Competitiveness and Private Sector Development

Competitiveness in South East Europe

A POLICY OUTLOOK 2018



OECD

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2018

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Foreword

In an increasingly interconnected world where competition for markets is more intense than ever before, countries around the globe need to address structural reform challenges to boost their economic competitiveness. By designing, adopting and implementing the right economic reforms and building functional institutions, governments can shape their citizens' future and contribute to their countries' productivity, prosperity and resilience.

In the last two decades, South East Europe (SEE) has emerged as a constellation of small but open economies that are making progress in liberalising investment and improving business conditions. However, slow annual growth rates and an average gross domestic product per capita of only one-third of the European Union's indicate that the region still has a significant gap to close. Despite growth in key manufacturing sectors, wage increases in the export sector are outpacing productivity growth, thus blunting the region's competitive edge. Innovative growth strategies are needed to ensure the region can circumvent the middle-income trap, while structural reforms can help pave the way for more inclusive and sustainable growth in knowledge-based sectors. Moreover, the conditions for long-term investment to enhance economic performance and citizens' well-being can also be improved. Here, an important driver of reform is the prospect of accession to the European Union (EU), where the Western Balkan economies can benefit from the recent experience of Bulgaria, Croatia and Romania. In view of the drive towards EU accession, the OECD has been working in partnership with South East Europe to provide the relevant expertise and evidence-based analysis required to support the reform process, and to ensure the inclusion of stakeholders in public consultations.

In this context, this second edition of the *Competitiveness in South East Europe: A Policy Outlook* offers a comprehensive account of the economic governance, regulation and investment in six SEE economies, forming a critical body of work to support structural reforms. It draws on qualitative and quantitative information in 17 key policy dimensions, and is broken down into over 600 individual indicators that allow SEE policy makers to directly compare one another's economic performances, 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 the first edition, published in 2016. This 2018 edition clearly highlights that progress – albeit uneven and incomplete – is being made across all dimensions, accompanied by increasing intergovernmental co-operation. For example, greater efforts have been made towards digitalisation and the adoption of e-commerce across the six economies, as well as the implementation of new support structures for business development.

Above all, the study emphasises the benefits of a strategic approach to policy making, informed by in-depth evidence-based analysis. The publication was drafted in close co-operation with the SEE governments and regional stakeholders. The six regional economies provided rigorous qualitative self-assessments and statistical data. I would like to thank all those who have contributed to this work. *Competitiveness in South East Europe: A Policy Outlook* is a resource to be shared for all those interested in forging more inclusive, prosperous and resilient economies for the people of South East Europe.

Angel Gurría,
OECD Secretary-General



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The methodology of this report was developed by the OECD Division for South East Europe and benefitted from the experience from similar policy assessments carried out previously, namely the *OECD Investment Reform Index*.

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Table of contents

Acronyms and abbreviations **21**

Executive summary **27**

Methodology **31**

Introduction 31
Scope 31
Methodology 31
The assessment process 34
The strengths and limitations of the *Competitiveness Outlook 2018* 36
Note 37

Overview **39**

Recent economic developments in six South East Europe economies 39
Key findings for each policy dimension 42
Overarching insights 47
Key recommendations 49
Note 50
References 51

***Chapter 1.* Investment policy and promotion in South East Europe** **53**

Main findings 54
Context 56
Investment policy 61
Investment promotion and facilitation 72
Conclusions 84
Notes 85
References 86
Annex 1.A1. Investment policy and promotion: Indicator scores 89

***Chapter 2.* Trade policy and facilitation in South East Europe** **91**

Main findings 92
Context 94
Trade policy formulation and evaluation 98
Trade liberalisation 105
Trade facilitation and non-tariff measures 112
Export promotion 122
Conclusions 125
Notes 125
References 127
Annex 2.A1. Trade policy and facilitation: Indicator scores 130

Chapter 3. **Access to finance in South East Europe** **131**

Main findings 132
Context 134
Policy, regulatory and institutional framework 138
Access to bank finance 147
Alternative financing tools 151
Conclusions 160
Notes 160
References 161
Annex 3.A1. Access to finance: Indicator scores 164

Chapter 4. **Tax policy in South East Europe** **165**

Main findings 166
Context 168
Tax policy 172
Tax administration 183
International tax and tax co-operation 189
Conclusions 194
Notes 195
References 195
Annex 4.A1. Tax policy: Indicator scores 198

Chapter 5. **Competition policy in South East Europe** **199**

Main findings 200
Context 201
Scope of action 205
Anti-competitive behaviour 208
Probity of investigation 214
Advocacy 216
Conclusions 220
Notes 221
References 221
Annex 5.A1. Competition policy: Indicator scores 225

Chapter 6. **State-owned enterprises in South East Europe** **229**

Main findings 230
Context 232
Efficiency and governance 235
Transparency and accountability 241
Ensuring a level playing field 246
Conclusions 251
Notes 252
References 253
Annex 6.A1. State-owned enterprises: Indicator scores 255

Chapter 7. **Education and Competencies in South East Europe** **257**

Main findings 258
Context 260
Access to and participation in high-quality education 268
Vocational education and training 277

Higher education 284
Conclusions 291
Notes 292
References 293
Annex 7.A1. Education and competencies: Indicator scores 297

Chapter 8. **Employment policy in South East Europe 299**

Main findings 300
Context 302
Labour market governance 309
Activation policies 314
Job quality 326
Social economy 331
Conclusions 332
Notes 333
References 334
Annex 8.A1. Employment policy: Indicator scores 339

Chapter 9. **Science, technology and innovation in South East Europe 341**

Main findings 342
Context 345
Governance of science, technology and innovation policies 351
Public research system 358
Innovation in firms 363
Public-private knowledge transfers and linkages 371
Human resources for innovation 376
Conclusions 379
Notes 380
References 381
Annex 9.A1. Science, technology and innovation: Indicator scores 385

Chapter 10. **Digital society in South East Europe 387**

Main findings 388
Context 391
ICT access and use 394
Digital empowerment 403
E-business and e-commerce 411
Digital security and privacy 418
Conclusions 423
Notes 424
References 425
Annex 10.A1. Digital society: Indicator scores 429

Chapter 11. **Transport policy and performance in South East Europe 431**

Main findings 432
Context 434
Planning 439
Governance and regulation 447
Sustainability 453
Conclusions 460

Notes 461
References 462
Annex 11.A1. Transport policy and performance: Indicator scores 467

Chapter 12. Energy policy in South East Europe 469

Main findings 470
Context 472
Governance and regulation 478
Sustainable development 482
Energy security 488
Energy markets 495
Conclusions 499
Notes 500
References 501
Annex 12.A1. Energy policy: Indicator scores 505

Chapter 13. Environmental policy in South East Europe 507

Main findings 508
Context 510
Resource productivity 513
Natural asset base 520
Environmental quality of life 528
Policies for green growth 534
Conclusions 540
Notes 541
References 541
Annex 13.A1. Environmental policy: Indicator scores 546

Chapter 14. Agriculture in South East Europe 547

Main findings 548
Context 550
Agricultural policy 558
Agro-food system capacity 565
Agro-food system regulation 571
Agricultural innovation system 574
Conclusions 578
Notes 579
References 579
Annex 14.A1. Agriculture: Indicator scores 583

Chapter 15. Tourism in South East Europe 585

Main findings 586
Context 588
Cultural and natural resources 593
Destination accessibility and tourism infrastructure 596
Availability of a qualified workforce 603
Safety and health 608
Tourism prioritisation and promotion 611
Conclusions 619
Notes 620

References 620
Annex 15.A1. Tourism: Indicator scores 624

Chapter 16. **Public services in South East Europe** **625**

Main findings 626
Context 628
Policy development and co-ordination 631
Human resource management 640
Accountability 645
Service delivery 649
Public procurement 653
Conclusions 662
Notes 663
References 663
Annex 16.A1. Public services: Indicator scores 665

Chapter 17. **Anti-corruption policy in South East Europe** **667**

Main findings 668
Context 670
Anti-corruption reforms, policy and implementation 674
Anti-corruption public awareness and education 678
Corruption prevention and co-ordination institutions 682
Preventing and managing conflicts of interest and whistleblower protection 686
Anti-corruption enforcement bodies and regional co-operation 690
Conclusions 696
Notes 696
References 697
Annex 17.A1. Anti-corruption policy: Indicator scores 701

Tables

Table 0.1. Key data for the six SEE economies (2016) 40
Table 0.2. Assessment in Dimension 1: Investment policy and promotion 42
Table 0.3. Assessment in Dimension 2: Trade policy and facilitation 42
Table 0.4. Assessment in Dimension 3: Access to finance 43
Table 0.5. Assessment in Dimension 4: Tax policy 43
Table 0.6. Assessment in Dimension 6: State-owned enterprises 43
Table 0.7. Assessment in Dimension 7: Education and competencies 44
Table 0.8. Assessment in Dimension 8: Employment policy 44
Table 0.9. Assessment in Dimension 9: Science, technology and innovation 44
Table 0.10. Assessment in Dimension 10: Digital society 45
Table 0.11. Assessment in Dimension 11: Transport policy and performance 45
Table 0.12. Assessment in Dimension 12: Energy policy 45
Table 0.13. Assessment in Dimension 13: Environmental policy 46
Table 0.14. Assessment in Dimension 14: Agriculture 46
Table 0.15. Assessment in Dimension 15: Tourism 46
Table 0.16. Assessment in Dimension 17: Anti-corruption policy 47
Table 1.1. Top five investing countries 60
Table 1.2. Investment promotion agencies: Number of employees and mandates 74
Table 1.A1.1. Investment policy and promotion: Indicator scores 89

