparation since the previous assessment and is expected to be adopted by the end of 2021. RATEL is well staffed and performs regular monitoring of the market and reviews of regulatory policy outcomes.[78] However, the regulator's financial and operational independence has been challenged by concerns about insufficient transparency in enforcing regulations to secure competitive safeguards in favour of the state-owned operator, Telekom Srbija. Despite relevant European Commission's recommendations, no action has been taken to improve this situation so far (EC, 2020[36]).

Regulatory impact assessments are implemented on new regulatory proposals, but their outcomes are not publicly accessible on line. EU Directive 2014/61/EU on measures to reduce the cost of deploying high-speed electronic communications networks, which would boost network infrastructure investment, hasn't yet been transposed. With no major regulations adopted since 2018, the regulator's market overview report for 2019 indicates that although all three mobile network operators have around 97% population LTE coverage, territorial coverage still ranges between 72% and 78% (RATEL, 2020[176]). In April 2019, Serbia signed the Western Balkan Regional Roaming Agreement, paving the way towards eliminating roaming charges within the region.

The framework for **data accessibility** has advanced significantly since 2018 through newly adopted or updated legislation on the accessibility, transparency and openness of data. This included the Law on e-Government that obliges government bodies to ensure reuse of their data, acting as an initial adjustment of national legislation to meet the EU Public Sector Information (PSI) Directive.[79] A by-law on the detailed conditions for creating and maintaining a web presentation of government bodies, which was adopted in 2018, defines the standards for publishing data and information in machine readable format. During 2018, Serbia adopted a series of other by-laws and regulations, such as the regulation on the operation of the

Open Data Portal and the by-law on the manner of keeping the Metaregister. The Open Data Portal,[80] launched in 2017, contained 273 open data sets published by 58 governmental and non-governmental organizations by the middle of 2020. The Office for IT and e-Government (ITE) co-ordinates the implementation of the data accessibility framework among government bodies and public institutions and monitors their compliance with e-accessibility standards and web presentation.

### *Sub-dimension 10.2: Use*

Serbia has made notable progress in **digital government** development in the last two years, with the adoption of important e-government legislation and programmes demonstrating that digitalisation is a top priority. The new digital government framework includes the Law on e-Government, adopted in April 2018, the Program for e-Government Development 2020-22, adopted in June 2020, and relevant secondary legislation that promotes the digitalisation of public administration and the development of electronic services on the e-government portal. The framework stipulates continuous improvement of legal and regulatory aspects of public administration and it is also in line with the economy's commitments under the Open Government Partnership[81] (OGP) action plan. Serbia also adopted the Artificial Intelligence (AI) Strategy in 2019, and the action plan for its implementation in June 2020, aiming to investigate the integration of AI technologies into e-government services, making it a front runner in this area in the Western Balkans region.

Given the cross-sectoral nature of digital government, the framework prescribes the creation of horizontal co-ordination mechanisms, including the ITE and the e-Government Coordination Council. The ITE is a key body in the policy governance structure, and is specifically engaged in the design, planning and implementation of related ICT systems. The ITE is also in charge of the Government Data Centre and the use of cloud technologies in e-government. The e-Government Coordination Council monitors and reports on the implementation of the Program for e-Government Development. In an effort to demonstrate progress and increase public access to programme outputs, the Ministry of Public Administration and Local Self-Government has created an online tool for monitoring the progress of the Public Administration Reform Strategy process, which provides data, statistics and reports regarding the implementation of the strategy's 2018-22 action plan.[82] By the end of 2020, the platform reported that 47% of planned activities had been implemented. The ministry has also leveraged donor co-financing to support the reforms through several projects outlined on its website.[83]

Over 1 million of Serbia's 7 million citizens have used the e-government portal[84] so far. Although citizen engagement is not yet as high as desired, the Program for e-Government Development aims to strengthen users' trust and improve their experience in using digital government services. Serbia is currently designing a more modern e-government portal and developing an e-participation module. The portal currently offers services provided by 20 state and 6 local authorities, including in areas of health, education and employment. "My First Salary" programme, subsidizing the first work experience of young graduates, is also accessible on the portal and implemented in a fully digital process, supported by an AI recommendation algorithm to match candidates and vacancies (OECD, 2020[178]). During the COVID-19 pandemic, the ITE and the Health Insurance Fund developed a service on the e-government portal that allows citizens to receive email and text notifications, when their COVID-19 test result is ready. In other cases, however, the services on offer only allow applications to be submitted or appointments scheduled, rather than entire administrative procedures to be completed on line.

Serbia has actively supported **private sector ICT adoption** since 2018, integrating relevant measures into a number of digital society policy documents. Leveraging e-commerce to boost the adoption of ICT, the government adopted the Programme for e-Commerce Development 2019-20 with an action plan, which includes incentives for e-traders (e.g. tax relief), awareness-raising activities promoting e-commerce development and consumers' trust, and measures to improve e-commerce legislation, logistics and financial infrastructure for e-commerce. The programme targets SMEs in all sectors, particularly focusing

on companies with limited IT capacities and those making unregistered (informal) online sales through social media or other channels. It provides training, mentoring and guidelines for e-traders[85] and supports those who wish to start registered online sales, contributing to the reduction of the online grey economy.

The use of ICT to modernise business operations in all branches of the economy is also an integral part of the action plan for the implementation of the Strategy for the Development of Information Technology (IT) Industry 2017-20. This strategy provides schemes to support companies, including consulting services to help them incorporate ICT solutions into their business practices and financial support for purchasing the necessary software or hardware equipment.

The government has not always fully budgeted awareness raising and training activities linked to these policies, but they have been supported by donors and the Chamber of Commerce and Industry in Serbia. The chamber continues to play a pivotal role in activities promoting private sector ICT adoption. Its key initiative, in collaboration with the MTTT, was establishing the Centre for Digital Transformation (CDT) in 2018, as a service unit that provides SMEs with hands-on support and information sharing on technical and funding issues, consulting, and training on digitalisation. The CDT is also focused on promoting the use of technological innovation across industries, providing qualitative analysis, and recording the current state of affairs regarding digitalisation in Serbian enterprises.

The CDT and the Development Agency of Serbia were supported by the German Organization for International Cooperation (GIZ) to implement the MSMEs 2019-2020 Digital Transformation Support Programme[86] for business digitalisation. Their efforts were continued and intensified during 2020 to address the adverse effect of the COVID-19 pandemic on micro, small and medium-sized enterprises (MSMEs), through two emergency support programs, SPEED 1.0 and SPEED 2.0, offering cost-free support to companies and helping them improve their business in line with digital trends and switch to remote work and online operations with customers and suppliers (WB6 CIF, 2020[179]). The MSME digitalisation programme has supported more than 700 companies so far in Serbia and Republika Srpska in Bosnia and Herzegovina.

### *Sub-dimension 10.3: Jobs*

Serbia has strengthened its policy framework on the development of **digital skills for students** since the last assessment in 2018. In 2020, it adopted the Strategy for Digital Skills Development 2020-24,[87] but without a budgeted action plan so far. The strategy and with the Law on the Education System Foundations from 2017, create positive conditions and align the policy framework with international standards for the development of basic and more advanced digital skills for students at all levels of the education system. Although there is no common digital competence framework for students, a certain level of digital skills is obligatory in pre-university education and is assessed according to the national rulebook. Computer information systems was introduced as a mandatory course for all students starting from Grade 5 of primary school, and the curricula are designed in consultation with the IT industry stakeholders. The number of specialised IT classes was also increased in the gymnasiums (secondary schools), while teachers working with specialised IT classes attend additional training. At the request of industry and parents, new digital skills profiles have been introduced for students at VET secondary schools, according to a dual VET system. Box 25.15 gives an example of the use of innovative methods to promote digital skills among students in Serbia.

### Box 25.15. Innovative teaching and learning to develop students' digital skills

In 2018, in order to improve teaching at tertiary education faculties in Serbia and to promote digital skills for students with innovative courses and teaching methods, a public call for ideas was held. Professors were invited to submit ideas for innovative programmes, and 166 teams of professors responded, of which 66 were selected to implement their ideas. The teams received funding ranging from RSD 250 000 to RSD 1 million (around EUR 8 500). When selecting projects, particular emphasis was placed on the degree to which they increase the use of information technology in the teaching and learning process, as well as how far they followed market needs and developed students' entrepreneurship skills and co-operation with other stakeholders in the local community.

Source: (Council for Innovative Entrepreneurship and Information Technologies, 2019[180]), Priority Measures and Activities of the Government Bodies for Enhancement of the IT Sector in Serbia in 2019, with Report for 2018, https://www.srbija.gov.rs/tekst/en/137375/plan-for-the-it-sector-improvement.php.

During the COVID-19 pandemic, MoESTD, in collaboration with ITE (which provided technical support and hosting), set-up a Moodle learning management system called My School. MoESTD manages the My School portal, but from the very beginning of the use of distance learning during the pandemic, the rich digital content on the portal has been contributed by primary and secondary teachers of all subjects on a voluntary basis. MoESTD is planning to make My School the national platform for e-learning management.

Although 95% of schools are reported to have the computer equipment needed to implement computer science teaching, digital skills' development in the education system is hampered by outdated computers and ICT equipment, low computer-to-student ratio (0.3 in 2018, compared to 0.81 in the EU) and limited connectivity speeds outside the main urban centres (OECD, 2020[181]). In efforts to improve the digitalisation of teaching, 10 000 laptops have been delivered to school classrooms since 2018. The MTTT also launched the Connected Schools project in 2019 to provide Internet access in primary and secondary schools. So far, around 1 600 schools have been connected to the Academic Network of Serbia (AMRES) and another 400 schools were provided with wireless connectivity. The project aimed to deliver wireless local area network (WLAN) connectivity to an additional 500 schools by the end of 2020 and connect all remaining schools (over 4 000 main and remote facilities) by the end of 2021, provided that technical requirements for WLAN rollout are fulfilled, as part of the rural broadband rollout project supported by the EBRD (see Sub-dimension 10.1: Access). According to the MTTT, approximately 92% of primary and secondary schools had a broadband connection of 10 Mbps or more by mid-2020.

Serbia is developing a strong framework for **digital skills for adults** to address the needs of the labour market through the Digital Skills Development Strategy 2020-24. The strategy was informed by a variety of stakeholders, and particularly the ICT industry, due to their growing demand for highly skilled ICT professionals. The strategy prioritises basic digital skills development for all citizens, including marginalised groups, and digital skills for the workplace, as well as training programmes for the unemployed. However, its implementation has not yet started[88] and the expected co-ordination mechanisms, like the local coalitions for the development of digital skills that ensure participation of various stakeholders in curriculum development for IT training programmes, are yet to be established.

The establishment of the Agency for Qualifications and the Sector Skills Councils in 2018 were steps towards bridging the identified skills' gaps. During 2019, the councils started to provide information about the needs of users and the labour market and to propose the list of qualifications by levels and types. MoESTD also published a revised Digital Competence Framework – Teacher for a Digital Age 2019 to help teachers integrate digital content into their practice. However, the European Commission has flagged the lack of systematic teacher training to support the implementation of new curricula and the development of students' key competencies, and outdated VET qualifications (EC, 2020[36]).

The conditions for non-formal adult learning in Serbia are outlined in the Law on Adult Education and the Law on the National Qualifications Framework. The Centre for Accrediting Publicly Recognised Adult Education Providers, part of the Agency for Qualifications, enables the accreditation of training programmes. The by-law on accreditation makes specific reference to digital skills for adults and requires all ICT-related non-formal adult education programmes to align with European Computing Driving Licence (ECDL) standards. Vocational qualifications are recognised from a lifelong learning perspective and trainees are certified according to the Law on Adult Education. The Centre for Vocational and Adult Education, part of the Institute for the Improvement of Education, is the body focused on the development of adult education programmes.

The action plan of the National Employment Service for 2018 also includes IT training within the government's IT requalification programme. During 2018, the NES organised specialist IT training for 778 participants in various cities in Serbia that covered programming and web applications (250-400 hours each) and internships with companies. The government also adopted the Programme for Enhancing Women in ICT for the period 2019-20 to increase digital literacy and competencies among women in rural areas to help them start their own business on line.

**ICT sector promotion** is supported by a number of sectoral and cross-cutting policies that promote the growth and internationalisation of Serbian ICT companies. ICT sector exports have grown constantly over the last decade and the average salary in the sector is more than twice as high as in other industries, while Each ICT sector job is claimed to create an additional 4-5 jobs in other sectors (Council for Innovative Entrepreneurship and Information Technologies, 2019[180]). The advanced implementation of the Strategy for Development of Information Technology Industry 2017-20 underpins these positive trends. The strategy reached the end of its term and an impact assessment is expected, but a new strategy is currently being developed. The government devoted resources and high-level co-ordination to its implementation, demonstrating clear recognition of the sector's contribution to the economy. For instance, the Office of the Prime Minister provides a strategical overview and initiates policy changes for the ICT sector. The Prime Minister is also the president of the Council for Innovative Entrepreneurship and Information Technology, where ministers, academia representatives, and the Governor of the National Bank of Serbia participate as council members.

Most major global IT companies have established development centres in Serbia or outsourced services to local IT companies. The 2019 Global Innovation Index report ranked Serbia on 21st out of 129 economies, in mobile applications development (Cornell University, INSEAD and WIPO, 2019[173]). However, the IT industry is interested in rebranding Serbia from an outsourcing destination to a world-class centre for innovation. The majority of financial instruments and policy programme measures for ICT Sector promotion focus on innovation support and exports of products and services. UNDP Serbia funded a programme for improving business capacity in the IT sector in co-operation with the Office of the Prime Minister and the ITE. The programme supported the transfer of business knowledge for innovative product development and better positioning of the domestic IT industry and its products in the global market.[89] The ICT industry can also use financial instruments and programmes, not specific to ICT, including tax incentives for R&D and start-ups, funding for innovation activities (e.g. provided by the Innovation Fund), and support for internationalisation provided by the Development Agency of Serbia.

### *Sub-dimension 10.4: Society*

Serbia has made positive progress in improving its **digital inclusion policy** framework through the digitalisation of public administration, while plans to empower citizens through digital skills and rural broadband development should help reduce the digital divide in the immediate future. Digital inclusion measures have been included in a number of policy documents on e-government development, broadband infrastructure development and education reform since 2018, but in some cases the relevant activities are not prioritised in action plans or resources are insufficient. The Ministry of Labour, Employment, Veterans

and Social Affairs has adopted strategies for people with disabilities and protecting children from violence that include measures for digital inclusion through access to information and safety on line, starting implementation in 2020. The Social Inclusion and Poverty Reduction Unit (SIPRU) provides strong co-ordination of the implementation of the digital inclusion framework at the highest level of government and across public institutions. The SIPRU publishes a report on digital inclusion every four years, but despite these efforts, the monitoring of indicators is insufficiently systematised and dispersed among the government bodies implementing the various programmes (Government of Serbia, 2019[182]). E-accessibility guidelines in line with international standards are applied to public sector websites, as discussed in Sub-dimension 10.1: Access.

The single electronic register of Serbian citizens and the eZUP information system (i.e. the Government Service Bus) delivers government-to-government (G2G) services. This eliminates the need for citizens to engage in gathering documents from different public services, advancing inclusion through digital technologies. Its effect is particularly evident in remote and underdeveloped areas, saving citizens time and resources when accessing public services. The recently launched rural broadband development programme and the ongoing implementation of the NGN strategy (see Sub-dimension 10.1: AccessSub-dimension 10.1: Access) aim to bridge the digital divide by providing free access to the Internet in public places in remote areas and ensuring that affordable services are available to all citizens throughout Serbia.

Significant regulatory changes are also planned for digital inclusion in education, including the Regulation for the Activity of Resource Centres for Assistive Technologies (supporting schools to provide inclusive education), and the Regulation for Distance Learning and the rigorous application of the instructions for the development of teaching materials in line with the universal design principle. The MTTT has supported numerous projects, co-financed through international co-operation programmes and civil society initiatives, in online safety, protection from digital violence and support for increasing digital literacy among vulnerable groups. The Programme for Enhancing Women in ICT for the period 2019-20, raising the digital competencies of women in rural areas is one successful example.

### *Sub-dimension 10.5: Trust*

Serbia has taken steps to improve the framework for **privacy protections** through the new Law on Personal Data Protection (PDP) in August 2019, which partly transposes the EU General Data Protection Regulation (GDPR) 2016/679 and the Police Directive[90] (EU) 2016/680 into national law. Eight by-laws aligned with the new PDP Law were adopted in 2019, but the framework requires further attention for full alignment with the GDPR (e.g. on restrictions imposed on data subjects' rights), as well as in harmonising outdated sectoral laws. The Ministry of Justice had planned relevant activity for the last quarter of 2020.

However, enforcement of the framework and capacity among public officials is rather weak. A new Commissioner for Information of Public Importance and Personal Data Protection was appointed in July 2019, after seven months of temporary governance, but obstacles to exercising the rights of the commissioner and enforcing decisions persist, especially with regards to the Law on Free Access to Information of Public Importance, which is provides a weak legal framework.[91] On a positive note, in January 2021, the Ministry of State Administration and Local Self-Government has formed a working group to amend this law, including the commissioner as a member. The National Assembly also considered the commissioner's annual report for 2018[92] (for the first time since 2014) and adopted certain conclusions to strengthen the enforcement of the framework; however most of these have not been implemented (Commissioner for Information of Public Importance and Personal Data Protection, 2020[183]).

Neither digital and online privacy protections, nor public information disclosure and transparency, are yet embedded in public sector mindsets in Serbia. Even the final text of the new PDP Law regarding data subjects' rights includes an article listing limitations to these rights, omitting the original text that stated they could only be restricted by law. This would mean that state institutions or private companies processing citizens' personal data could arbitrarily restrict their rights as data subjects. The law also fails

to cover video surveillance, a particularly important aspect of personal data processing. The installation of smart video surveillance in Belgrade is indicative of this climate. The installation includes thousands of cameras and face-recognition software that raised public concern, and analysis by civil society organisations found it was breaching the new PDP law. The commissioner has also ruled that the assessment of the impact of processing on personal data protection using video surveillance system submitted by the Ministry of Interior was not done in accordance with the PDP Law (Commissioner for Information of Public Importance and Personal Data Protection, 2019[184]).

Serbia has demonstrated its intention to improve **consumer protection in e-commerce** and to align the framework to international practices and standards**.** The government adopted a new Strategy for Consumer Protection for 2019-24 and an action plan for 2019-22. It also amended the Law on e-Commerce and adopted a new Law on Trade in 2019. A specialised donor-funded Programme for e-Commerce Development was launched in 2019 to address obstacles to e-commerce development. The first positive achievement was the publication of a Guide to e-Commerce, and relevant web services for consumers,[93] delivered by the Department for Digital Agenda Development in the MTTT. The MTTT's Consumer Protection Department enforces the law and maintains the National Register of Consumer Complaints. The ministry also conducted a public awareness campaign to boost consumers' trust in e-commerce, and to promote the safety of e-banking and card payments. It also implemented the EU-funded Twinning project[94] (2017-19), to improve public sector capacity to protect consumers using e-commerce.

The improved framework for **digital security risk management** is also gradually increasing levels of trust in electronic services and information systems in Serbia. The recent adoption of the new Strategy for the Fight Against Cybercrime 2019-23 complements the implementation of the Information Security Strategy 2017-20, which has led to significant improvements in the relevant legislation since 2017. The government has sufficient resources and capacity to implement these strategies and continues capacity building in methods and tools for combating cybercrime. The Body for Coordination of Information Security Affairs provides horizontal co-ordination among public bodies involved in digital security risk management.

The national computer emergency response team (CERT) operates as a unit of RATEL and has been accredited according to international standards since 2019. Its human resources remain very low, due to continuing restrictions on creating new posts in the public sector, despite the amended Law on Information Security from 2019 that specifically stipulates increasing human resources for the national CERT. Co-operation with other domestic, public and private sector CERTs is ongoing and capacity building programmes are being implemented for public authorities and businesses. The Serbian competent authorities and the national CERT are actively engaging in international co-operation in the fight against cybercrime. However, although some information security data are being collected through surveys, no regular monitoring of digital risk management indicators is in place.

### *The way forward for digital society*

Despite taking some significant steps to improve its digital society policy framework, the government should pay more attention to the following aspects:

- **Accelerate the adoption of new laws and regulations to ensure an enabling ICT investment framework**, including the new Law on Electronic Communications and the Law on Broadband Development. An improved legal and regulatory framework that aligns with the EU and reduces the cost of developing and sharing broadband network infrastructure will be vital for reaping the benefits of the "gigabit society". The government will need to transpose EU Directive 2018/1972 on Electronic Communications Code and Directive 2014/61/EU on measures to reduce the cost of deploying high-speed electronic communications networks, especially with the launch of its ambitious rural broadband development project in 2021.
- **Strengthen the demand for open data innovation through inclusive co-creation processes to enable re-use of public sector data by the private sector to deliver e-services and**

**applications to citizens**. Although the legal and regulatory framework is advanced, few datasets have been published so far. The general public have not been widely engaged and the level of informed public debate on data-driven issues remains low. The government will need to raise public awareness, build the capacities of public officials and develop public-private partnerships on open data innovation.

- **Systematise the monitoring of digital government indicators to support informed policy making**. Despite making some progress in implementing the digital government framework, and individual external evaluations of the public administration reform process, there is not yet a database of digital government indicators. No public authority is publishing consistent reports on specific measurable indicators.
- **Accelerate the implementation of the Strategy for Digital Skills Development 2020-24** with the development of an action plan and sufficient budget allocation. Although the adoption of the strategy undoubtedly constitutes a positive step forward, specific resources need to be allocated to implementing the measures and activities it includes. Serbia has a realistic opportunity to respond to the need for highly skilled ICT professionals among its IT industry and to effectively rebrand Serbia from an outsourcing destination to a world-class centre for innovation. A regularly updated database of digital skills indicators will also be needed to monitor policy impact.
- **Empower citizens to reap the benefits of digitalisation and monitor progress in digital inclusion**. As digitalisation of government and public services accelerates, it will be important to strengthen digital literacy and digital competency programmes for underprivileged groups of the population, to avoid deepening the digital divide. The SIPRU has developed a set of indicators for e-inclusion, pending implementation within the Unique Register of institutions, specifically referring to information accessibility. This could be augmented with digital inclusion indicators drawn from the fields of electronic communications, education, social protection and online safety and privacy, in collaboration with competent bodies. A systematic, cross-cutting, approach to monitoring digital inclusion indicators would enable regular policy impact assessments and better policy design.
- **Complete the alignment of the framework for personal data protection with the EU and ensure its stronger enforcement**. The government should complete its alignment with the GDPR Directive (EU) 2016/679, update the law on access to information and update or adopt necessary relevant secondary legislation. Combined with public sector capacity building, the ultimate goal of these reforms should be to remove obstacles that reduce the executive power of the Commissioner for Information of Public Importance and Personal Data Protection, improve the voluntary disclosure of information by public institutions, and impose greater transparency and accountability of public authorities without exceptions.

## Transport policy (Dimension 11)

### *Introduction*

Since the last Competitiveness Outlook assessment in 2018, the main improvements Serbia has made have been in procurement and implementation, followed by transport project selection, combined transport and environmental sustainability. It has made moderate progress in rail regulation sector and progress in asset management has stalled. Serbia's performance in the transport policy dimension is the highest in the region and significantly above the WB6 average (Table 25.18) but further efforts are still needed to achieve the EU average level. Serbia scores above the WB6 regional average in all three sub-dimensions of the transport dimension. Serbia shares the lead with Albania for the planning sub-dimension while for the governance and regulation and sustainability, it scores the highest in the WB6 region.

**Table 25.18. Serbia's scores for transport policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Transport policy dimension** | Sub-dimension 11.1: Planning | 3.3 | 2.3 |
| | Sub-dimension 11.2: Governance and regulation | 3.8 | 2.6 |
| | Sub-dimension 11.3: Sustainability | 2.2 | 1.3 |
| **Serbia's overall score** | | **3.0** | **2.0** |

### *State of play and key developments*

#### *Sub-dimension 11.1: Planning*

In the area of **transport vision**, Serbia has continued to follow the Plan of Rail, Road, Inland Waterway, Air and Intermodal Transport Development 2015-20 as the draft National Transport Strategy (NTS) for the period 2016-25 has not yet been approved. The measures needed to improve the transport sector have also been based on the General Transport Master Plan (GTMP) for 2009-27. The GTMP has a clear vision and measurable objectives, including a timeline for implementing the proposed measures. It uses a transport model to prioritise and rank the recommended measured across all transport modes, including intermodal transport, and has defined budgets for both implementation and maintenance. The priority projects presented in the strategy have been adopted for development after wide-ranging consultation with the relevant stakeholders. Multimodality has been considered in all these documents.

The NTS is outdated and the updated version should take into consideration the GTMP and the individual strategies that have since been developed for each transport mode. It should also take into consideration the fact that some municipalities and regions have made significant economic progress, directly influencing transport demand and infrastructure needs. The adoption of the strategic transport documents has not gone smoothly, with some of the documents remaining as drafts and a national strategy still not in place. Serbia's transport-related strategic documents have been aligned with the commission staff working document on EU Enlargement Policy up to 2019.[95] The European Commission issued a new working document in October 2020 (EC, 2020[36]) and, as required in the terms of reference (ToR) for the development of the NTS, it is expected that the new NTS will be fully aligned too.

The development of a new NTS for the period 2022-30[96] is currently under tender, which should include analysis and alignment with the remaining requirements of the EU accession Chapters 14 (Transport policy) and 21 (Trans-European networks). It will therefore directly generate a set of actions and measures that will bring the transport sector closer to European standards and improve regional trade and transport integration.

The existing transport strategies are aligned with the tourism policy to a certain extent as the Master Plan for Marking Touristic Objects in Serbia (Public Enterprise Roads of Serbia, n.d.[185]), and the Rulebook for

Cycle Path Design (Public Enterprise Roads of Serbia, 2012[186]) have been developed and adopted, showing a holistic policy-making approach. A new governance tool[97] from 2020 is expected to facilitate inter-ministerial communication as all ministries can use the same procedure to identify capital projects, and their pre-selection, financing, implementation, monitoring and impact assessment. They will all be co-ordinated through the same procedure by the Ministry of Finance. The degree to which the policy has been implemented is not entirely known as there are no monitoring reports of implemented strategies available. The Republic Commission for Capital Investment was established in 2020, and will be in charge of confirming the pre-selected investments, selecting capital projects based on their relevance, and doing the justification and compliance checks of the funding sources. Some legislation has been adopted (see the individual transport modes below) as a result of the transport strategy but the level of harmonisation with the Transport Community Treaty (TCT) is not available.

The last Competitiveness Outlook recommended co-operation with other WB6 economies to exchange experience on a common approach to transport planning. This has taken place, particularly through the cross-border co-operation programmes (EC, n.d.[187]), projects related to transport facilitation at border crossing points (BCPs) with Montenegro and North Macedonia, and co-operation over the realisation of Bar-Boljare highway along Route 4 (EC, 2015[188]). Co-operation also takes place through participation in EU regional strategies such as the EU Strategy for the Development of the Danube Region (EUSDR, n.d.[189]) and the EU Strategy for the Adriatic and Ionian Region (EUSAIR, n.d.[190]). Such regional co-operation, and exchange of good practices, needs to take place on a regular basis and be intensified, as the proper development of a transport vision and planning can only happen through regular regional discussion, leading to a single and competitive regional transport market.

Since the last assessment, Serbia made excellent progress in developing legislation for **transport project selection** and implementation. The Rulebook on the Management of Capital Projects (Ministry of Finance, 2019[191]) was adopted in 2019 and the Law on Special Procedures for the Implementation of the Project of Construction and Reconstruction of Line Infrastructure Structures of Particular Importance to the Republic of Serbia[98] in 2020. The procedure by which projects are identified, analysed for relevance, pre-selected, funded, implemented, monitored (during and after implementation), and their impact assessed is clear and publicly available (Government of Serbia, n.d.[192]), and co-ordinated by the MoF. The prioritisation process, which is applied to all capital projects, uses, among other criteria, cost-benefit analysis (CBA), environmental and social impact, and safety assessment.

A pre-selection tool has been developed and access to the Public Investment Management Information System is under development, which should improve the efficiency of the monitoring of capital projects. *Ex post* monitoring and impact assessment is to be conducted for all third category projects[99] three years after the completion of works, which is a significant advance on the existing legislation. Serbia also needs carry out regular *ex post* monitoring and impact assessment of its prioritisation and implementation processes (on an annual basis) based on which the prioritisation and implementation framework could be regularly adjusted. The first single project pipeline has been developed but it is neither publicly available nor regularly updated, according to information provided by the government.

There are national guidelines for road transport CBAs, but they are outdated and require either updating or the development of new ones. Up to now, the EU's 2014 CBA guide has been used (EC, 2014[193]). National CBA guidelines should be developed as soon as possible and regularly updated, which will help to prioritise and control funds. The prioritisation framework does not take affordability into account, so the project selection framework should be updated to incorporate affordability, directly assessing whether the projects under consideration are affordable for wider population but also for the economy. The government has the human and financial capacities it needs to carry out the transport project selection process.

In the area of **implementation and procurement**, the new Law on Public Procurement (2019) allows alternative procurement processes for specific groups of projects defined by the implementation strategy (projects funded based on the contracts as a result of international co-operation for which Serbia has to

inform the European Commission, projects funded by international organisations, etc.). The roles and responsibilities of the government bodies involved are defined, including those with oversight of the procurement and monitoring of public-private partnerships. The public enterprises (Public Enterprise Roads of Serbia, Serbian Railways Infrastructure, Serbia Cargo, etc.) with jurisdiction over individual transport modes have adequate human and financial capacity to execute their procurement and implementation tasks.

Horizontal co-operation with other WB6 economies over implementation and procurement is well established and good practice shared and applied where possible, for instance the development of one-stop-shops (OSSs)[100] at the road and railway border crossing points with North Macedonia. Procurement procedures have only been consistently monitored though the regular annual audits conducted by the State Audit Institution (State Audit Institution, n.d.[194]). No exchanges of good practice have taken place related to the lessons learnt from the implementation and procurement of PPP projects in the region.

Serbia is making moderate progress in the development of its **asset management system.**[101] An asset management system is not required by the national legal framework but each public entity needs to have the list of the inventory under its jurisdiction. The key objective of a well-developed asset management system is to provide justification for the maintenance budget and to help to direct limited funds towards those areas where the return on investment will be greatest. A soundly developed system should be considered an integral component of the transport planning, identification, prioritisation, implementation, monitoring and impact assessment processes.

Some efforts have been made in the last few decades to establish an asset management system as presented in the Preparation of Maintenance Plans 2018-2022 for Road/Rail TEN-T indicative extensions to WB6 (CONNECTA, 2018[195])[102] but these have not been successful, although some partial actions have been undertaken since the last assessment. The road sector uses the highway development and management (HDM-4)[103] tool for road maintenance and planning and there are various databases for structures. The data are surveyed occasionally but not regularly updated, mainly due to lack of funds and capacity. The same applies in the railway sector; a railway infrastructure asset management system was tested by Serbian Railways during 2010-13, but no regular monitoring of the condition of railway infrastructure assets has been performed since then. A project to determine the condition of the state road network is in the final stage, while a contract to install 54 road meteorological stations, including software and training on the Road Weather Information System, was signed at the end of 2019. There are ongoing performance-based maintenance contracts (PMBCs) for the maintenance of 3 000 km of roads, while the remaining 12 000 km are maintained though ongoing contracts. If PBMCs were implemented for all roads, this could lead to roads being maintained to predefined conditions at relatively low cost. In 2020, the Serbian Railways Infrastructure adopted a programme for the construction, reconstruction and maintenance of railway infrastructure and organisation and management of rail traffic for 2021-24.

The government will need to make more efforts to follow and implement regional asset management plans. The road asset management system needs to be integrated into the policy framework, becoming the basis for the assessment, operation and maintenance of transport assets in the economy. One very good example, recently established in the region, is Albania's financial management system, which also includes asset values. Other good examples can be found in North Macedonia (road asset database, bridge asset databases, etc.). Co-operation with the Albanian authorities to exchange good practice could be worthwhile in this area.