Table 2.1. Trade policy formulation and evaluation: Indicator scores 101
Table 2.2. Bilateral trade agreements involving the SEE economies 107
Table 2.3. Number of accredited conformity assessment bodies in the SEE economies (2017) 115
Table 2.4. Trade facilitation and non-tariff barriers sub-dimension: Technical barriers to trade and SPS measures 115
Table 2.5. Export promotion sub-dimension: Indicator scores 123
Table 2.A1.1. Trade policy and facilitation: Indicator scores 130
Table 3.1. Coverage of public and private credit bureaus in SEE economies (% of adult population) 142
Table 3.A1.1. Access to finance: Indicator scores 164
Table 4.1. Debt level (in 2015) and budget deficit (in 2016) in the SEE economies 171
Table 4.A1.1. Tax policy: Indicator scores 198
Table 5.A1.1. Competition policy: Indicator scores 225
Table 6.1. Number of state-owned enterprises held by (central) governments 235
Table 6.2. Rationales for state ownership of enterprises 238
Table 6.A1.1. State-owned enterprises: Indicator scores 255
Table 7.1. Percentage of resilient students among disadvantaged students (2015) 274
Table 7.2. Enrolment in pre-vocational or vocational education (2015) 278
Table 7.3. Enrolment in pre-vocational or vocational education by school socio-economic profile (2015) 278
Table 7.A1.1. Education and competencies: Indicator scores 297
Table 8.1. Distribution of employment (2015) 307
Table 8.2. Active labour market policies (expenditure) in 2015 319
Table 8.3. Active labour market policies (participants) in 2015 319
Table 8.4. Active labour market policies (coverage) 319
Table 8.A1.1. Employment policy: Indicator scores 339
Table 9.1. Innovation strategy frameworks in the SEE economies 354
Table 9.A1.1. Science, technology and innovation: Indicator scores 385
Table 10.A1.1. Digital society: Indicator scores 429
Table 11.1. Current transport strategies in the SEE economies 440
Table 11.2. Active public-private partnerships by transport sector 443
Table 11.3. Key features of aviation reforms in the SEE economies 450
Table 11.A1.1. Transport policy and performance: Indicator scores 467
Table 12.1. Installed capacity: Wind and solar (2010 and 2016) 485
Table 12.A1.1. Energy policy: Indicator scores 505
Table 13.A1.1. Environmental policy: Indicator scores 546
Table 14.1. Importance of agriculture in the economy (2015) 552
Table 14.2. Farmers' educational attainment 568
Table 14.A1.1. Agriculture: Indicator scores 583
Table 15.1. Key tourism statistics by economy 592
Table 15.A1.1. Tourism: Indicator scores 624
Table 16.A1.1. Public services: Indicator scores 665
Table 17.1. Areas of primary responsibility of specialised prevention and co-ordination institutions 683
Table17.A1.1. Anti-corruption policy: Indicator scores 701

Figures

Figure 0.1. Overall assessment approach of the *Competitiveness Outlook 2018* 41
Figure 1.1. Investment policy and promotion: Dimension and sub-dimension average scores 54
Figure 1.2. Investment policy and promotion assessment framework 58
Figure 1.3. FDI inflows as a percentage of GDP (2000-16) 59
Figure 1.4. FDI stock as a percentage of GDP (2016) 59
Figure 1.5. Investment policy: Sub-dimension average score and indicator scores 62
Figure 1.6. OECD *FDI Regulatory Restrictiveness Index* (2016) 64
Figure 1.7. OECD *FDI Regulatory Restrictiveness Index*: SEE economies versus OECD and non-OECD, sectoral distribution (2016) 65
Figure 1.8. Investment promotion and facilitation: Sub-dimension average score and indicator scores 73
Figure 2.1. Trade policy: Dimension and sub-dimension average scores 92
Figure 2.2. Trade policy and facilitation assessment framework 96
Figure 2.3. Key trends in external SEE trade in goods and services (2007-15) 97
Figure 2.4. South East Europe's main trading partners and export destinations (2015) 97
Figure 2.5. Export composition (2015) 98
Figure 2.6. Evolution of intra-regional and international trade in goods (2010-15) 99
Figure 2.7. Trade policy formulation and evaluation: Sub-dimension average scores and indicator scores 100
Figure 2.8. Contribution of services to GDP in the SEE economies (2006-15) 108
Figure 2.9. Restrictions to road freight transport services in the SEE economies (2017) 109
Figure 2.10. Restrictions to rail freight transport services in the SEE economies (2017) 109
Figure 2.11. Trade facilitation and non-tariff measures: Sub-dimension average scores and indicator scores 113
Figure 2.12. SEE average performance against the OECD trade facilitation indicators (2017) 116
Figure 2.13. Comparing the OECD trade facilitation indicators for South East Europe (2015 and 2017) 117
Figure 2.14. OECD trade facilitation indicators in the SEE economies (2017) 118
Figure 2.15. The costs of border compliance (2015 and 2017) 120
Figure 2.16. The costs of documentary compliance (2015 and 2017) 121
Figure 2.17. Export promotion: Sub-dimension average scores and indicator scores 123
Figure 3.1. Access to finance: Dimension and sub-dimension average scores 133
Figure 3.2. Access to finance: Dimension and sub-dimension average scores 135
Figure 3.3. Key banking sector indicators 136
Figure 3.4. SME loan shares (2009 and 2016 or latest available data) 137
Figure 3.5. Policy, regulatory and institutional framework: Sub-dimension average score and indicator scores 139
Figure 3.6. Time and cost of insolvency proceedings 144
Figure 3.7. Access to bank finance: Sub-dimension average scores and indicator scores 147
Figure 3.8. Cumulative market share of the top three banks (2006 and 2016) 148
Figure 3.9. Alternative financing tools: Sub-dimension average scores and indicator scores 152
Figure 4.1. Tax policy: Dimension and sub-dimension average scores 166
Figure 4.2. Tax policy assessment framework 170
Figure 4.3. Tax revenues as a percentage of GDP in SEE economies (2005 and 2015) 171
Figure 4.4. Tax revenues as a share of total tax revenues (2015) 172
Figure 4.5. Tax policy: Sub-dimension average score and indicator scores 173

Figure 4.6. Marginal tax wedges at the income level where the top personal income tax rate starts being levied 177
Figure 4.7. Tax administration: Sub-dimension average score and indicator scores 184
Figure 5.1. Competition policy: Number of adopted criteria 200
Figure 5.2. Competition policy assessment framework 204
Figure 5.3. Scope of action: Number of adopted criteria 205
Figure 5.4. Annual budget of competition authorities (2012-16) 207
Figure 5.5. Annual staffing of competition authorities (2012-16) 207
Figure 5.6. Anti-competitive behaviour: Number of adopted criteria 209
Figure 5.7. Index of prices for successful bids for a single high-volume drug 211
Figure 5.8. Probity of investigation: Number of adopted criteria 215
Figure 5.9. Advocacy: Number of adopted criteria 217
Figure 6.1. State-owned enterprises: Dimension and sub-dimension average scores 230
Figure 6.2. State-owned enterprise assessment framework 234
Figure 6.3. Efficiency and governance: Sub-dimension average score and indicator scores 237
Figure 6.4. Transparency and accountability: Sub-dimension average scores and indicator scores 242
Figure 6.5. Protection of minority shareholders, general corporate sector 245
Figure 6.6. Ensuring a level playing field: Sub-dimension average scores and indicator scores 247
Figure 7.1. Education and competencies: Dimension and sub-dimension average scores 258
Figure 7.2. Education and competencies assessment framework 262
Figure 7.3. GDP per person employed 263
Figure 7.4. Highest educational attainment by gender (2015) 263
Figure 7.5. PISA 2015 performance in science, reading and mathematics 265
Figure 7.6. PISA 2015 low achievers in science, reading and mathematics 266
Figure 7.7. Public expenditure on education by level of education (2014) 267
Figure 7.8. Access to and participation in high-quality education: Sub-dimension average scores and indicator scores 269
Figure 7.9. Participation rate in early childhood education 270
Figure 7.10. Minimum and maximum monthly teachers' salaries (2015) 272
Figure 7.11. Early leavers from education and training among 18-24 year-olds 275
Figure 7.12. Vocational education and training: Sub-dimension average scores and indicator scores 277
Figure 7.13. Enrolment in a pre-vocational or vocational programme and science performance (2015) 279
Figure 7.14. Participation in learning among 25-64 year-olds 281
Figure 7.15. Higher education: Sub-dimension average scores and indicator scores 285
Figure 8.1. Employment policy: Dimension and sub-dimension average scores 301
Figure 8.2. Employment policy assessment framework 305
Figure 8.3. Employment rate at age 15 and above 306
Figure 8.4. Employment growth (2010-15) 307
Figure 8.5. Unemployment rates at age 15 and above 308
Figure 8.6. Unemployment growth (2010-15) 308
Figure 8.7. Labour market governance: Sub-dimension average scores and indicator scores 310
Figure 8.8. Informal employment (2014 and 2015) 311
Figure 8.9. Activation policies: Sub-dimension average score and indicator scores 316
Figure 8.10. Economic activity rate for the 15-64 age group (2015) 317
Figure 8.11. Share of long-term unemployment (12 months +) 318