### *Sub-dimension 11.2: Governance and regulation*

Since the last assessment, reforms have progressed in the field of **aviation regulation**. Serbia has fully transposed the Single European Sky (SES) I package into national law, along with a large number of SES II regulations. In the field of air traffic, Serbia has fully completed the transposition and local implementation of SES I and SES II. Serbia is not a member of any functional airspace block (FAB), which could help it

avoid national fragmentation which in turn affects safety, limits capacity, and above all, adds to costs. On a positive note, Serbia has a similar arrangement to a FAB with Montenegro through the Serbia and Montenegro Air Traffic Services (SMATSA), and has established a free route airspace with Austria, Bosnia and Herzegovina, Croatia, Montenegro, and Slovenia, which reduces fuel consumption and emissions, and improves flight efficiency. The Civil Aviation Directorate (CAD) is Serbia's national supervisory authority[104] and is adequately staffed to fulfil its obligations.

The EU Airport Charges Directive has been transposed.[105] The market is monitored regularly by the CAD as required by the EU Air Service Regulation, which provides the economic framework for air transport on the granting and oversight of operating licences of Community air carriers, market access, airport registration and leasing, public service obligations, traffic distribution between airports, and pricing. An air traffic management plan has been developed and is monitored regularly through the Local Single Sky Implementation Monitoring (EUROCONTROL, 2019[196]). A safety culture, covering safety risk assessment and safety assurance, is being fostered through a State Safety Programme, designed as an integrated set of regulations and activities aiming to improve safety (e.g. safety risk management, safety assurance). The programme adopted by the government is being implemented through the State Safety Plan published by the CAD.

Air traffic is growing in Serbia. The total number of passengers transported from all airports by approximately 13.4% between 2017 and 2019 to 6.4 million passengers, compared with global growth of 4% (IATA, 2020[197]) and EU average growth of 4% (Eurostat, n.d.[198]) over the same period. Given the significant growth of this transport mode and projected importance for the economy, it will be important for Serbia to continue its regulatory reforms and bring the governance of the aviation sector closer to European standards and international good practice.

Serbia has made substantial progress in **rail regulation** since the last assessment. The Third Railway Package (EC, n.d.[199]) of 2007 has been fully transposed while the Fourth Railway Package (EC, n.d.[200]) of 2016 is expected to be transposed by 2022. The Law Amending the Law on Railways is expected to be adopted by the end of 2021. However, the degree of active policy implementation and the implementation of the regional Rail Action Plan (Transport Community, 2020[201]) is not currently available. A Network Statement (NS) is issued only for infrastructure, but includes some data related to service facilities. National legislation[106] has been aligned with the EU Regulation on Access to Service Facilities and Rail-Related Services 2017/2177 since 2019, and therefore the NS will be published as of 2021. EU Interoperability Directive 2016/797 has been transposed and implemented, helping to reach an optimal level of technical harmonisation to facilitate, improve and develop international rail transport services within the EU and with third countries.

The Directorate for Railways is the regulatory body and safety authority, including supervising the implementation of legislation, and has had enough capacity so far. However, the amended Law on Railways (2020) has expanded its remit (cableways, passenger rights, licensing, market regulation, metro, etc.) so it is estimated that it will need additional staff. The market is open to local companies while the opening of the market for foreign companies depends on bilateral agreements and the compliance of the origin country with the EU's Transport Community Treaty (TCT). There are currently two state-owned operators and ten private operators, of which two are responsible for maintenance. This is the largest number of private operators in the region and could serve as a regional good practice example of an open rail market. The National Register of Railway Vehicles has existed since 2013 although the new National Vehicle Register will be transformed in line with EU Commission Implementing Decision 2018/1614 into a centralised registry for European Vehicle Register vehicles. The EU Rail Freight Corridor Regulation has been transposed and the first freight corridor developed: the Alpine-Western Balkan Rail Freight Corridor (going through Austria, Bulgaria, Croatia, Serbia and Slovenia),[107] which will increase the competitiveness of rail against other modes.

Serbia has advanced bilateral co-operation in the railway sector, by signing border crossing agreements with North Macedonia and Montenegro. Since the last assessment, the Ministry of Construction, Transport and Infrastructure has initiated a process to sign or renew border crossing facilitation agreements with all other neighbouring economies (Bulgaria, Croatia, Hungary, Romania, etc.) but this is only in progress with the Government of Croatia, with agreement expected during 2021, while the other economies have been either slow or reluctant to respond.

### Table 25.19. Trends in rail transport of passengers and goods in Serbia (2017 and 2019)

| Rail network utilisation | Change over 2017-19 (%) | 2019 (million) | share of the EU average (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of track) | -14 | 0.085 | 3.9% |
| Freight (tonnes*km/km of track) | -1 | 0.861 | 44.4% |
| Rail network utilisation (train*km/ km of track) | -24 | 0.005 | 22.4% |
| **Rail fleet utilisation** | **Change over 2017-19 (%)** | **2019** | **share of the EU average (2017) (%)** |
| Passengers (passengers*km/train*km) | +39 | 32 | 23.7% |
| Freight (tonnes*km/ train*km) | -22 | 516 | 90.8% |

Source: Inputs provided by the government as part of the quantitative questionnaire (CO2021); (European Commission, 2019[202]); (Statistical Office of the Republic of Serbia, 2021[203])

Road freight transport's mode share is 70%, significantly higher than that of rail, at 24%, and similar to the EU average of 75.3% for road, 18.7% for rail, and 6% for inland waterways in 2018 (Eurostat, n.d.[204]). Rail transport has shown a slight decline (Table 25.19). There is still much to be done[108] to achieve the numbers which will make the rail network cost-effective and achieve rail utilisation levels close to the EU average. Increasing rail's mode share could also have direct positive effects on air pollution and climate change.

In the context of **road market regulation**, good progress has been made, with significant efforts undertaken to harmonise legislation with the TCT. Legislation on the transport of dangerous goods, training of professional drivers, certificates of professional competence, driver's qualification cards, and working times of vehicle crew engaged in road transport and tachographs has been further aligned with TCT requirements.

Serbia continues to participate in the European Conference of Ministers of Transport (OECD-ITF, 2014[205]) multilateral quota system, which enables hauliers to undertake an unlimited number of multilateral freight operations in 43 European countries participating in the system. Its regulations comply with the road haulage qualifications standards for companies, managers and drivers under the Quality Charter for Road Haulage (OECD-ITF, 2015[206]).

Road network performance[109] is regularly measured for some indicators and occasionally for others. There is still space to improve the list of indicators[110] to assess the performance of the road network better. The average age of passenger cars in 2019 was 15.6 years, which is almost 50% higher than the EU average (10.6 years) in 2018 (ACEA, 2019[207]). Such old vehicles can endanger the environment, and the policy instruments controlling vehicle pollution needs to be stricter.

On a positive note, incentives for purchasing new electric vehicles (EVs) have already been implemented, in 2020 (Ministry of Construction, Transport and Infrastructure, n.d.[208]; Paragraf, n.d.[209]; Paragraf, n.d.[210]). The first chargers for electric vehicles on a motorway in Serbia were installed by Public Enterprise Roads of Serbia (PERS) in July 2017 and the list of charging points grows. Serbia still lacks a specific legislative framework for the development of the EV sector, but the policy framework is expected to be drafted when the project A Pathway for Electric Mobility for Belgrade, funded by the World Bank Group, is finalised in June 2021.

The total number of passenger cars that entered Serbia increased by approximately 22% over the period 2017-19 while the total number of freight vehicles crossing the border (including export, import and transit) fell by 3.3% in the same period. Recent trends show an increase in the utilisation of the road network, particularly for the transport of goods (Table 25.20).

### Table 25.20. Trends in road transport of passengers and goods in Serbia (2017 and 2019)

| Road network utilisation | Change over 2017-19 (%) | 2019 (million) | share of the EU28 (2017) (%) |
|---|---|---|---|
| Passengers (passengers*km/km of road) | +4 | 0.328 | 32.8% |
| Freight (tonnes*km/km of road) | +28 | 0.291 | 15% |

Source: Inputs provided by the government as part of the quantitative questionnaire (CO2021); (European Commission, 2019[202]); (Statistical Office of the Republic of Serbia, 2021[203])

Having in mind a high road freight share, which is 70% as mentioned above, the negative effects on air pollution and climate change are obvious, therefore, incentives for shifting freight from road to rail could have a positive impact on reducing air pollution and climate change impact.

The COVID-19 outbreak is affecting the entire transport and mobility market across the world, and the WB6 economies are no exception. In the second quarter of 2020 Serbia introduced measures at border and customs control to enable the provision of essential goods and medical equipment. These consist of "green lane" measures on its major corridors for transporting emergency goods. Passing through these green lane border crossings should not exceed 15 minutes (including any checks and screenings), and so procedures should be minimised and streamlined, etc. In the first quarter of 2020, as part of a joint assignment with four economies along Corridor X (Croatia, Greece, Hungary and North Macedonia), Serbia also started developing technical documentation for the implementation of the pilot electronic border queuing management system (e-QMS), inspired the system in the Baltic countries.[111] It is expected to finalise the documentation during 2021. The system will support the Connectivity Reforms Measure, which aims to create a more competitive, safe and reliable transport system and network, to decrease waiting times at border areas and transfer physical queues to virtual queuing (Transport Community / CEFTA, 2020[211]; Transport Community, 2020[212]; Government of Serbia, 2019[213]). The implementation of these measures could have a direct impact on how the border crossing is treated in the future.

In the area of **inland waterways** (IWWs) Serbia's market regulation legislation has achieved a high level of alignment with the TCT and EU *acquis*, and has been permanently updated with the latest updates since the last assessment. The market access framework is established through the aligned legislation. The national framework on market access to port services and the financial transparency of ports was developed before the adoption of EU Regulation 2017/352, but was already in line with the later regulation. The relevant strategy is the Strategy on the Development of Water Transport (2015-25). This defines clear and measurable objectives, including timelines and budgets for the recommended measures and actions.

A lot of effort has been made to increase IWW transport in recent years, including the privatisation of river ports and incentives for combined transport. The impact is apparent in the current results, with a further increase expected if the measures defined in the strategy are implemented. The total weight of freight transported on IWWs in Serbia increased by 17% in the period 2017-19, to reach 1.7 million tonnes, while the total tonnes*km remained the same at 0.7 million tonnes*km. This represents 6% of total land transport in Serbia (SORS, 2020[214]), the same as the EU average in 2018, while transport on EU inland waterways fell by 10% during 2016-18 (Eurostat, n.d.[215]).

Monitoring indicators to assess the performance of all transport modes are either non-existent, not properly established, or not fully updated. The missing indicators include average user costs, travel time satisfaction levels, value of assets, market research and customer feedback, quality of user information, audit programmes). Data surveys are either not soundly planned (e.g. the purpose, and the level of data needed

have not been planned, or budgets allocated), as they have not yet been planned by the government or not conducted regularly but only for specific projects rather than regular transport infrastructure assessment and planning. Therefore, Serbia lacks the basis for a quality assessment of its transport network performance.

### *Sub-dimension 11.3: Sustainability*

Further efforts are required to improve **road safety** in Serbia even though some progress has been made.[112] There is a Road Traffic Safety Strategy (RTSS) for the period 2015-20 (MCTI, 2015[216]). The Road Traffic Safety Agency has been tasked with preparing a new one for the next decade which will be adopted by the government. The RTSS was not fully aligned with the TCT and EU *acquis* as both the treaty (European Union, 2017[165]) and the new EU policy orientation (European Commission, 2019[217]) were adopted after the RTSS, but the new strategy is expected to be harmonised with both. The development process of the RTSS included consultations with a wide range of stakeholders, some of which were also members of the working group developing the strategy. However, implementation of the road safety framework and corresponding measures remains a concern. The implementation plan contains measurable indicators and the bodies responsible for implementation. The budget for each measure is not provided, but clear information was provided under which budget it is expected to be financed. One important area which has not been well developed is the monitoring of the strategy's implementation, and the process for updating the strategy and legislation based on the resulting monitoring report.

Data on road safety are collected by a government body, the Ministry of the Interior. Road accident data are developed in line with the Common Accident Data Set (CADAS) (EC, 2017[218]). The data are regularly collected and publicly available on the Road Safety Traffic Agency website, under various road safety data categories (e.g. tunnels, bridges, intelligent transport systems equipment, etc.), and on the government's open data portal (Government of Serbia, 2019[219]).

The ongoing EU-funded project Improving Road Safety in Serbia has the goals of improving local communities' traffic safety management capacities, establishing the MAIS3+ (Safety Cube, 2016[220]) scale of injury classification system, and improving road infrastructure management at national and local level. Introducing an improved traffic accident injury classification system will improve the ability of national and local government officials to apply proven road safety tools and to identify and improve the most dangerous sections of state and local roads. There is a need to further strengthen institutional capacities in the field of road safety, particularly enforcement. The human and financial resources of the relevant institutions (Road Safety Traffic Agency, PERS, Transport Ministry, local road traffic safety bodies, etc.) are not adequate for executing their responsibilities, according to information provided by the government.

Serbia has been a member of the International Safety Data and Analysis Group (OECD - ITF, n.d.[221]) since 2016, and could contribute to international co-operation on road accident data and their analysis. The level of implementation of the Regional Road Safety Action Plan (Transport Community, 2020[222]) which has been endorsed by the Ministerial Council of the Transport Community Permanent Secretariat (TCPS) in October 2020, is already on a high level compared to other WB6 economies[113] although slightly more efforts are needed to align local legislation with the Road Safety Action Plan. The number of fatalities per million inhabitants is higher than the average risk from fatalities in EU countries and it is clearly necessary to continue efforts to improve traffic safety in Serbia (Table 25.21).

### Table 25.21. Road safety trends in Serbia (2010-19)

| Road safety trends | 2010-2019 (%) | 2017-2019 (%) | 2019 |
|---|---|---|---|
| Change in the number of fatalities (Serbia) | -19 | -7.8 | 534 |
| Change in the number of fatalities (EU) | -23 | -2.5 | - |
| Number of fatalities per million inhabitants (Serbia) | - | - | 79.1 |
| Number of fatalities per million inhabitants (EU) | - | - | 51 |

Source: EC (2020[223]), *2019 road safety statistics: What is behind the figures?*, https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_1004. (Road Safety Agency, 2020[224]), *Statistical Report on the Status of Road Safety in the Republic of Serbia for 2019*, https://www.abs.gov.rs/admin/upload/documents/20200813084936--izvestaj-o-stanju-bezbednosti-saobracaja-u-republici-srbiji-u-2019.-godini.pdf. (Government of Serbia, 2019[219]), *Open Data Portal - Data on traffic accidents by police administration and municipality, https://data.gov.rs/sr/datasets/podatsi-o-saobratshajnim-nezgodama-po-politsijskim-upravama-i-opshtinama/*.

The RTSS is aligned with the European Policy Orientation on Road Safety 2011-20 (EC, 2010[225]), which has the goal of reducing road fatalities by 50% between 2010 and 2020 in line with Decade of Action for Road Safety 2011-20, officially proclaimed by the UN General Assembly in March 2010. This goal would have been difficult to achieve considering Serbia only managed an average 3% annual reduction in fatalities during 2010-19 (Table 25.18). It will need to make significant additional efforts to secure a newly defined goal aligned with the European Vision Zero strategy for 2050 (European Commission, 2019[217]), which also set an intermediate goal of a 50% reduction in road fatalities during 2021-30. As no strategy for the new decade has yet been developed, expectations should not be high.

Serbia has addressed some of the **environmental sustainability** goals related to the transport sector across multiple strategies, making them difficult to monitor.[114] Having a section explicitly dealing with sustainability in all transport modes in the national transport strategy or transport sector strategies for each specific mode, will be needed.

There is no evidence that the government is preparing an environmental sustainability strategy. The National Strategy for Sustainable Development obliges the government to calculate the emissions of pollutants into the atmosphere from traffic on state roads and PERS often performs these assessments (so far they have been conducted for the periods 1990-2012, 2013-15 and 2015-19). PERS has also developed studies related to climate resilience.[115] The Strategy of Railway, Road, Inland Waterway, Air, and Intermodal Transport Development 2008-15 promoted the “polluter pays” principle which has been introduced in road transport so that the vehicles which pollute the environment more pay more to use the roads. It is expected the same approach and more will be implemented in the transport strategy as of 2022.

The SORS recently published its Eco-Bulletin (SORS, 2020[226]), presenting trends related to environment in the economy. In the period 2010-19 the total use of liquid fuels increased by 64%, while in road transport (which accounts for 48% of the total consumption of liquid fuel in the economy) it increased by 143% over the same period. At the same time, electricity consumption fell by 38% in total. Further efforts are needed to shift transport from road to other more sustainable modes.

**Combined transport**[116] is the transport mode that has the best cost efficiency, decreases environmental pollution, and increases co-operation between the freight forwarding network companies. The legal and regulatory framework in Serbia is covered in several existing strategic documents[117] related to the development of logistics and multimodal transport. The new multimodal transport strategy, the Five-year Action Roll-on Plan, is under development and expected to be finalised in 2021. Since the last assessment several regulations have been developed to strengthen multimodal transport legislation and partially align with the Combined Transport Directive. Full transposition of the Council Directive 92/106/EEC will not be carried out at this stage of the harmonisation due to the announcement that new EU regulations are to be adopted that will replace the existing ones.

The Department for Railways and Intermodal Transport of the Ministry of Construction, Transport and Infrastructure is the main institution responsible for combined transport in Serbia. There is no monitoring

body, except for representatives on the Technical Committee for the Transport Facilitation of the TCPS, which is yet to follow implementation of the regional Transport Facilitation Action Plan endorsed by the Ministerial Council of the TCPS in October 2020.

Currently, a construction contract for the multimodal terminal Batajnica near Belgrade has been signed. Construction is expected to commence in the second quarter of 2021 and it is expected to be completed in the first quarter of 2023. Depending on the readiness of local governments and the state of infrastructure capacity, future intermodal terminals could be planned in Pirot, Apatin, Smederevo, Bačka Palanka, Šabac, Novi Sad, and Vršac. These proposals need to be tested against transport demand modelling, and align with plans in the new logistics and transport strategies.

he World Bank's Logistics Performance Index (LPI) (World Bank, 2020[227]), is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation. In the last index in 2018, Serbia was ranked 65th out of 160 economies, with an LPI score of 2.84 which is around the world average of 2.85 but well below the EU average of 3.52. Serbia ranked best for international shipment[118] (57th) and worst for logistic competence (ranked as 80).

Data collection, which is currently moderate to weak, needs to be one of the key areas of focus. Serbia needs to establish a strategy for data as a basis for the assessment of the transport sector, as it will directly influence prioritisation processes within transport policy in general.

### *The way forward for transport policy*

Serbia has taken some important steps in the development of a competitive transport sector, as presented above, but special attention should be paid to the following areas:

- **Enhance the implementation, monitoring and readjustment of the existing policy framework.** The transport policy framework is not regularly revised based on the monitoring reports and available information. Doing so will be key to keeping it up to date, relevant and effective. Monitoring reports need to be developed for each strategy and other strategic documents, and also be publicly available. Based on these monitoring reports, the policy framework then needs to be regularly adjusted.
- **Update or renew outdated national cost-benefit analysis guidelines, covering all transport modes.** Economies need to regularly update their own CBA guidelines with accompanying national technical instructions needed for a proper CBA, at least every two years. A good example is the United Kingdom's Transport Analysis Guidance (UK Government, 2019[228]), which provides all the information on the role of transport modelling and transport project appraisal tailored to the UK market. To ensure consistency in the discount rates used for similar projects economies need to develop their own benchmark for all technical and economic parameters, including the financial and economic discount rate in the national guidance documents, and then apply it consistently in project appraisal at the national level. The empirical researches needs to be conducted on the national level to generate input data for the calculation of externalities.
- **Ensure road safety remains a key priority.** Further efforts are required to align national legislation with the TCT and EU *acquis*, with the aim of removing black spots and dangerous locations, placing the safety of vehicles at the top of the agenda, and enforcing the implementation of legislation (e.g. proper spending of funds allocated from fines on road safety improvements, transport of dangerous goods, speed enforcement, and licensing of road safety auditors and inspectors). Box 25.16 is an example of an innovative approach in Montenegro.
- **Keep transport facilitation as a key priority.** Serbia needs to implement more OSSs, and other measures in line with the newly endorsed regional Action Plan for Transport Facilitation (Transport Community, 2020[212]), which includes: electronic queuing management systems, upgrades of existing ICT infrastructure, construction or modernisation of infrastructure to remove physical and

technical barriers and increase existing capacities, and capacity building to improve performance efficiency.

- **Establish the basics of a transport asset management system in line with the national inventory system.** Sound asset management practices[119] enable economies to collect data and manage and analyse conditions across all transport modes, in order to optimise transport maintenance strategies and justify maintenance budgets by directing funds to those areas where the return on investment will be the greatest. Performance-based maintenance contracts (PBMC) are already implemented in WB6 economies, including Serbia (CONNECTA, 2018[195]), and are an essential component of the road asset management system. The quality of transport infrastructure affects an economy's investment attractiveness, making it seen as a good market for foreign direct investment.
- **Develop an integrated environmental and transport action plan.** This plan needs to integrate existing indicators and to include any missing ones in a framework for environmental sustainability in the transport sector. Measures and indicators should then be applied in the strategies where they belong, including the new transport strategy. A good example was developed by the European Environment Agency in the form of Transport and Environment Reporting Mechanism (EEA, 2000[229]), which prescribes indicators for tracking transport and environmental performance in the EU.

### Box 25.16. Innovative ideas in road safety: Road safety social impact bonds in Montenegro

In 2018, the UNDP in Montenegro, in co-operation with the key national players in road safety, developed the new idea related to road safety social impact bonds. These are an innovative alternative performance-based public financial instrument, which shifts the policy framework from inputs and outputs to outcomes and value for money. The idea is to involve the private sector in investing in road safety improvements with the main aim of strengthening sustainability jointly with the public sector. The public partner commits to paying outcome payments to the investor if and only if the predefined and measurable social goals are met. This idea has great potential for other economies in the region (and beyond) to replicate and scale up the model.

Source: (UNDP[230]), Rethinking road safety in Montenegro, https://www.me.undp.org/content/montenegro/en/home/projects/RoadSafety.html.

## Energy policy (Dimension 12)

### *Introduction*

Serbia has made significant strides in introducing more advanced policy and legislation in the energy sector. As a result, Serbia achieved an overall score of 3.0 for energy in this assessment compared to 2.3 in the last Competitiveness Outlook (Figure 25.1). The improvement has been driven by the increased transposition of EU's Third Energy Package into national legislation and policy.

However, while there has been progress in the development of policy and legislation, there are gaps in their implementation across all sub-dimensions. This is reflected in the assessment of the Energy Community Secretariat (2020[231]) which gave Serbia a score of 67% for transposition of the Third Energy Package – with the remaining 33% being only partially transposed – while it scored 30-70% for implementation across the different sub-dimensions, averaging 56%. In particular, Serbia's implementation of unbundling and third-party access falls short when compared to other WB6 economies with the second lowest score of 2.5, ahead of only Bosnia and Herzegovina. Nonetheless, as can be seen in Table 25.22, Serbia performed fairly well in other sub-dimensions, especially in the governance and regulation sub-dimension, so that despite its low performance in unbundling and third party access, Serbia's overall scoring is in line with WB6 average.

**Table 25.22. Serbia's scores for energy policy**

| Dimension | Sub-dimension | Serbia | WB6 average |
|---|---|---|---|
| Energy policy dimension | Sub-dimension 12.1: Governance and regulation | 3.3 | 3.1 |
| | Sub-dimension 12.2: Security of energy supply | 2.9 | 2.9 |
| | Sub-dimension 12.3: Energy markets | 2.8 | 3.0 |
| **Serbia's overall score** | | **3.0** | **3.0** |

### *State of play and key developments*

#### *Sub-dimension 12.1: Governance and regulation*

Overall, Serbia's **energy policy, legal and institutional framework** is comprised of an extensive array of legislations, action plans, and strategies that govern the energy sector. Serbia has transposed a significant share of the EU's Third Energy Package.

Both the natural gas and electricity markets are liberalised, and price are deregulated, although the markets remain dominated by key players (see Sub-dimension 12.3: Energy markets). Moreover, policy is informed by an extensive array of indicators and monitoring systems and *ex post* assessments are used to analyse and inform adjustments to policy. A large number of the EU's Network Codes have been fully or partially transposed, but the full transposition of all codes is not possible without amending the primary legislation – something that is currently being tackled.[120]

Beside the need to adopt and transpose the remaining EU legislation, there are some key areas of concern. First and foremost – and a theme throughout this dimension – Serbia lacks in implementation of the framework. For example, unbundling and third-party access are key pillars of EU's Third Energy Package, but the Energy Community Secretariat concluded that it "has not yet been finalised in compliance with the Third Energy Package" (Energy Community Secretariat, 2020[232]). Progress in the implementation of unbundling and third-party access has been slow over the years partly due to the strong position of the incumbent firms (see Sub-dimension 12.3: Energy markets). Moreover, key policy documents are absent, including a new National Energy Efficiency Action Plan, which has been drafted but not yet adopted, and the National Energy and Climate Plan, which is in the early stages of drafting. And finally, Serbia continues to expand its fossil fuel generation, in part as greenhouse gas pricing is not currently factored in.[121]

### Box 25.17. The EU's Third Energy Package

In 2007, the European Commission proposed a new legislative package, the Third Energy Package, in an effort to further enhance and harmonise the EU's Energy Union and internal energy market. This package entered into force in September 2009 and consisted of several important directives and regulations.[1]

The Third Energy Package largely rests on four pillars: 1) transparency; 2) non-discrimination; 3) a strong, independent national regulator; and 4) sustainability. Together, these pillars represent EU best practice and aim to establish a fair and level-playing field for competitive energy markets that seek to optimise scarce resources. For example, the first two pillars drive the need for unbundling the transmission and distribution system, combined with guaranteed, non-discriminatory and open access to those networks to all users backed by transparent rules and prices. Without such unbundling requirements and third-party access, it is very possible that the system operators, which are natural monopolies, could prohibit market entry and lead to sub-economic market outcomes.

In addition to these pillars, the Third Energy Package also seeks to enhance international co-operation within the EU by establishing an international regulatory agency (the Agency for the Cooperation of Energy Regulators – ACER) and promoting regional integration. Regulation (EC) No 714/2009 contains clauses that open and allow for further regulation to be drafted to enhance harmonisation in the form of network codes.

In 2019, the EU introduced the Clean Energy Package which supplements and in part replaces the Third Energy Package. That is, while the Clean Energy Package retains the key legislative aspects of the Third Energy Package, it expands measures for sustainability and green energy growth, as well as consumer rights and protections. Despite this, the Third Energy Package remains a good starting point for all of WB economies as many of its key pillars have so far not been introduced or implemented in their entirety in the region. Aligning with it is also a requirement for the WB economies as members of the Energy Community, whose *acquis* reflects most of the Third Energy Package. Moreover, with many WB6 economies aspiring to become EU members, the transposition and implementation of the Third Energy Package and subsequent Clean Energy Package are accession requirements. To conclude, the Third Energy Package provides for the implementation of international best practice on competitive markets, and is also a firm requirement for the Western Balkan economies.

1: Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC; Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC; Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005; Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators.

The theme of the policy being in place but the implementation lacking is also apparent when it comes to the regulatory framework, or more precisely the **energy regulator**. The legislative framework for the regulator conforms with the EU's Third Energy Package and clearly intends to establish a competent and independent regulator. This independence is partly reflected by the reporting requirements and oversight of the Energy Agency of the Republic of Serbia (AERS), which is in line with the EU Third Energy Package. Moreover, AERS's revenues are separate and independent with AERS being financed through revenue from regulated activities, fees for issued energy licences, as well as from other revenue from activities within its jurisdiction.

However, there are several issues when it comes to implementation. First and foremost, AERS lacks the human resources it needs to fulfil the role as prescribed by the Third Energy Package.[122] While plans are in place to hire more staff over the next few years, it is not quite clear how successful it will be at hiring

new staff and retaining existing staff.[123] This is particularly challenging as the financial budget is subject to approval by Parliament.[124]

Another issue with AERS's independence is with its Statute. That is, according to Article 47 of the Energy Law, the Statute is subject to approval by the Parliament. This limits the regulator's independence as it limits its ability to structure itself according to the task and roles it faces. Moreover, it creates another avenue through which political influence can be asserted and lead to interference of the operation of the regulator, particularly when combined with the requirement for parliamentary approval of its budget.

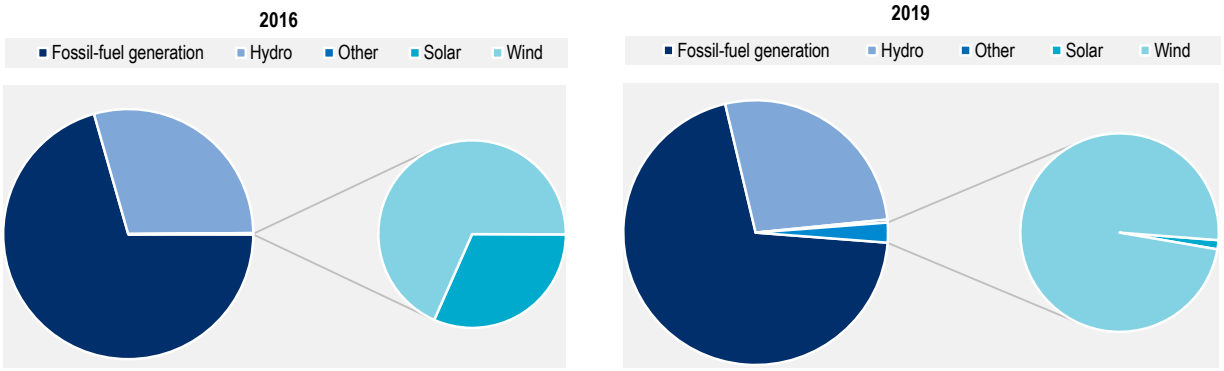
Finally, in a minor point that largely does not affect the score, AERS does not have the authority to impose fines. According to Article 58 of the Energy Law, it cannot impose fines but can initiate proceedings at the appropriate court. While this approach is permitted by the Third Energy Package, it does weaken AERS' ability to act as a credible market enforcer as it partly transfers this role to the judicial system, and also slows the enforcement process.[125] In part, as this becomes more of a judicial issue, it raises the danger that when the matter becomes "[…] overly legalistic in the application of rules and imposition of fines, […] business people would tend to respond by scaling down their efforts to comply with the intent of the law; instead, they would aim to achieve only the minimal level of compliance which the rules required" (OECD, 2000, p. 16[233]).

The theme continues with the **management of energy infrastructure**. Serbia has strategies and action plans that guide the infrastructure development and management.[126] At their core, these strategies provide guidance on the rehabilitation, modernisation and expansion of infrastructure with the aim of increasing the efficiency and reliability of energy supply to consumers. However, several factors reduce Serbia's score when it comes to implementation. First, although there has been significant progress in finalising the transposition of EU regulations, some existing transposition needs to be improved and the final implementation remains outstanding. This is most clearly seen in the lack of the adoption of the network development plans from the transmission system operator (TSO) and distribution system operator (DSO) within the natural gas sector, which creates uncertainty about the path of infrastructure development. Another problem is high distribution losses (see Sub-dimension 12.2: Security of energy supply), although the policy plans to tackle this issue.

### *Sub-dimension 12.2: Security of energy supply*

When considering energy supply, there is a wide gap between the natural gas and the electricity sector. Considering the **natural gas supply framework**, while an extensive policy and legal framework is in place, the market is dominated by one player, *Srbijagas*.[127] Such centralisation exposes the market to the risk of a dominant player abusing their market position to achieve certain outcomes, which could include behaviour that raises barriers to competition and market entry. This risk is aggravated by the lack of third-party access which means that the nature and extent of competition is limited, giving more opportunities to abuse market position. Moreover, it should be noted that Serbia is currently completely reliant on oil-indexed natural gas sources[128] exclusively from a single source, Russia, which further increases energy security risks due to the lack of alternative natural gas supply sources.

## Figure 25.17. Serbia's gross electricity generation mix (2016 and 2019)




Source: Eurostat (2021[234]), Gross and net production of electricity and derived heat by type of plant and operator, https://ec.europa.eu/eurostat/web/energy/data/database.