Figure 8.12. Long-term unemployment rate (12 months +) in 2015 318
Figure 8.13. Youth unemployment rate for 15-24 age group (2010-15) 323
Figure 8.14. Not in employment, education or training at age 15-24 (2015) 324
Figure 8.15. Job quality: Sub-dimension average score and indicator scores 327
Figure 8.16. Gross average real monthly wages (2014) 328
Figure 8.17. Income inequality (2014) 328
Figure 8.18. Social benefits indicators 330
Figure 8.19. Social economy: Sub-dimension indicator scores 331
Figure 9.1. Science, technology and innovation: Dimension and sub-dimension average scores 342
Figure 9.2. Science, technology and innovation assessment framework 347
Figure 9.3. Labour productivity evolution (2005-16) 348
Figure 9.4. High-tech exports as a share of manufactured exports (2005-15) 349
Figure 9.5. Knowledge-intensive services exports as a share of all services exports (2010 and 2016) 350
Figure 9.6. Patenting trends in South East Europe 350
Figure 9.7. Charges for the use of intellectual property, receipts and payments 351
Figure 9.8. Governance of STI policies: Sub-dimension average score and indicator scores 352
Figure 9.9. Gross domestic expenditure on R&D (GERD) 353
Figure 9.10. International co-publications 355
Figure 9.11. Public research system: Sub-dimension average scores and indicator scores 360
Figure 9.12. Scientific production in SEE and comparator countries 361
Figure 9.13. Productivity of scientists in SEE and comparator countries 361
Figure 9.14. Innovation in firms: Sub-dimension average scores and indicator scores 364
Figure 9.15. Business expenditure on research and development in SEE 365
Figure 9.16. Motivational index in SEE 365
Figure 9.17. Firms introducing innovations in SEE (2016) 366
Figure 9.18. Public-private knowledge transfers and linkages: Sub-dimension average scores and indicator scores 372
Figure 9.19. Human resources for innovation: Sub-dimension average scores and indicator scores 377
Figure 10.1. Digital society: Dimension and sub-dimension average scores 388
Figure 10.2. Digital society assessment framework 393
Figure 10.3. ICT goods exports (2015) 394
Figure 10.4. ICT services exports (2015) 394
Figure 10.5. ICT access and use: Sub-dimension average score and indicator scores 395
Figure 10.6. Fixed broadband subscriptions (2010-15) 397
Figure 10.7. Active mobile-broadband subscriptions (2010-15) 397
Figure 10.8. Trends in fixed-broadband monthly subscription charges (2008-15) 401
Figure 10.9. Digital empowerment: Sub-dimension average scores and indicator scores 404
Figure 10.10. Percentage of individuals accessing the Internet once a week (2016) 406
Figure 10.11. E-business and e-commerce: Sub-dimension average score and indicator scores 412
Figure 10.12. Percentage of firms with their own website (2010, 2013) 414
Figure 10.13. Percentage of individuals purchasing online in the last 12 months (2016) 416
Figure 10.14. Percentage of all enterprises selling online (excluding the financial sector) (2016) 416
Figure 10.15. Digital security and privacy: Sub-dimension average scores and indicator scores 418

Figure 11.1. Transport policy and performance: Dimension and sub-dimension average scores 432
Figure 11.2. Transport policy and performance assessment framework 436
Figure 11.3. Logistics Performance Index (average 2014-16) 437
Figure 11.4. Global Competitiveness Index: Quality of overall infrastructure (2016-17) 438
Figure 11.5. Availability and use of information and communications technology (2016) 438
Figure 11.6. DHL Connectedness Index (2015) 439
Figure 11.7. Planning: Sub-dimension average score and indicator scores 440
Figure 11.8. Evolution of road freight transport volumes (2005-15) 441
Figure 11.9. Rail and road transport infrastructure investment and maintenance (average 2013-15) 445
Figure 11.10. Governance and regulation: Sub-dimension average scores and indicator scores 447
Figure 11.11. Rail network utilisation (2015) 448
Figure 11.12. Modal share of rail freight transport (2011 and most recent year) 449
Figure 11.13. Average age of private motorised vehicles (2016) 452
Figure 11.14. Sustainability: Sub-dimension average scores and indicator scores 454
Figure 11.15. Road fatalities (2015) and percentage change over 2005-15 455
Figure 11.16. CO_2 emissions from transport per unit of GDP (2014) 456
Figure 11.17. Exposure to $PM_{2.5}$ in metropolitan areas (2005 and 2015) 457
Figure 12.1. Energy policy: Dimension and sub-dimension average scores 470
Figure 12.2. Energy policy assessment framework 474
Figure 12.3. Percentage of firms experiencing electrical outages (2013) 475
Figure 12.4. Energy intensity (2008-15) 477
Figure 12.5. Electricity prices for industrial customers (2013-16) 479
Figure 12.6. Share of firms identifying electricity as a major constraint (2013) 479
Figure 12.7. Governance and regulation: Sub-dimension average score and indicator scores 480
Figure 12.8. Sustainable development: Sub-dimension average scores and indicator scores 483
Figure 12.9. Energy security: Sub-dimension average score and indicator scores 489
Figure 12.10. Transmission and distribution losses (2007-14) 492
Figure 12.11. Energy dependence (2007-15) 494
Figure 12.12. Energy markets: Sub-dimension average score and indicator scores 496
Figure 13.1. Environmental policy: Dimension and sub-dimension average scores 508
Figure 13.2. Environmental policy assessment framework 512
Figure 13.3. Composition of value added by economic sector (2016) 513
Figure 13.4. Resource productivity: Sub-dimension average scores and indicator scores 514
Figure 13.5. Production-based CO_2 productivity (2009 and 2013) 515
Figure 13.6. CO_2 emissions by sector (2014) 515
Figure 13.7. Material productivity (2009-15) 516
Figure 13.8. Waste treatment by type (2014) 516
Figure 13.9. Municipal waste generation and coverage of collection services (2008-15) 518
Figure 13.10. Natural asset base: Sub-dimension average scores and indicator scores 520
Figure 13.11. Freshwater availability and use 521
Figure 13.12. Terrestrial and marine protected areas (1990, 2000 and 2014) 523
Figure 13.13. Forest area (2006 and 2014) 524
Figure 13.14. Land use (1992, 2000 and 2014) 525
Figure 13.15. Per capita land use (2000, 2010 and 2014) 525

Figure 13.16. Environmental quality of life: Sub-dimension average score and indicator scores 528
Figure 13.17. Mean population exposure to $PM_{2.5}$ air pollution (2000-13) 529
Figure 13.18. Air pollutant emissions per capita (2007-15) 530
Figure 13.19. Access to improved water sources and sanitation facilities (2000 and 2015) 532
Figure 13.20. Policies for green growth: Sub-dimension average score and indicator scores 534
Figure 13.21. Revenue from environmental tax (2010 and 2014) 536
Figure 13.22. Number of ISO 14001 certificates (2009 and 2016) 538
Figure 14.1. Agriculture: Dimension and sub-dimension average scores 548
Figure 14.2. Agriculture assessment framework 552
Figure 14.3. Value of agricultural production (2006-08 and 2012-14) 553
Figure 14.4. Agro-food trade (2010-12 and 2014-16) 554
Figure 14.5. Distribution of farm size 555
Figure 14.6. Crop and livestock yields as ratios of European Union yields 556
Figure 14.7. Agricultural labour productivity 557
Figure 14.8. Commercial fertiliser intensities per area of agricultural land (2006 and 2014) 558
Figure 14.9. Share of agriculture in total greenhouse gas emissions (2000-02 and 2008-10) 558
Figure 14.10. Agricultural policy: Sub-dimension average scores and indicator scores 559
Figure 14.11. Budgetary support to producers and total budgetary support to agriculture (2013-15 average) 562
Figure 14.12. Import tariffs for agricultural and non-agricultural goods (2015) 563
Figure 14.13. Agro-food system capacity: Sub-dimension average scores and indicator scores 565
Figure 14.14. Global Competitiveness Index: transport, electricity and telephony infrastructure (2016-17) 566
Figure 14.15. Share of total agricultural area equipped for irrigation (2014) 567
Figure 14.16. Agriculture in tertiary education (2015) 569
Figure 14.17. Agro-food system regulation: Sub-dimension average scores and indicator scores 572
Figure 14.18. Agricultural innovation system: Sub-dimension average scores and indicator scores 575
Figure 15.1. Tourism: Dimension and sub-dimension average scores 586
Figure 15.2. Tourism assessment framework 591
Figure 15.3. The growth in international tourism (1995-2016) 593
Figure 15.4. Cultural and natural resources: Sub-dimension average scores and indicator scores 594
Figure 15.5. Destination accessibility and tourism infrastructure: Sub-dimension average scores and indicator scores 597
Figure 15.6. Availability of a qualified workforce: Sub-dimension average scores and indicator scores 604
Figure 15.7. Safety and health: Sub-dimension average scores and indicator scores 609
Figure 15.8. Tourism prioritisation and promotion: Sub-dimension average scores and indicator scores 612
Figure 16.1. Public services: Indicator score range 627
Figure 16.2. Public services assessment framework 630
Figure 16.3. Policy development and co-ordination: Sub-dimension indicator scores 631
Figure 16.4. Degree to which businesses agree relevant laws are written clearly (2017) 634
Figure 16.5. Degree to which businesses agree relevant laws are easy to obtain (2017) 638