StatLink https://doi.org/10.1787/888934256349

Serbia's **electricity supply framework**, while still not optimal, is more advanced than is the case for natural gas. The power mix is more diversified, but still dominated by coal power generation, which accounted for around 70% of power generation or between 27 and 26 TWh in between 2016 and 2019 (Eurostat, 2021[234]) – see Figure 25.17. Meanwhile, Serbia's energy strategy suggests that it plans to continue its reliance on coal as it seeks to build new coal-based power generation capacity (MRE, 2016, pp. 81-85[235]). While its stated goal is to replace old and less efficient plants, it is not clear to what extent the climate impact, especially compared to renewable energy, was or is a factor in these decisions.

Another issue facing the electricity supply framework in Serbia is the aspect of network losses. Although the Western Balkans, including Serbia, are in line with European average with regard to transmission losses, Serbia and the Western Balkans as a whole are still lagging behind with regard to distribution losses (Table 25.23),[129] and urgent action is needed to upgrade infrastructure to avoid wasting energy.

## Table 25.23. Serbia's distribution losses as % of final electricity consumption (2014-18)

| GEO/TIME | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| European Union | 10.7% | 8.0% | 7.8% | 7.6% | 6.7% |
| Serbia | 14.4% | 14.4% | 13.0% | 13.0% | 12.2% |
| CEEC | 5.9% | 5.8% | 5.5% | 5.3% | 5.2% |

Note: CEEC: Central and Eastern European countries. Both the EU and CEEC exclude Bulgaria and Romania.
Source: (CEER, 2020[236]). 2nd CEER Report on power losses https://www.ceer.eu/documents/104400/-/-/fd4178b4-ed00-6d06-5f4b-8b87d630b060.

## Table 25.24. Serbia's renewable energy generation as a share of gross inland consumption (2014-19)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| EU | 13.6% | 13.8% | 14.0% | 14.1% | 14.7% | 15.5% |
| Serbia | 15.5% | 13.4% | 13.3% | 12.1% | 13.4% | 13.6% |
| Western Balkans | 18% | 17% | 17% | 14% | 19% | -- |

Source: (Eurostat, 2021[234]), Gross and net production of electricity and derived heat by type of plant and operator, https://ec.europa.eu/eurostat/web/energy/data/database.

Meanwhile, although coal remains dominant, **renewable energy** is on the rise, with wind generation rising from 26 GWh in 2016 to 898 GWh in 2019 and solar rising from 12 GWh to 13 GWh (Eurostat, 2021[234]). However, although Serbia has various legislation and action plans governing and guiding renewable energy generation,[130] it does not appear that it will meet its 2020 target. Renewable energy accounted for just 13.6% of gross inland consumption in 2019, compared to the target share of 27% by 2020 and an EU

average share of 15% and WB6 share of 19% (Table 25.24). Moreover, in 2018 nearly all (approximately 98%) of Serbia's renewable energy generation comes from hydropower (Eurostat, 2020[237]). In 2018, just 0.4% of Serbia's generated power came from non-hydro renewable energy sources. This is below the WB6 average and significantly less than the EU average of 15% (Eurostat, 2020[237]). The key issue facing Serbia is therefore the promotion of renewable generation other than hydropower. Serbia recently amended key laws and adopted new legislation to promote the use of non-hydro renewable energy sources. These laws introduce promising elements such as a new funding scheme and auctions for renewable energy projects, which should further promote the use of non-hydro renewables.

When looking at the legislative and policy environment and the actual renewable energy market, Serbia faces several issues. The first is that despite having made significant strides in transposing and implementing the EU renewable energy *acquis*, including the adoption of secondary legislation for biofuels in 2019, it still has not fully transposed all of it and more remains to be implemented. The second is promoting the share of renewable energy in Serbia's primary energy mix. This could be supported by streamlining the approval process for new renewable energy projects at every stage (permits, construction, licensing, etc.).

Another challenge has been the suspension of feed-in tariff payments under the previous scheme for existing renewable energy generators as a consequence of the COVID-19 pandemic, with some sources suggesting that payments to generators were completely suspended and other sources suggesting payments were limited to one-third of the feed-in-tariff. This suspension risks undermining investor confidence and, consequently, the sustainability of renewable energy financing in Serbia.

Serbia's old tariff system used feed-in-tariffs combined with purchasing power agreements. As Serbia has a wholesale market with an organised day-ahead market,[131] it is encouraging that the new Law on renewable energy adopted in April 2021 introduced feed-in-premiums, which represent a more modern and efficient approach to subsidising renewable generation (Box 25.18).[132]

### Box 25.18. A new approach to subsidising renewable energy

Feed-in tariffs were the dominant form of financial support for renewables within the EU at the beginning of the 21st century. In this system, power plant operators receive a fixed payment for each unit of electricity generated independent of the electricity market price (Banja et al., 2017, p. 15[238]).

Feed-in tariff schemes offer several advantages, but mainly they insulate new market entrants from market price risks, which lowers their capital costs and enables private investment. The simplicity of feed-in tariffs makes them suitable for markets with a large number of non-commercial participants such as households or local community-based initiatives (CEER, 2018, p. 12[239]).

However, feed-in tariff schemes exclude producers from actively participating in the market, which hinders efforts to develop large, flexible and liquid electricity markets as the share of renewable energy grows. This limits growth to certain technologies and sizes of installations, and creates difficulties in setting and adjusting appropriate tariff levels (EC, 2013, pp. 12-13[240]). The latter has been a problem especially as costs of renewable generators have fallen rapidly in recent years.

The European Commission suggests switching from feed-in tariff to feed-in premium schemes (EC, 2013[240]). In these, plant operators sell the electricity generated directly on the electricity market and earn an additional payment on top of the electricity market price. This is received as a fixed payment or one adapted to changing market prices, thereby limiting price risks for plant operators, as well as the risks of providing windfall profits (Banja et al. 2018). Feed-in premium schemes are beneficial because they force renewable energy producers to find a seller on the market. They also ensure that renewable energy operators are exposed to market signals. A well-designed premium scheme can limit costs and drive innovation by using a competitive process to allocate support. Such schemes also include automatic and predictable adjustments to cost calculations, which give investors the information and confidence necessary to invest (EC, 2013, p. 8[240]).

The European Commission suggests using a feed-in premium scheme in combination with the following good practice recommendations (EC, 2013[240]):

- Do not pay premiums for production in hours where the system price is negative or above the level of remuneration deemed necessary.
- Assign renewable project and associated premiums using competitive allocation mechanisms such as auctions.
- Make planned volume-based premium reductions for new installations dependent on when they are approved, connected or commissioned.
- Conduct regular, planned and inclusive reviews of premiums for new installations.

However, the Council of European Energy Regulators reports that in 2016/17, 17 of the 27 European Union member countries still used some form of feed-in tariff, although mainly for small projects, while around 16 used feed-in premiums, including to complement feed-in tariffs (EC, 2014[241]).

For further and more detailed exploration of renewable energy subsidies and best practice please see the sources below. Meanwhile, for more information on the different renewable support schemes employed across Europe please see http://www.res-legal.eu/home/ and for an overview of auctions and outcomes (including databases on auctions) see http://aures2project.eu/.

Source: (Banja et al., 2017[242]), *Renewables in the EU", doi:10.2760/521847*; (CEER, 2018[239]), *Status Review of Renewable Support Schemes in Europe for 2016 and 2017*, https://www.ceer.eu/documents/104400/-/-/80ff3127-8328-52c3-4d01-0acbdb2d3bed; (EC, 2013[240]), *Guidance for the design of renewable support schemes*, https://ec.europa.eu/energy/sites/ener/files/com_2013_public_intervention_swd04_en.pdf; (EC, 2014[241]), *Guidelines on State Aid for Environmental Protection and Energy 2014-2020*, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014XC0628%2801%29.

Besides using supply-side policies to promote security, Serbia needs to improve its demand-side management through **energy efficiency policies**. The Energy Community has extensively reported that Serbia's legislative framework does not fully transpose and thus is not fully compliant with EU's Third Energy Package (Energy Community Secretariat, 2021[243]), (2020[231]), (2020[232]). Issues range from the energy performance of buildings to energy labelling. That said, Serbia has adopted a new Law on energy efficiency and the rational use of energy in April 2021 that expands Serbia's energy efficiency approach. Among other measures, the law expands the transparency and data collection for measuring energy efficiency, provides a detailed legislative framework for highly efficient cogeneration, the public energy efficiency supply framework, energy labelling and eco-design standards.

Meanwhile, much like the legislation, policies needs to be enhanced. The Ministry of Mining and Energy's Third National Energy Efficiency Action Plan has been adopted, but only provides guidance for energy efficiency in Serbia up to 2018. Meanwhile, the fourth National Energy Efficiency Action Plan is still being drafted.

Serbia has implemented energy efficiency funding of some sort since 2014. The new Law on energy efficiency expands the availability of funding for energy efficiency projects (i.e. renovations of buildings, replacing of heating systems), to cover private initiatives. This is a welcome change, as previously funding was only allocated to public projects.

Most state entities involved in the energy efficiency sector lack human resources, which limits their ability to implement and monitor government policy objectives.[133] The monitoring of developments in energy efficiency is neither comprehensive nor regular but is limited to the collection of indicators on a project basis.[134] Furthermore, it is not clear which entity collects which data/indicator. However, the introduction of the changes mentioned above through the new law might present improvements to data collection.

### *Sub-dimension 12.3: Energy markets*

In the area of **market operations**, Serbia may be the most advanced economy in the region both from legislative and implementation perspective. Serbia allows for free selection of suppliers and has switching rules in place. Moreover, markets are liberalised, and prices deregulated, although households and small consumers can opt to be supplied by the regulated supplier of last resort/universal supplier. Serbia's electricity market also has an active power exchange with an organised day-ahead market in addition to bilateral trading. For natural gas, only the latter exists. Also, it should be noted that wholesale traders do not have a seat requirement,[135] although they are required to obtain a licence in Serbia much as for all other activities.

Despite its advanced progress, some shortcomings remain in Serbia. The EU market model has only partially been implemented. Moreover, despite market liberalisation in both natural gas and electricity, the incumbents have the largest market share. In the case of electricity, the Energy Community Secretariat also asserts that "the regulated price of guaranteed supply, to which households and small customers are entitled, is still below a competitive and economically justifiable price" which discourages the switching of consumers to non-regulated retail suppliers (Energy Community Secretariat, 2020[232]). In the natural gas market, there is no organised market or trading point—although *Srbijagas* aims to deploy a virtual trading point at some point in the future. Finally, balancing services and ancillary services remain in part regulated due to low competition. That is, due to limited liquidity and service providers, price formation is not likely to be indicative of efficient market equilibrium meaning prices remain regulated. In the long run, it would be advisable to establish and implement a strategy to promote competition in order to have market forces drive prices for balancing services and ancillary services down.

Despite these issues, the area which has the greatest need for improvement is **unbundling and third-party access,** particularly in the natural gas sector. While Serbia's legislation, action plans and strategies conform with the EU's Third Energy Package, the implementation of unbundling is far from complete.

In the case of electricity, the Energy Community Secretariat (2020[232]) notes that the unbundling of both the TSO and the DSO are not in compliance with the Third Energy Package requirements. Although some efforts have been expended, the Energy Community Secretariat has so far not confirmed the unbundling with a positive opinion.[136] More precisely, while the TSO, Elektromreža Srbije (EMS), was certified by AERS as unbundled, for technical reasons[137] the Energy Community has not given a positive opinion. Meanwhile, the DSO, Elektrodistribucija Srbije, has been legally unbundled and has a compliance officer in place. Moreover, although progress has been made in functional unbundling through the adoption of a new foundation act in January 2021, and AERS has issued a licence to operate as a distribution system operator in April 2021, the Energy Community affirmation is still outstanding.

The situation is not much different for the three TSOs within the natural gas sector. Although the legislation is in place, Srbijagas still continues to effectively operate both as a supplier and TSO. Srbijagas has established a company for the purpose, Transportgas Srbija, but it is not equipped to handle the operational tasks of a TSO and nor have the transfer of assets taken place. In other words, it is not functionally unbundled and accordingly has not been certified by AERS as such. In the case of the other TSO,

Yugorosgaz JSC Belgrade, the independent system operator model applied is not compliant with the Third Energy Package. The third, Gastrans, was certified in February 2020 by AERS (AERS, 2020[244]) as an independent TSO despite Energy Community objections (Energy Community Secretariat, 2019[245]). Both Yugorosgaz and Gastrans have implemented compliance officers.[138]

The situation for non-discriminated third-party access is also mixed. While the legislative requirement is in line with the Third Energy Package for the electricity sector, there are concerns over its implementation. For instance, most of the cross-border interconnectors are allocated based on bilateral agreed auctions. Only the interconnector capacity on the border with Bulgaria and Croatia are being assigned using the international standard for joint capacity auction through the Joint Allocation Office.[139]

Another concern is with regard to use of congestion revenue to subsidise domestic transmission tariffs. While this use of revenue to reduce transmission tariffs is not prohibited by EU regulations (see EU Regulation 714/2009 Article 16 Paragraph 6), the regulation does encourage using such income to guarantee the availability of capacity, or to maintain or increase interconnection capacity in order to further interconnection, rather than to lower domestic transmission costs..

Much as in the electricity sector, the legislation for unbiased third-party access, including entry-exit tariff system, is also in place for the natural gas market but implementation is lacking. For instance, the Srbijagas run interconnector at Horgoš on the Hungary-Serbia border is foreclosed to third-party access. The new interconnector through the Gastrans project, which started commercial operations on 1 January 2021, offers some volume to third party. However, an exemption was granted that permits Gastrans to limit the volume open to third parties to 10% of the entry and exit capacities based on short-term capacity auctions (AERS, 2019[246]). This means third parties can supply approximately 15% of the domestic market via Gastrans pipeline's Serbian exit points. The Energy Community Secretariat have stated that confining access to just 10% of capacity is detrimental to the development of competition in the natural gas market (Energy Community Secretariat, 2019[245]).

Finally, although **regional market integration** is not completely lacking it still has potential for improvement. Currently there are two natural gas interconnectors which are significant from a supply perspective. As discussed above, one is for closed completely to third party access, while the second restricts access to 10% of its capacity, limiting the competitive nature of international integration. Meanwhile, market coupling is absent, partly due to Serbia lacking an organised market/trading point. Although Srbijagas has codified a virtual trading point in its network codes, in practice it has failed to implement it so far. Gastrans also included in their Network Code provisions for a virtual trading point although it is unclear to what extent this has been implemented.

Regional integration is a bit more advanced in the electricity sector. On the positive side, the Connection Network Codes and the Grid Code are partially implemented. Moreover, the outlines of regional co-operation are in place.[140] However, for the most part, regional co-operation for interconnection allocation is done on a bilateral basis, except for with Croatia and Bulgaria, where it is done via joint auction through the Joint Allocation Office, and (manually) balancing reserves.

Serbia also has been and is part of various project to couple markets, but these have failed to result in actual market coupling and integration.[141]

### *Cross-cutting sub-dimension: Energy incentives – direct and indirect subsidies in the energy sector*

While no information was provided on the topic of cross subsidisation, our understanding is that substantial subsidisation is taking place, particularly in the coal sector, which has a cascading effect on power. More precisely, a study by (Miljević, Mumović and Kopač, 2019[247]) estimated that, between 2015 and 2017, the Serbian government provided on average direct subsidies to coal producers of around EUR 99.78 million per year. They estimate that this amounted to an indirect subsidisation of electricity generated from coal

of about 4 EUR/MWh. In other words, subsidising coal producers has a pass-through effect that results in coal-fired generation being around EUR 4 cheaper per MWh than it would have been without it.

Moreover, information provided by the government seems to suggest that state entities do not settle their bills with the power sector in full and promptly, which is another form of subsidy. This is supported by Srbijagas writing off of EUR 1.2 billion in debt in 2019.[142] However, the extent of this is unclear at this stage.

### *The way forward for energy policy*

Given the various points raised above, Serbia should:

- **Finalise the transposition of EU Third Energy Package** across all sub-dimensions but especially with regard to the EU Network Code, EU target model and renewable energy. This should complete the framework for a competitive market that can harness competitive economic forces to drive the optimisation of consumed energy and enhance the value added of energy for the entire economy.
- **Improve implementation across all sub-dimensions**, in particular:
  - **Fully unbundle TSOs and DSOs**. These roles have an essential natural monopolistic role in any energy market and so, to maximise social gain, it is best if they do not operate in the interest of certain suppliers or generators. To this end, the unbundling and the national certification should conform with Chapter IV, V and VI of EU Directive 2009/72/EC and be confirmed by the Energy Community to that effect that the TSOs and DSOs have been unbundled pursuant to those requirements.[143]
  - **Implement non-discriminated and transparent third-party access to transmission and distribution systems**. This is essential for more competitive market forces to be brought to bear. To this end, third-party access on a national level should conform with Chapter VIII of EU Directive 2009/72/EC and this should be confirmed by the Energy Community.
- **Improve regional integration and market coupling**. Market integration and coupling is essential to help keep price variances in check through the use of regional forces. While some projects are ongoing, the authorities need to step up their efforts and finalise projects successfully. Regional trade and integration is also are important tool to help bolster the national energy sector subject to rising integration of variable renewable energy capacity.
- **Implement a new approach to support and subsidies renewable energy**. Serbia's support for renewable energy faces a variety of issues and so it should take the opportunity to overhaul its approach. This should also be combined with new approach to energy diversification by reducing the reliance on coal and a single natural gas supply. In part, with the adoption of the new laws, the opportunities lie in their implementation including with regard to switch from a Feed-in-Tariff model to Feed-in-Premiums.
- **Increase the share of renewable energy by streamlining the approval process at every stage** (permits, construction, licensing, etc.) for new renewable energy projects—with focus on none-hydro renewable energy sources.

## Environment policy (Dimension 13)

### *Introduction*

With an overall score of 2.2 in environmental policy, Serbia is third among the WB6 economies and performs slightly above the regional average (Table 25.25). It has significantly improved its performance in resource productivity and achieved further increases in environmental quality of life since the previous assessment. However, its results for the natural asset base sub-dimension are below the regional average, reflecting a decrease in performance in this regard since 2018.

**Table 25.25. Serbia's scores for environment policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Environment policy dimension** | Sub-dimension 13.1: Resource productivity | 2.2 | 2.0 |
| | Sub-dimension 13.2: Natural asset base | 1.8 | 2.1 |
| | Sub-dimension 13.3: Environmental quality of life | 2.5 | 2.3 |
| **Serbia's overall score** | | **2.2** | **2.1** |

### *State of play and key developments*

#### *Sub-dimension 13.1: Resource productivity*

As a Non-Annex-I signatory to the UN Framework Convention on Climate Change (UNFCCC) and its Paris Agreement and party to the Kyoto Protocol,[144] Serbia has joined the international effort to combat climate change. It has committed to reducing greenhouse gas (GHG) emissions by 9.8% by 2030 compared to 1990 levels with the goal of limiting global warming to a maximum of 2°C by the end of this century. Despite some efforts in this area, Serbia's carbon productivity has not improved since the last assessment. Almost 70% of total GHG emissions come from the energy sector, followed by transport which accounts for slightly over 15% (World Bank, 2020[248]).

Serbia's **climate change mitigation and adaptation** policies are at an early stage of development. Promisingly, in March 2021, it adopted the climate law it had prepared in 2018. However, it still lacks a long-term climate change mitigation strategy that would encompass energy and climate targets. The draft Low Carbon Development Strategy, submitted for public consultation until the end of January 2020, has not yet been adopted, while the Ministry of Mining and Energy was developing the integrated National Energy and Climate Plan (NECP) at the time of drafting.[145] Given the dominance of the energy sector in total GHG emissions, the adoption and implementation of the NECP, which is consistent with the EU 2030 framework for climate and energy policies, will be crucial for Serbia's future low carbon development. The government will also need to make sure that the NECP is integrated into all other relevant sectoral policies and strategies, such as transport, industry and agriculture. Other positive developments have been the improvement of GHG inventories and updating of the Nationally Determined Contributions (2021-30), mostly as a result of the establishment of a new Department on Climate Change in the Ministry of Environmental Protection (MoEP).

The National Programme for Disaster Risk Management (2014-20) and its draft action plan for implementation addresses climate change related issues but does not contain sufficient climate change adaptation measures and policies. The government therefore asked for support from the international community to develop its National Adaptation Plan (NAP) to increase its capacity to address its vulnerability to climate change[146] and integrate climate change adaptation considerations into its development planning and budgeting, particularly in the agriculture-water management nexus, and transport infrastructure and construction. Serbia was one of the first economies to request Green Climate Fund (GCF) readiness financing for this purpose (UNDP, 2019[249]). As part of these efforts, a stocktaking report was produced in 2017 and served as a basis for Serbia's NAP Readiness Proposal, Advancing Medium and Long-Term

Adaptation Planning in the Republic of Serbia. This was approved by the GCF in July 2019 (UNDP, 2019[249]).

Serbia was the first WB6 economy to put a **circular economy framework** in place. The key institutions involved in the policy framework are the MoEP, and the Serbian Environmental Protection Agency (SEPA).[147] In October 2018 the MoEP established a Special Working Group for Circular Economy, which works on the transition process and acts as the main co-ordinator of stakeholders in the circular economy. In 2020, Serbia prepared its Roadmap for Circular Economy, an important document that sets the guidelines for the transition towards a circular economy (Box 25.19).

### Box 25.19. A roadmap for a circular economy in Serbia

A Special Working Group for Circular Economy within the Ministry of Environmental Protection (MoEP) developed a roadmap for the circular economy in April 2020, important guidance that outlines the actions Serbia needs to take to make the transition from a linear economy. It is modelled on the same type of document developed in EU countries such as Finland, France, the Netherlands, Slovenia and Spain. This initial document will be harmonised with EU recommendations to align it with newly adopted EU documents (the Green New Deal and the new Circular Economy Action Plan). The working group will undertake a range of activities to this end, including developing a Circular Economy Roadmap 2.0.

The aim of the roadmap is to initiate a dialogue between decision makers and representatives of industry, academia and civil society, in order to encourage industry to innovate, increase market opportunities for production through circular business models, create new jobs and improve business, while preserving the environment. The intention is to encourage the whole of society to adopt radical changes in attitude towards limited resources. The roadmap is accompanied by a communication plan that contains measures to raise public awareness about the circular economy. Its main goal is to inform and involve as many actors as possible and thus achieve a broader social consensus for the implementation of the roadmap.

The key drivers behind the roadmap can be grouped into four main areas:

- **Economic**: boosting competitiveness, market development, (horizontal) economic diversification, and development and application of new business models and new technologies.
- **Political:** regional positioning, creating a national political consensus, EU accession process and implementation of international obligations in the field of environmental protection and combating climate change.
- **Environmental**: waste reduction, GHG emission reduction, conservation of natural resources and improving energy independence and the use of renewable energy sources.
- **Social**: improving social welfare, improving consumer rights, savings in household budgets, improvement in people's health and green jobs.

Source: (Government of Serbia, 2020[250]), Roadmap for a Circular Economy, https://www.ekologija.gov.rs/wp-content/uploads/razno/2020/FINAL_202004020_roadmap%20SRBIJA.pdf.

Serbia generates 319 kg of municipal waste per capita. This is lower than the EU average (492 kg per capita in 2018) but has been steadily, albeit slowly, increasing over the last five years. Waste collection is provided for 87% of the population (in 2018), but the waste is primarily deposited untreated at disposal sites that do not comply with any sanitary standards (Eurostat, 2020[251]; SORS, 2017[252]). Only 3% of waste was recycled in Serbia in 2018, with the rest ending up in landfill (SORS, 2017[252]).There are only 10 operating sanitary landfills, and no composting centres or incinerator facilities. Local stakeholders also reported an estimated 3 000 wild dumpsites (CEVES, 2018[144]). There is no systematically organised collection, sorting and recycling of separated municipal waste, although primary waste selection in Serbia

is defined by law. Hazardous waste is also often mixed with municipal waste or piled up in temporary storage facilities.[148]

Serbia's **municipal solid waste management framework** is relatively well developed. There have been no major changes since the last assessment except for the adoption of a new regulation on the reduction of packaging waste for the period 2020-24, which contains objectives for recycling and reuse of packaging waste and all packaging waste streams. The Law on Waste Management (2016) is the legal basis for waste management in Serbia. At the time of writing, this was being used to prepare the new Waste Management Strategy (2020-25) and National Waste Management Plan.[149] The new strategy will mark a shift from the model of regional sanitary landfills to regional waste management centres which will include waste sorting, separation and recycling, as well as non-recyclable waste treatment.

No systematic monitoring is taking place. The State of the Environment Report, one of Serbia's fundamental environmental reports which SEPA produces each year, provides a comprehensive assessment of the state of the environment and trends, and thus indirectly on waste management and progress towards a circular economy. SEPA also prepares the annual Report on Economic Activities of Importance to the Environment in the Republic of Serbia, which covers industry, energy, agriculture, forestry, tourism, and resource efficient and circular economy. These two reports also describe the funds for subsidies and other incentive measures, which include incentives for waste re-use and recovery, i.e. for the recycling industry.

In addition to SEPA and MoEP, a number of bodies[150] are involved in municipal solid waste management. Vertical (national and local) institutional co-ordination is ensured through special working groups and commissions for drafting national regulations. Opportunities for capacity building in local governments are regularly offered through various projects in Serbia, implemented by the donor community.

As in other WB6 economies, waste collection and treatment infrastructure in Serbia is financed through waste collection fees, budgets and donor funds, while services are funded from waste collection fees. Some investments into new waste treatment facilities have been made since the last assessment[151] and measures have been taken to combat unregulated burning and illegal dumping of waste by the Sector for Environmental Monitoring and Precaution within the MoEP. Nevertheless, stakeholders report the existence of a large number of illegal landfills and the lack of systematic approach in prevention and sanction of illegal dumping and burning of waste. The undertaken measures proved ineffective as many institutions are involved in their realisation and the responsibility is often taken away from one body to another, making the introduction of changes difficult.

### *Sub-dimension 13.2: Natural asset base*

With 24 443 m³ of water per year per capita, Serbia is a water-rich country, with far larger quantities of renewable internal fresh water resources per inhabitant than its WB6 peers (which averaged 11 560 m³ of water per year in 2017) (World Bank, 2017[253]). In 2017, around 75% of water was used in the industry sector, mainly for cooling in electric power generation (SORS, 2017[252]), followed by agriculture (13%) and municipal use (14%)[152] (Worldometers, 2016[254]).

**The freshwater management** framework in Serbia is relatively well developed. The Law on Water (2012) and the Water Management Strategy (2017-34) regulate this area, but the level of alignment with the EU *acquis* on water quality remains moderate (EC, 2020[36]). While the first steps towards development of the Water Management Plan for the Territory of the Republic of Serbia (2021–27) were taken at the end of 2019, its progress has been rather slow (Coalition 27, 2020[255]).

The provisions of the Law on Water apply to all surface and groundwater, prevention of pollution at source, emissions control and water quality standards, and prevention and protection against flood risks. In 2019, Serbia adopted a Regulation on Establishing a General Flood Protection Plan which covers a six-year period and stipulates measures to be undertaken in periods of high water, as well as institutional

responsibilities, the interpretation of data, forecasting and flood alerts. However, the Flood Risk Management Plan has not yet been adopted. The development of the plan is required by the Law on Water, as well as the EU directive on assessment and management of flood risks (Coalition 27, 2020[255]). Mapping of flood hazards and risks is still at an initial stage, mainly due to the lack of human and financial resources and data availability (EC, 2020[36]).

The law also regulates licences for the construction of hydropower plants. These require a detailed environmental impact assessment (EIA) and strategic impact assessment to be conducted. Yet, this procedure seems to be widely circumvented: there are cases in which hydropower licences were issued before the EIA report or which did not take the EIA report into account when issuing a licence. The most recent violation of this sort was in 2019, when the MoEP banned an investor in a mini hydropower plant from performing any work in the village of Rakita in Eastern Serbia, in the Stara Planina national park – although the municipality had issued a permit for it – and ordered the investor to restore the location to its original state.[153]

Approximately 90% of the Serbian territory lies in the Danube River Basin, the second largest in Europe, and Serbia is part of other transboundary basins, the Sava, Tisa and Drina. Work on the river basin management plan is progressing slowly, as such a plan has yet to be prepared and adopted (EC, 2020[36]).

Numerous bodies are responsible for freshwater management in Serbia. The Ministry of Agriculture, Forestry and Water Management is the main body but its administrative capacities remain limited, in particular for monitoring, enforcement and inter-institutional co-ordination. SEPA conducts annual water status monitoring and as part of this work it plans the development and supervises the functioning of the state network of stations for water quality monitoring.

As in the previous assessment, no data or projections of water demand from agriculture, industry (including energy) and households are collected, so cannot guide decisions about handling competing uses now or in the future. Data on water risk management – meteorological data (including data on rainfall) and historical data on water disasters – are available, but not all are publicly available or communicated to citizens to increase awareness of water-related risks.

The **biodiversity and forest management frameworks** have been slightly improved. The Nature Conservation Programme (2020-22) was being prepared at the time of drafting. Although the scope of the draft Nature Protection Programme (2021-23) is harmonised with the Law on the Planning System, the period it covers is significantly shorter than that stipulated by the Law on Nature Protection. The previous Biodiversity Strategy of the Republic of Serbia (2011-18) is currently being revised.

Numerous bodies[154] are responsible for biodiversity and forestry in Serbia, but institutional and human resource capacities at national and local level remain weak, particularly regarding enforcement (EC, 2020[36]). Capacity building and training are being conducted, mostly as part of various regional or national projects or through the National Academy for Public Service.

SEPA develops biodiversity, forestry, hunting and fishing indicators, as well as on sustainable use of natural resources, and prepares national reports. However, a fully operational system for monitoring biodiversity is still being developed. SEPA co-ordinated and prepared the Sixth National Report of the UN Convention on Biological Diversity. Serbia had not attained Aichi Target 11[155] at the time of drafting; its terrestrial protected area stood at 7.6% of its total landmass in 2019 (instead of the 17% target by 2020 set in the Aichi Target 11) (Ministry of Environmental Protection of the Republic of Serbia, 2019[256]).

Forests make up a smaller share of Serbia's total land area (31%) than the WB6 average (42%). It has made some changes to the legislative framework since 2017, such as the amendments to the Law on Forests, adopted in 2018. The Second National Forest Inventory[156] (the first was in 2009) and the National Forestry Programme were being developed at the time of drafting. There are no reports on the implementation of the Forestry Development Strategy of Serbia, which was adopted in 2006 and formally expired in 2018 when the Law on the Planning System came into force, even though the law stipulated

that the revised policy document needs to include *ex post* analysis of the implementation of the previous one. There is no systematic monitoring in place but instead monitoring takes place indirectly through the monitoring of the health of forests within the Monitoring and Assessment of Air Pollution Impacts and its Effects on Forest Ecosystems in Serbia.

Although the preparation of the Law on Trade in Timber and Timber Products has been announced, there has been no action to adopt new strategic or legislative documents to transpose EU legislation in this area.[157] The Law on Forests prescribes penalties for illegal logging and timber trading but they are rather mild, or poorly enforced in practice. Out of 1 519 misdemeanour charges filed in 2017, 433 people were fined an average of EUR 70 each for illegal logging (Forest Directorate of Serbia, 2017[257]). Although national statistics and official reports show extremely low levels of illegal forestry activities, by combining data with other sectors, primarily energy, it is possible to conclude that illegal logging levels in Serbian forests are several times higher than reported by the Directorate of Forests and the Statistical Office of Serbia. Over one million households in Serbia use wood as the main energy source for heat and cooking in a very inefficient way.[158] Moreover, according to local stakeholders, the lack of appropriate planning and control of the use of privately owned forests remains a significant issue in Serbian forestry. They report that data about privately owned forests, needed for appropriate forest management, are often of poor quality or unavailable.

The **land-use management** policy framework in Serbia was being developed at the time of drafting. The legal framework is well established through the Law on Soil Protection (2015), on the basis of which Serbia is in process of establishing a national soil monitoring programme. Serbia was also preparing a new Spatial Plan for the period 2021-35 at the time of drafting.