Figure 16.6. Human resource management: Sub-dimension indicator scores 641
Figure 16.7. Degree to which businesses agree paying bribes to public officials is common (2017) 644
Figure 16.8. Share of citizens reporting to have paid a bribe for any government service (2017) 644
Figure 16.9. Accountability: Sub-dimension indicator scores 645
Figure 16.10. Backlog of administrative cases and clearance rates of administrative courts (2014 and 2016) 647
Figure 16.11. Degree to which the public agrees the judicial system is independent (2017) 648
Figure 16.12. Service delivery: Sub-dimension indicator scores 650
Figure 16.13. Business satisfaction with public services for businesses (2017) 652
Figure 16.14. Degree to which citizens agree that public administrative procedures are efficient (2017) 652
Figure 16.15. Public procurement: Sub-dimension indicator scores 6524
Figure 16.16. Reasons businesses did not take part in public procurement (2017) 658
Figure 16.17. Share of contracts awarded by competitive procedures (2014 and 2016) 659
Figure 17.1. Anti-corruption policy: Dimension and sub-dimension average scores 668
Figure 17.2. Anti-corruption policy assessment framework 671
Figure 17.3. Corruption Perceptions Index (2012-16) 672
Figure 17.4. Control of Corruption score (2005-15) 673
Figure 17.5. Percentage of households who paid a bribe in the past year (2005-16) 673
Figure 17.6. Share of respondents who believe their government is poor at fighting public corruption (2016) 674
Figure 17.7. Anti-corruption reforms, policy and implementation: Sub-dimension average score and indicator scores 675
Figure 17.8. Anti-corruption public awareness and education: Sub-dimension scores 679
Figure 17.9. Budgets of the corruption prevention and policy co-ordination institutions (2016) 684
Figure 17.10. Staffing levels of corruption prevention and policy co-ordination institutions (2016) 684
Figure 17.11. Number of sanctions (including warnings) applied for conflict-of-interest related violations (2016) 687
Figure 17.12. Anti-corruption enforcement bodies and regional co-operation: Sub-dimension average score and indicator scores 691



Acronyms and abbreviations

AEOI	Automatic exchange of information
ALB	Albania
ALL	Albanian lek
ALMP	Active labour market policy
AIDA	Albanian Investment Development Agency
APEC	Asia-Pacific Economic Cooperation
BEPS	Base erosion and profit shifting
BIH	Bosnia and Herzegovina
CAP	Common Agriculture Policy
CEB	Central Europe and the Baltics
CEFTA	Central European Free Trade Agreement
CEO	Chief executive officer
CERT	Computer Emergency Response Team
CESEC	Central and South-Eastern European Gas Connectivity
CET	Continuing education and training
CIT	Corporate income tax
CO_2	Carbon dioxide
CSR	Corporate social responsibility
DMC	Domestic material consumption
DSM	Digital Single Market
DTIDZ	Directorate for Technological Industrial Development Zones
EBITDA	Earnings before interest, taxes, depreciation and amortisation
EBRD	European Bank for Reconstruction and Development
ECE	Early childhood education
ECS	Energy Community Secretariat
EFTA	European Free Trade Association
EGFSN	Expert Group on Future Skills Needs
EIA	Environmental impact assessment

EIB	European Investment Bank
EIS	European Innovation Scoreboard
EITC	Earned income tax credit
EOIR	Exchange of information on request
EPL	Employment protection legislation
EPO	European Patent Office
EPR	Extended producer responsibility
EQF	European Qualifications Framework
ERP	Economic Reform Programme
ESCS	Economic, social and cultural status
ETF	European Training Foundation
EU	European Union
FDI	Foreign direct investment
FIPA	Foreign Investment Promotion Agency of Bosnia and Herzegovina
FITD	Fund for Innovation and Technology Development
FTA	Free trade agreement/area
GCI	Global Competitiveness Index
GDP	Gross domestic product
GERD	Gross expenditure on research and development
GHG	Greenhouse gas
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GPP	Green public procurement
GSSE	General support services estimate
GVC	Global value chains
GW	Gigawatt
HE	Higher education
HEI	Higher education institution
IA	Independent assessor
ICN	International Competition Network
ICT	Information and communications technology
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IP	Intellectual property
IPA	Investment promotion agency

IPARD	Instrument for Pre-Accession Assistance in Rural Development
IPO	Initial public offering
IPPC	Integrated pollution prevention and control
ISCED	International Standard Classification of Education
ISO	International Organisation for Standardisation
IT	Information technology
ITF	International Transport Forum
ITU	International Telecommunication Union
KCGF	Kosovo Credit Guarantee Fund
KEISA	Kosovo Investment and Enterprise Support Agency
KOS	Kosovo
LPI	Logistics Performance Index
LSU	Livestock unit
M&E	Monitoring and evaluation
MEA	Multilateral Environmental Agreement
MFN	Most favoured nation
MIPA	Montenegrin Investment Promotion Agency
MKD	Former Yugoslav Republic of Macedonia/Macedonian dinar
MLA	Mutual legal assistance
MNE	Montenegro/multinational enterprise
MQF	Macedonian Qualifications Framework
Mt	Megatonne
NEEAP	National Energy Efficiency Action Plan
NEET	Not in employment, education or training
NGO	Non-government organisation
NO_x	Nitrogen oxides
NPL	Non-performing loan
NQF	National qualifications framework
NRA	National regulatory authority/agency
NREAP	National Renewable Energy Action Plan
NTB	Non-tariff barrier
OCPA	Office of Commissioner of Public Appointments
OECD	Organisation for Economic Co-operation and Development
OFIO	Office of the Foreign Investment Ombudsman

OSS	One-stop-shop
PDP	Personal data protection
PEEM	Public Environmental Expenditure Management
PES	Public employment services
PIAAC	Programme for the International Assessment of Adult Competencies
PISA	Programme for International Student Assessment
PIT	Personal income tax
$PM_{2.5}$	Fine particulate matter
PPP	Public-private partnership/purchasing power parity
PRO	Public research organisation
PSE	Producer support estimate
PV	Photovoltaics
R&D	Research and development
RAS	Development Agency of Serbia
RCC	Regional Cooperation Council
RDI	Research, development and innovation
REEP	Regional Energy Efficiency Programme
RES	Renewable energy sources
RIA	Regulatory impact assessment
RSD	Serbian dinar
SAA	Stabilisation and Association Agreement
SDG	Sustainable Development Goal
SEA	Strategic environmental assessment
SEE	South East Europe
SEEHN	South-Eastern Europe Health Network
SEETO	South East Europe Transport Observatory
SELDI	Southeast Europe Leadership for Development and Integrity
SES	Single European Sky
SEZ	Special economic zone
SIGMA	Support for Improvement in Governance and Management
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
SO_x	Sulphur oxides
SPS	Sanitary and phytosanitary measures

SRB	Serbia
SSC	Social security contribution
STEM	Science, technology, engineering and mathematics
STI	Science, technology and innovation
STP	Science and technology park
STRI	OECD Services Trade Restrictiveness Index
TAFTIE	The European Network of Innovation Agencies
THAP	Triple Helix Action Plan
TiVA	Trade in value added
TSE	Total support estimate
UKGI	UK Government Investments
UNCAC	United Nations Convention against Corruption
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations Children's Fund
USAID	United States Agency for International Development
USPTO	United States Patent and Trademark Office
VAT	Value-added tax
VET	Vocational education and training
WB6	Western Balkans Six
WB6 MAP	Multi-annual Action Plan for the Western Balkans Six
WISE	Western Balkans Research and Innovation Centre
WTO	World Trade Organization

Executive summary

For the better part of the last decade, the economies of the South East Europe (SEE) region have committed themselves to a comprehensive reform programme driven by the need for increased competitiveness, regional co-operation and more effective economic governance. Despite some progress in implementing reforms, the SEE region still grapples with high levels of unemployment, slow growth rates and a raft of infrastructure problems, particularly in the transport and energy sectors.

Against the backdrop of the prospect of European Union (EU) accession, confimed by the recently adopted European Commission Strategy for the Western Balkans, and further regional co-operation, this report, which is the second in a series, aims to help participating economies develop better policies by providing an in-depth assessment of economic performance and regional competitiveness across 17 policy dimensions. In producing this assessment, the OECD worked in partnership with six economies of the SEE region (Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia) from early 2016 to early 2018 to provide the expertise and evidence-based analysis required to support the structural reform process.

The publication offers a wide-ranging account of the key economic challenges and structural impediments to competitiveness in South East Europe. Drafted in close co-operation with SEE governments and including over 1 000 regional stakeholders, the report is based on a rigorous system of qualitative and quantitative policy assessments. The end result is a comprehensive report encompassing over 600 individual indicators.

Since the last edition of the *Competitiveness Outlook*, there have been areas of noteworthy progress. The six assessed SEE economies have adopted strategies to improve the overall standard of education, acted to remove technical barriers to trade and taken steps to establish better financing mechanisms for small and medium-sized enterprises (SMEs). Further efforts are underway to expand broadband services and close the digital divide, tackle inefficiencies in the energy and agriculture sectors, and address demographic challenges posed by long-term unemployment. But notwithstanding these important gains, there remain considerable socio-economic challenges for these economies as they continue their journey towards structural reform and regional competitiveness.

Key challenges

Throughout the region, weak implementation and inadequate monitoring continue to hamper structural reforms, while human capital and labour market deficits limit the capacity for economic growth. Low levels of enrolment in early childhood education and

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

a persistent digital divide have contributed to a regional skills gap, while chronic underfunding of science, technology and innovation is holding the economies back in their transition to knowledge-based societies. Science, technology and innovation in the SEE economies continues to lag behind comparable economies, exacerbated by weak linkages between the business community and academia and by the high level "brain drain" of young graduates.