SEPA, as an administrative body within the MoEP, carries out state administration tasks related to the development, harmonisation and management of the national environmental information system within the land information system. It has a legal obligation to report on the state of the environment in Serbia, which it does through the Change in Land Use indicator.[159] The SORS covers agricultural land and publishes key indicators on the land usage and cover of agricultural and farm structures. The data are updated through several surveys run approximately every five years, with the last one being conducted in 2018 (SORS, 2018[258]). However, little information can be found about other key indicators related to land-use management including whether they are georeferenced and harmonised with government bodies like property tax and forest management, or if the data are publicly available.

### *Sub-dimension 13.3: Environmental quality of life*

Air quality in Serbia remains a concern. The population is exposed to air pollutants like fine particulate matter ($PM_{2.5}$) levels that are more than twice those guidelines set by the WHO[160] (25 µg/m$^3$ as compared to 10 µg/m$^3$) (World Bank, 2017[259]). The main sources of outdoor air pollution include the energy sector (thermal power plants,[161] district heating plants and individual household heating), the transport sector (due to an ageing vehicle fleet), waste dump sites and industrial activities (oil refineries, the chemical industry, mining and metal processing and the construction industry) (WHO, 2019[260]). Air pollution has become of even greater concern during the COVID-19 pandemic as it is known that exposure to ambient and indoor air pollution increases the risk of cardiovascular, respiratory and developmental diseases, as well as premature death, thus making individuals even more vulnerable to COVID-19 (OECD, 2020[261]). Air pollution also contributes significantly to the overall burden of disease and premature death in Serbia, which has higher estimated premature deaths due to air pollution than most countries in the EU (World Health Organisation, 2019[262]).

Serbia recognises the seriousness of the health risk from air pollution and it is managed through a relatively well-developed legislative and policy **air quality framework**. No major changes in the legislative framework have been recorded since the last assessment, but the policy framework has seen the adoption of the National Plan for Reducing Emissions of Major Pollutants from Old Large Combustion Plants (NERP)

was adopted in January 2020. This plan aims to reduce total annual emissions of sulphur dioxide, nitrogen oxides and particulate matter from the combustion plants it covers, to meet limit values prescribed in the plan by 1 January 2028 the latest. Supported by an EU-funded project,[162] Serbia was also developing the Air Protection Programme with an action plan at the time of drafting (to be finalised in 2021). This Program is expected to provide a basis for further development and adoption of by-laws and continued implementation of the EU legislation in the field of air protection.

Air quality plans have also been developed at the local level. Since 2013, 6 out of 13 local governments have obtained the ministry's approval for their plans, including 4 since the last assessment. However, Serbia's annual air quality report for 2018 lists 11 urban agglomerations with air pollution above the limits,[163] 5 of which do not have air quality management plans in place (EC, 2020[36]). Also worrying is the lack of funding for environmental protection and investment in climate change by the largest air polluters in Serbia. The pollution caused by the Kostolac B thermal power plant needs to be addressed as a priority (EC, 2020[36]).

Numerous bodies are responsible for air quality, but the lack of human resources and insufficient funding at all three levels (national, provincial and local) are a continuing problem, with clear consequences for operational monitoring and reliable assessment of air quality in zones and agglomerations. Capacity building is regularly offered, mostly though the support from the international community. Horizontal and vertical co-ordination have been functioning well.

SEPA regularly monitors air quality, conducting automatic air quality monitoring at the national level. It maintains the air quality information system (as a subsystem of the environmental protection information system), conducts laboratory analyses of air samples, carries out regular calibration of equipment and produces annual and periodic reports on the state of air quality, thus enabling decision makers to take measures to reduce air pollution. SEPA publishes monthly reports on the state of air quality, based on data obtained from the state and local air quality monitoring networks. It also prepares and publishes an annual report on the state of air quality.

No mitigation measures have been specified for when air pollution thresholds are exceeded, which means that there is often no immediate response, especially from local governments. According to the Law on Air Protection and the accompanying by-laws, SEPA is obliged to inform the public about the exceedance, which is done exclusively through the website in real time. According to data obtained by SEPA, around 2.5 million people, or one-third of the Serbian population, have been exposed to excessively polluted air. At the same time, local stakeholders report incomplete data about air pollution, due to insufficient monitoring infrastructure (in particular in rural areas) and the number of pollutants monitored. Local stakeholders confirm that the data provided should be interpreted with caution, due to limited availability of valid hourly data provided by the state air quality monitoring network. Only 48% of stations provided valid data in 2019 (Coalition 27, 2020[255]). Local stakeholders also noted that the air quality monitoring framework does not stipulate clear obligations for polluters, thus impeding the efficiency of responses.

Another element that strengthens public health by reducing health risks is a high-quality **water supply and sanitation (WSS) system**. Although traditionally Serbia has good access to drinking water with proven water service continuity, the quality of the water is rather low, especially in rural areas and the Autonomous Province of Vojvodina, in the latter due to high concentration of arsenic in the groundwater (Serbian Environmental Protection Agency, 2020[263]). Untreated sewage and waste water are still the main source of water pollution (EC, 2020[36]). Around 58% of the population is connected to public sewerage systems, but only 10.5% are connected to public sewerage served by a wastewater treatment plant. This is higher than the WB6 average of 6.5%, but lower than the EU average of 86% (Eurostat, 2020[264]). In 2018, 42 municipal wastewater treatment plants were operational in Serbia, but worked at lower efficiency level and 18 are still under construction or being rebuilt (Serbian Environmental Protection Agency, 2019[265]).

Serbia has made no major changes to its WSS legislative and policy frameworks since the last assessment (2018). It still needs to make significant efforts to align its legislation further with the EU *acquis*, and to

strengthen administrative capacity, in particular for monitoring, enforcement and inter-institutional co-ordination (EC, 2020[36]). As mentioned in the section on freshwater management, the government failed to adopt the action plan for the Water Management Strategy (2017-34), which impeded appropriate implementation in the field.

The Ministry of Agriculture, Forestry and Water Management, and the Ministry of Construction, Transport and Infrastructure, as well as local enterprises established by municipalities, are the key bodies responsible for wastewater management in Serbia. However, the administration is of the view that they do not have the financial and human resources to undertake their assigned responsibilities and nor are there any regular activities aimed at building their capacity. No horizontal or vertical co-ordination tools exist in this area, which impedes effective implementation of the envisaged measures.

The water supply network in Serbia is very old (approximately 35 years) and that is one of the main reasons for the large water losses in the system, around 33% in 2019 (State Audit Institution, 2019[266]). Despite these statistics, the government has not taken any action to reduce these losses. Additional investments in wastewater treatment plants are planned, but they remain largely dependent on donor funding. Current water service fees have proved too low to cover or even supplement investment in WSS infrastructure; indeed they aren't even covering the operational costs of the system.

At the time of drafting, the strategic **industrial waste management** framework (the Waste Management Strategy 2020-25 and the National Waste Management Plan) was being updated, together with the establishment of the National Soil Monitoring Programme. Alignment with most of the EU *acquis*, including the Industrial Emissions Directive, is at an early stage. Serbia adopted its long-awaited national emission reduction plan in 2020 and established a database strengthening the monitoring of Seveso III operators[164] (EC, 2020[36]). Serbia has a high level of alignment with the EU *acquis* on chemicals; in 2019, it opened an online platform for registering biocidal products (EC, 2020[36]).

Urban soils are being monitored locally in order to determine contamination levels and potential risks to population health, with SEPA collecting data from local authorities. The monitoring includes the concentration of hazardous and harmful substances in soils in industrial zones, zones situated near the roads, drinking water supply zones, recreational and residential zones, agricultural areas, and zones near landfills.

Reporting on contaminated sites was established in 2020 through the Cadastre of Contaminated Sites information system, which is part of the environmental information system. SEPA maintains the cadastre,[165] which includes data on contaminated, endangered and degraded land, and is an integral part of the Land Information System.

### *The way forward for environment policy*

Despite taking some important steps to improve the overall environment, especially in the areas of waste and freshwater management, biodiversity, and forestry, the authorities should still consider the following steps:

- **Step up efforts to combat air pollution and climate change, primarily by reforming power generation**. Serbia would need to phase out coal subsidies and start implementing renewable support schemes that are fully aligned with the EC's guidelines on state aid for environmental protection and energy 2014-20. In particular, the share of incentives dedicated to renewables continues to be modest in Serbia compared to coal subsidies and almost half of them were dedicated to support the expansion of small hydropower plants, which continue to be more privileged than other sources (CEE Bankwatch Network, 2019[267]). Permanently closing two of its thermal power plants (Kolubara A and Morava) and installing the best-available modern filters for the Kostolac plant are highly recommended. Subisidies for renewable energy should prioritise solar and wind over hydropower to address the current support imbalance and negative practices that

have harmed biodiversity. High levels of pollution are also linked to socio-economic conditions, as most citizens depend on coal as a low-cost source of energy. Subsidies could therefore be considered for other forms of heating, such as solar space heating.

- **Invest in improving the water supply and sanitation system and treating more waste water**. Despite its abundant freshwater, Serbia faces increasing water pollution, mostly as a result of continuing discharges of municipal and industrial wastewater into the rivers, a large number of illegal dumpsites, uncontrolled waste deposits, and pollution from agriculture sources. Inadequate sewage infrastructure is a significant cause of surface and underground water pollution due to the inadequate collection and treatment of waste water. Serbia's ageing infrastructure is also at the root of high levels of water losses. This is why it is important to conduct a thorough investigation of the situation and identify key investment priorities. The government should try to finance these projects as much as possible from the domestic budget and water tariffs (taking into account the needs of poor and vulnerable groups in the population). If it does reaching out for support from donor funds, it will need to make sure such funding flows regularly to ensure sustainable maintenance of the water supply and sanitation system.

## Agriculture policy (Dimension 14)

### *Introduction*

Serbia has significantly improved its performance in this dimension. Its score has increased from 2.8 since the 2018 *Competitiveness Outlook* to 3.1 in this assessment (Figure 25.1), with notable progress in enhancing its agricultural support systems.

**Table 25.26. Serbia's scores for agriculture policy**

| Dimension | Sub-dimensions | Score | WB6 average |
|---|---|---|---|
| **Agriculture policy dimension** | Sub-dimension 14.1: Agro-food system capacity | 2.5 | 2.8 |
| | Sub-dimension 14.2: Agro-food system regulation | 3.3 | 2.9 |
| | Sub-dimension 14.3: Agricultural support system | 3.3 | 2.7 |
| | Sub-dimension 14.4: Agricultural innovation system | 3.0 | 2.6 |
| **Serbia's overall score** | | **3.1** | **2.7** |

### *State of play and key developments*

Agriculture is an important sector for Serbia, accounting for 6.2% of total GDP in 2019 (SORS, 2020[127]). The importance of the agricultural sector is also evident in in its contribution to employment: it accounted for 15.1% of total employment in 2020 (SORS, 2020[127]). However, only 51.6% of the total agricultural workforce are formally employed, and around 19% are already aged over 65. Agricultural land takes up 39.3% of the total land area, with arable land accounting for 29.6%. In 2018, arable made up 74.1% of land under agricultural use, while 5.3% was plantations/orchards, 0.6% vineyards, 10.1% permanent grasslands and 9.3% pastures. Cereals accounted for 66.3% of arable land, industrial crops 19%,[166] vegetables 1.9% and fodder crops 8.9%.

Agriculture is one of Serbia's top five export sectors: (SORS, 2020[127]) food and livestock accounted for 13.2% of total exports in 2019; maize and raspberries (frozen, no sugar) were among the top ten exported goods. Serbia is the world's largest exporter of frozen berries (raspberries, blackberries, mulberries and loganberries). In 2019, it exported 148 000 tonnes of frozen berries valued at more than USD 250 million, 30.5% of the world's exports.

Serbia is among the top five global producers of raspberries and plums, cultivating 127 011 tonnes of raspberries and 430 199 tones of plums in 2018. After fruit, grain is the dominant crop: it produced 6.2 million tonnes of maize (corn) and 2.1 million tonnes of wheat in 2018, making Serbia among the 30 largest producers of these crops in the world. In 2020, compared to 2018, maize production has increased by 9.6% and plums by 4.2%. Over the last decade, production of wheat (17.8%), maize (29.4%), sunflower (26.3%) and soya (60.3%) have all increased.

In 2019, crops accounted for 66.3% of total agricultural production, while livestock accounted for 33.7%. The net index of the volume of agricultural output increased by 14.3% over 2018. The value of livestock production also increased by 1.3% over the previous year while the production of raspberries increased by 7.4% and sour cherries by 70.9% (SORS, 2020[268]).

The COVID-19 crisis has affected all sectors of the Serbian economy, with most of the impact felt in services and tourism, resulting in reduced incomes, significant financial losses, increased unemployment, and the closing down of a number of small and medium-sized service providers. The agriculture sector also faced difficulties that have broken value chain linkages. Movement restrictions (lockdown) closed the traditional open green markets and prevented visitors coming to farms providing agro-tourism services (especially during the weekends). Lockdown, uncertainty and widespread fear of the virus created significant gaps into provision of seasonal labour, especially in March-June 2020. Complications with the transport of goods (both domestic and export) has slowed down the performance of the agriculture sector

overall. Some of Serbia's traditional agriculture export markets saw significantly decreased demand for some products (mostly fruits, lamb meat). On the other hand, the demand for wheat (flour) has increased.

In September 2020, the SORS noted an overall increase in the agriculture sector of 2.5% overall compared to 2019% (SORS, 2020[269]). The buy-out prices of most of the crops have remained the same as in 2019, or slightly increased. The most significant fall in prices has been in the livestock sector where broilers fell by 5.46%, pigs by 4.04% and calves (veal) by 8.68%. Comparing August 2020 with August 2019, prices rose for industrial crops (13.3%) and fruits (30.3%). Salaries in the agriculture, hunting and forestry sector fell by 10.2% compared to 2019, while employment in the sector fell by 1.8%. Exports of agriculture products (January-August 2020) increased by 7.8%, while imports decreased by 0.9%. The government adopted a few measures to support agricultural producers, including financial support measures (per ha/per head) to agricultural producers to mitigate the negative consequences to agriculture in April 2020. It also granted all types of agricultural producers preferential access to financial products (credit lines, leasing), prolonged grace periods, lower interest rates, paid insurance on financial products, etc. In September 2020 it introduced financial support measures (per head) to veal producers and slaughterhouses to mitigate the reduction in market demand caused by COVID-19.

At this stage, the government appears to have successfully mitigated the immediate and medium-term impact of COVID-19 on the agriculture sector. The support measures have been welcomed and widely used by producers. At the time of writing, even though the infection rate is increasing strongly in Serbia and the region, the government has completely changed its strategy compared to April 2020. Borders are open for the whole region (Albania, Kosovo, North Macedonia) without PCR tests and there is free movement for both people and goods, which should protect the economy from the harmful effects of COVID-19. This will not have any significant impact on agriculture during the winter period, when activity levels are very low.

### *Sub-dimension 14.1: Agro-food system capacity*

Serbia has significantly enhanced its **rural infrastructure policy framework** over the last decade, with large projects investing in greater connectivity and faster expansion of broadband access in rural areas. Serbia's national rural infrastructure policy predominately falls under the remit of the Ministry of Agriculture, Forestry and Water Management (MAFWM)[167] while provincial secretariats[168] handle regional rural infrastructure. While these secretariats are independent and have their own budgets, their measures and activities are consistent with the policies of national ministries.

Serbia's investment in infrastructure, particularly in road construction and the railway network, reached close to EUR 3.5 billion in the period 2016-20. The E-80 corridor from Nis to the Bulgarian border was completed in 2016, enabling faster movement of goods and people from Bulgaria and Turkey to the EU. The E-75 road corridor was completed in 2019, enabling faster movement from the border with North Macedonia to the borders with Croatia and Hungary. The highway Milos Veliki from Belgrade to Cacak towards Montenegro, connecting the Ibar Valley to Belgrade, was completed the same year. Sizeable investments were also made in the E-70 corridor linking Serbia with Romania and Croatia which was completed in 2011.

Apart from these large-scale projects, there have been a number of ongoing investments in the rehabilitation of local roads, bridges and river banks. In August 2019, Serbia announced a EUR 12.4 billion investment plan for 2020-25, of which EUR 3 billion of which was allocated to improving sewage systems in rural areas while an additional EUR 1.3 billion was allocated to improving local and regional speed railways.

The MAFWM has implemented the Rural Development Strategy for the protection, development and use of agricultural land including land consolidation and the restoration of field roads. In 2019, the rulebook on subsidies for investments in physical assets of agricultural holdings for field electrification was adopted, defining support for investments related to electrification of fields. The goal is to accredit this measure as

part of rural infrastructure in the Instrument for Pre-Accession Assistance in Rural Development (IPARD) programme and to provide users with support for the realization of investments.

As of November 2020, the Ministry of Trade, Tourism and Telecommunications has begun implementing the Last-Mile Broadband to Households in White Zones in Rural Areas project, aimed at households that are not targeted for network expansion by any commercial operator in the next three years – see Digital society (Dimension 10).

In addition to the national budget, funding is provided through the World Bank, the EBRD, the EIB, and the European Agency for Reconstruction (EAR), as well as the China Investment Fund[169] and Abu Dhabi Fund[170] with an investment plan of EUR 300 million in agriculture infrastructure for the period 2013-21.

When it comes to Serbia's **irrigation policy framework**, the new irrigation strategy for 2020-30, which is under preparation, should include measures to use water more efficiently, considering Serbia's overall low water productivity. The current irrigation infrastructure is underused and in need of rehabilitation while drainage systems remain limited.

In 2018, a total of 159 587 ha was covered by irrigation systems, which is 6.18% of arable land in Serbia (which totals 2.58 million ha). Only 46 863 ha of agricultural land was actually irrigated in 2018, which represents 29.3% of the total area covered by irrigation systems.[171] In 2018, 33% of all Serbia's farms could use some form of irrigation system (564,540 ha). The commonest form of irrigation system is through sprinklers. Of the total irrigated area in 2018, 92.3% was irrigated by sprinklers (down 1.6% on the previous year), 7.6% by drip irrigation (up 1.6%) and 0.1% by surface irrigation.

At the end of 2019, the government announced the EUR 14 billion Serbia 2025 investment programme for economic development, with EUR 300 million earmarked for investments in agriculture. A sizeable amount of this investment (EUR 86 million) has been allocated to developing irrigation and drainage systems that will double the arable land under irrigation and drainage. The National Programme for Rural Development 2018-20 also provides support for three types of irrigation measures. Farmers and water users' organisations can apply for support to buy new irrigation equipment (50% support) or new irrigation systems (100% support). Water supply/irrigation public companies can apply for 100% support for preparing technical documents for new irrigation systems. IPARD also provides support for the use of groundwater (from springs and wells) and surface water (from rivers, lakes and reservoirs), and the construction of irrigation systems, including pumps, pipes, valves and sprinklers, which replace old inefficient systems and contribute to reducing the amount of water used.

In 2019, the Government of Serbia signed a memorandum of understanding (MoU) with the EBRD to implement joint programmes and investment activities aimed at strengthening Serbia's agri-food sector. One of the priority areas of co-operation set out in the MoU is upgrading, expanding and modernising irrigation infrastructure and water management systems to reduce farmers' vulnerability to climate change. The programme describes on the financing, construction and rehabilitation of critical irrigation infrastructure in three regions of Serbia: Negotin (Eastern Serbia), Svilajnac (Central Serbia), and Vojvodina (Northern Serbia) with a total of EUR 30 million. It also continues policy dialogues with the MAFWM by assisting in the preparation of Serbia's first Irrigation Strategy and a five-year action plan.

As part of the co-operation between Serbia and the United Arab Emirates, the current Abu Dhabi Fund for Serbia, envisages EUR 300 million support, with more than 30% for investment in irrigation. As of 2017, the fund had supported 12 irrigation projects, and planned to finalise an additional 10 by the end of 2020. The projects cover investment in small to medium-sized irrigation/drainage systems, each covering around 1 000-3 000 ha.

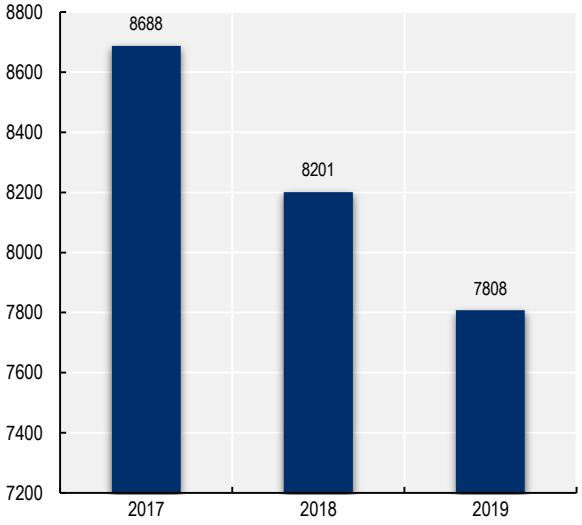
Serbia has made progress in updating the legislation on qualifications and establishing monitoring and evaluation of **agricultural education**. The educational system in agriculture is regulated and organised by MoESTD while the Institute for Improvement of Education is responsible for preparing the initiatives and reforms introduced by MoESTD. In 2020, Serbia adopted the By-law on Special Educational

Programmes which defines the implementation of teaching and learning in case of a state of emergency or unpredictable circumstances, in particular, the ongoing COVID-19 measures.

Agricultural education in Serbia is covered by 4 universities and 26 secondary schools, which are supported by 16 specialised research institutes predominantly focused on technologically advanced production. The four universities are the faculties of agriculture at the University of Belgrade, the University of Novi Sad, the University of Kragujevac and the Faculty of Bio Farming at the Megatrend University in Belgrade.[172]

The share of students enrolled in agriculture, forestry, fisheries and veterinary tertiary programmes in Serbia increased from 2.45% in 2018 to 3.39% in 2019 (Trading Economics, 2021[270]). While the number of students graduating from high school agriculture programmes has slightly increased, the number enrolling in the first year of university agriculture programmes fell from 9 147 in 2017 to 8 201 in 2019 (Figure 25.18). In secondary vocational schools, the share of students enrolling in agriculture, food production and processing increased from 6.5% of total high school students in 2017 to 6.7% in 2018. In 2018, 49% of farmers had completed primary education, 45% had completed secondary education and 6% completed tertiary education. Only 0.7% of all employees in Serbia are skilled agricultural, forestry and fishery workers.

### Figure 25.18. Number of students enrolling in the first year of university agriculture programmes




Source: (SORS, 2020[214]), *Statistical Yearbook 2020*, https://publikacije.stat.gov.rs/G2020/Pdf/G20202053.pdf.

The Strategy for Education Development in Serbia 2012-20 aims to improve the quality of education, increase the share of the population covered at all educational levels, maintain the relevance of public education, and increase the efficiency and use of all education resources. A new strategy to follow on from this is currently being prepared. In line with the strategy's action plan, MoESTD established the Qualifications Agency and 12 sectoral councils in 2018, one of which is the Council for Agriculture, Food Production, Forestry, Fishery and Veterinary Sectors which is responsible for updating the skills, qualifications, education and training required to practise in these fields.[173]

Serbia has also begun implementing an evaluation mechanism for the agricultural education system. In March 2020, the national system for assessment of the education and its outcomes was established as an education management information system, on the basis of the education strategy. The system is connected to the SORS, which is in charge of gathering and managing education data in the fields of economy, agriculture, finance and regional policy, as well as the Institute for Education Quality and Evaluation. The first results from the systems are expected next year and the information gathered will serve for planning and implementation of education programmes in agriculture.

*Sub-dimension 14.2: Agro-food system regulation*

Serbia has made progress regarding **regulations on natural resources** through an enhanced land consolidation process and the Land Parcel Identification System (LPIS), but inter-institutional co-operation is lacking. Natural resources in Serbia are the remit of the MAFWM and MoEP but inter-sectorial co-operation between the two ministries is limited, and there is no committee or administrative body where they could formally share information regarding the activities and challenges. Several regulations cover this field including the Law on Land Protection,[174] the Law on Environmental Protection,[175] the Law on Planning and Utilisation of Natural Resources, the Law on Nature Protection, and the Water Law,[176] which is harmonised with EU directives.

Recently, Serbia has emphasised land consolidation as a way to increase agricultural production. A new draft Law on Land Consolidation is being prepared, which will define the reasons and conditions for initiating land consolidation; land consolidation procedures; competent bodies, organisations and other bodies to implement land consolidation; sources of land consolidation; and other issues of importance for land consolidation, as well as the procedure for voluntary grouping of land. The Strategy for Rural Development 2014-24 also prioritises land consolidation to improve agriculture competitiveness, while the Serbia 2025 programme allocates an additional EUR 70 million to land consolidation processes.

The National Strategy for Sustainable Use of Natural Resources and Goods[177] also aims to further protect land and minimise damage and loss of agricultural land due to natural resource extraction. However, there has been no significant progress in the implementation of this strategy in relation to agriculture (World Bank, 2020[271]) Efforts to increase investment and productivity in agriculture continue to be hampered by land tenure uncertainty, the fragmentation of farms, and the incentive structure of agricultural subsidies. Large tracts of arable land continue to be owned by the state, including in zones with high production potential. The MAFWM has been offering state-owned land on multi-year leases (5-40 years), especially after 2018. There are now multi-year lease agreements covering 161 212 ha of state agricultural land. The ministry has also granted approvals for investments in agricultural infrastructure on 10 259 ha of leased agricultural land.

The LPIS[178] is an important tool for planning, implementing and monitoring support in agriculture. The main reasons for the establishment of both it and the Integrated Administration and Control System (IACS) are transparent and fair distribution of subsidies, easy identification and declaration of the land cultivated by farmer(s), easy control of declarations by the administration, reliable and accurate sources of information for policy and statistics on crops and area cultivated, and the assessment of policy impacts. As of November 2019, an EU project[179] has assisted in developing the technical software specification for the LPIS and land cover, developing a methodology, and training employees in the Directorate for Agrarian Payments and representatives of local self-government in the establishment of the LPIS. An analysis of the advantages and disadvantages of the four types of reference parcels has been done to select the most suitable type of reference parcel for Serbia. The LPIS pilot project (phase II) will include updating the LPIS methodology, developing an action plan to implement it across the whole of Serbia, and training on the new software.

When it comes to **regulations on products,** the regulations for seeds are comprehensive and regularly updated and thorough impact assessments and evaluations are conducted on an annual basis. The MAFWM is responsible for regulations on seed products which are based in the Law for Agricultural Plant Species, the Law on Seeds, the Law on Plant Health, and several rulebooks based on these laws. The Law on Plant Nutrition Products and Soil Improvers was updated in 2019 and regulates the classification, quality, designation, phytosanitary control and sampling for the sale, import and use of seeds and planting material. In adopting new laws and rulebooks for product regulations, impact assessments are conducted at least once a year. Officials of the Plant Protection Directorate are responsible for seeds and fertilisers.

The MAFWM established a Public Register of Plant Nutrition Products and Soil Improvers, available on its official website. The register contains over 2 500 plant nutrition products and soil improvers and is updated on daily basis. Entry in the register is enabled by the manufacturer, distributor or importer with approval of the ministry. Plant nutrition material, planting material and plant protection products are subject to documentation checks to identify shipments upon import. Sampling and testing are carried out to verify the product quality as mandated by the decision of entry in the Register of Plant Nutrition Products and Soil Improvers. Registrations are valid for a maximum of 10 years and can be extended by the ministry. If there is a suspicion that the plant protection product does not meet the conditions for registration, the ministry may initiate the procedure of reviewing the decision on registration. The register of agricultural plant varieties contains nearly 5 000 registered varieties and it is also regularly amended with new varieties.

### *Sub-dimension 14.3: Agricultural support system*

The **agricultural policy framework** in Serbia is partially harmonised with the EU and there are multiple stakeholder consultation processes for the adoption of new policies. The creation and implementation of agricultural and rural development policies falls under the auspices of the MAFWM while at the local level, all municipalities have bodies responsible for local agricultural and rural development policies in their territories. Additionally, the Ministry for European Integration is responsible for monitoring and reporting on the harmonization of the national policies with Chapters 11, 12 and 13 of the EU *acquis*. Serbia's plan for the development of agriculture and rural areas is set out in the National Agriculture and Rural Development Strategy (NARDS) of Serbia 2014-24,[180] developed with the participation of over 200 stakeholders from universities, the food industry, producers' associations, individual producers, relevant ministries and other government bodies. The procedure for adopting agriculture policies in Serbia includes public debate during which multiple stakeholders have the possibility to send their suggestions regarding policy content.

Based on the NARDS, the National Agriculture Programme (NAP) 2018-20 aims to support the development of agriculture, in particular the implementation of the agricultural policy and its harmonisation with the EU and Common Agricultural Policy (CAP) requirements. Besides the NAP, there is also National Programme for Rural Development in the period 2018-20 that sets the medium-term courses for the development of rural areas and describes the methods of implementing rural development measures for 2018-20. As of March 2020, the preparations for drafting the next national programmes for agriculture and rural development for 2021-24 had been started, with six agriculture sectoral analyses completed.

The 2018-23 action plan for the transposition, implementation and enforcement of the EU *acquis* in agriculture and rural development covers agricultural policy reforms, legislation changes and the strengthening of administrative capacities in the period before the EU accession. The action plan provides an assessment of necessary resources and capacity development measures required to strengthen and implement programmes and control bodies, as well as establishing the Paying Agency and the IACS.

The National Programme for the Adoption of the Acquis 2018-21 is a detailed, multi-year plan for harmonising domestic regulations with EU regulations. It is designed to link European legislation and domestic legislation in order to monitor the pace, scope and quality of that harmonisation. EU law is divided according to the responsibilities of state bodies, which enables regular planning and monitoring of their legislative activities. However, the agriculture policy framework in Serbia is still only partially harmonised.

Serbia's **domestic support instruments for producers** in agriculture are comprehensive and numerous. Income support measures improve farmers' income by reducing variable costs and increasing gross margins. The milk premium is the only scheme based on price support, i.e. payment per output. Basic subsidies for plant and livestock production contribute to farmers' income by paying them a fixed amount per hectare/head. All subsidies are available to farmers registered in Farm Register but basic subsidies for plant production are limited to 20 ha per beneficiary while there are also limits on livestock subsidies, depending on the animal.

Support is provided for rural development investments that contribute to increasing competitiveness and reaching quality standards. The support rate for such rural development measures is a minimum of 30% of the measure value; for farms in areas with difficult working conditions in agriculture the minimum rate is 45%, rising to 70% for some districts. The rural development programme supports 15 measures, including investment in agricultural households' physical assets; investments in the processing and marketing of agricultural, food and fishery products; subsidies for the preservation and improvement of the environment and natural resources; support for organic production; and the conservation of plant and animal genetic resources. Rural development measures also focus on economic activities and income diversification in rural areas, as well as improving the transfer of knowledge and innovative projects in agriculture.

Support is provided through national measures to support rural development and through the IPARD programme. As part of the IPARD programme, two public calls have been made for investments in the physical assets of agricultural holdings. Users can receive up to 60% of the value of the investment and young farmers can up to 65%, up to a maximum of EUR 1 million per person. The same programme has issued three public calls for investments in physical assets related to the processing and marketing of agricultural and fishery products. Beneficiaries can receive support of up to 50% of the value of the investment, up to a maximum of EUR 2 million per person. Despite significant EU resources being allocated to agriculture in Serbia, the available investment funds are underused because of the limited uptake of development grants by small and medium-sized producers (World Bank, 2019[272]).

To help with risk management, farmers can receive support to cover 40% of their insurance premiums for crops, permanent crops, nurseries and animals (45% in areas with difficult agricultural conditions), to encourage them to insure their crops and animals and avoid losses in the event of natural disasters.

The MAFWM lacks the administrative capacity to deal with policy creation and implementation. Budgetary funding for agricultural subsidies and rural development are monitored and are used to plan funding for following years. The MAFWM publishes the Green Book (by 30 June each year), which contains a review of all budgetary spending on subsidies in the previous year, as well as an overview of production in the agricultural sector. It is available on the MAFWM's official website.

Monitoring and evaluation of implementation of the IPARD II programme is carried out on a monthly, bi-monthly, semi-annual and annual basis, as well as on request. During the preparation of the IPARD II programme, an *ex ante* evaluation was conducted, and evaluation has been ongoing during its implementation. An impact assessment will be conducted after implementation and will include the impact of the programme on innovation adoption, structural change and sustainability.