Throughout the six economies, a lack of business finance is inhibiting economic growth and stunting free market potential, while inefficiencies in tax management and collection systems undermine government revenue streams. These structural inefficiencies have negative consequences for SMEs and encourage informal activity. What is more, poor enforcement of competition policy – especially in the highly concentrated banking, utilities and transport sectors – leads to unfair market conditions. The region also suffers from cumbersome state-owned enterprises, large-scale tax avoidance and feeble anti-corruption enforcement, all of which hurt productivity.

Excessive regulation of trade in goods and services has increased operating costs for businesses in SEE economies, while also affecting the inflow of foreign capital. Additional obstacles include poorly developed transport infrastructure and an ineffective utilities market, the latter characterised by high levels of vertical integration. In the area of sustainability, economic policies fail to facilitate economic growth in an environmentally friendly way, undermining public health and long-term competitiveness.

The way forward

Taken as a whole, these challenges present a formidable set of hurdles for the region. Therefore, developing short- and medium-term strategies to ensure policy implementation is critical.

- **Build skills and innovation.** A first priority for the region should be to invest in human capital formation and enhance labour market effectiveness. The SEE economies should also work to foster participation in early childhood education by improving affordability. Moreover, governments should adopt a holistic approach to aid in the transition towards a knowledge-based society, by stepping up support to foster scientific excellence, technology absorption, entrepreneurial growth and create momentum for innovation by involving and connecting stakeholders from business, academia, government and civil society.
- **Help businesses to grow in a fair environment.** The SEE economies should also prioritise access to finance by fostering alternative sources of financing and venture capital. A commitment to making finance accessible would benefit SMEs, as well as improve conditions for all market participants by opening up excessively restrictive credit markets. Likewise, foreign direct investment and SME linkages should be strengthened by prioritising long-term and sustainable investments in high-skilled and creative sectors. Finally, the region should focus on anti-corruption co-ordination, including offering more robust whistleblower protection across all six economies.
- **Develop infrastructure which supports efficient and sustainable growth.** In the medium term, the SEE economies would benefit from further investment in infrastructure, including overhauls of the transport and energy sectors. In particular, railway reforms and improvements in information systems are needed to bring the region up to par with OECD best practice and EU standards.

Additionally, attention should be paid to technical standards such as harmonising environmental legislation to meet international commitments. In the energy sector, policy frameworks should be fully aligned with climate change objectives, whilst better institutional capacity is required to realise ongoing energy market reforms.

To enable successful policy reform, these recommendations should be crafted to meet the specific context of each economy, while also accounting for the many overlaps and interconnections inherent in the region.

Methodology

Introduction

The publication series *Competitiveness in South East Europe: A Policy Outlook* (hereafter, the *Competitiveness Outlook*) provides a comprehensive assessment of competitiveness reforms in six economies of South East Europe (SEE): Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia. It provides policy makers with actionable policy recommendations, informed by international and OECD good practice, to define a sustainable economic reform agenda and to achieve greater economic competitiveness through productivity gains.

The *Competitiveness Outlook* is a key benchmarking tool for SEE governments, supporting the domestic policy cycle through its prioritisation, implementation and monitoring stages. The assessment process is a valuable means to foster government capacity in strategic planning and designing reforms, as well as change management. It uses a collaborative approach to integrate the perspective of non-government stakeholders into the process of identifying the main challenges in the economic environment and then addressing them through tailored policy reform.

The *Competitiveness Outlook 2018* is the second publication in the series. Since the 2016 edition, its methodology has been only marginally refined, thus making it possible to track progress in the advancement of policy design and implementation over time.

Scope

In order to boost an economy's competitiveness, policy reforms need to build on each other and be co-ordinated across different areas, rather than conducted in isolation. Acknowledging this holistic imperative and seeking to provide policy makers with a single window through which to assess and, if necessary, re-adjust policies favouring competitiveness, the *Competitiveness Outlook 2018* encompasses 17 policy dimensions, grouped into key pillars which are crucial for strengthening competitiveness.

Methodology

The *Competitiveness Outlook*'s methodology was conceived to provide an evidence-based assessment of progress in the design and implementation of policies to foster an economy's competitiveness. It is based on a list of indicators which has been tailored to each of the 17 policy dimensions, and implemented through a highly participatory process involving more than 1 000 local stakeholders.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

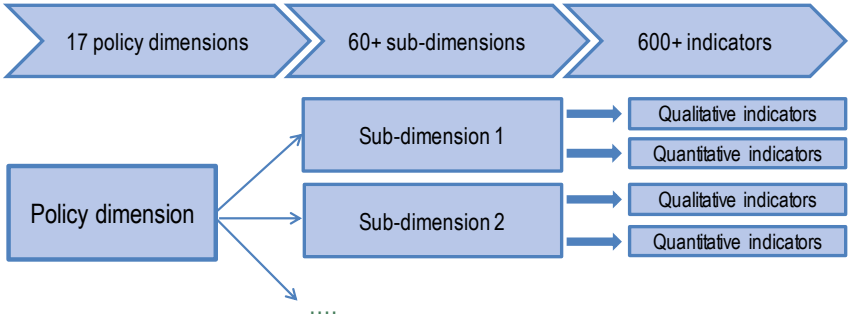
Policy dimensions assessed in the *Competitiveness Outlook 2018*

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

The overall assessment approach

Each policy dimension has two to five sub-dimensions that highlight the key elements of that policy area.[1] The sub-dimensions in turn are made up of a total of more than 600 indicators, both quantitative and qualitative (see figure below), which capture in detail the design, implementation and performance of policy settings, processes and institutions.

Overall assessment approach of the *Competitiveness Outlook 2018*



This publication has taken the indicators from the *Competitiveness Outlook*'s 2016 edition and refined them further in order to increase the focus on critical areas and integrate additional OECD tools. The set of indicators used for each of the 17 policy dimensions can be found in the assessment framework included at the start of each chapter.

Refinements to the *Competitiveness Outlook*

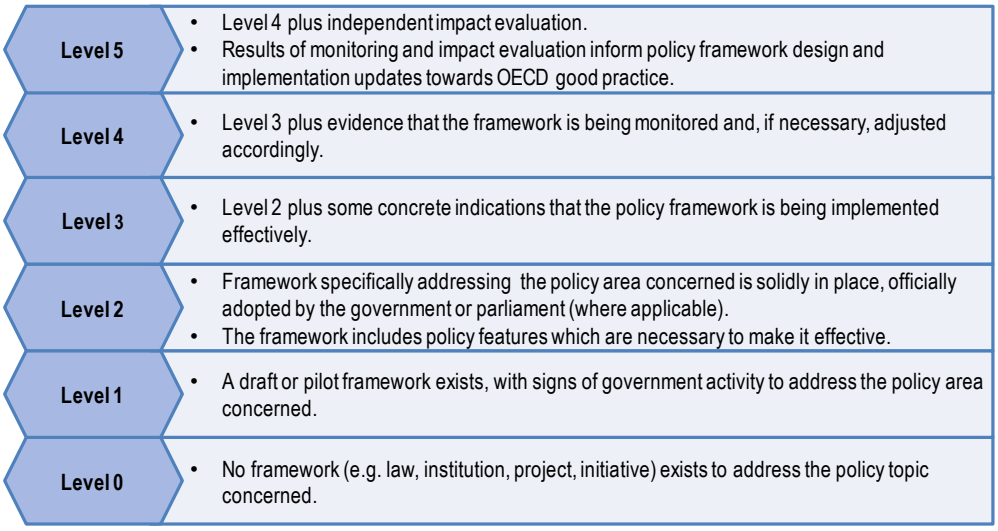
Compared to the first edition of the *Competitiveness Outlook* series which was published in 2016, the *Competitiveness Outlook 2018* includes new features introduced to strengthen the analysis and increase its impact. These refinements include:

- the inclusion of additional policy dimensions
- refined indicators to increase the focus on certain critical areas
- more detailed questionnaires to capture more nuanced qualitative information
- closer co-operation with SEE governments through government co-ordinators to improve intra-government co-ordination and data collection
- policy roundtables held in each capital city to increase ownership within SEE economies
- closer co-operation with SEE statistical offices to refine quantitative data collection and analysis
- more extensive collaboration with OECD directorates and bodies, including an increased application of OECD tools to SEE economies.

Qualitative indicators

Qualitative indicators assess whether the economies have the relevant competitiveness-enhancing policy settings, strategies, processes or institutions, and if so, the extent to which they have been adopted, implemented, monitored and updated. The qualitative indicators are assigned a numerical score according to the level of policy development and implementation so that performance can be compared across economies (see figure below).

General level scale and descriptors of qualitative indicators



The table below shows an example of how the general structure of the scoring scale used to measure qualitative information has been translated into level descriptors for the digital society policy dimension's national broadband strategy indicator.

Simplified level descriptors for the national broadband strategy indicator

Level	Level descriptor
Level 5	Regular monitoring activities and **impact assessment** on the national broadband strategy are conducted. Clear accountability mechanisms for government bodies are in place. Results of monitoring and evaluation analysis inform policy framework design and **implementation towards OECD good practice.**
Level 4	Planned **monitoring activities** assess programme inputs (budget and assets) and outputs (results such as greater broadband capacity and coverage). Administrative activities and programmes are fully government-funded.
Level 3	**Evidence of active policy implementation** as measured by programme inputs and outputs. Good institutional co-ordination between national and sub-national level government bodies which design policy and implement programmes. Government bodies' human and financial resources (mostly government-funded) are adequate to execute their responsibilities.
Level 2	A national broadband strategy has been **adopted** by the central government. The strategy has 1) clear and measurable objectives; and 2) defined actions and measures with timelines and budgets to meet objectives. The strategy **includes policy measures** to: 1) increase broadband capacity and speed; 2) improve the resilience of existing broadband infrastructure; and 3) promote access on fair terms and at competitive prices to all communities, irrespective of location. Relevant legislation resulting from policy measures outlined in the strategy has been adopted by parliament.
Level 1	A national broadband strategy is **under development. There is government activity in drafting** and stakeholder consultations.
Level 0	A national broadband strategy **does not exist or is obsolete**.