The current agriculture support system is funded by direct payments, rural development measures plus specific subsidies and credit support, and IPARD. All schemes are financed out of the MAFWM's annual budget, while the IPARD measures are co-financed by the EU fund. The annual regulation on allocation subsidies in agriculture and rural development defines the level of support for each scheme in that year. The current subsidies have been in force since 2013 and have since been harmonised, in terms of categorisation, with the CAP.

As almost all the schemes defined by the Law on Subsidies in Agriculture and Rural Development have been implemented, the entire budget for subsidies in agriculture and rural development is spent every year. There are no significant differences in the use of the national budget and IPARD fund, as the application procedures are similar, but IPARD applications are subject to several controls and are therefore more time-consuming than the national measures.

Although **agricultural trade policy** in Serbia is mostly harmonised with World Trade Organization (WTO) and EU standards, its customs regulations are unorganised and ambiguous. Agricultural trade policy is based on the Law on Foreign Trade which requires that measures affecting foreign trade, including in agriculture, are applied in accordance with WTO rules, EU legislation and commitments undertaken under international agreements. The law envisages the possibility of introducing quantitative restrictions in the

case of a critical shortage of basic products, or to alleviate the effects of such a shortage. Tariff quotas are implemented through the Customs Administration within the Ministry of Finance. The use of quotas is registered and deducted after the goods have gone through customs, and an automatically updated overview of the use of quotas is available on the Customs Administration website.

Serbia has begun the process of negotiating its membership of the WTO[181] and begun consolidating the form and level of customs protection of agriculture. The liberalisation of trade in the region has continued through bilateral free trade agreements, under which significant agricultural concessions were agreed and later integrated into the Central European Free Trade Agreement (CEFTA). Tariff quotas are defined in the Stabilization and Association Agreement (SAA) with the EU, the free trade agreement with Turkey and the European Free Trade Association (EFTA) Agreement. Serbia does not apply export quotas except for sugar and some other products exported to the EU market, based on the SAA double-checking model.

There have been no export duties for agricultural products since 2013. Customs for the agriculture sector are regulated by the Law on Customs Tariffs, the Law on Specific Duties for Import of Certain Agricultural and Food products, and the Customs Law which includes the Decision on Seasonal Tariff Rates for products such as flowers, vegetables and fruits with *ad valorem* rates of 20%. As tariff protection for agricultural products is subject to decisions by the government, agricultural trade policy is unpredictable and not transparent. Serbia's accession to the WTO will consolidate customs regulations into a single piece of legislation and establish a binding maximum level of tariffs.

In terms of its **agricultural tax regime**, Serbia applies reduced taxes on agriculture products. The taxation system distinguishes between agricultural holdings and individual agriculture. Agricultural legal entities enjoy the same tax treatment as all other legal entities, and are included in the corporate income tax system. Individual farmers are natural persons, and are included in the personal income tax system. A natural person who generates income from agriculture, and does not have the status of entrepreneur, is not obliged to keep business and financial records.

In principle, farmers in the Republic of Serbia are not VAT payers, even when their total turnover is more than RSD 8 million. They can voluntarily choose to pay VAT by submitting a registration application, in which case the obligation to pay VAT lasts for at least two years (Article 34, paragraphs 5-7 of the Law on Value Added Tax). After two years, their status as VAT payers does not cease automatically, but they must submit the appropriate request. The situation is different for farmers who have entrepreneur status and who keep books. They become VAT payers once their total turnover exceeds RSD 8 million. However, since they choose freely whether or not to have the status of an entrepreneur, entering the VAT system can also be seen as a choice. When they enter into the VAT system, farmers are subject to the same treatment as other VAT payers.

The standard VAT rate in Serbia 20%, and the reduced rate for agricultural products is 10%. In most cases, VAT on agriculture products is at the reduced rate. VAT for agricultural inputs that are not produced in Serbia are updated every year based on a proposal by the MAFWM to the Ministry of Finance, most of which are technical production machinery and equipment. Personal income tax is 10% but increases for those whose income is three times the average salary, by an additional 10% on the difference between their net earnings and the average salary.

Although Serbia's annual programmes for plant health are aligned with the EU, the organisation and monitoring of its **sanitary and phytosanitary (SPS) measures** are still being developed. The veterinary and food policies need further improvement in the process of alignment with EU legislation. The authorities responsible for SPS measures are the Veterinary Directorate, the Plant Protection Directorate and the Sector for Agriculture inspection under the MAFWM, and the Sanitary Inspection Sector under the Ministry of Health. SPS regulations are based in the Food Safety Law which covers the organisation, implementation and monitoring of SPS measures as well as the division of responsibilities, and the Law on Inspection Control.

The annual programmes for plant health measures have been adopted and the list of approved active substances in pesticides is aligned with the EU. While duplication may occur over composite products, due to their complex structure, this is rare and the responsibilities for inspection are clearly divided in the Law on Food Safety. This law was amended in 2019, adopting the rulebook on the division of competencies regarding food safety and listing composite foods. Risk analysis for SPS measures and plant products uses the International Plant Protection Convention methodology, and phytosanitary inspections and financing are based on a risk approach.

Serbia lacks the capacity to introduce SPS initiatives as it has no written processes for the systematic evaluation of the quality of services and the capacity requirements of the organisations involved, and the overall system. However, the management hierarchy is clearly defined, as are the working plans and objectives. There is system for evaluating employees and in-house procedures, all of which could be a good basis for establishing written processes for the systematic evaluation of the quality of services. Due to a permanent shortage of staff to carry out phytosanitary inspections, 16 new inspectors were hired in 2020.

In 2019, Serbia adopted annual programmes for veterinary policies consisting of animal health protection measures. The further delegation of inspection duties from Phytosanitary in the Veterinary Inspectorate led to the employment of 39 new veterinary inspectors in 2020. Serbia has a large network of accredited reference laboratories with well-established data and information exchange between laboratories and inspections. Accreditation of the national reference laboratories directorate was extended for milk (additional methods), food and seeds for between 3 and 10 years, depending on the product. Although animal welfare legislation is mostly harmonised with EU regulations, some legislation remains to be amended, such as the regulation on official controls for slaughter. Serbia is also not fully harmonised with EU legislation over maximum residue levels of related substances, as the permitted level of aflatoxins in milk remains five times that permitted by the EU *acquis*.

### *Sub-dimension 14.4: Agricultural innovation system*

Serbia has made substantial progress in improving its **agricultural research and development framework**. Research regulations are fully harmonised with the EU and the key EU research goals are incorporated into the policy on scientific and technical advancement. Serbia has continued its involvement in the EU research framework and international co-operation, through Horizon 2020 and Eureka.

The scientific work at the faculty level in Serbia is realised through basic, applied and developmental research. The aims are to raise the quality of teaching, improve the skills of scientific and teaching staff, introduce students to scientific work, create material conditions for work and development of the faculty, and develop new technologies and products, new species, breeds, varieties, etc. Research in the field of agriculture and food has always been in the most direct connection with the development of agriculture and the food industry of Serbia. Teachers, researchers and associates of the faculty participate in a large number of national and international projects.

Work has begun on the implementation of a new research and innovation plan for the next seven years and the Science, Technology and Innovation Roadmap, focused on the Smart Specialisation Plan. Some progress has been made with the new Science and Research Act and the introduction of the first Smart Specialisation Strategy, but no action plan for the strategy has yet been implemented.

Extension services in Serbia are comprehensive, widely available and commonly used by farmers. The **agriculture extension services framework** is based in the Law on Agricultural Advisory and Extension Services and several by-laws.[182] The key action plan is the Multiannual Programme for the Creation of Agricultural Advisory Services, along with seven statutory and administrative provisions.

The farm advisory system has 36 agricultural advisory and extension services (AAES), 31 of which are public and 5 of which are private, employing a total of 273 advisors. The work of the AAES is managed by

the MAFWM (Sector for Rural Development, Advisory Group) and the Provincial Secretariat for Agriculture, Water Management and Forestry (PSAWMF), for the territory of the Autonomous Province of Vojvodina. Since 2016, the MAFWM and PSAWMF have authorised two organisations to educate and train advisors, monitor them and report on their work for a 10-year period, the Institute for Agricultural Science Application (IPN) and the (Poljoprivredna Stanica) ( PSS) Novi Sad Education Centre. These approved entities assess the effects of the advisors' work and the advisory activities carried out by them in accordance with the Monitoring and Assessment Programme of the Work Effects of the Advisors.

Extension services are widely used by agricultural producers. The advisory work of the MAFWM is entirely financed in conjunction with the annual programme for the production of agricultural advisory services. Some groups of farmers are targeted for individual work with consultants and facilities and educational programmes are often offered free of charge. A training programme for advisory services is also available and is implemented periodically in conjunction with the annual training plan prepared by the approved organisation. There are also one-off initiatives to encourage creativity, environmentally sustainable practices and transfer of knowledge on farms.

The current rural development support mechanisms include subsidies for improving knowledge creation and transfer and the development of technical-technological, applied, developmental and creative projects in agriculture and rural development. Since 2006, the MAFWM has funded subsidies for the implementation of science, growth and innovation projects in agriculture with agricultural faculties in Belgrade, Novi Sad, Čačak and Lesak. Projects are carried out in close collaboration between research institutions and extension services. Impact evaluations are performed by the MAFWM and are updated based on the previous annual review of the operations of the extension offices.

### *The way forward for agriculture policy*

For the further improvement of the agriculture policy, Serbia needs to:

- **Continue investment in irrigation infrastructure**. Irrigation and drainage are crucial to Serbian agriculture and can double yields, or even triple them in some agricultural sub-sectors. The current plans and strategies for investment in irrigation need to be implemented as planned to improve the competitiveness of Serbia's agriculture products.
- **Enhance the agriculture land management policy**. Full establishment of a functional and operational LPIS is crucial. The LPIS is one of the preconditions for accreditation of new IPARD measures and represents a strong tool for planning, implementing and monitoring agricultural support policy.
- **The Common Market Organisation** law needs to be adopted through secondary legislation in areas including marketing standards, public and private storage, and producer organisations.
- **Improve the performance of the Directorate for Agrarian Payments**. Accelerate the processing of applications for the measures already entrusted under the IPARD II programme in order to prevent any shortage of EU funds and begin to entrust the execution of the budget to the remaining initiatives of the programme.
- **Improve food safety policies.** After a proper and inclusive public consultation, Serbia needs to prepare a strategy and action plan for completing its alignment with the EU *acquis*. Although the rules on monitoring systems for food of animal and plant origin have been introduced, along with those for animal feed, will be important to further develop its risk-based approach to imports, including products subject to sanitary checks, and ensure that audits are carried out by inspection workers.

## Tourism policy (Dimension 15)

### *Introduction*

Table 25.27 shows Serbia's scores for the five tourism sub-dimensions and compares them to the WB6 average. Serbia has the second highest score in the tourism dimension (after Montenegro). Serbia scores higher than the WB6 average in all sub-dimensions. Since the previous assessment, Serbia has made only limited progress (Figure 25.1). Its main progress has been in improving the accessibility and quality of its tourism infrastructure by supporting investments in public and private infrastructure and establishing a mandatory accommodation categorisation system. The adoption of the Law on Tourism and the Law on Hospitality in 2019 provided a good basis for improving its accommodation quality assurance framework and the establishment of the central information system (E-Tourist) which will enable more accurate statistical monitoring of domestic and foreign tourists. Nevertheless, underdeveloped tourist infrastructure and poor-quality tourist services remain important challenges.

**Table 25.27. Serbia's scores for tourism policy**

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Tourism policy dimension** | Sub-dimension 15.1: Governance and co-operation | 3.0 | 2.3 |
| | Sub-dimension 15.2: Destination accessibility and tourism infrastructure | 2.7 | 2.2 |
| | Sub-dimension 15.3: Availability of a qualified workforce | 2.0 | 1.8 |
| | Sub-dimension 15.4: Sustainable and competitive tourism | 1.7 | 1.6 |
| | Sub-dimension 15.5: Tourism branding and marketing | 1.8 | 1.6 |
| **Serbia's overall score** | | **2.3** | **2.0** |

### *State of play and key developments*

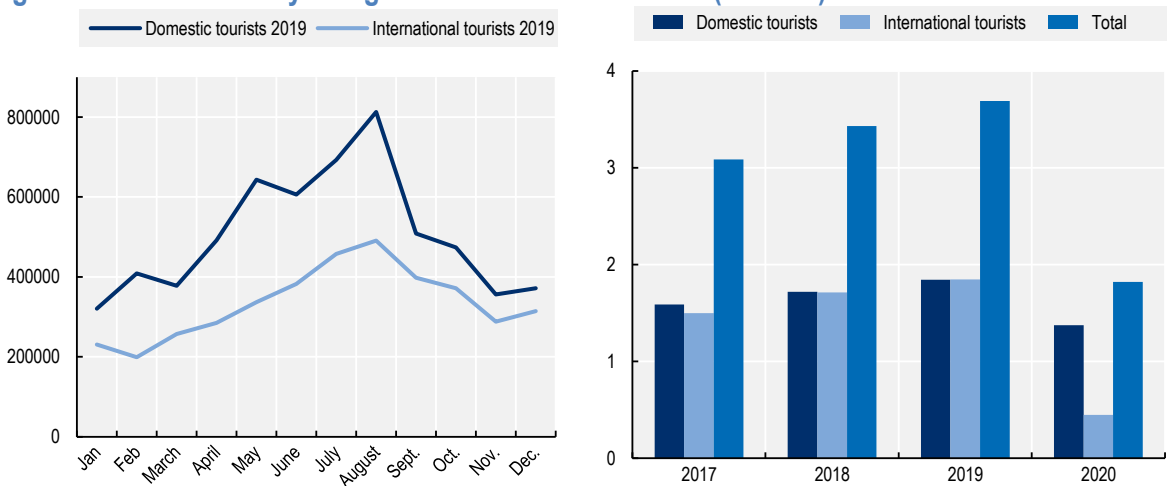
Tourism has not yet been recognised as an important sector of Serbia's economy. However, the rapid increase of tourist arrivals and overnight stays in the last ten years (11% average annual growth since 2010), and other positive trends indicate its growing economic importance. In 2019, tourism directly accounted for 2.4% of GDP (USD 2.99 billion) and 2.1% of employment, or 44 300 jobs. Overall, it was responsible for 6.2% of employment, or 134 800 jobs in tourism and tourism-related sectors (WEF, 2019[273]). In 2019, tourism accounted for 8.2% of Serbia's exports and tourism-related exports are growing faster than total exports (Radivojevic, 2020[274]). The industry attracted capital investment of RSD 33.8 billion, or 4.1% of total national investment. This is expected to rise by 2% per year to RSD 43.5 billion by 2028 (World Bank, n.d.[275]).

Serbia ranks second in the Western Balkan region, just behind Montenegro for average receipts per arrival. There were 3.7 million tourist arrivals in Serbia in 2019, an increase of 84.4% compared to the beginning of the decade (2010) (SORS, 2019[276]). Foreign tourism grew faster than domestic tourism, with foreign tourist arrivals growing by 170% to 1.8 million arrivals, and domestic tourists by 39.3% since 2010, which contributed to foreign tourist arrivals reaching 50% of total tourist arrivals in 2019 (Figure 25.17). This clearly shows the growing attractiveness of Serbia as a destination for foreign tourists.

This progress is a result of continuous improvement of Serbia's competitiveness in the global market. Serbia has made significant efforts to improve its standing in the World Economic Forum (WEF) 2019 Travel & Tourism Competitiveness Index by 12 places, ranking 83rd in 2019 (WEF, 2019[273]). This is, along with Albania, the fastest rise among the WB6 economies. The most prominent progress has been in improving the overall business environment. Serbia has improved its international openness (visa requirements reduction), construction permit procedures, human resources and labour market investment, and environmental sustainability. Nevertheless, key challenges remain; Serbia ranks 105th for the stringency of its environmental regulations and 116th for their enforcement in the index.

Serbia faces challenges in the sector, such as its relatively high seasonality (69% of tourist overnight stays are from April to October; Figure 25.19) and a high level of informality. This not only reduces the real impact of tourism on the economy but also hampers government efforts to improve its quality. Although there has been increased investment in public tourism infrastructure and transport (such as investments in new sections of highways or the new Morava Kraljevo airport), the quality of tourism services and infrastructure is still underdeveloped compared to other economies in the region. The lack of tourism marketing and branding (Serbia ranked 133rd in 2019; 6 places lower than 2017), and the lack of government prioritisation of the travel and tourism industry (137th place, 6 places lower than 2017) are also an issue (WEF, 2019[273]).

## Figure 25.19. Seasonality and growth of tourism in Serbia (2017-20)




Source: (SORS, 2021[277]), *Tourism Statistics* provided in quantitative assessment questionnaire.

StatLink https://doi.org/10.1787/888934256368

In order to address these challenges, Serbia has already set up clear and measurable strategic goals, defined in the Tourism Development Strategy 2016-25. The strategy includes commitments to strengthen the sector's governance and co-operation with private tourism stakeholders in order to improve the quality and attractiveness of tourism products. This represents a solid basis for successful tourism development in a sustainable way and for the benefit of local communities.

In early March 2020, the Serbian government declared a national state of emergency and adopted containment measures to limit the spread of COVID-19. Borders were closed and public transport and leisure venues suspended. These measures had a strong impact on the tourism industry. In 2020, the number of domestic tourists fell by 25,4%, and the number foreign tourist arrivals by 75.9% compared to the year 2019 (SORS, 2021[277]). The Ministry of Construction, Transport and Infrastructure estimates the tourism industry lost over EUR 137 million in 2020.

To address the immediate economic impacts, the government delivered three waves of economic support, which also include support to tourism-related sectors. These focused on the deferment of labour taxes and social security contributions (RSD 100 billion), deferment of corporate income tax advance payment during the second quarter of 2020 (RSD 21 billion), wages subsidies (RSD 93 billion), approval of state guarantee scheme for bank loans to SMEs (RSD 240 billion) and approval of new loans to SMEs from the Development Fund (RSD 24 billion) to improve their liquidity and working capital during the crisis. The government set aside RSD 2.8 billion to distribute 560 000 tourist vouchers worth RSD 5 000 each in order to boost domestic tourism. In late August, the government announced a one-off fiscal support package to help hotels in cities, through a fixed subsidy per room and per bed, at a cost of about RSD 1.1 billion (WB6-CIF, 2020[278]). Moreover, the government has made sure to maintain regular contact and gather and exchange relevant data with all stakeholders in tourism and hospitality from the public and private sectors.

The crisis has emphasised the importance of a resilient tourism industry. COVID-19 will have the worst impact on city tourism, specifically tourism businesses and city hotels. Serbia should focus first on assessing its impact on the tourism industry, followed by designing a recovery plan with an emphasis on the development of sustainable tourism. The recovery plan should also focus on green tourism and further developing domestic tourism. Serbia should focus on moving away from further developing mass tourism and start developing new, high-quality and personalised tourist experiences around natural and cultural sites. A dedicated co-ordination framework would guarantee the efficient implementation of policy responses. Marketing and promotion strategies will also contribute to a prompt recovery.

### *Sub-dimension 15.1: Governance and co-operation*

Serbia's national tourism **governance structure and institutional set up** was developed in the Tourism Development Strategy 2016-25. The Ministry of Trade, Tourism and Telecommunications (MTTT) is the government authority overseeing tourism in Serbia. It has jurisdiction over the National Tourism Organisation of Serbia (NTOS), the national agency for promoting tourism domestically and abroad. The Serbian Convention Bureau is a part of the NTOS, responsible for meetings, incentives, conferences and exhibitions (MICE) tourism development. The MTTT co-ordinates, monitors, analyses and reports on the implementation of the strategy, and proposes measures and carries out activities within its jurisdiction. Each year, the government analyses and proposes measures for the implementation of the strategy, especially in the context of inter-ministerial co-operation. Regular co-operation among public officials in the ministries has been formally established. Due to the cross-cutting nature of the tourism sector, it is included in other national strategies, such as the Strategy for Agriculture and Rural Development 2014-24, the Strategy of Sustainable Urban Development until 2030 and the Culture Development Strategy 2020-29.[183] However, stakeholders report that actual inter-ministerial co-operation is still weak and monitoring of implemented policy measures is still lacking, hindering adaptation and more realistic assessments.

**Partnerships with stakeholders** is mainly implemented through the National Council for Tourism Development, which was established in 2017.[184] The council is the main body for inter-ministerial and public-private co-operation. As well as establishing co-operation and dialogue with tourism sector stakeholders, it is responsible for publicising and developing Serbia as a tourist destination. It is in charge of improving the tourism business and investment climate. It also takes steps to improve competitiveness through promotion and marketing, construction of infrastructure, harmonisation of local and regional institutions and other actions. Besides the ministries, its members are representatives of the Tourism Organisation of Serbia (TOS), the National Association of Travel Agencies of Serbia (YUTA), the National Hotel and Catering Providers Association of Serbia (HORES), the Association of Tourist Guides, Spa Associations of Serbia, Air Serbia, and representatives from universities and Belgrade municipality. The Minister of Trade, Tourism and Telecommunications chairs the council. Although public-private co-operation and dialogue have been established, private sector stakeholders would like to be more involved in defining long-term decisions about tourism development (such as the development of new tourism products, digitalisation and improving the quality of the tourism offer). In contrast, the focus of discussion is mostly on short-term and direct incentives (such as grants, tax reductions and regulations).

**Vertical co-operation** in tourism development has been established. The aim is to implement the national tourism strategy measures and actions as well as any local or destination tourism strategies and formunicipalities and regional authorities to harmonise their strategic documents with the National Tourism Strategy. There are 3 regional and 116 local tourism organisations. Local and regional governments manage these with the support of the private sector. In 2019, Serbia started the comprehensive process of preparing strategic master plans for the municipalities and tourism development programmes for regional and provincial levels. The process for preparing these strategic documents is defined in the new Law on Tourism, adopted the same year, and the Rulebook on the Content and Manner of the Preparation of the Tourism Development Programmes, which was adopted in 2020.

Several municipalities and local tourist organisations have already started developing tourism development programmes with the assistance of local institutions and stakeholders, as well as with logistical assistance from the MTTT over harmonisation with the national tourism strategy and legislation. The main constraints on the more efficient development and implementation of master plans and development programmes are the lack of knowledge and skills among local public officials, weak public-private co-operation and the lack of financial resources. These could reduce the quality of newly prepared master plans, especially in the context of the new trends in tourism demand due to the COVID-19 pandemic.

The tourism **data collection and interpretation** framework is formally in place. The SORS is the main producer and distributor of official statistics, as well as the authorised professional agent, organiser and co-ordinator of the statistical system of Serbia. It performs statistical activities according to a five-year programme and annual plans. Although there is no established formal co-ordination body for tourism data collection, the SORS co-operates with the National Bank of Serbia, the City administration of Belgrade and the other authorised producers of official statistics, listed in the five-year statistical programme. Tourism statistics have a permanent repository in the form of an online portal. However, local stakeholders reported that the portal was not user friendly and that Tourism Satellite Accounts (TSAs) have still not been implemented.

Since the last assessment, the Law on Hospitality was adopted in 2019, introducing a central information system for hospitality and tourism (E-tourist). This system aims to consolidate all data on accommodation providers in order to enable more accurate statistical monitoring of domestic and foreign tourists. The rulebook regulating the central information system was adopted, and E-tourist started operating in October 2020. Nevertheless, further improvements in tourism data collection and sharing are needed, and they should include visitor satisfaction surveys and TSAs.

### *Sub-dimension 15.2: Destination accessibility and tourism infrastructure*

Since 2017, Serbia has improved its **connectivity framework** for tourists by further reducing visa requirements. The number of countries whose citizens do not need a visa to visit Serbia as tourists has increased from 81 in 2017 to 93 in 2019. This has contributed to the increase of tourist arrivals from China (42% growth between 2018 and 2019, and 280.5% growth since 2017), giving China the highest market share, with 7.9% of total international arrivals.[185] There was also an increase of arrivals from Ukraine (34.6% compared to 2018, and 67.9% compared to 2017), and the Russian Federation (28.8% growth in 2019 compared to 2018) (UNWTO, 2020[279]).

Since 2017, Serbia has also improved its **accommodation capacity and quality assurance framework** by fostering greater availability and quality among all types of accommodation. The Law on Tourism and the Law on Hospitality both provide a good basis for improving the field of quality assurance of accommodation as well as other tourist services (catering, travel agencies, etc.). A consistent accommodation quality standard framework has been established, including the mandatory categorisation of accommodation facilities. The Tourism Inspectorate monitors the implementation of this categorisation. However, it needs more financial and human resources for more effective and efficient monitoring, which could in turn contribute towards reducing the high levels of informality in the tourism sector.

The MTTT is supporting tourism development through a programme of incentives and loans. Over the past two years, the ministry has been financing projects focusing on promoting, training, improving and developing the tourism supply chain, as well as projects that support the improvement of tourism infrastructure, including private accommodation. Loans at favourable interest rates (1%) are available to companies and entrepreneurs registered to perform activities in the field of tourism as well as agricultural holdings investing in tourist infrastructure, including building or renovating accommodation facilities. The budget for these loans is around EUR 1.5 million, funded by the Development Fund. Incentives for investments in rural tourism accommodation and development are available through IPARD. Investors

have also access to funds aimed at supporting investments according to the Law and Decree on Investments. However, no evaluation of the implementation of these measures has yet been undertaken.

Reliable **information is available** through the tourist information system on tourist destinations, accommodation and attractions, and the services available at destinations. Information is provided via websites, road signs, in tourist information centres, etc. According to the Law on Tourism, the TOS is responsible for developing and managing the tourist information system, as well as for co-ordinating tourist information activities with regional and local tourist organisations. The TOS is also responsible for the definition of the standards of arrangement, equipment and services offered in tourist information centres. Information is available in multiple foreign languages and is regularly updated by the TOS and regional and local tourist organisations. The main room for improvement in this regard is the establishment of a tourist information system framework that will include regular monitoring and evaluation of the information provided. More intensive involvement of tourism stakeholders in the tourism information system is needed, and this could be accomplished through awareness-raising campaigns and capacity-building activities.

### *Sub-dimension 15.3: Availability of a qualified workforce*

A qualified workforce is vital for further developing tourism. Between 2017 and 2019, Serbia improved its position in the WEF Competitiveness Index Human Resources and Labour market indicator by 24 places, ranking 58th. The largest improvements have been made in the ease of finding skilled employees (moving up 51 places to 70th), pay and productivity (up 46 places to 59th), and on the labour market indicator (up 30 places to 69th) (WEF, 2019[273]).

Despite these improvements, Serbia still needs to strengthen its human resources and labour market framework in the sector. Its competitiveness in these dimensions could quickly change due to the overall lack of qualified workers and increasing competition in the wider region to attract the few who exist. However, the development of human resources in tourism is poorly represented in the Tourism Development Strategy. There are no concrete policy measures for the goals targeting the improvement or sustainability of the **availability of qualified workforce** in the action plan. The assessment of skills gaps and training needs is yet to be implemented. The **skills supply framework** depends on the activities of private tourist associations such as HORES, which organises training programmes in the hotel and catering industry. These programs include seminars and courses for waiters, bartenders, cooks, confectioners, receptionists, hotel housekeepers and other occupations. YUTA also provides training for tourist animators and travel agencies.

Serbia has a **VET framework for tourism** in place. However only limited progress has been made since the last assessment due to the lack of financial resources and equipment in schools. Serbia has established quality assurance agencies, which involve private sector stakeholders in the elaboration of VET curricula. Mandatory practical training is part of the VET. However, in general, the monitoring and evaluation of VET framework still needs improvements to better assess the efficiency of VET in the economy, and the effectiveness of cooperation with private sector in this area.

Progress in the **higher education framework in tourism** since the last assessment has been rather limited. Tourism studies are included in higher education programmes at universities but Serbia does not have a specific two-year higher education framework dedicated to tourism. Serbia should consider establishing such a framework for tourism, which would include obligatory practical training.

### *Sub-dimension 15.4: Sustainable and competitive tourism*

Serbia is developing a comprehensive **natural and cultural heritage enhancement framework** for tourism. The Culture Development Strategy 2020-29 has been adopted by the government but was yet to be ratified by Parliament at the time of drafting. The Tourism Development Strategy underlines the importance of natural and cultural heritage for tourism, and contains an analysis of the impact of tourism

on cultural heritage and natural resources. It pays special attention to setting rules to protect cultural and natural heritage from the possible negative impacts of tourism. The project documentation for any public or private investment should include an assessment of its impact on the environment and cultural heritage. Each project should adhere to the protection regulations and practices of the institutions in charge of protecting natural and cultural heritage.

The Environment Report in the Republic of Serbia, prepared by the Environmental Protection Agency (Ministry of Environmental Protection) includes monitoring of the impact of tourism on the environment. Although there is co-operation among the responsible ministries to co-ordinate policy measures and activities in this area, the policy measures defined in different policy documents should be combined into one tourism specific policy. This policy should be more in line with the annual Tourism Action plan, which will allow regular monitoring and evaluation of implemented policy measures and especially their effectiveness and impact on tourism development.

The policy framework for the **promotion of sustainable development and operations within the tourism sector** is in place. The principles of sustainable tourism development are defined in the Law on Tourism and in the Tourism Development Strategy. The MTTT supports the development of sustainable tourism through a programme of incentives and loans, which includes energy efficiency and use of renewable energy as part of the selection criteria for approving loans and grants to private investors. It also provides capacity building in this area which it promotes to tourism businesses to enhance the sustainability of their projects and operations. The Environmental Education Foundation (FEE) or the National FEE Operators have been awarding Blue Flags since 2012 and Green Keys since 2014, which are both renewed annually.[186] However, the effectiveness of these policy measures could not be assessed as no monitoring and evaluation are in place. According to the best practice examples of some advanced tourism countries,[187] a more comprehensive policy framework for promoting sustainable tourism should be adopted in order to achieve sound improvements.

In the area of **tourism investment and innovation**, Serbia has established a comprehensive tourism investment policy framework but its tourism innovation policy framework is not yet in place. Investment policy is one of the most extensive parts of the Tourism Development Strategy. The action plan for the strategy includes measures to promote investment in tourism infrastructure, and to improve the quality of tourism products and services, training, and promotion. In 2018, the MTTT allocated RSD 679 million to support 57 tourist infrastructure projects, RSD 115 million to support promotion projects and RSD 179.8 million to the Development Fund to support investments in tourism with favourable loans. In 2019, it allocated RSD 875 million to 64 tourist infrastructure projects, and RSD 125 million to promotion projects, and supported 14 tourism projects with the credit funds. While a monitoring system is in place, no evaluation that would enable future policy measures to be adjusted has been implemented yet.

### *Sub-dimension 15.5: Tourism branding and marketing*

The NTOS is responsible for **tourism branding and marketing** at the national level and has established co-operation with regional and local tourist organisations. Serbia adopted its Strategic Marketing Plan for Tourism until 2025 in 2021. The plan projects monitoring and evaluation of the brand image and marketing strategy framework. Monitoring should be done regularly to ensure information about the effectiveness of its marketing activities. Serbia co-operates with Montenegro and North Macedonia in some regional marketing activities in long-distance markets. The NTOS budget has increased from nearly EUR 4 million in 2016 to EUR 4.7 million in 2019, although staffing levels remain the same, at 52 employees. Although Serbia improved its ranking for the effectiveness of its marketing and branding in the WEF Travel & Tourism Competitiveness Index by 29 places in 2019 (from 107$^{th}$ in 2017 to 78$^{th}$ in 2019), its overall ranking is still low. It fell 6 places in the country brand strategy ranking, to 133$^{rd}$ in 2019.

**The digital tourism marketing framework** is at an early development stage. It should be included in the new Marketing Strategy and supported by the MTTT, and should be developed with the implementation of

the Strategy. Private stakeholders are involved in implementing some digital marketing activities, but the main weakness is the lack of financial resources. The lack of knowledge about digital marketing in the overall sector could also be a constraint on the efficient use of digital marketing tools. Policy measures to build capacity among tourism stakeholders and provide incentives for them to implement their digital marketing strategies and tools could be helpful.

### *The way forward for tourism policy*

To ensure the further successful development of tourism in Serbia, policy makers should:

- **Empower municipalities and local tourist organisations to manage tourism development** by providing co-ordinated expert support, designing tourism master plans, improving capacity building and allocating sufficient budget to implement policy measures at the destination level. This is important for the harmonised and efficient development of competitive tourism products in a sustainable way. Destinations should be prepared for the re-opening of tourism after COVID-19 with personalised bookable products aimed at domestic tourists and tourists from the region.
- **Strengthen dialogue and co-operation** with private sector stakeholders, educational institutions and NGOs from the national to the local level. Stakeholders should be included in discussions on the key challenges of tourism development, such as seasonality, the lack of new and high-quality tourist products, digitalisation, and sustainability.
- **Develop a sector-specific human resource policy for tourism** and strengthen co-operation and dialogue with the private sector to better address the specific needs of the tourism industry and tourism overall, and ensure that tourism education is more attractive for lecturers and students.
- **Upgrade the tourism investment policy framework with a focus on innovation**. Innovations do not necessarily require a huge amount of financial resources to implement but can help increase the attractiveness of the tourism offer by developing unique experiences with high added value.
- **Maintain and enhance local community prosperity and quality of life,** for example by encouraging the purchase of local goods and services, and the promotion of local culinary heritage, history and culture, handicrafts and folk art, small museums, and vineyards.
- **Establish regular monitoring and introduce independent evaluation of implemented policy measures** to assess the efficiency of such measures and make adjustments accordingly.
- **Further improve tourism data collection and sharing by introducing tourism satellite accounts**, to empower policy makers with reliable information for designing policy measures.
- **Tailor the marketing and branding strategy** to the new circumstances in the market and new trends in tourism demands. This should include a digital marketing strategy to improve Serbia's visibility as a tourist destination in the international market (Box 25.20).

#### Box 25.20. The digital tourism roadmap in Finland

In 2018, the Roadmap for Digitalisation of the Finnish Tourism Sector was developed to steer the sector towards greater digital competency, through digital platforms and data management. The goal is to create nation-wide digital ecosystems and to have Finnish travel products and services available in multiple digital channels locally and globally. The vision was to become a smart, pioneering destination providing the best customer experience.

The key steps to reach these are:

1. data management and collaboration to enable seamless purchases and real-time information for travellers

2. using platforms and programming interfaces to enable multi-channel online booking
3. starting with pilots and scaling up to nationwide ways of working
4. supporting the sustainable development of the Finnish travel industry with digital tools.

The roadmap was developed with a team of industry and digital experts and is updated annually to keep up with the fast changing industry. Pilot projects focusing on the digital customer experience and data were carried out in four travel destinations. The pilots enabled tailored and cost-effective development of digital know-how and services. They developed initiatives to help travellers find and get to hidden destinations like Turku and the archipelago, to handle scattered destination information (Lake Saimaa, Kuopio Tahko, North Karelia), to design the ideal digital customer journey (Visit Rovaniemi & Finnair) and to share and analyse data (Helsinki, House of Lapland, Finnair). In 2020, the focus was to scale up the work to the national level, improving data-driven tourism marketing and sales and deploying a national travel data hub. There is also e-learning and "Visit Finland" academy digital training available to the travel trade. Based on the work undertaken, a digital inventory of tourism assets is the main priority to be developed in future years.

Source: (OECD, 2020[280]), *Finland*, https://doi.org/10.1787/cb702fad-en.

## Anti-corruption policy (Dimension 16)

### *Introduction*

Table 25.28 shows Serbia's scores for the Anti-corruption policy dimension and compares them to the Western Balkan (WB) average. Serbia along with Montenegro and North Macedonia has some of the more elaborate systems for corruption risk assessment and proofing of legislation. Serbia has a generally advanced legal framework for the prevention of corruption. Since the previous competitiveness outlook assessment, Serbia has strengthened the legal grounds for corruption proofing of legislation and improved the capacity of its anti-corruption law enforcement and prosecutorial bodies. It has established a track record for the investigation and prosecution of high-level corruption, but its sustainability and effectiveness are yet to be demonstrated.

### Table 25.28. Serbia's scores for anti-corruption policy

| Dimension | Sub-dimension | Score | WB6 average |
|---|---|---|---|
| **Anti-corruption policy dimension** | Sub-dimension 16.1: Anti-corruption policy framework | 2.8 | 2.1 |
| | Sub-dimension 16.2: Prevention of corruption | 3.0 | 3.3 |
| | Sub-dimension 16.3: Independence of the judiciary | n.a. | n.a. |
| | Sub-dimension 16.4: Business integrity and corporate liability | n.a. | n.a. |
| | Sub-dimension 16.5: Investigation and prosecution | 3.0 | 2.8 |
| **Serbia's overall score** | | **2.9** | **2.5** |

Note: For comparability with the previous assessment, two sub-dimensions (16.3 and 16.4) have not been scored but are discussed in the text below.

### *State of play and key developments*

Since the previous assessment, Serbia has undertaken noteworthy initiatives for the fight against corruption (Box 25.21).

#### Box 25.21. Recent initiatives in the fight against corruption in Serbia

- The launch of the Business Integrity Country Agenda (BICA) report for Serbia by Transparency Serbia in 2020. The Business Integrity Assessment is the first study of its kind conducted in Serbia. The research covered the following topics: bribery in public and private sector; money laundering; restrictive agreements; whistle-blower protection; accounting and auditing; conflict of interest, lobbying, and party financing; public procurement; taxes and customs; integrity mechanisms in the private sector; transparency of business entities; business sector anti-corruption initiatives; role of media and CSOs.
- Pištaljka is a civil society organisation that investigate abuses in government, public and private enterprises and other institutions and to advocate for whistleblowers' rights. Some of its activities include:
  - training for local self-governments and public utility companies
  - integrity and internal whistleblowing training for public prosecutors (December 17-18 2020), in cooperation with the Republic Prosecutor's Office and the Government Accountability Initiative (USAID project)
  - setting up a database of public procurement jobs and investigating abuse in public procurement (UNDP-funded), thru June 2021

- integrity and ethics training for judges (in 2021 and 2022), with the Judicial Academy and the Supreme Court of Cassation

- The signature of the International Treaty on Exchange of Data for the Verification of Asset Declarations in March 2021 in Belgrade, as part of a regional anti-corruption initiative. Serbia, North Macedonia and Montenegro are the first signatories of the Treaty that was prepared and negotiated with the support of the Austrian Development Cooperation.

Source: (OECD, 2021[281]), The OECD and South East Europe: Fair Market Conditions for Competitiveness in the Adriatic Region, https://www.oecd.org/south-east-europe/programme/fair-market-conditions-adriatic.htm; (Transparency Serbia, 2020[282]), *Business Integrity Country Agenda – BICA Assessment Report Serbia,* https://transparentnost.org.rs/index.php/en/110-english/naslovna/11820-business-integrity-country-agenda-bica-assessment-report-serbia; (Pistaljka, n.d.[283]), *Pištaljka.rs, https://www.pistaljka.rs/*; (Regional Anti-Corruption Initiative, 2021[284]), *Regional Data Exchange on Asset Disclosure and Conflict of Interest, https://www.rai-see.org/what-we-do/regional-data-exchange-on-asset-disclosure-and-conflict-of-interest/.*

### *Sub-dimension 16.1: Anti-corruption policy framework*

Serbia has made progress in the development of its **anti-corruption policy documents, co-ordination and implementation.** The planning of its anti-corruption policy is integrated with its accession negotiations with the European Union. The main strategic document is the Action Plan for Negotiations of Chapter 23,[188] originally adopted in 2016 with a revised version approved in July 2020 (Negotiation Group for Chapter 23, 2020[285]). The action plan envisages the preparation and adoption of a new planning document – the Operational Plan for Prevention of Corruption – in areas of particular risk. According to the government response to the OECD questionnaire in mid-2020, more than 60% of activities envisaged in the Fight against Corruption sub-chapter of the Chapter 23 action plan had been implemented. The Anti-Corruption Agency published annual reports on the implementation of the National Anti-Corruption Strategy 2013-18 on its website,[189] but regular public reporting on the implementation of the action plan appears to have ceased in 2018.[190] The new Law on Prevention of Corruption changed the title of the ACA to the Agency for Prevention of Corruption (APC) as of September 2020. Further in the text the choice of the acronym (ACA or APC) reflects the time that is referred to.

As of mid-March 2020, 105 local self-government (LSG) units (70% of the total) had adopted local anti-corruption action plans, according to Transparency Serbia. The model local action plan envisages the identification of corruption risks and measures to eliminate them. Every local self-government unit should designate a person/body in charge of co-ordinating the activities and set up a body responsible for monitoring and informing the public and other concerned actors (ACA, 2017[286]). The effects of the local action plans on the transparency of LSGs are reportedly not yet apparent (Transparency Serbia, 2020[287]).

The authorities have actively co-operated with civil society. During the drafting of the Chapter 23 Action Plan in 2016 and its revised version in 2019/20, several working versions were discussed with civil society organisations (CSOs), notably through the participation platform National Convention for the EU (a body for structured debate on the accession of Serbia to the EU). After the consultations, the Ministry of Justice published feedback on its website.[191] However, at least some civil society stakeholders argue that they have been engaged late in the process after the final draft has already been developed, so there are only limited possibilities to introduce changes. In 2017, the ACA held public consultations on the model local action plan and published a report containing comments submitted by CSOs as well as feedback regarding each of the comments (ACA, 2017[288]). Another consultative arrangement – the Anti-Corruption Council[192], established in 2001, acts as an advisory body to the government, established in 2001. The Council has seven members – current and former public office holders and academics.

The ACA/APC has been providing grants to CSOs on a competitive basis. In 2017, the grants supported alternative reporting on the implementation of the action plan. In 2018, the ACA provided five grants to CSOs to directly assist local self-government units in drafting local action plans. Against this favourable background, it is notable that CSOs have not been routinely involved in the monitoring and evaluation of

the implementation of the action plan since 2018. The revised plan aims to remedy this gap, and positive developments in this area will indicate significant progress in the implementation.

**Corruption risk assessments** are mandatory for all public sector institutions as a step towards the preparation of integrity plans (IPs). The Law on the Anti-corruption Agency obliged all public bodies – national and local – to adopt integrity plans. The new Law on Prevention of Corruption (in force from 1 September 2020) contains a similar obligation and explicitly defines risk assessments as part of an IP. The handbook on the preparation and implementation of the IP adopted by the ACA envisages the assessment of the state of affairs as a stage in the preparation of the plans. IPs shall contain, among other elements, an assessment of exposure to risks and measures to detect, prevent and diminish those risks (ACA, 2015[289]). An online IP template is available on the website of the APC. The process of developing, monitoring and reporting on the implementation of IPs takes place in electronic form. IPs are to be revised every three years, and in practice most public institutions are carrying out risk assessments and adopting IPs. During 2016-19, 2 716 out of 4 267 public authorities adopted IPs and the remaining authorities should do so in 2020. However, the ACA/APC supervises the development and implementation of IPs and has observed that IPs remain formal documents; organisations pay little attention to their content and meaning (ACA, 2020[290]). In the area of corruption risk assessment, there seems to be a gap between the volume of activity and its impact.

The **corruption proofing of legislation** has a firm legal ground in the Law on Prevention of Corruption. State administration bodies are obliged to submit draft laws in areas of high risk and areas affected by international agreements in the anti-corruption field to the APC to obtain its opinion. This means all relevant draft laws are potentially subject to corruption proofing. The assessment of legislation used to be a regular activity of the ACA. Since 2013, it has published more than 100 assessments, but the last published assessment is dated 27 February 2018 and this kind of activity appears somewhat diminished (ACA, n.d.[291]). In 2019, the ACA issued 18 opinions on proposals and draft regulations (ACA, 2020[290]). According to the government, most of the recommendations of the ACA have remained unimplemented, without any reasons provided.

### *Sub-dimension 16.2: Prevention of corruption*

The main **corruption prevention body** is the APC, which has multiple preventative and oversight responsibilities. Operational since 2010, the APC has operated according to the Law on Corruption Prevention since 1 September 2020. The APC is an independent state body accountable to the National Assembly (NA). Several elements of the legal framework aim to safeguard its independence. These include collective management (the council, consisting of five members and the director) and transparent appointment procedures. The NA appoints the director and members of the council from among candidates who have gained at least 80 out of 100 points in a public competition conducted by the Judicial Academy (under the previous law the director was appointed by the non-political board of the ACA). The new law authorises the NA to dismiss the director on specific grounds before the expiry of his or her five-year term, which used to be a power of the board. The consent of the committee of the NA is required for the adoption of the rulebook on the internal organisation and systematisation of jobs in the APC.

The director of the APC proposes its budget and submits it to the Ministry of Finance. The law contains general guarantees of funding and financial independence: the funds shall be sufficient for efficient and independent operation; the APC has autonomy over the disposal of the funds; and the government shall not suspend, delay, or limit the funds without the consent of the director. In practice, the budget of the ACA/APC has been fluctuating: it was RSD 364 million in 2018, RSD 253 million in 2019, and RSD 283 million (approximately EUR 2.4 million) in 2020. The APC is bound by the general criteria that apply to civil servants on the remuneration of its employees, but the director may increase salaries by 30%. The APC has 71 specialists and 9 administrative staff members. According to the government, numerous in-service training opportunities have been available to staff.

The more direct role of the NA in the appointment and dismissal of the director, as well as the limited funding safeguards, warrant further monitoring to ensure political decision makers respect the independence of the APC in practice. The public regard for the ACA has been modest. In 2019, on a scale from 1 to 5, the average evaluation of the work of the ACA was 2.3; the same as for the police and marginally lower than for the government (USAID, 2019[292]).

The Law on Corruption Prevention provides a concise but generally comprehensive framework on **conflicts of interest** and applies to public officials – defined as any elected, appointed or nominated person in a position of public authority. Meanwhile the Law on Civil Servants envisages that conflicts of interest among civil servants who are not public officials be managed and resolved within their respective public bodies. The definition of conflict of interest covers actual, potential and apparent conflicts. The Law on Corruption Prevention provides few details of the ways conflicts of interest should be resolved. Generally, public officials should notify their superiors and the APC of any conflict and suspend the affected proceedings. The APC then proposes measures to eliminate the conflict of interest. Public officials must transfer the management rights of any company stakes or shares to another person but there is no explicit prohibition on officials giving instructions regarding the management or obtaining any information about the company, i.e. the transfer is not a blind trust (which could render officials unaware of their private interest in a company).

The law sets general principles and empowers the APC to assess situations where the holders of public office perform other work or activities outside their role on a case-by-case basis. Public officials who do another job or activity at the time of entering public office should inform the APC, and the APC then determines whether this activity could endanger their impartial performance of the public function. The somewhat inconclusive provisions of the law and the considerable discretion of the APC in applying them could raise questions regarding the sufficient clarity of the law. The Group of States Against Corruption (GRECO) has noted that the new Law on Corruption Prevention has some shortcomings; for example, the lack of criteria for allowing or restricting public officials from performing business activities (GRECO, 2020[293]). The capacity of the APC appears limited as it has only nine staff members handling conflicts of interest and lobbying matters.

As well as its powers to determine how to tackle individual cases of conflicts of interest and incompatibilities, the APC decides on violations of the Law on Corruption Prevention. It may issue a warning or a public recommendation of dismissal from public office (where officials are elected directly by citizens and former officials, it makes a public announcement of the decision on violation). The announcements should contain brief reasoning. According to the government, the ACA issued 83 recommendations of dismissal for violations of the Law on ACA between January 2017 and December 2019 (related to conflicts of interest and other areas). The bodies concerned complied with 11 recommendations, and in further 12 cases the official had already been dismissed.

When the APC identifies offences, it should submit a notification of a crime to the competent body and apply to start misdemeanour or disciplinary proceedings. According to the government, the ACA filed two crime notifications for acts associated with conflicts of interest, but the prosecutor's office did not find grounds for prosecution. The law clearly implements the GRECO recommendation to provide the ACA/APC with the right to act upon anonymous complaints.

The Law on Corruption Prevention also governs **asset and interest disclosure**. Under this law, as under the previous one, the obligation of regular disclosure applies to most public officials with a few exceptions such as members of local government councils (although the APC may still request declarations from them). According to the government, coverage does not extend to the staff of offices of political officials (such as advisors) and officials responsible for public procurement except the director of the Directorate for Public Procurement and his or her assistants. Declarations should also provide information regarding public officials' spouses or common-law partners, and minor children if living in the same household. By default, declarations should be submitted upon starting and leaving public office, with extraordinary

declarations due only when significant changes of assets or income have occurred. The declaration leaves a few gaps in the comprehensive coverage of the economic and private interest of a declarant, such as gifts not covered under other categories of declarable income or assets, cash savings, and beneficial ownership of entities or assets when not based on formal ownership.

Declarations are filed through an online platform. Information subject to public disclosure is published by default and searchable by the name of the official. However, broad categories of data are exempt from public disclosure such as sources and amounts of income from non-public sources, amounts of savings, or the ownership of financial instruments. The publicly available information does not provide a comprehensive picture of an official's economic situation. Nevertheless, on several occasions, declarations have helped the public to detect possible illicit enrichment of high-level officials.

The APC verifies the declarations based on an annual verification plan, and extraordinary verifications are also permitted. Public authorities must provide the APC with direct access to their databases kept in electronic form upon written and reasoned request. The requirement of a reasoned request could turn out to be an obstacle for efficient routine verifications. The APC may also obtain data on the accounts of public officials from banks and other financial institutions (according to the government's response, in practice, banks rarely provide this type of data). To enable electronic data exchange between all competent institutions, multiple bodies, including the APC, have agreed to develop the National Criminal Intelligence System, but it is not yet decided what exact access the APC will have through the system.

If the APC suspects that officials have failed to report their assets or provided false data to conceal information about their assets, it should file a crime notification. Since 2013, it has referred 18-28 cases per year to law enforcement bodies based on the verification of declarations. If officials fail to submit their reports on time, the APC should request the initiation of misdemeanour proceedings with the court. In recent years, the number of sanctions imposed for non-submission of declarations has been falling, which could be a sign of improved overall compliance.

The Law on **Whistle-blower Protection** (adopted in 2014) is comprehensive and extends to both the private and public sectors. Whistleblowing may be carried out by internal or external reporting, or by public disclosure. However, the grounds for public disclosure are narrow: essentially, in cases of imminent danger, but not when there is a risk of retaliation or there is little chance of the breach being effectively addressed otherwise, as envisaged in EU Directive 2019/1937 on the protection of persons who report breaches of EU law. The law contains multiple provisions to protect whistle-blowers. These include obliging the recipient of information to protect the whistle-blower's personal data, an express prohibition on placing the whistle-blower in an unfavourable position, enabling courts to impose temporary protection measures, compensation for damages, reinstatement of employment, the protection of people associated with the whistle-blower, the right to protection due to mistaken identity, etc. In case of reprisal, protection also applies to anonymous whistle-blowers. The law expressly prohibits the hindering of whistleblowing.

Employers must inform employees about their rights stemming from the Law on Whistle-blower Protection and appoint an authorised person to receive information and administer procedures regarding whistleblowing. An employer with more than ten employees must have an internal whistleblowing procedure.

Serbia has had a high level of whistleblowing activity. The courts received 774 whistle-blower cases between June 2015 and December 2019 (Negotiation Group for Chapter 23, 2020[285]) and have a track record of decisions in favour of whistle-blowers. Whistle-blowers are entitled to seek protection from the court but the procedure to do so is relatively complicated. The Law on Free Legal Aid does not recognise whistle-blowers as a special group, and they are entitled to free legal aid only if they meet the general conditions. In view of lack of legally guaranteed external counselling support and lack of a centralised system to protect whistle-blowers, the need to apply to courts and sometimes seek professional legal assistance represent barriers to the more effective and consistent implementation of the law (Worth et al., 2018[294]). The whistle-blower protection system seems to fall short of providing all measures of support

envisaged in EU Directive 2019/1937, such as comprehensive and independent information and advice, which is easily accessible and free of charge, effective assistance from competent authorities before any relevant authority involved in the protection against retaliation, financial assistance and other measures, including psychological support.

The government has continued to carry out **anti-corruption public awareness and education** activities although there is no evidence of broader campaigns since 2018. The ACA has been organising annual conferences on 9 December (International Anti-Corruption Day) and produced various tutorials and guidance materials: online tutorials for the development of integrity plans and monitoring and reporting on their implementation, a model local anti-corruption plan, the methodology for monitoring and reporting on the implementation of the local anti-corruption plan, online tutorials for officials regarding the declaration of income and assets, a manual on media co-operation, and educational videos on asset declaration and gifts. Meanwhile there is no evidence that the effectiveness of awareness-raising activities is being monitored, or corrective action taken based on such monitoring.

The ACA has been engaged in numerous training and education activities. In 2017-19, it held 51 educational/training programmes for public officials, 6 training sessions for trainers, online training on ethics and integrity in the public sector, and 9 training courses on ethics and integrity organised in co-operation with the Government Agency for Human Resources Management and the National Academy for Public. In 2019, the ACA held four training sessions attended by more than 1 000 high school pupils. Most of the training activities have been funded from the ACA budget. However, the amount of funding that for awareness raising and public education have been in decline since at least 2017.

### *Sub-dimension 16.3: Independence of the judiciary*

Serbia has had serious discussions about constitutional reforms to strengthen the independence of judiciary, but they have not been adopted. According to the constitution (adopted in 2006), judicial appointments are permanent, but a probationary period of three years applies for first-time judges. The constitutionally established power of the NA to appoint judges remains a limitation on the independence of judiciary. The NA also directly or indirectly appoints members of the High Judicial Council (HJC) even though 7 out of 11 members are judges (Venice Commission, 2007[295]). A key task in the Judicial Development Strategy (2020-25) is to complete the amendment of the constitution with a view towards, further strengthening of independence of courts. Public comments by some government officials regarding court proceedings represent a form of pressure on the judiciary (EC, 2020[36]).

The HJC has adopted rulebooks defining criteria for candidates for judicial positions to be elected for the first time, the evaluation of candidates for permanent judicial positions at the second or higher court, the nomination of court presidents, modalities of examinations of candidate judges, etc. These rules strengthen the objectivity and transparency of proceedings at various stages of judges' careers. The HJC has strengthened the transparency of its work by establishing that all interested parties can attend interviews with candidates for the first election to a judicial function, and that interviews are recorded. Lists of candidates and the grades they achieve are made public on the website of the HJC (GRECO, 2019[296]). Nevertheless, the European Commission has recommended the thorough revision of the system for judicial appointments and the evaluation of the work of judges and prosecutors (EC, 2020[36]). The Judicial Development Strategy contains priorities and tasks clearly in line with these recommendations.

In 2019, the Disciplinary Commission of the HJC handled 31 cases. The commission issued public warnings, imposed salary reductions and initiated one dismissal procedure. The disciplinary and ethics rules have been being revised to improve the definitions of offences, among other things. One positive feature for upholding impartiality is the random distribution of cases among judges through an automatic case allocation system (European Commission, 2019[14]; EC, 2020[36]). However, random case assignment has not yet been established in all courts (Government of the Republic of Serbia, 2020[297]).

*Sub-dimension 16.4: Business integrity and corporate liability*

Serbian company law does not specifically address **business integrity** and the management of corruption risks. The law prescribes general principles of oversight, such as the duty of the supervisory board of a joint-stock company to supervise the management. More specific obligations apply to public joint-stock companies where at least one dedicated person shall be responsible for the internal supervision of operations. This person must meet the requirements prescribed for internal auditors, must be employed by the company and perform only internal supervision, and cannot be a director or a member of the supervisory board. This internal supervision should encompass, among other tasks, verification of the implementation of risk management policies.

According to the Law on the Central Records of Beneficial Owners (adopted in 2018), information on beneficial owners of legal entities has to be publicly disclosed in the Central Records of Beneficial Owners kept by the Serbian Business Registers Agency. The disclosed information is accessible free of charge and searchable by the registration number of a legal entity. The law complies with the 5th EU Anti-Money Laundering Directive (2018/843) as far as the requirement to provide access to any member of the general public is concerned, and the definition of a beneficial owner covers most types of beneficial owners defined in the anti-money laundering directives. The law envisages criminal liability as well as fines for non-compliance for legal entities and their responsible persons. However, no data are available about the enforcement of this liability.

There is no designated institution such as a business ombudsman responsible for receiving complaints from companies about corruption-related matters apart from the APC.

Serbia has established **liability of legal persons** for all criminal offences established in law. According to the Law on Liability of Legal Persons for Criminal Matters (adopted in 2008), a legal person shall be held accountable for criminal offences that have been committed for the benefit of the legal person by a responsible person within the scope of his or her authority. Lack of supervision by the management can also trigger corporate liability. Legal entities, which are entrusted by law with the exercise of public authority, are exempt from liability for criminal offences committed during the exercise of public authority.

The liability of legal persons is autonomous, i.e. a legal person shall be liable even though criminal proceedings against the responsible person have been suspended or the indictment has been rejected. If, due to certain reasons, it is not possible to initiate or conduct criminal proceedings against the responsible person, the proceedings may be initiated and conducted only against the legal entity.

The law envisages both fines and the termination of the legal entity as penalties, as well as security measures (prohibition of certain registered activities or tasks, confiscation, public announcement of the judgment) and other possible legal consequences, such as a ban on participation in public procurement. The upper limit of fines for corruption offences such as active bribery is approximately EUR 42 500, which is extremely low compared to the potential scale of large corrupt transactions. Active bribery also carries the maximum prison sentence of up to five years (Article 368 of the Criminal Law). Courts may impose suspended sentence, after taking into account any measures taken by the legal entity to prevent and detect the crime and against the responsible person after the crime. Thus, although the law does not explicitly envisage due diligence or compliance as defence or a mitigating circumstance, taking such preventive measures may serve a basis for suspended sentencing.

The legal framework for corporate liability would benefit from guidance on the anti-corruption compliance that responsible persons of legal entities should ensure. The effectiveness of the corporate liability framework for combatting corruption could not be assessed due to the absence of the relevant statistics.

*Sub-dimension 16.5: Investigation and prosecution*

Based on the Law on Organisation and Competences of State Bodies in the Suppression of Organised Crime, Terrorism and Corruption (adopted in 2016 and in force since 2018), the Prosecutor's Office for Organised Crime (POOC) and the Section for Suppressing High-Level Corruption within the Service for Combating Organised Crime (SCOC) of the Criminal Police Directorate have responsibility for the **investigation and prosecution of high-level corruption**. High-level corruption is not defined explicitly but the anti-corruption remit of these bodies comprises abuse of official authority, trading in influence, and passive and active bribery when the defendant or the person to whom a bribe is given is an official or responsible person performing a public function on the basis of election, appointment or appointment by the NA, the President of the Republic, the Government, the general session of the Supreme Court of Cassation, the HJC or the State Prosecutorial Council.

Available statistical data on convictions for high-level corruption vary slightly but generally reflect a similar decreasing trend. According to the government, 42 convictions for high-level corruption took place in the first instance in 2017, 41 convictions in 2018, and 25 convictions in 2019. According to the European Commission, based on indictments from the POOC, the courts rendered first instance judgements against 50 individuals for high-level corruption in 2017, 41 in 2018, and 30 in 2019 (EC, 2020[36]). For this assessment, the authorities stated that the majority of the defendants received prison sentences plus a prohibition on carrying out certain professions, activities or duties. In 2019, 10 out of 30 convictions were based on plea agreements, and confiscation of assets was imposed in 3 cases (EC, 2020[36]). This information suggests that the level of recovery of corruption proceeds remains modest. No data are available about final convictions for high-level corruption, and this gap makes it difficult to fully assess the track record. Although the SORS gathers data on prosecutions and convictions, the government has recognised that current record keeping is not suitable for measuring progress and the efficiency of the criminal justice system, and aims to establish a new information system (Negotiation Group for Chapter 23, 2020[285]).

According to the law, the Ministry of Interior (MoI) has at least two **specialised anti-corruption investigative bodies**: the unit responsible for the suppression of organised crime (the SCOC) and the unit responsible for the suppression of corruption (the Anti-Corruption Department of the Criminal Police Directorate, responsible for cases other than high-level corruption).

The police units generally do not have special guarantees of independence. The Minister of the Interior appoints and dismisses the head of the SCOC with the advice of the Prosecutor for Organised Crime. The minister also issues acts which further regulate the organisation and work of both specialised units. Otherwise the general procedures and conditions of the Ministry of the Interior apply to the selection, appointment and dismissal of officers as well as the determination of the budget and salaries. The units submit regular reports to superior officials, but these reports are not published.

Serbia has several **specialised anti-corruption prosecutorial and judicial bodies**. The relevant prosecutorial bodies are the POOC and special anti-corruption departments of four higher public prosecutor's offices. The Prosecutor for Organised Crime manages the work of the POOC. The law is rather general regarding the criteria for this office. When proposing candidates for prosecutor and selecting the deputy prosecutor, priority should be given to candidates who have the necessary professional knowledge and experience in the field of the fight against organised crime and corruption. The State Prosecutorial Council (SPC) holds a competition for the post and submits a list of suitable candidates to the government, which in turn submits a proposal to the NA. The NA appoints the prosecutor for a term of six years. The procedure for dismissal is similar; the SPC determines reasons for the dismissal and forwards the decision to the government, which proposes the dismissal to the NA. Unless otherwise provided by the law, the general rules governing the public prosecutor's office also apply to the POOC. Heads of higher public prosecutor's offices appoint and dismiss heads of the special anti-corruption

departments who have no fixed term. Thus, the law provides stronger safeguards of independence and transparency for the POOC than for the anti-corruption departments.

Investments have been made in the capacity of the specialised prosecutorial bodies. Within the POOC, 21 prosecutors act as processors of economic crime and criminal offences related to corruption, supported by 27 administrative staff members. As of 2020, there were 45 deputy public prosecutors working in the anti-corruption departments. Six task forces have been established in the prosecutorial bodies, which include representatives of the police, the tax administration and the anti-money laundering administration. There are regular co-ordination meetings between the police and the prosecution, and liaison officers have been appointed (European Commission, 2019[14]; EC, 2020[36]). The law envisages the possibility of establishing financial forensics services in the specialised prosecutorial bodies, and, since 2018, the POOC has employed a financial forensic expert.

There is evidence of training on various relevant topics for the staff of the investigation and prosecution bodies: courses and education meetings on the detection, investigation and prosecution of high-level corruption and other related topics for representatives of the ministry and prosecutors, education activities through projects led by international organisations, and continuing education organised by the Centre for Police Training of the Ministry of the Interior and the Judicial Academy.

As well as the investigation and prosecutorial bodies, Serbia has established special departments for organised crime in the High Court and in the Court of Appeals in Belgrade as well as special anti-corruption departments in high courts.

### *The way forward for anti-corruption policy*

To strengthen the anti-corruption policy framework and its implementation, policy makers should:

- **Create a mechanism to involve civil society in the monitoring of the implementation of the Action Plan for Chapter 23 negotiations**. Ensure that the monitoring is carried out in an inclusive and transparent way. The revised Action Plan foresees systematic, continuous and institutionalized inclusion of civil society organizations in the process of monitoring the implementation. This is a significant commitment considering the widely recognised crucial role of the civil society for the success of anti-corruption policies. The OECD Recommendation on Public Integrity envisages encouraging transparency and stakeholders' engagement at all stages of the political process and policy cycle to promote accountability and the public interest. This is all the more important regarding anti-corruption efforts, which often provoke attempts of obstruction by powerful beneficiaries of corruption.

#### Box 25.22. The Citizen Participation Space for monitoring the implementation of the anti-corruption strategy in Catalonia (Spain)

Catalonia has set up the Citizen Participation Space (CPS) for monitoring the execution of the Strategy for Fighting Corruption and Strengthening Public Integrity of the *Generalitat de Catalunya*. Three public authorities (the Anti-fraud Office, the Regional Audit Office, the Regional Ombudsman) and three civil-society organizations (the Ostrom Institute of Catalonia, the Citizen against Corruption Observatory, the College of Political Scientists and Sociologists of Catalonia) are key partners in the activity.

The CPS comprises ten people who act as an independent commission for auditing the implementation. Seven members have been chosen by lot from among people who participated in the development of the Strategy. Three are representatives of the organised civil society and have been chosen by the above-mentioned civil society organizations.

Members of the CPS receive constantly updated information regarding the state of actions carried out under the Strategy. In January 2021, the first annual report of the Strategy was published. The CPS evaluated the report and provided public feedback like they had already done in relation to earlier quarterly reports.