As an example, an economy that meets the conditions of level 5 would receive a score of 5 for this indicator. Policy dimension and sub-dimension average scores are arrived at by calculating the simple average across the relevant qualitative indicator scores. Indicators are not weighted because the importance of each indicator will be different for different stakeholders. Average scores should therefore be interpreted with caution and taken only as a rough indicator of policy development.

Quantitative indicators

Quantitative indicators are the input, output and outcome factors which are pertinent to the assessment of policies, policy making, institutional conditions and policy results. Examples include public or private spending in the policy field in question, the percentage 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.

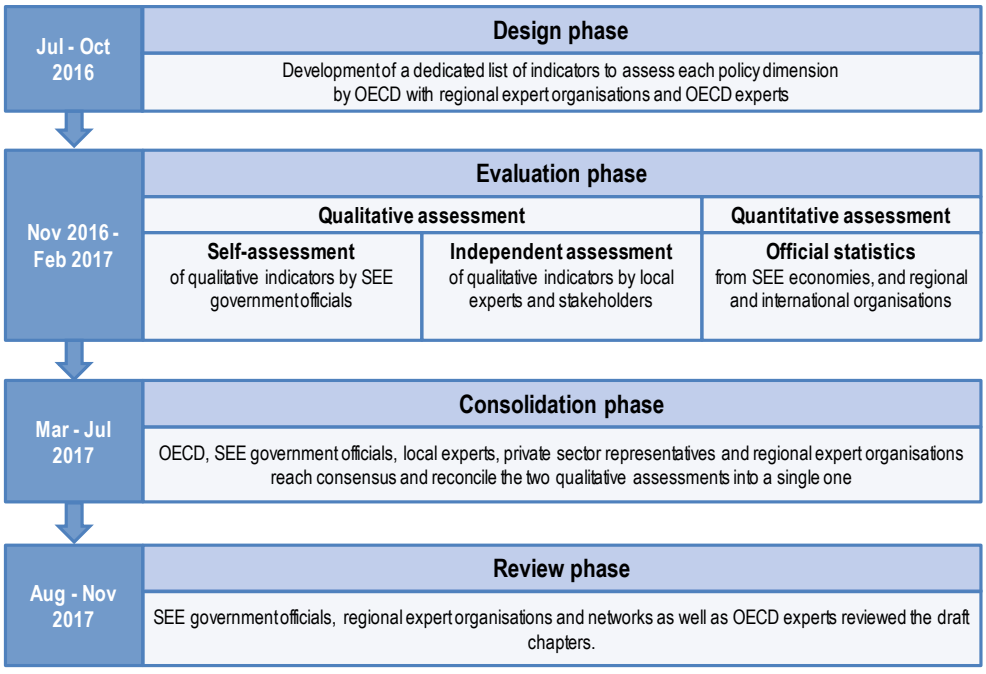
The assessment process

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 assessment process phases

The *Competitiveness Outlook 2018*'s assessment process consisted of four main phases which were conducted between July 2016 and November 2017: 1) the design phase; 2) the evaluation phase; 3) the consolidation phase; and 4) the review phase (see figure below).

Assessment process phases of the *Competitiveness Outlook 2018*



1. Design phase (July-October 2016)

   The OECD, in close co-operation with regional expert organisations and networks, developed the list of indicators to assess each of the 17 policy dimensions.

2. Evaluation phase (November 2016 - February 2017)

   This phase consisted of a questionnaire-based qualitative government self-assessment and a questionnaire-based independent qualitative OECD assessment, as well as the collection of quantitative statistical data. The government self-assessment was led by a designated government co-ordinator in each economy (see the acknowledgements for a list of names); the OECD assessment was supported by a team of local independent experts and researchers.

3. Consolidation phase (March-June 2017)

   The results of the government self-assessments and the independent assessments were compared and consolidated into a single assessment at roundtables held in the six SEE capitals, which brought together all the stakeholders who contributed to the assessments. These included SEE government officials, local independent experts, representatives from the private sector, the academic community and international donor organisations. The consolidated assessment and first policy recommendations for each policy area were discussed with SEE government co-ordinators and formed the basis for completing the draft chapters of the *Competitiveness Outlook 2018*.

4. Review phase (July-December 2017)

   Government officials, regional expert organisations and networks, and experts across the OECD reviewed the draft chapters.

The OECD then prepared the report for publication. The publication was launched at the OECD High-Level Conference in Paris on 24 April 2018.

A participatory assessment process

The participatory nature of the *Competitiveness Outlook*'s assessment process is reflected in the large number and diversity of the stakeholders who contributed to the assessment and attended *Competitiveness Outlook* meetings and roundtables (see table below).

Assessment stakeholders and meetings of the *Competitiveness Outlook 2018*

Stakeholders involved:	– 8 SEE government co-ordinators – 128 SEE policy dimension contact points – More than 1 000 SEE government officials – 8 SEE statistical offices – More than 300 representatives from the private sector, academia, civil society and international donor organisations – 13 regional organisations and networks – 6 local expert consultant agencies – 6 international expert consultants
Meetings and roundtables:	– More than 200 roundtables in each capital – 3 co-ordination meetings at the OECD

While the involvement of these stakeholders has benefitted the analysis in terms of data collection, the stakeholders also benefit from exchanging with one another and the OECD on concrete policy issues. In this regard, the participatory approach is a particular strength of the *Competitiveness Outlook* and enables the assessment process to:

- Act as a change-management tool, since the government self-assessment and roundtables ask stakeholders to judge the success of current policies and resource allocations, while identifying possible directions for improvement.
- Strengthen inter-ministerial consultation by asking SEE government officials across various ministries and agencies to exchange and co-ordinate while assessing the different policy dimensions. Bringing them together through roundtables allows them to reflect on the roles of their respective services in the policy dimension in question.
- Facilitate public-private consultation by convening both SEE government officials and representatives of the private sector, academia and civil society for roundtables to share their views on their respective assessments of the policy dimension.
- Encourage SEE statistics offices and government bodies to produce new or more frequent statistics by expressing demand for the indicators which are crucial to assess competitiveness.
- Support regional integration by including a regional perspective on policy issues through the consultation of regional expert organisations and networks during the design of the assessment, the roundtables and the review phase.

The strengths and limitations of the *Competitiveness Outlook 2018*

The *Competitiveness Outlook 2018* has a number of strengths which make it a uniquely valuable tool for SEE policy makers, citizens, researchers and international donor organisations. It also has a number of limitations which need to be borne in mind:

Strengths and limitations of the *Competitiveness Outlook 2018*

Strengths	Limitations
– Independent and rigorous assessment enables it to benchmark the performance of peer economies against OECD good practice. – Government self-evaluation acts as a change-management tool and creates a process that enhances the quality of pro-competitiveness policy development. – Good-practice examples and policy recommendations offer guidance to policy makers who are designing or redefining a sustainable economic reform agenda to foster competitiveness. – 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 over 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. – The assessed economies' contexts and other wide-ranging factors that affect competitiveness and policy development underpin the analysis and supplement the scores.	– Although qualitative indicators often specify the minimum design features a policy should possess, they do not necessarily reflect the quality of the individual policies themselves, but rather the extent to which they have been designed, implemented and monitored. – While the *Competitiveness Outlook 2018* focuses on areas crucial for strengthening competitiveness in SEE, it does not cover all areas of competitiveness exhaustively. – Statistical coverage of many issues is limited in the six economies, and the specific context of the quantitative data cannot always be acknowledged. – As the same set of indicators is applied to all six economies, the scoring may not fully reflect characteristics which are specific to an individual economy. – The benchmarking potential is limited since this edition is only the second in the series, and for three of the chapters it is only the first edition. Furthermore, some qualitative indicator levels were refined for this edition.

Note

1. Except for competition policy (Chapter 5), which has 12 sub-dimensions grouped into 4 policy areas.

Overview

Recent economic developments in six South East Europe economies

The 2018 *Competitiveness Outlook* for South East Europe provides an economic overview of six economies in South East Europe (SEE): Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia. With a combined population of nearly 18 million people, a landmass roughly the size of the United Kingdom and its strategic location at the crossroads of Central Europe, the Adriatic and Black Sea regions, this region has for centuries played an integral role in European business and commerce. Today, the six SEE economies participating in the *Competitiveness Outlook* have a joint gross domestic product (GDP) of USD 89.1 billion (current USD; World Bank, 2017), the equivalent of roughly half of Portugal's GDP. Serbia is the largest of the six economies, accounting for 43% of the region's total GDP, followed by Bosnia and Herzegovina with 19% and Albania with 13% (World Bank, 2017).

In the wake of Yugoslavia's disintegration and the SEE region's transition towards a free market economy, the SEE economies faced the dual hardship of conflict and economic stagnation (OECD, 2016). At the turn of the new millennium, the return of peace laid the foundations for regional stability and economic growth. However, the 2008 financial crisis hit the six economies hard: GDP fell by 2% in 2009 and growth remained sluggish for years afterwards. Indeed, between 2008 and 2012, average unemployment rates increased by 8 percentage points (World Bank, 2017).