The CPS assessed positively the exhaustive work that had been performed for the elaboration of the report, recognized efforts made to address requests formulated in the previous evaluation by the CPS and the incorporation of the theory of change that would allow evaluating the impact of the Strategy.

On the other hand, the CPS emphasized the need to specify more clearly how the degree of execution is determined and assessed, incorporate methods used and specify the reason why certain actions or sub-actions remain uninitiated. The CPS also raised the need to set a timetable for the start and execution of all actions in order to impose proper monitoring and ensure compliance with the timeframe.

Source: Generalitat de Catalunya (2021), *L'Espai de participació ciutadana de seguiment de l'Estratègia de lluita contra la corrupció avalua l'Informe anual de seguiment de l'Estratègia*, http://governobert.gencat.cat/ca/detalls/noticia/noticia_espai-participacio-informe-estrategia
Open Government Partnership, *Create citizen Monitoring Space for anti-corruption strategy (ES0095)*, https://www.opengovpartnership.org/members/spain/commitments/ES0095/

- **Ensure that reports on property and income of public officials and the data subject to public disclosure are comprehensive**, reflecting their full economic position Continue steps to smooth the APC's access to the information it needs for verification. According to the Western Balkan Recommendation on Disclosure of Finances and Interests by Public Officials, income and asset declarations need to show the fullest picture possible of incoming and outgoing cash and asset flows during the time in office, and the oversight body needs to cross-check the data with a wide range of databases (ReSPA, 2014[298]). While it is necessary to exclude certain personal data from publication, the publicly available data should also provide as full as possible picture of an official's economic situation.
- **Monitor protection of whistleblowers to identify and mitigate practical obstacles that they face**. In particular, ensure that it is easy for any whistleblowers to find out where and how they can apply for protection. The relevant EU directive envisages mandatory and optional measures of support for whistle-blowers such as information and advice on procedures and remedies available, on protection against retaliation, and on the rights of the person concerned; effective assistance from competent authorities and legal aid, counselling or other legal assistance, etc. Serbia has taken some actions in these areas, but the efforts need to continue and strengthen. Serbia should also widen recognised grounds for public reporting by whistle-blowers.
- **Safeguard judicial independence** by continuing the debate over the relevant legal provisions and ultimately amend them to reduce the role of political bodies in judicial careers, among other things. Judicial independence is a fundamental principle enshrined in international standards such as the European Convention on Human Rights, according to which "everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law" (European Court of Human Rights, 2021[299]). Serbia should continue efforts to reach compliance with international standards, for example, to ensure that not less than half the members of councils for the judiciary are judges chosen by their peers (the Council of Europe Recommendation CM/Rec(2010)12 on judges: independence, efficiency and responsibilities).
- **Strengthen corporate liability for corruption offences** by significantly increasing the maximum applicable fines. International standards do not define the sufficiency of the sanctions in specific terms, but the OECD Working Group on Bribery in International Business Transactions has adhered to the standard that monetary sanctions should be sufficiently severe to impact large multinational corporations. In certain economies, statutory ceilings of sanctions even up to a few

million EUR have been found to be insufficient (OECD Anti-corruption Network, 2015[300]). Even though such levels of fines may appear beyond relevance relative to the limited size of many companies in Serbia, the law should provide the possibility to apply adequate sanctions also in a case of a large business player engaging in corruption.

- **Monitor the effectiveness of the investigation and prosecution of high-level corruption** by collecting, analysing, and publishing data on, inter alia, official position at the time of offence, indictments, final convictions, sentences, and recovered proceeds of corruption. Several kinds of factors affect investigations, prosecutions and convictions in corruption cases, for example, the qualification, number and independence of investigators, public prosecutors and judges, effectiveness of procedural and substantive law, efficiency of international legal co-operation, case management and prioritisation of work, etc. Comprehensive and detailed record keeping, collection and analysis of relevant statistical indicators, systematic review of case law are necessary conditions for fair assessment of challenges for the effective repression of high-level corruption.

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## Notes

[1] The headcount ratio (HCR) is the proportion of a population that exists, or lives, below the poverty line.

[2] Staff from the Statistical Office of the Republic of Serbia who co-ordinated the statistical data collection.

[3] A person from the Ministry of Finance of the Republic of Serbia and from the Public Policy Secretariat of the Republic of Serbia who co-ordinate the whole assessment in Serbia.

[4] EU STAKEHOLDER CONSULTATION GUIDELINES 2014

[5] These reforms started in 2014 as part of the pre-accession discussions with the EU.

[6] The legal framework for IP rights includes: the Law on Copyright and Related Rights, the Patent Law, the Trademark Law, the Law on the Legal Protection of Industrial Design, the Law on Legal Protection of Topographies of Semiconductor Products and the Law on Indications of Geographical Origin.

[7] Dolovo Cibuk Wind Farm (USD 354 million), Kovacica Wind Farm (USD 225.2 million), Kosava Wind Farm Phase I (USD 138.8 million), and Alibunar Wind Farm (USD 100 million).

[8] Apart from the Ministry of Trade, other relevant government agencies include the Ministry of Finance, Ministry of Agriculture, Ministry of Economy, and the Customs Administration, while business community involvement in trade policy ranges from the Serbian, American and French Chambers of Commerce to the Foreign Investors Council and the National Alliance for Local Development.

[9] The NTFB holds meetings to address issues and regulations on agricultural, sanitary and phytosanitary measures, technical barriers to trade, customs procedures, and co-ordination of trade facilitation activities under international and regional trade agreements.

[10] According to the Law on the Chamber of Commerce, chambers of commerce play an active role in the preparation of legal acts important for the economy and business environment. They monitor all legislative amendments, conduct related analysis and submit initiatives for policy changes to the relevant ministries.

[11] https://euprava.gov.rs/.

[12]This issue has been raised in previous editions of the Competitiveness Outlook as an ongoing issue in Serbia. In 2017, 60% of laws relevant to business did not go through a public hearing, 90% were made by urgent procedure and half of all draft laws were not available on the relevant ministry websites. According to statistics from the Public Policy Secretariat (PPS), a consultation process in accordance with the Law on Planning System was conducted for 15 out of 42 relevant draft laws (35.71%) during 2020. However, these data should be viewed in the context of the COVID-19 pandemic.

[13] OECD member states and the following partner economies: Brazil, the People's Republic of China, Costa Rica, India, Indonesia, Kazakhstan, Malaysia, Peru, the Russian Federation, South Africa and Thailand.

[14] The full set of OECD STRI indices and comparison tools as well as policy simulators for OECD member states and partners states that have undertaken the OECD STRI are available on the dedicated OECD website https://www.oecd.org/trade/topics/services-trade.

[15] The complete list of measures sector by sector is available on the OECD STRI website http://www.oecd.org/trade/topics/services-trade.

[16] According to the Law on Agricultural Land, the prohibition on the sale of agricultural land to foreigners was removed in 2017, however restrictions remain: residency in Serbia for at least 10 years in the local self-government unit in which they want to buy land; a history of cultivation for at least 3 years; and possession of registered agricultural farm machinery and equipment.

[17] According to Article 7 ("Principle of ensuring competition and prohibition of discrimination") Paragraph 3 of the Law on Public Procurement, the contracting authority/entity shall not impose conditions that would constitute national, territorial, or personal discrimination among economic operators, directly or indirectly.

[18] According to Article 27 and Article 49. Paragraph 2 of the Law on Public Procurement, "Contracting authority/entity shall regulate in a special act in greater detail the manner of planning, conducting public procurement procedures and monitoring of the execution of the public procurement contract, (the manner of communication, the rules, duties and responsibilities of persons and organisational units), the manner of planning and conducting procurements exempted from the law and procurements of social and other specific services".

Also, according to Article 18, the contracting authority/entity shall record data on values and types of public procurements referred to in Article 11 - 21 of this Law, for each exemption ground separately, as well as the public procurements referred to in Article 27, paragraph 1 of this law. Contracting authorities/entities shall aggregately publish data referred to in paragraph 3 of this article on the Public Procurement Portal, no later than 31 January of the current year for the previous year, pursuant to the instruction published by the Public Procurement Office on the Public Procurement Portal.

[19] In order to facilitate comparison with OECD member states that have undergone the STRI exercise, the paragraphs below have been drafted in accordance with the methodology of the STRI project publications. Country Notes for the OECD members, as well as Sector Notes, are available on the STRI web page: https://www.oecd.org/trade/topics/services-trade/.

[20] Access to the railway infrastructure and the ability to do business on its territory is provided to all companies registered in Serbia (Article 32, paragraph 1 of the Law on Rail Services; https://www.paragraf.rs/propisi/zakon_o_zeleznici.html). In accordance with the provisions of the Agreement on the Establishing the Transport Community, there are plans to further liberalise the market, i.e. opening the market at the regional level (the Western Balkans signatories to the agreement) and, later, at the EU level (Transport Community Treaty, Art 11).

[21] Srbija Kargo is main railway freight operator but the rail market has been open to all interested stakeholders since 2016. Serbia now has 10 railway freight transport operators and Srbija Kargo's share of market has decreased relative to other operators, from about 95% in 2016 to about 80% in 2020.

[22] The National Bank of Serbia adopted a set of regulations implementing Basel III standards, that apply from June 30, 2017. The set of regulations consisted of the following decisions: Decision on Capital Adequacy of Banks, Decision on Disclosure of Data and Information by Banks, Decision on Reporting on Capital Adequacy of Banks, Decision Amending the Decision on Reporting Requirements for Banks, Decision on Liquidity Risk Management by Banks, and Decision Amending the Decision on Risk Management by Banks.

[23] Some evidence for this lies in the fact that the market is largely dominated by foreign-owned insurance companies. According to the Serbian authorities, out of the total of 20 insurance undertakings, 15 were majority foreign owned in 2020.

[24] In 2019, 34% of the population purchased goods on line at least once. E-commerce revenue in the e-commerce market is projected to reach EUR 395 million in 2020. The market's largest segment is toys, hobbies and DIY. User penetration is expected to reach 48.1% in 2020 and prior to COVID-19 it had been estimated it would reach 60% by 2024.

[25] The project's target groups are: e-commerce traders, primarily small and medium-sized enterprises, women working in the field of e-commerce, companies providing postal services, consumers and inspection bodies.

[26] Decision Amending the Decision on Capital Adequacy of Banks and Decision Amending the Decision on Risk Management by Banks.

[27] Decision on Capital Adequacy of Banks and Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items.

[28] MONEYVAL is a permanent monitoring body of the Council of Europe which is assessing compliance with the principal international standards to counter money laundering and the financing of terrorism and the effectiveness of their implementation, as well as with the task of making recommendations to national authorities in respect of necessary improvements to their systems.

[29] A passenger car is a road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver). (OECD, 2013[414])

[30] The Decision on Management of Risks Arising from Introduction Of New Products/Services By Lessor (RS Official Gazette, No. 149/2020).

[31] Startup Genome is the research and policy advisory organisation for public and private agencies committed to accelerating the success of their start-up ecosystem. For more information see https://startupgenome.com/.

[32] Concrete PPP examples include: the renovation and expansion of existing optical telecommunication network in Novi Sad; the construction, financing and operation of the internal ports and roads on the Danube in Apatin; the acquisition of necessities of public transport services in Loznica; the design, construction, financing and operation of public car parks in Sabac; the construction of factories for the processing of biomass in Zrenjanin; the acquisition of necessities of public transport services in Topola; and the acquisition of necessities of public transport services in Srbobran.

[33] Belgrade Stock Exchange has two indices: BELEXline, the general benchmark index of the Belgrade Stock Exchange, and BELEX15, representing the 12 most liquid stocks.

[33] A newly established company that performs so-called "innovative activities" is a company established for less than three years and which mainly performs innovation activity in terms of the law governing innovation activity (activities undertaken to create new products, technology, processes and services or significant changes to existing ones, in accordance with the needs of the market). A series of criteria define what a company performing innovative activity: R&D costs should account for at least 15% of total expenditure, highly qualified employees should make up more than 80% of all employees and no dividends should be distributed within a three-year period.

[34] The maximum monthly base for contributions is five times the statutory average monthly salary in Serbia (RSD 368 590 in 2020, or around EUR 3 130).

[35] Under the destination principle, tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction.

[36] The OECD Database on General Competition Statistics (OECD CompStats) is a database with general statistics about competition agencies, including data on enforcement and information on advocacy initiatives. In 2020, it included data from competition agencies in 56 jurisdictions, including 37 OECD countries (36 OECD countries and the European Union), i.e. Argentina, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Peru, United States (Americas): Australia, Brazil, Chinese Taipei, India, Indonesia, Japan, Korea, New Zealand (Asia-Pacific); Austria, Belgium, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, European Union, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Romania, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, the United Kingdom (Europe); Egypt, Israel, Kazakhstan, Russian Federation, South Africa, Turkey, Ukraine (Other) (OECD, 2020[417]).

[37] According to the Serbian authorities, there is not a fixed number of SOEs that fall under the scope of the Law on Public Enterprises, but rather fixed criteria for determining which enterprises fall under its scope.

[38] Calculations based on data provided by the authorities of Serbia and the number of employed persons in Serbia (2 938 200) as reported in the national Labour Force Survey Quarter IV 2019 (SORS, 2019[85]).

[39] According to the Serbian authorities, public-interest activities are those defined as such by the relevant laws applicable to the following fields of activity: mining and energy; transportation; electronic communications; publishing the official gazette and publishing textbooks; nuclear facilities, armaments and military equipment; the use, management, protection, development and promotion of goods of general interest and goods in general use (water, roads, forests, navigable rivers, lakes, banks, spas, game, protected areas, etc.); waste management; and other fields.

[40] Good practices include making publicly available: audit reports for the past 3-5 years; information about discounts and benefits; information about SOE debts and loans; information about SOE financial claims; policy on collecting financial claims; minutes of governing, supervisory and audit body meetings, and inventories (or information on major assets – real estates/properties, vehicles). Transparency Serbia has published comprehensive report regarding reporting practices of Serbia's SOEs (Transparency International, 2019[418]).

[41] For the purpose of this profile, the instruction system refers to teaching and learning processes that takes place in school education. It generally consists of curricula, standards for schools and student learning, assessment and evaluation frameworks, and other elements that support instruction.

[42] Students may take this exam in Grade 12 (for general education and four-year VET upper secondary schools) or in Grade 11 (for three-year VET schools).

[43] Examples include Peace-Building and Inclusive Local Development (PBILD), Youth Employment and Migration (YEM), Career Development and Youth Entrepreneurship in Serbia (US Embassy), The Sustainable Local Development Project (USAID), the Economic Security Enhancement Project (USAID), TEMPUS projects (EU), IPA projects (EU), and many others. The regional and national programmes related to the topic of professional orientation and entrepreneurship were also recognized - Balkan Community Initiatives Fund (BCIF), European Movement in Serbia (EPuS), SMART Kolektiv, Group 484, Initiative for Development and Cooperation - Serbia (IDC). etc.

[44] Under the 2019 revised accreditation standards, the teacher practicum must be at least 90 hours per year in the 2nd,3rd and 4th year of the programme. In the 5th year of the programme, the teaching practicum is at least 180 hours and 6 European Credit Transfer and Accumulation System (ECTS) credits.

[45] Starting in 2021/22, students in Serbia will take the state Matura examination to certify their completion of upper secondary school and inform student selection into tertiary education.

[46] In 2017-18, Serbia piloted a new national assessment for students in Grades 7 (basic education) and 11 (the third year of upper secondary). The results will inform discussions about how to establish a new national assessment system (Maghnouj et al., 2020[8]).

[47] The only criteria was that companies did not cut employment by more than 10%.

[48] In the field of labour law, the law of 2014 is only partially aligned with the EU *acquis*. A new law on the right to strike has yet to be adopted.

[49] Platform workers are individuals who use an app (such as Uber) or a website (such as Amazon Turk) to match themselves with customers, in order to provide a service in return for money. They offer a diverse range of services including transport, coding and writing product descriptions (OECD, 2019[407]).

[50] Self-employed persons without employees

[51] During 2019, 59 fatalities in the workplace were recorded – a record number. Most were in the construction sector.

[52] The procurement was planned for the third quarter of 2020.

[53] Government response to the questionnaire

[54] The ILO consider that the ratio of labour inspectors to workers should be approximately 1:10 000 in industrial market economies.

[55] These programmes are supported by the European Union and Council of Europe for Western Balkans and Turkey.

[56] Published in the Official Gazette of RS, No. 18/21 on 1 March 2021.

[57] Duality is the division of the labour market into two separate submarkets or segments, distinguished by different characteristics and behavioural rules. Segmentation may arise from the particularities of labour market institutions, such as governing contractual arrangements (segmentation along permanent/temporary nature of employment contracts), lack of enforcement (segmentation along formal/informal line), as well as types of workers concerned (such as migrant and non-migrant workers).

[58] In particular the European Commission notes that the co-ordination body for monitoring the strategy's implementation, chaired by a Deputy Prime Minister, met three times during the reporting period, not six times a year as previously agreed in the 2017 Roma Seminar conclusions. The Expert Group involving civil society organisations, mandated to support the co-ordination body, never met. The fifth Roma Seminar was held in October 2019. The operational conclusions were finalised but their adoption has yet to be formalised nor their implementation closely monitored and reported on. The institutional structure dealing with Roma integration remains ineffective and complicated, without a clear distribution of tasks. Co-ordination between the national and local authorities, and Roma-sensitive budgeting, still need to be strengthened. There has been a serious delay in establishing the legal basis for local Roma co-ordinators and pedagogical assistants.

[59] Official Gazette of RS, No. 125/04, 104/09 and 50/18.

[60] Based on the International Standard Classification of Education (ISCED 2011), the term low-educated refers to people with less than primary, primary and lower secondary education (levels 0-2), medium educated refers to people with upper secondary and post-secondary non-tertiary education (levels 3-4) and highly educated refers to people with tertiary education (levels 5-8).

[61] Data received from the government.

[62] Jobs Gateway Database, based on data provided by national statistical offices and Eurostat, WIIW' own calculations).

[63] Reducing personal income taxes or employee social security contributions has the potential to stimulate labour supply and create work incentives, in particular for low-income and second earners, who are especially responsive to changes in after-tax wages (European Commission, 2020[464]).

[64] Overall, the share of the population with lower educational level was higher than the EU Member States that joined in 2004 and later (18%).

[65] Note that this does not refer to hourly gross wages.

[66] Registered unemployed refer to data provided by the registers of the PES, according to different national definitions and rules, while LFS unemployed refer to harmonised data which are figures provided by the Labour Force Survey, according to the ILO definition of unemployment.

[67] Note that the average of the unemployment rate of the five peer EU countries (Bulgaria, Croatia, Hungary, Romania and Slovenia) was 4.1%.

[68] Informal employment includes employment in unregistered companies, employment in registered companies but without a formal contract and without paying social and pension contributions, and unpaid family workers (SORS, 2020[127]).

[69] There were 191 000 people informally employed outside the agricultural sector. It is assumed that there is no informal employment in the public sector (SORS, n.d.[419]; SORS, n.d.[420]).

[70] Information from government (policy roundtable).

[71] Around 1 000 mediated through NES each year, and another 5 000 to 7 000 workers mediated through private agencies in the past. The numbers have been lower in 2020, due to the COVID-19 pandemic.

[72] Horizon 2020 is the biggest European Union's framework programme for research and innovation. It provides funding for multi-national collaboration projects as well as for individual researchers, and supports SMEs with a special funding instrument. (https://ec.europa.eu/programmes/horizon2020//en/what-horizon-2020 ; https://www.euneighbours.eu/en/east/stay-informed/projects/horizon-2020)

[73] Eureka is the largest intergovernmental network for cooperation in R&D and innovation in the world. It is present in over 45 economies, where it provides access to public funding, promotes collaboration and innovation or offers advice, through various programmes (such as Eureka Clusters, Globalstars, InvestHorizon). (https://www.eurekanetwork.org/)

[74] European Research Area (ERA) is the ambition to create a unified research area open to the world, based on the EU Internal Market, that enables free circulation of researchers, scientific knowledge and technology. (https://ec.europa.eu/info/research-and-innovation/strategy/era_en).

[75] EURAXESS - Researchers in Motion is a pan-European initiative delivering information and support services to professional researchers, backed by the EU, member states and associated countries. It supports researcher mobility and career development and enhances scientific collaboration. (https://euraxess.ec.europa.eu/).

[76] Marie Skłodowska-Curie Actions (MSCA) are an EU programme, which provides grants to support research careers and encourages transnational, intersectoral and interdisciplinary mobility. (https://ec.europa.eu/programmes/horizon2020/en/h2020-section/marie-sklodowska-curie-actions; https://ec.europa.eu/research/mariecurieactions/msca-actions_en).

[77] White zones are areas which have no broadband infrastructure (based on the availability of Internet access speeds higher than 30Mbps) and where it is unlikely to be developed in the near future.

[78] Until the new Law on Electronic Communications is adopted, RATEL continues to conduct the analysis of relevant markets. In cases where there is no effective competition in a relevant market, the regulator designates the operator who, individually or jointly with other operators, has significant market power and its regulatory obligations.

[79] Directive 2013/37/EU of the European Parliament and of the Council of 26 June 2013 amending Directive 2003/98/EC on the reuse of public sector information.

[80] The Open Data Portal (https://data.gov.rs/sr/), as accessed in October 2020.

[81] The OGP is an international agreement aiming to increase transparency, civic participation and the use of new technologies in achieving a more open, effective and accountable government. Currently, 78 governments are members of the partnership (www.opengovpartnership.org/about/approach/).

[82] The data displayed on the platform are automatically downloaded from the Unified Information System for Planning, Implementation Monitoring, Policy Coordination and Reporting, maintained by the government through the state administration body responsible for policy co-ordination (Republic Secretariat for Public Policies) in accordance with Article 47 of the Law on Planning System of RS. The platform is co-financed by the European Union, (https://monitoring.mduls.gov.rs/), as accessed on 12 February 2021.

[83] Ministry of Public Administration and Local Self-Government, Projects and Programmes (http://mduls.gov.rs/en/category/projects-and-programmes/), as accessed on 12 February 2021.

[84] The e-Government Portal (https://euprava.gov.rs/) had been used by 1 026 347 people, according to data on the website, as accessed on 10 October 2020.

[85] For instance, the MTTT's Smart and Safe platform: Tips and Guides for Traders (https://pametnoibezbedno.gov.rs/saveti-za-trgovce/).

[86] GIZ-funded "Digital transformation support program for MSMEs" by the Development Agency of Serbia in cooperation with the Center for Digital Transformation (https://ras.gov.rs/javni-poziv-za-ucesce-u-programu-podrske-digitalnoj-transformaciji-mmsp).

[87] UNICEF in Serbia and USAID Cooperation for Growth Project (CFG) supported the preparation of the Digital Skills Development Strategy for the period 2020-24, through surveys and analysis performed under the framework of co-funded programmes like “Digital transformation of the labour market” by USAID CFG and “kids online” by UNICEF.

[88] At the time of writing (Q3 2020), the implementation of the Digital Skills Development Strategy had not yet started; the strategy action plan for the period 2020-21 was still being prepared and budget planning was under development.

[89] The programme is part of the Serbia at Your Fingertips - Digital Transformation for Development project, implemented by UNDP Serbia in co-operation with the Office of the Prime Minister of the Republic of Serbia and the ITE.

[90] The Police Directive (EU) 2016/680 deals with processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties and on the free movement of such data.

[91] The Annual Report of the former Commissioner for Information of Public Importance and Personal Data Protection for 2018 vividly describes the refusal of controlled public authorities to co-operate, submit data and fulfil their legal obligations according to the Law on Access to Information. It also outlines the reduced level of transparency of the new draft law through provisions excluding state-owned enterprises from its jurisdiction, which has also been signalled as contrary to the principles of openness and transparency by the Support for Improvement in Governance and Management, Joint Initiative of the European Union and the Organization for Economic Cooperation and Development (Commissioner for Information of Public Importance and Personal Data Protection, 2019[406]).

[92] Annual Report of the Commissioner for Information of Public Importance and Personal Data Protection for 2018 (Commissioner for Information of Public Importance and Personal Data Protection, 2019[406]).

[93] Smart and Safe Platform: Guide for Consumers in e-Commerce, Tips for e-Traders (https://pametnoibezbedno.gov.rs/elektronska-trgovina) and the eShop Fast, Easy and Simple video campaign (https://pametnoibezbedno.gov.rs/video/4).

[94] The twinning project "Further Development of Consumer Protection in Serbia" [SR 13 IPA OT 01 16], jointly funded by the European Union and the Republic of Serbia in the total amount of 1.425 million EUR, is implemented by the Ministry of National Development of the Republic of Hungary and the Regional Development Agency Pezinok from the Slovak Republic in cooperation with the Ministry of Trade, Tourism and Telecommunications of the Republic of Serbia (user organisation). Project duration is August 2017 - August 2019, (https://zastitapotrosaca.gov.rs/o-nama#S4).

[95] The working document elaborates in detail the steps taken so far and initiatives involving WB6 economies in the following areas: closer ties with the EU and enhancing regional co-operation, people-to-people contacts, familiarising people with the EU, civil society development and dialogue, good governance, parliamentary co-operation, trade integration, investment and economic and social development, community financial support, and donor co-ordination.

[96] The NTS should cover the following fields: 1) non-physical bottlenecks; 2) reform path for the transport sector including objectives and the key performance indicators; 3) the national transport model and demand forecast; 4) a strategic policy options paper covering road transport and infrastructure, urban transport, rail infrastructure and railway transport, intermodal transport, ports and inland waterways, air transport, e-mobility, active mobility, and technology uptake; 5) a draft national transport strategy with

detailed action plan; and 6) a strategic framework for the sustainable implementation of intelligent transport solutions (ITS), defining the ITS vision and priority interventions, development of the ITS architecture and institutional arrangements and roadmap for adopting ITS standards and the relevant EU Directives, and finally an ITS strategy and action plan with prioritised interventions.

[97] For more information, please see: https://mfin.gov.rs/dokumenti2/saobracaj.

[98] Its purpose is to regulate the determination of the public interest for complete and incomplete expropriation and temporary occupation of immovable property for the construction of those structures, then to determine specific expropriation procedures if needed permits, approvals, etc.

[99] The Rulebook on the Management of Capital Projects has three categories of projects: 1) less than EUR 5 million; 2) EUR 5-25 million; and 3) over EUR 25 million.

[100] A one-stop-shop is a business or office where multiple services are offered so that customers can get all they need in just "one stop." The term originated in the United States in the late 1920s or early 1930s to describe a business model offering customers the convenience of having multiple needs met in one location, instead of having to drive all over town to attain related services at different stores. One-stop-shops are a way of facilitating trade.

[101] An appropriate definition of “asset management” for the roads sector is the one proposed by the OECD in 2001: “A systematic process of maintaining, upgrading and operating assets, combining engineering principles with sound business practice and economic rationale, and providing tools to facilitate a more organised and flexible approach to making the decisions necessary to achieve the public’s expectations.” (OECD, 2001[380]).

[102] The assignment covered the preparation of detailed needs assessments, guidelines, maintenance plans and recommendation for performance-based maintenance contracts. Regional action plans for transport facilitation, rail, road and road safety (https://www.transport-community.org/library/meetings/ministerial-council/) have been endorsed by the Council of Minister of the Transport Community Permanent Secretariat (TCPS) in October 2020 and economies need to align their own plans to achieve the goals set within these ones.

[103] HDM-4 is a powerful tool for road management, economic analysis, programming road works, estimating funding requirements, predicting road network performance, project appraisal, and policy impact studies.

[104] According to Article 234 of the Air Transport Law, the CAD is the national supervisory authority of the Republic of Serbia in air navigation, in accordance with the regulations of the European Union, issuing the certificate of competence for air navigation services provision and assessing whether air navigation services providers fulfil the requirements for the provision of services.

[105] Regulation on Airport Charges.

[106] Regulation on the details of the procedure and the criteria applied for access to services provided in service facilities and Rulebook on the elements of service facility description.

[107] Alpine-Western Balkan rail freight corridor, https://www.rfc-awb.eu/.

[108] Full opening of the market, more incentives for shifting, development of multimodal facilities, etc.

[109] The indicators include: traffic flows (transparent per vehicle categories in the last 15 years, currently 407 counters in operation constantly measuring the traffic intensity, conducted by PERS), detailed road accident database (transparent road safety indicators through the Road Traffic Safety Agency), for road network – IRI coefficient, databases on bridges and tunnels, a database of landslides. Regional maintenance centres supervise the state of all roads.

[110] Additional indicators that could be monitored include average user costs, travel time satisfaction levels i.e. reliability, value of assets, market research and customer feedback, forecasted value of assets, audit programme, quality of user information, allocation of resources, long term programmes for investment, maintenance and operations, lowering of overhead percentage, etc.

[111] See the example of the border queue management system in Estonia (Estonia Border, n.d.[452]).

[112] Since the last CO2018 assessment, road safety legislation has been updated: adopted amendments of Law on road traffic safety; adopted new Law on roads and its corresponding by-laws which introduce a system of licensing of professional drivers and introduce tools for infrastructure safety management; updated new Rulebook on roadworthiness test. A survey of performance safety indicators is conducted every year using a methodology revised in 2017. Annual road traffic safety statistical reports have been published. A lot of road safety campaigns were conducted for all road users especially for children and young drivers. Seminars refreshing the knowledge of traffic police and traffic inspectors have been conducted. Most local communities (110 out of 161) have established Road Safety Councils and adopted their own road safety strategies.

[113] Established and operated the Road Safety Coordination Body; established and operated Road Traffic Safety Agency from 2010; Data collection according to CADAS started from January 1, 2016; established integrated road safety database from 2015, with data publicly available on the website of the Road Traffic Safety Agency; measured key performance indicators on a yearly basis from 2013 (publicly available on the website of the Road Traffic Safety Agency) based on the methodology according to Safety Net project; developed specific programmes for vulnerable road users (safety training for bicyclists, moped drivers since 2018 and motorcycle drivers since 2017).

[114] The goals include: modal shift from road, standards for energy efficiency, standards for noise emission, reduction of greenhouse gas emissions, vehicle labelling for emissions and fuel efficiency, introduction of carbon footprint calculators, eco-driving and speed limits, ITS applications, co-modality in transport, and urban mobility solutions.

The following environmental sustainability measures have been proposed: 1) to prepare sustainable urban mobility plans for Belgrade and major cities by 2020 (Belgrade's was completed in 2020); 2) to reduce dependence on conventionally fuelled cars in the five biggest Serbian cities by 25% by 2025 (several legal acts were adopted in 2019 and 2020 to provide incentives to promote electric vehicles); 3) to prepare strategies and define concepts of city logistics for Belgrade and bigger cities by 2020 (the city logistic strategy for Belgrade is in the procurement plan for 2020 but has not yet been tendered out); 4) shifting freight and transport to more environmentally friendly modes (such as rail and water); and 5) more intensive promotion of intermodal transport (see section on combined transport for more details).

These measures are included in the National Sustainable Development Strategy, National Environmental Approximation Strategy for the Republic of Serbia and the National Environmental Protection Programme, but also in the Serbian Strategy of Energy Sector Development; the overall Strategy of Railway, Road, Inland Waterway, Air and Intermodal Transport Development in the Republic of Serbia; and many other existing strategic documents as spatial plans, sector strategies and action plans.

[115] Study of snow deposits on state roads, study of endangerment of the state roads from the occurrence of floods (Kolubara river basin, Sava river basin, South Morava River Basin, West Morava basin without Ibar river, etc.). PERS also implements the Technical Assistance to Mainstream Climate Resilience in the Road Transport Management in Serbia.

[116] Combined transport refers to the transport of goods between Member States where the lorry, trailer, semi-trailer (with or without tractor unit, swap body or container of 20 feet or more) uses the road on the initial or final leg of the journey and rail or inland waterway or maritime services on the other leg, where this section exceeds 100 km as the crow flies (Combined Transport Directive 92/106EC, amended by the Directive 2013/22/EU).

[117] The General Transport Master Plan for Serbia for the period 2009-20027; Plan for Railway, Road, Water, Air and Intermodal Transport Development in the RS 2015-2020; Railway Master Plan for years 2012-2021; National Program of Public Railway Infrastructure from 2017 to 2021; and The Law on Spatial Plan of the Republic of Serbia from 2010 to 2020 defines potential locations of intermodal terminals and logistics centres.

[118] Ease of arranging competitively priced shipments.

[119] Periodical and regular measurements to monitor infrastructure assets' conditions, assessment of the value of assets and costs for non-maintained assets, adoption of the asset management strategies, consistent approach in the identification of the mix and timing of asset operation and construction strategies, etc.

[120] Network Codes were established under Article 6 of EU Regulation 714/2009 and are secondary acts, in many cases of technical nature, to overcome legislative gaps and barriers to a non-discriminated, open internal EU energy market by establishing uniform regulation. In essence they overcome barriers and friction in order to promote competition. In some sense, they represent lessons learned over time that aim to perfect the legislative framework for the EU internal energy market and represents EU best practices and standards. While not an exhaustive list, the interested reader can find more information about Network Codes under (Eurostat, 2021[465]; ENTSOE, 2021[449]; Florence School of Regulation, 2021[388]).

[121] More precisely, Serbia does not currently have a legal binding documents (policy, regulation or legislation) that govern or require the pricing or taxation of greenhouse gases. However, it is understood that Serbia is currently working on legislation that would implement some type of pricing mechanism akin to the EU emission certification market, with similar monitoring verification and reporting requirements and mechanisms. Moreover, the Energy Community, of which Serbia is a member, plans to adopt relevant legislation into its *acquis* that would require the establishment of national or even regional greenhouse gas market that would eventually be integrated into the European Union Emission Trading Scheme. For more information, please see Capros (2020[434]), Energy Community Secretariat (2020[387]), Kantor (2020[393]; 2021[392]).

[122] This conclusion is supported by the European Commission (2020[301]) which notes that "staff levels are still insufficient to allow the agency implement all regulatory responsibilities under the Third Energy Package and the new acquis upfront" (page 89).

[123] More precisely, according to AERS (2020[423]) it had 45 staff members in 2018 and planned to expand that to 51 at the end of 2019. However, at the end of 2019, AERS had 43 staff members. Based on conversation with AERS, it plans to hire additional 9 staff members, in part to support its work on the full transposition and implementation of the network codes.

[124] Parliamentary approval of the budget is not a necessarily a prohibitive procedure, but it does increase the risk of delays in adopting a budget and makes it more susceptible to political influence. Both factors could lead to delays or interruptions to hiring and retaining staff as well as interrupting the general function of the regulator.

[125] Although related to matters of security please see IOSCO (2015[390]) for further elaboration.

[126] The framework includes the Energy Development Strategy of the Republic of Serbia until 2025 - with projections until 2030, the Electricity Transmission System Development Plan of the Republic of Serbia for 2020-29, the Electricity Transmission System Investment Plans for 2020-22, and the Natural Gas Transport Transmission System Development Plan for 2020-29 – see AERS (n.d.[424]).

[127] Although another significant player is Gazprom as the dominant exporter of natural gas to Serbia and part owner of the Serbian transmission system operators, Yugorosgaz and Gastrans. Moreover, Gazprom is the majority owner of NIS j.s.c. which is actively engaged in the development of the 200 MW thermal power plant in Pancev where construction started in 2019. Additionally, Gazprom Germania, a subsidiary of Gazprom, is part owner of the natural gas underground storage facility Banatski Dvor, LLC.

[128] Oil indexation was once the dominant pricing format for natural gas in Europe. This largely reflected the fact that natural gas spot markets were not liquid enough at the time to provide good price signals. Moreover, when natural gas was competing with oil for power generation and heating, oil indexation was a good approach for assuring that natural gas was competitive with the main alternative fuel. Oil indexation is often also justified by natural gas being produced as a by-product from oil exploration or because natural gas competes with oil for capital investment. However, in the current market situation, oil indexation means that price of natural gas price does not reflect the supply and demand realities which are largely now disconnected from oil, both in terms of alternative demand and on the production side. Furthermore, Europe has a variety of liquid natural gas spot markets that offer good pricing and indexation points, especially considering the interconnected natural gas markets, including those based on the European natural gas pipeline network. However, it should be stressed that there is an extensive literature discussing benefit and drawbacks of the oil indexation of natural gas pricing and this endnote only scratches the surface of the debate. Some examples of the literature are: Dubreuil et al. (2020[439]), European Commission (2015[458])—with regard to legality of oil indexation, Melling (2010[394]), IEA (2020[389]) --for the current split in pricing approach in Europe, see Stern (2007[396]).

[129] For a more detailed exposition of the issue of losses in the transmission and distribution of electricity please see CEER (CEER, 2020[236]).

[130] Please see Ministry of Mining and Energy's website (https://mre.gov.rs/dokumenta-efikasnost-izvori.php) or Energy Community website (https://www.energy-community.org/implementation/Serbia/secondary.html) for a comprehensive list of the regulations and legislation that govern the renewable energy sector in Serbia.

[131] A day-ahead market is an organised market space in which interested parties can buy and/or sell energy for the next day in the form of putting in bids/offers that are algorithmically matched. For more detailed explanations please see, for example, NordPool (2021[395]) or ISO-NE (2021[391]).

[132] A feed-in tariff (FIT) refers to a renewable support scheme in which "[…] power plant operators receive a fixed payment for each unit of electricity-generated independent of the electricity market price" (Banja et al., 2017, p. 15[238]). A feed-in-premium is a renewable support scheme in which "[…] plant operators have to market the electricity generated directly at the electricity market and receive an additional payment on top of the electricity market price either as a fixed payment or adapted to changing market prices in

order to limit both the price risks for plant operators and the risks of providing windfall profits at the same time" (Banja et al., 2017, p. 16[238]). Contract-for-difference is a renewable support scheme in which variable premiums are paid to plant operators for delivered electricity where the "[…] variable premium [is] calculated as the difference payment between an administratively prefixed price (the strike price) and a measure of the market price for electricity (the reference price)" (Eurostat, n.d., p. 5[198]). For a brief but comprehensive non-technical overview of the different renewable financial subsidy schemes please see Aures (2021[425]). For an overview of the different support schemes applied across Europe please see http://www.res-legal.eu/.

[133] This conclusion is based on the government input, indicating that the current human resources are not sufficient. This is also support by Energy Community Secretariat (Energy Community Secretariat, 2020[232]) which reports that "the Ministries [Ministry of Mining and Energy and the Ministry of Construction, Transport and Infrastructure] reported about the needs and plans to strengthen the currently weak human capacities for implementation of the energy efficiency directives. Human resource capacities for energy efficiency in the Ministry of Mining and Energy were slightly increased but still remain insufficient to effectively implement the required reforms."

[134] The government response indicated that "The collected indicators are not collected systematically. It is done on the project base."

[135] A seat requirement is "a provision of national law under which an undertaking established in another Member State must create a permanent establishment in the Member State in which it seeks to" be active (Energy Community Secretariat, 2018, p. 13[448]).

[136] As Serbia is a member of the Energy Community, the Energy Community Secretariat publishes opinions that the network operator(s) is(are) unbundled in line with EU Directive 2009/72/EC and 2009/73/EC. To this end, the absence of a positive opinion could indicate that the network operator is not unbundled in line with the Directives and thus do not conform with international best practices.

[137] Following the publication of the original opinion of Energy Community Secretariat, the relevant aspect of the Law on Ministries was amended. However, without a re-opening of the certification procedure by AERS, the Energy Community is not in a position to submit a new, positive opinion on the matter.

[138] The requirement for a compliance officer in the transmission system operator originates in Article 21 of the EU Directive 2009/72/EC. It establishes the role of compliance officer as an independent position to monitor that the TSO complies with transparency and non-discriminatory behaviour requirements and that it operates independently from any other influence when part of a vertically integrated undertaking. This is a vital role as it assures that the TSO behaves equally and adequately towards all market participants and thus, does not use its natural monopoly position to hamper the competitive nature of the market.

[139] The Joint Allocation Office (JAO) is a service company that facilitates the electricity market by organising auctions for cross border transmission capacity jointly for both TSO. The Joint Allocation Office is the single allocation platform (SAP) for all European TSOs that operate in accordance and compliance with EU legislation. For more details, please see www.jao.eu/aboutus/aboutus/overview.

[140] This spirit of regional co-operation is best exemplified by AERS's participation in the Energy Community as well as in:

1) Energy Regulators Regional Association which is an association of regulators aiming at the improvement of co-operation, exchange of experience and capacity building in member states.

2) Council of European Energy Regulators (CEER), a platform for co-operation, information exchange and assistance between Europe's national energy regulators and their interface at EU and international level, aiming to facilitate the creation of a single, competitive, efficient and sustainable EU internal energy market.

3) Balkan Advisory Forum, a national regulatory agency platform for exchange of experience on regulatory issues falling within the scope of the electricity, gas and water and sewerage markets in the region.

[141] Please see (Energy Community Secretariat, n.d.[446]).

[142] See (BIZLife, 2019[466]).

[143] Please see (Energy Community Secretariat, 2021[467]) for the current state of TSO certification and thus state of unbundling.

[144] The Paris Agreement was signed in 2016 and ratified in 2017, while the Kyoto protocol was ratified in 2007. Serbia submitted two National Communications on climate change in 2010 and 2017 (UNFCCC, 2020[307]). The Ministry of Environmental Protection, together with the UNDP, drafted the Second Biennial Update Report and initiated drafting of the Third National Communication under the UNFCCC. Both are expected to be submitted in 2021.

[145] The NECP will define targets in the field of renewable energy sources, energy efficiency and reduction emissions of GHG for 2030 with long-term vision until 2050. The NECP is prepared through the IPA 2017 "Further Development of Energy Planning Capacity" project, which started in February 2021.

[146] In the period from 2006 to 2019, Serbia suffered 10 natural disasters, 8 of which were floods. It suffered flooding once in 2007 and in 2009, twice in 2010 and in 2013, and then once in 2014 and in 2019. The floods in May 2014 were particularly severe, affecting 22% of the population (1.6 million people) and two-thirds of Serbia's municipalities (mostly located in Central and Western Serbia). The damage amounted to EUR 1.5 billion (EC/UN/World Bank, 2014[456]).

[147] SEPA performs public administration tasks relating to the development and management of the national information system for environmental protection, collection and compilation of environmental data and preparation of reports on the state of the environment. It also ensures the right of access to relevant environmental data and information at national and international levels, and improves communication and dissemination of information to decision makers and the public.

[148] In 2019, the Ministry of Environmental Protection revoked the waste management licences of one of the largest hazardous waste management operators. The inability of hazardous waste producers to transfer waste to an appropriate operator resulted in hazardous waste accumulating in temporary storage, creating an additional hazard for the environment and human health. The Draft Law on the Amendments to the Law on Waste Management amends Article 36 paragraph 4 to allow waste to remain in temporary storage for 24 months instead of 12 months, which will result in large amounts of hazardous waste piling up in temporary storage facilities.

[149] The National Waste Management Plan should include: estimates of expected quantities of municipal waste, as well as other relevant waste streams (e.g. "special waste streams" in accordance with definitions from Articles 47 to 58 of the Law on Waste Management), a review of existing waste collection systems and networks of waste recovery and disposal facilities, assessment of the need for new collection systems and additional waste management infrastructure, criteria for identifying the location and required capacity of additional waste management facilities, an implementation plan for reducing the amount of

biodegradable waste in landfills, and the estimation of waste management costs, measures, guidelines and deadlines for the implementation of the plan.

[150] The Ministry of Construction, Transport and Infrastructure; Provincial Secretariat for Sustainable Development and Environmental Protection; local self-government units; public and private utility companies, the Serbian Chamber of Commerce / boards of utility companies; the Standing Conference of Towns and Municipalities; and the non-governmental organisation (NGO) sector.

[151] The capital city of Belgrade is working on the construction of a new landfill Vinca, with the construction of a municipal waste incinerator planned for the second phase, as well as plants for biodegradable waste treatment (anaerobic digestion). Both plants will convert waste to energy, which is in accordance with the Law on Waste Management and related by-laws. Communal infrastructure is being built, in accordance with the regional waste management principle, such as the construction of regional waste management centres. One of these is the construction of the regional landfill Kalenic for 11 municipalities in the Kolubara region with accompanying infrastructure. Infrastructural development plans have also focused on the construction of such centres in Novi Sad, Zaječar, Niš, Priboj and Nova Varoš, Kraljevo, Kruševac and other regions that were not built by 2020.

[152] Data for agriculture and municipal use are from 2016.

[153] In its decision of January 2019 the MoEP ordered the investor to remove 300-350m of pipes from the riverbed because the works had been carried out in violation of the conditions issued by the Institute for Nature Conservation of Serbia in September 2018. Inspectors have also determined that a landslide has been activated at the water intake level on the right bank of the river, and that the flora on the left bank has been destroyed. The investor's appeal against the ministry's decision was rejected in April 2019. However, not only did the investor fail to comply with the decision, but also continued with construction works, and the mini hydropower plant recently obtained a use permit from the municipality of Babušnica where the village of Rakita is situated. This ignited anger in the local population, who as part of the protest held during summer 2020, removed some of the pipes to implement the ministry's decision (Balkan Green Energy News, 2020[428]).

[154] The MoEP; SEPA; Institute for Nature Conservation of Serbia; Provincial Secretariat for Urbanism and Environmental Protection; Institute for Nature Conservation of Vojvodina Province; the city of Belgrade; local self-governments; and the Directorate of Forests, situated in the Ministry of Agriculture, Forestry and Water Management. Operational and field activities are covered by the activities of public forest enterprises, Srbijašume and Vojvodinašume, while the management in national parks are the responsibility of five national parks (Kopaonik, Tara, Fruška Gora, Đerdap and Šar Planina).

[155] Aichi Target 11 states: "By 2020, at least 17% of terrestrial and inland water, and 10% of coastal and marine areas, especially areas of particular importance for biodiversity and ecosystem services, are conserved through effectively and equitably managed, ecologically representative and well-connected systems of protected areas and other effective area-based conservation measures, and integrated into the wider landscapes and seascapes".

[156] The Implementation of an Innovative Forest Management Planning Considering Economic, Ecological and Social Aspects in Serbia project was being implemented at the time of drafting, to help establish the basic outlines of the Serbian national forestry programme.

[157] The Forest Law Enforcement, Governance and Trade (FLEGT) regulation governing the import of timber products into the EU, and the EU Timber Regulation, governing the trade in timber and timber products, are two key elements of the EU *acquis* regarding forestry.

[158] According to interviews with government representatives.

[159] This indicator shows trends in the change in use of agricultural, forest and other semi-natural and natural land into urban land and other artificial areas. It shows surfaces occupied by construction and urban infrastructure, as well as urban green, sports and recreational areas. The indicator shows changes in the use of agricultural land, land used for different types of human activities, the origin of urban land expressed through the share of different categories to which the change was made. The indicator is calculated by analysing maps based on Landsat satellite images from the CLC database for 1990, 2000, 2006, 2012 and 2018, i.e. based on the increasing trend of areas use of which has changed in a certain period of time and based on CLC databases of changes.

[160] The most recent data (2017) indicate the economy's annual mean concentration of particulate matter ($PM_{2.5}$) is 25 μg/$m^3$, exceeding the recommended maximum of 10 μg/m3. This is equal to the WB6 average of 25.77 μg/$m^3$ in 2017 . PM concentrations in the winter months regularly reach ten times the limit in the majority of municipalities of Serbia.

[161] Several of the most polluting coal power plants in Europe are located in Serbia: Kostolac B is the most notorious sulphur dioxide polluter in Europe with 128 000 tonnes of emissions of $SO_2$ in 2016, followed by Kostolac A (109 000 tonnes of $SO_2$) and Nikola Tesla B (57 100 tonnes of $SO_2$), Kolubara A (3 255 tonnes of $PM_{10}$) and Nikola Tesla A (2 680 tonnes of $PM_{10}$) (Health and Environment Alliance. Climate Action Network, 2017).

[162] "Further implementation of the Approximation Strategy in the field of environment - Implementation framework for full compliance with legislation in the field of air, chemicals and horizontal legislation".

[163] Belgrade, Subotica, Pančevo, Užice, Smederevo, Kosjeric, Valjevo, Kraljevo, Sremska Mitrovica, Kragujevac and Niš.

[164] The Seveso-III Directive (Directive 2012/18/EU) is a European Union directive aimed at controlling major chemical accident hazards.

[165] SEPA was developing its capacity to maintain the Cadastre of Contaminated Sites at the time of drafting. Co-operation between different UN Agencies and ministries over projects related to contaminated sites in Serbia has included improving the reporting system for the cadastre, developing capacity to carry out investigations and improving the management of contaminated sites overall.

[166] Industrial crops include both annuals (flax, **potatoes**, sunflower, caraway) and perennials (olive, essential-oil rose, hevea, hops, ginseng). They belong to many botanical families, including Solanaceae (**potatoes**, tobacco), Compositae (sunflower, safflower), Cruciferae (rape, mustard), and Rosaceae (essential-oil rose).

[167] Other relevant ministries are the Ministry of Economy; the Ministry of State Administration and Local Self-Government; the Ministry of Labour, Employment, Veterans and Social Affairs; and the Ministry of Environmental Protection as well other government agencies or departments with specific mandates for certain projects

[168] As a province, Vojvodina has its own institutions supporting rural infrastructure. These include the Provincial Secretariat for Agriculture, Forestry and Water Management; the Provincial Secretariat for Interregional Cooperation and Local Self-Government; the Provincial Secretariat for Economy, Employment and Gender Equality; and the Provincial Secretariat for Urban Planning, Construction and Environmental Protection.

[169] Serbia was the first economy in the region to enter the Chinese Belt and Road Initiative. Due to the particular bilateral relations with China, its investments in infrastructure in Serbia are much larger than in neighbouring economies.

[170] In 2014, the UAE-based Arabtec Holding, which is 21% owned by the Abu Dhabi investment fund Aabar, opened its regional headquarters in Belgrade to drive its expansion into the Balkan region.

[171] The area under irrigation is less than 1.5% of Serbia's arable land, significantly lower than in Bulgaria (3.0%), Hungary (5.0%), and Italy and Greece (around 30%).

[172] These faculties offer a wide range of programmes including agricultural economics, agriculture engineering, veterinary medicine, water management, animal husbandry, field and vegetable crops, fruit growing and viticulture, environment protection, organic agriculture, agricultural technological equipment, agritourism, rural development, forestry, and horticulture.

[173] The council is also responsible for identifying any required qualifications in the sector that need to be updated or no longer reflect the sectoral requirements; provide opinions about expected outcomes of knowledge and skills within the sector; promote opportunities for education, training and employment within the sector; propose lists of qualifications per levels and types, that may be acquired by the recognition of prior learning, etc.

[174] Regulates the planning, protection, arrangement and use of agricultural land.

[175] Regulates the protection and preservation of nature, biological, geological and landscape diversity as part of the environment as well as the integral system of environmental protection to ensure a healthy environment.

[176] Regulates the legal status of waters, integral water management, water land management, sources and methods of financing water activities.

[177] The National Strategy for Sustainable Use of Natural Resources and Goods was adopted in May 2012, based on the Law on Environment. The main, basic goals set to be achieved by this National Strategy are: directing and providing conditions for sustainable use of natural resources and goods, reducing the negative impact of resource use on the economy and the environment, contribution to directing development towards sustainable production

[178] The LPIS serves to identify land use for a given area. It uses orthophotos – basically aerial photographs and high precision satellite images that are digitally rendered to extract as much meaningful spatial information as possible. A unique number is given to each land parcel to provide a unique identification in space and time. This information is then updated regularly to monitor the evolution of the land cover and the management of the crops.

[179] Technical Assistance for the IPA2018: Action "Introducing and maintenance of functioning Land Parcel Identification System in pilot municipalities in Republic of Serbia" FWC SIEA 2018 – LOT 1. The value of entire project is EUR 300 000.

[180] The goals of NARDS are: 1) increased production growth and stability of producers' incomes; 2) improved competitiveness by adjustments to the requirements of the domestic and international markets and through the technological and technical improvement of the sector; 3) sustainable resources management and environmental protection; 4) improvement of the quality of life in rural areas and poverty reduction; and 5) efficient public policy management and institutional framework improvement for agricultural and rural areas development.

[181] As regards common commercial policy, no progress has been made on Serbia's accession to the WTO. The possibility of Serbia becoming a member of the WTO depends on the adoption of a modified law on the trade in genetically modified organisms, and the completion of market access negotiations with a small number of WTO members.

[182] Regulation on the performance of agricultural advisory services; Regulation on the issuance of licences and ID cards; Regulations on the maintenance of the register of agricultural extension agents

[183] The Culture Development Strategy was adopted by the government, but still needs to be ratified by the parliament.

[184] Through the Decree on the Formation of the National Council for Tourism Development of the Republic of Serbia.

[185] Bosnia and Herzegovina had the second highest market share, at 7.38% of total international tourist arrivals in 2019.

[186] The Blue Flag is one of the world's most recognised voluntary awards for beaches, marinas, and sustainable boating tourism operators. In order to qualify for the Blue Flag, a series of stringent environmental, educational, safety, and accessibility criteria must be met and maintained. Central to the ideals of the Blue Flag programme is the aim of connecting the public with their surroundings and encouraging them to learn more about their environment. As such, environmental education activities must be offered and promoted in addition to a permanent display of information relevant to the site in terms of biodiversity, ecosystems and environmental phenomena (Blue Flag, n.d.[431]).

The Green Key is a voluntary eco-label awarded to more than 3 200 hotels and other establishments in 65 countries. It is the leading standard for excellence in the field of environmental responsibility and sustainable operation within the tourism industry. This prestigious eco-label represents a commitment by businesses that their premises adhere to the strict criteria set by the Foundation for Environmental Education. A Green Key stands for the promise to its guests that by opting to stay with the Green Key establishment, they are helping to make a difference on an environmental level. The high environmental standards expected of these establishments are maintained through rigorous documentation and frequent audits. Hotels, hostels, small accommodation providers, campsites, holiday parks, conference centres, restaurants and attractions are all eligible for Green Keys (Green Key, n.d.[405]).

[187] For example, the Green Scheme of Slovenian Tourism https://www.slovenia.info/en/business/green-scheme-of-slovenian-tourism.

[188] The chapter of the *acquis* on the judiciary and fundamental rights.

[189] See the Agency for Prevention of Corruption website www.acas.rs.

[190] See the implementation reports the Ministry of Justice website: https://mpravde.gov.rs/tekst/26470/izvestaji-o-sprovodjenju-akcionog-plana-za-poglavlje-23.php.

[191] See the website of the Ministry of Justice: https://www.mpravde.gov.rs/tekst/26437/nacrt-revidiranog-akcionog-plana-za-poglavlje-23.php.

[192] www.antikorupcija-savet.gov.rs/.

# Annex A. The Competitiveness Outlook 2021 scoring model for Bosnia and Herzegovina

## Constitutional set-up of Bosnia and Herzegovina

The governance structure of Bosnia and Herzegovina (BiH) is highly decentralised, comprising the state-level institutions of Bosnia and Herzegovina, the governments of the two entities – the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska (RS) – as well as the autonomous Brčko District. The FBiH and the RS have significant constitutional autonomy and responsibility for the matters which the Constitution of Bosnia and Herzegovina has not assigned to the state-level government.[1] The entities have jurisdiction over a range of policies including health care, education, agriculture, culture, labour, police and internal affairs. Both entities have a president, prime minister and their own governments. The FBiH is furthermore divided into ten federal units (cantons), each with its own government and constitution that defines the institutions and functioning of government authorities.

## The 2021 Competitiveness Outlook assessment of Bosnia and Herzegovina

Bosnia and Herzegovina submitted questionnaire responses from the state level and both entities for the Competitiveness Outlook (CO) 2021 assessment. Information from all three sources has been taken into account in the analysis.

Policy making in Bosnia and Herzegovina is much more decentralised than in the other Western Balkan economies covered by the CO 2021 assessment. Therefore, information from the state level, FBiH and RS has been taken into account in the calculation of the assessment scores for the different policy dimensions. Following the changes to the CO assessment framework (see Assessment framework sections in the 16 policy dimension chapters), the scoring model for Bosnia and Herzegovina has been revisited to allow for a more accurate assessment of the different policy dimensions at the different levels of governance.

However, policy recommendations have in many cases been formulated to emphasise the importance of policy co-ordination in Bosnia and Herzegovina in order to strengthen the single domestic market and avoid imbalances in competitiveness between the entities.

Based on these considerations, a scoring system with three models has been developed (Table A A.1).

### Table A A.1. Overview of the three scoring models

| Model 1 | Model 2 | Model 3 |
|---|---|---|
| 1/3 (state) + 1/3 (FBiH) + 1/3 (RS) | 1/2 (FBiH) + 1/2 (RS) | State-level only |

Table A A.2 shows which scoring model has been applied in which CO 2021 policy dimension, as well as a rationale for its selection. For most of the 16 policy dimensions, a score has been derived by giving one-third of the weight to the state and both entities (Model 1). This reflects a more balanced division of competencies and responsibilities in the policy area between the state level and the entities. For five dimensions (Access to finance, Tax policy, State-owned enterprises, Employment policy and Environment

policy) a score has been derived by calculating a simple average of the two entities' scores. This approach (Model 2) reflects that major policies, mechanisms and institutions in these policy areas exist mainly at the level of the entities. Lastly, the Competition policy dimension only takes state-level information into consideration as it is an exclusively state-level competence (Model 3).

### Table A A.2. Application of the scoring models to the CO 2021 policy dimensions

| Policy dimension | CO 2021 assessment | Rationale |
|---|---|---|
| 1. Investment policy and promotion | Model 1 | Investment policy and promotion is managed at both the entity and state level. The Ministry of Foreign Trade and Economic Relations (MoFTER) regulates the economy's overall investment policy, while the entities follow supplemental legislation on topics such as expropriation, contract enforcement and alternative dispute mechanisms. Although the economy's investment promotion agency exists at the state level, promotion activities, incentive regimes and investor targeting also occur at the entity level. |
| 2. Trade policy | Model 1 | Trade policy is guided by the jurisdiction, framework laws and priorities put in place at the state level by MoFTER. However, the entities have an important role to play as they adopt their own sectoral laws and regulations governing and affecting various aspects of trade. Moreover, in various services sectors (i.e. road and rail transport, courier services or telecommunications) the entities control and operate key publicly-owned enterprises. |
| 3. Access to finance | Model 2 | Responsibilities under this dimension are largely at the entity level, with legal and regulatory frameworks mostly put in place at the entity level (and FBiH cantons in the specific case of public-private partnerships). However, the state level also plays a role in this area given that the Central Bank of Bosnia and Herzegovina oversees the central registries. |
| 4. Tax policy | Model 2 | While the Indirect Tax Authority collects indirect taxes and is managed at the state level, the entities define their own taxation framework for direct taxes and are in charge of tax collection. As scoring was not provided at the state level, and the majority of tax policies remain at the entity level, scores for the tax policy dimension's indicators and averages are based solely on FBiH and RS scores. |
| 5. Competition policy | Model 3 | Competition policy is within the competencies of the state level. The Bosnia and Herzegovina Competition Council has exclusive competence and decision-making power in competition matters. Three out of the six members of the Competition Council are designated by the Council of Ministers of Bosnia and Herzegovina, two members by the FBiH Government and one member by the RS Government. |
| 6. State-owned enterprises | Model 2 | Bosnia and Herzegovina's performance in the state-owned enterprises dimension is based on FBiH and RS activities. The assessment focuses mostly on enterprises held by the central levels of FBiH and RS rather than by cantons and municipalities. |
| 7. Education policy | Model 1 | Education policy is primarily under the responsibility of the entities (and cantons in FBiH). However, the state level does play a role by adopting important framework laws and through the Agency for Pre-school, Primary and Secondary Education, which is a state-level institution responsible for developing learning standards and common core curricula, as well as evaluating learning achievements for pre-primary, primary and secondary education. |
| 8. Employment policy | Model 2 | Employment, labour and social policy is within the remit of the entities. The state level is not responsible for labour, employment and social policy, nor social protection. The Ministry of Civil Affairs of Bosnia and Herzegovina is assigned only a co-ordinating role when representing the economy's interests abroad. |
| 9. Science, technology and innovation | Model 1 | The strategic and institutional frameworks on science, technology and innovation (STI) are highly decentralised, with dedicated ministries in the two entities, as well as at the canton-level in FBIH. However, the state level plays a role as the Ministry of Civil Affairs co-ordinates STI policy across Bosnia and Herzegovina and represents the economy internationally. |
| 10. Digital society | Model 1 | Digital society encompasses a number of different policy areas, such as data accessibility, digital skills development and privacy protection, in which policy frameworks are developed at the state or entity levels. Policies in different areas are guided by state and/or entity-level institutional and regulatory frameworks. |
| 11. Transport policy | Model 1 | Transport policy is guided by state-level framework laws and investment priorities. However, the entities have a significant role to play as they adopt their own laws and regulations governing different transport modes, make their own investments and operate key publicly-owned enterprises. |
| 12. Energy policy | Model 1 | Energy policy is guided by legal and regulatory frameworks at both the state and entity levels. The state-level MoFTER plays an important role in co-ordinating energy policy between the entities, as well as in international co-operation and trade. |
| 13. Environment | Model 2 | Responsibility for environment and climate policy rests with the two entities. In the FBiH, |

| Policy dimension | CO 2021 assessment | Rationale |
|---|---|---|
| policy | | responsibility is shared between the entity level and the ten cantons. At the state level, MoFTER is responsible for defining policies and basic principles, co-ordinating activities and consolidating entity plans with those of international institutions in the areas of energy, agriculture, protection of environment and use of natural resources, and tourism. Entity-level institutions are responsible for strategic frameworks, policy setting, data exchange and reporting. |
| 14. Agriculture policy | Model 1 | Agricultural policy is guided by framework laws and priorities established at the state level by MoFTER. The ministry is responsible for defining and co-ordinating the state agricultural policy framework in co-operation with the relevant entity institutions. The entity institutions are responsible for the management and implementation of policies, programmes and measures in their respective territories. |
| 15. Tourism policy | Model 1 | Tourism is under the jurisdiction of the two entities. Accordingly, the entities are responsible for the adoption of their own tourism strategies and the establishment of the governance structure and institutional set up, which differ in each entity. While the tourism governance framework in the RS is similar to the most commonly established governance frameworks in other Western Balkan economies, the governance structure in the FBiH is divided among the Federal Ministry of Environment and Tourism and the ministries of the cantons responsible for tourism, which have also adopted their own legislation and regulation. At the state level, the Tourism Working Group was established by MoFTER to co-ordinate tourism activities among the entities. |
| 16. Anti-corruption policy | Model 1 | The state-level Agency for Prevention of Corruption and Co-ordination of the Fight Against Corruption focuses primarily on countering the corruption of state-level public officials and on co-ordinating the anti-corruption efforts of the entities. The entities are responsible for most aspects of the prevention and repression of corruption at their level. |

## Notes

[1] Paragraph (3) of Article III of the Constitution of Bosnia and Herzegovina stipulates that all government competences not expressly assigned to the state-level government belong to the entities.

Competitiveness and Private Sector Development

# Competitiveness in South East Europe 2021

## A POLICY OUTLOOK

The future sustainable economic development and well-being of citizens in South East Europe depend on greater economic competitiveness. Reinforcing the region's economic potential in a post-COVID-19 context requires a holistic, inclusive and growth-oriented approach to policy making. Against the backdrop of enhanced European Union (EU) accession prospects and a drive towards deeper regional integration, the governments of the six Western Balkan (WB6) economies have demonstrated a renewed commitment to enacting policy reforms.

The third edition of *Competitiveness in South East Europe: A Policy Outlook* comprehensively assesses policy reforms in the WB6 economies across 16 policy dimensions crucial to their competitiveness. It leverages a highly participatory assessment process, which brought together the views of OECD experts, WB6 policy makers and local non-governmental stakeholders to create a balanced and realistic depiction of their performance. The report seeks to provide WB6 policy makers with a multi-dimensional benchmarking tool, enabling them to compare performance against regional peers as well as OECD good practices, and to design future policies based on rich evidence and actionable policy recommendations.

Economy-specific profiles complement the regional assessment for the first time in this edition of *Competitiveness in South East Europe: A Policy Outlook*, and provide each WB6 economy with an in-depth analysis of their competitive potential as well as policy recommendations tailored to their specific challenges to inform their structural economic reforms and sustainable development agenda.

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