Eight years after the crisis, a return to economic growth brought with it new investment opportunities. In 2016, the average GDP growth rate for the six SEE economies was 2.8%, with Kosovo (3.6%) and Albania (3.2%) showing the strongest growth (Table 0.1; World Bank/WIIW, 2017). What is more, at 5% of GDP in 2016, regional average foreign direct investment (FDI) inflows were well above the OECD average of 2.6%. FDI inflows were particularly strong in Albania (9.3%) and Serbia (6.1%), with about 60% of FDI inflows to the region originating from the European Union (EU), and other investments originating from the People's Republic of China, the Middle East, the Russian Federation and Turkey. Over the last decade, the SEE mining, manufacturing and financial sectors have attracted the most FDI (UNCTAD, 2017).

However, the six economies' overall economic development record is less positive than in neighbouring transition economies. Among the assessed economies, GDP per capita levels have reached 34.3% of the EU average, compared to 68.5% in Central Europe and the Baltic states (CEB) (World Bank, 2017). A similar picture can be drawn

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

for the unemployment rate, which stood at 23.1% in the SEE economies in 2015, compared to 7.8% in CEB (World Bank/WIIW, 2017; World Bank, 2017). Average youth unemployment in the region is higher yet, resting at a staggering 48% (World Bank, 2017).[1] High levels of unemployment compounded by slow regional growth make it unlikely that the income gap with the European Union will narrow in the near future.

Table 0.1. **Key data for the six SEE economies (2016)**

Economy	Population (million inhabitants)	GDP (current USD billion)	GDP per capita, PPP (current international USD)	Unemployment (% of labour force over 15 years old)[2]	FDI inflows (% of GDP)
ALB	2.87	11.9	11 540	17.1	9.3
BiH	3.51	16.9	12 172	27.7	1.7
MKD	2.08	10.9	14 942	26.1	3.6
KOS	1.81	6.7	10 064	32.7	3.6
MNE	0.62	4.4	17 633	17.5	5.5
SRB	7.05	38.3	14 515	17.7	6.1
Averages/total	17.94	89.1	13 478	23.1	5

Note: 1. Unemployment data are from 2015 (World Bank/WIIW, 2017), whilst all other data are from 2016.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators (including FDI inflows for Kosovo); for unemployment data: World Bank/WIIW (2017), *The Jobs Gateway in South Eastern Europe* (database), www.seejobsgateway.net/charts; for FDI inflows (except Kosovo): UNCTAD (2017), *World Investment Report 2017: Investment and the Digital Economy*, http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782.

A heavy dependence on remittances in the six SEE economies continues to pervade economic life. In Kosovo, personal remittance payments account for 14.8% of GDP. The statistics are similar, if less pronounced, in Bosnia and Herzegovina, where remittances account for 11% of GDP, and Albania, where they are 8.9% (World Bank, 2017).

What is more, investments in knowledge-intensive activities that create high value remain the exception. The region's labour market will have to contend in the near future with the middle-income trap. Rising wages in the main export sectors may reduce their competitive edge – particularly in manufactured goods and textiles – while underdeveloped skills in the labour market keep the economies from competing with more developed countries in advanced value-added services (OECD, 2017).

In view of the macroeconomic weaknesses of the assessed economies, governments are showing renewed commitment to enacting policy reforms. The reform agenda is also structured by the goal of eventual EU membership, which was invigorated by the recently adopted European Commission Strategy for the Western Balkans and is an important driver of change. In this context, the European Commission and the OECD are partnering with the assessed SEE economies to develop annual economic reform programmes. These initiatives assist in shaping economic governance by identifying and addressing key economic obstacles to growth.

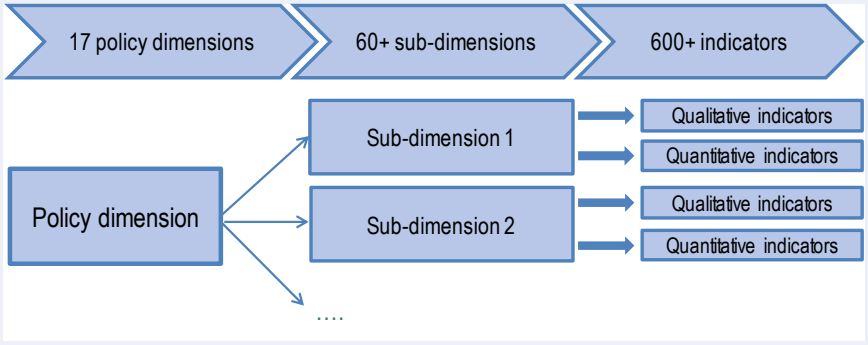
Given the small size of their economies, participating SEE governments recognise the need for deeper regional economic co-operation. Addressing macroeconomic challenges in a collaborative way can help generate stronger, more inclusive and more sustainable growth that can benefit the entire region. The idea of reinforced regional economic co-operation was endorsed during the Berlin Process Western Balkan Six Summit in Trieste in 2017.

This publication seeks to complement the existing regional initiatives by resolving competitive challenges as the basis for stronger, more inclusive and more sustainable economic growth. The report seeks to help policy makers by: 1) providing a comprehensive assessment of economic competitiveness in the region across 17 policy dimensions, assessed on a score gradient from 0 to 5 (Box 0.1); and 2) proposing actionable policy recommendations based on international and OECD good practice. Greater economic competitiveness – driven by productivity gains – is needed to unlock these economies' potential. In view of these objectives the report offers key findings on a range of socio-economic challenges, including how current policies can be improved to support economic governance reform and how policy makers can draw on regional experience to tailor solutions that better serve local communities.

Box 0.1. **The *Competitiveness Outlook* scoring methodology**

In each of the six economies, the 17 policy dimensions are assessed as to whether the relevant competitiveness-enhancing policy settings, strategies, processes or institutions are in place, and if so, the extent to which they have been adopted, implemented, monitored and updated. Each policy dimension has two to five sub-dimensions that highlight the key elements of that policy area. The sub-dimensions in turn are made up of a total of more than 600 indicators, both quantitative and qualitative (Figure 0.1), which capture in detail the design, implementation and performance of policy settings, processes and institutions.

Figure 0.1. **Overall assessment approach of the *Competitiveness Outlook 2018***



In 15 of the 17 dimensions,[1] the indicators are assigned a numerical score according to the level of policy development and implementation so that performance can be compared across economies. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practice: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

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

1. The exceptions are Dimension 5 and Dimension 16, which used a slightly different assessment approach.

Source: For more information see the methodology chapter.

Key findings for each policy dimension

Dimension 1: Investment policy and promotion

Investment is central to economic growth and sustainable development. It expands an economy's productive capacity, drives job creation and secures overall competitiveness. To these ends, the investment policy and promotion dimension examines the existence of policies for market access and exceptions to national treatment, investor protection and intellectual property rights. With regard to investment promotion, the dimension assesses strategies and institutional frameworks, investment promotion activities, investment facilitation services and measures to promote linkages between foreign and domestic firms.

Across the assessed economies, flows of FDI have increased in the last decade, indicating a more favourable business environment for foreign firms. Moreover, procedures for setting up companies have been streamlined. Despite progress, more could be done to further strengthen the linkages between foreign and domestic firms.

Table 0.2. **Assessment in Dimension 1: Investment policy and promotion**

Dimension 1	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.6	2.1	2.6	3.3	2.6	3.4

Dimension 2: Trade policy and facilitation

Fair, reciprocal and predictable cross-border trade arrangements are important pillars of a healthy regional economy. Consequently, the trade policy and facilitation dimension assesses the implementation, evaluation and co-ordination of cross-border trade, including the monitoring of domestic law to meet OECD good practice.

Throughout the region, the economies perform best on non-tariff measures and export promotion, including the removal of technical barriers to trade. However, the *ex post* monitoring of free trade agreements, as well as the transparency and effectiveness of public-private consultation mechanisms, could be improved. The region would also benefit from limiting undue regulatory restrictions on services, such as easing barriers on the free movement of people.

Table 0.3. **Assessment in Dimension 2: Trade policy and facilitation**

Dimension 2	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.8	2.2	2.3	3.8	2.6	3.3

Dimension 3: Access to finance

Facilitating access to finance is important for small and medium-sized enterprises (SMEs) and entrepreneurship promotion, and ultimately for an economy's competitiveness, growth and employment creation. External finance, whether acquired through bank loans, grants or investments from private individuals or investment firms, enables enterprises to meet their working capital requirements. This dimension focuses on policies and instruments which facilitate access to finance for SMEs in the assessed SEE economies. Across the six economies, the role of SMEs in economic activity is greater than in the European Union, and all economies have taken steps to establish better regulatory frameworks and financing support programmes. Notwithstanding these efforts, the implementation phase of these developments remains weak and there is a shortage of alternative financing instruments and mechanisms across the region.

Table 0.4. **Assessment in Dimension 3: Access to finance**

Dimension 3	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.5	1.9	2.4	3.1	2.4	3.2

Dimension 4: Tax policy

Tax policy refers to the design of domestic and international tax rules which allow economies to raise revenues to finance public services in ways which are the least distorting for economic growth and share the tax burden across different agents in a fair manner. Throughout the six SEE economies assessed, corporate and personal income (CIT and PIT) tax rates are low and social security contributions (SSCs) are high. The six SEE economies would benefit from broadening the tax base – particularly for value-added tax (VAT) and CIT – as well as strengthening their tax policy assessment tools. The region should also revisit its wide range of corporate tax incentives and take steps to avoid falling into the trap of a "race to the bottom" type of tax competition.

Table 0.5. **Assessment in Dimension 4: Tax policy**

Dimension 4	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.8	1.4	2.3	2.4	2.0	2.6

Dimension 5: Competition policy

An effective competition policy allows for new firms to challenge incumbents, while also encouraging efficient ones to grow and inefficient ones to exit the market. As such, competition regimes ensure that markets operate at their optimal level by taking remedial action against anti-competitive behaviour. In general, a competitive environment drives economic growth, increases living standards and reduces inequality. While the six SEE economies have the basic legal structures in place for a functioning competition regime, efforts should be made to implement them and to allocate additional resources to the relevant authorities. This dimension was assessed using a different methodology to the other dimensions; hence it lacks an assessment table.

Dimension 6: State-owned enterprises

State-owned enterprises (SOEs) represent the most direct way for a government to intervene in the commercial economy. Historically, SOEs have been concentrated in critical sectors of the economy such as energy, infrastructure and finance. Throughout the region, financial disclosure and audit practices have improved. Nevertheless, SOEs would benefit from the further professionalisation of the ownership function, including ensuring that SOEs are free from potential conflicts of interest with other government agencies, as well as prioritising oversight mechanisms.

Table 0.6. **Assessment in Dimension 6: State-owned enterprises**

Dimension 6	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.7	1.9	3.3	2.4	2.7	3.1

Dimension 7: Education and competencies

Ensuring inclusive and high-quality education is central to creating a competitive environment. Investing in education is necessary to increase human capital and further improve labour productivity. Across the region, the SEE economies have adopted

national strategies to improve the overall standard of education and/or address specific aspects of education, such as equity, vocational education and training, and adult education. However, the latest results from the Programme for International Student Assessment (PISA) for participating SEE economies are well below those for peers from Central and Eastern Europe and the OECD average. Encouraging participation in early childhood education and increasing spending on primary and secondary education could help to ensure that all students reach the PISA baseline level needed for full socio-economic participation.

Table 0.7. **Assessment in Dimension 7: Education and competencies**

Dimension 7	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.4	1.8	2.5	2.8	2.8	2.5

Dimension 8: Employment policy

Employment policy can provide a framework of strategies, action plans, laws, measures and institutions that improves the functioning of labour markets, makes them more inclusive, and enhances their ability to address post-crisis and demographic challenges. The participating SEE economies have a number of common structural labour market challenges, including high rates of youth unemployment and long-term unemployment, as well as a significant share of the population working outside the formal sector. While most SEE economies have made efforts to design comprehensive employment frameworks through consultative processes, and have relevant institutions in place, more efforts are required to address the structural challenges in the labour market. Specifically, labour market institutions should be strengthened and broadly co-ordinated to ensure effective delivery of services to job seekers.

Table 0.8. **Assessment in Dimension 8: Employment policy**

Dimension 8	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.6	2.0	1.5	2.3	2.1	2.5

Dimension 9: Science, technology and innovation

Science, technology and innovation (STI) provide the means for the transition to high value-added products and services. This dimension assesses the governance of STI policy, the performance of the public research system, the support to business innovation, as well as the linkages between the public and private sectors. Throughout the region STI outcomes remain modest. A lack of funding for research and development (R&D) limits the potential for innovation, while the wider diffusion of technology does not receive sufficient policy attention. In the future, a more structured link between business and academia would help facilitate the spread of cutting-edge research, while an emphasis on individual innovation could help foster new creative sectors.

Table 0.9. **Assessment in Dimension 9: Science, technology and innovation**

Dimension 9	ALB	BIH	KOS	MKD	MNE	SRB
Average	1.3	1.3	1.1	2.1	1.8	2.1

Dimension 10: Digital society

The digitization of society has emerged as an important driver of socio-economic benefits. A solid policy framework for digital society ensures the availability and uptake of digital technologies for a well-connected digital economy. Participation in the envisioned Digital Single Market in Europe promises to boost the SEE economies' growth. Throughout the region, positive steps have been taken to expand broadband and increase access to e-business and e-commerce. In light of certain weaknesses in the digital society framework in South East Europe, e-business uptake remains low, e-inclusion is not a priority and users' perception of trust and security in digital technologies is not yet established. Improving these frameworks has therefore become a key priority in the region's economic reform agenda.

Table 0.10. **Assessment in Dimension 10: Digital society**

Dimension 10	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.9	1.6	2.2	2.3	2.4	2.4

Dimension 11: Transport policy and performance

Transportation networks are necessary to facilitate the flow of people moving between rural and urban areas. There is a positive correlation between efficient transportation logistics and overall competitiveness as it lowers access costs to regions and cities, as well as to international markets. An efficient transportation grid is also critical for securing foreign investment. Across the region, development strategies ensure the alignment of transport investment and maintenance spending with long-term goals (Table 0.11). Strides have also been made in the governance sphere, owing to wide-ranging legislative and regulatory efforts. However, progress has been slow on the operational front, including on procurement and asset management.

Table 0.11. **Assessment in Dimension 11: Transport policy and performance**

Dimension 11	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.7	1.2	1.8	2.0	1.6	2.6

Dimension 12: Energy policy

Energy policy seeks to achieve energy security and long-term sustainability based on effective governance and regulation; where possible energy should be delivered through market-based mechanisms. Although the six economies have taken steps to improve the competitiveness of their energy sectors, significant hurdles remain. Energy strategies and action plans must set out measurable objectives and outcomes, including on renewable energy and energy efficiency. Similarly, energy policy should be more closely aligned with international and EU good practice, and in particular should aim to meet each economy's commitments under the Paris Climate Accord. Taken as a whole, this new dimension reflects how the assessed economies have improved the delivery of reliable and affordable energy to consumers. Nevertheless, there exists room for improvement in several areas, notably in modernising infrastructure and meeting sustainability goals.

Table 0.12. **Assessment in Dimension 12: Energy policy**

Dimension 12	ALB	BIH	KOS	MKD	MNE	SRB
Average	1.9	1.4	2.3	1.6	2.1	2.2

Dimension 13: Environmental policy

Long-term economic competitiveness in the six SEE economies depends on fostering growth while also safeguarding natural assets. Despite progress in adopting overarching legal and policy frameworks, as well as land-use management frameworks, significant challenges remain in the assessed economies. Crucially, they should further integrate environmental considerations into their main economic and sectoral policies, emphasising the transition to a low-carbon economy. A key sector is energy, where their current energy mix and future plans to build coal-fired power plants contradict their climate change objectives and, ultimately, will exacerbate already high levels of air pollution. Furthermore, economic instruments including taxes and user fees should better reflect environmental costs.

Table 0.13. **Assessment in Dimension 13: Environmental policy**

Dimension 13	ALB	BIH	KOS	MKD	MNE	SRB
Average	1.8	1.3	1.8	1.6	1.8	2.1

Dimension 14: Agriculture

Increasing the productivity and sustainability of agriculture in the six SEE economies is critical for achieving their full economic potential. Regulations for agricultural inputs safeguard the economies' rich natural resources, while also enabling more productive agricultural activities. However, further policy measures and regulations are required to ensure greater efficiency and to protect local populations from harmful pollutants. For example, agricultural producer support schemes should be oriented towards productivity and sustainability objectives. Additionally, farmland consolidation plans should be implemented. Policy analysis, including evaluation and data collection, should be strengthened to better inform policy development.

Table 0.14. **Assessment in Dimension 14: Agriculture**

Dimension 14	ALB	BIH	KOS	MKD	MNE	SRB
Average	2.9	2.5	2.4	3.0	2.4	3.3

Dimension 15: Tourism

A robust tourism sector can support economic development and offer employment growth, particularly in seasonal labour markets. This dimension considers how tourism policy can be leveraged to meet the highest industry standards and support regional economies in destination branding and promotion. Considering the importance of tourism to regional economies, the private sector is slowly embracing strategy development. Nonetheless, the tourism workforce in the six SEE economies still lacks professionalism, and tourism is not yet seen as an attractive and profitable career choice. Hence, stronger links between the business sector, academia and tourism are needed to achieve the sector's full potential.

Table 0.15. **Assessment in Dimension 15: Tourism**

Dimension 15	ALB	BIH	KOS	MKD	MNE	SRB
Average	1.9	1.2	1.3	1.5	2.0	2.1

Dimension 16: Public services

High-quality public services – including all aspects of their design and delivery – are critical to competitiveness and growth in the six SEE economies. Legal frameworks for public procurement, merit-based recruitment and government session procedures are generally well developed, but full implementation remains a challenge. In public procurement, procedural compliance is the focus rather than good outcomes. The legislated principle of merit-based access to civil service positions is not fully reflected in practice. The assessed economies should strengthen the use of evidence-based approaches and public consultations in policy making. They should also continue their efforts to modernise and digitalise public services. This dimension was assessed using a different methodology to the other dimensions; hence an assessment score table is not applicable.

Dimension 17: Anti-corruption policy

Corruption imposes a variety of costs on society and can diminish the competitiveness of an economy. It wastes public resources, widens economic and social inequalities, breeds discontent and political polarisation, and reduces trust in institutions. Corruption perpetuates inequality and poverty, affecting well-being and the distribution of income. Moreover, it undermines opportunities to participate equally in social, economic and political life. Corruption can hamper growth, lower the productivity of capital, reduce incentives for innovation and productive labour, and discourage foreign direct investment. As such, fighting corruption is essential to foster long-term economic growth and competitiveness. This dimension assesses the state of current anti-corruption policies across the region. All of the SEE economies have begun to effectively collect detailed information on the implementation progress of their anti-corruption strategies and action plans. They have adopted new laws and established anti-corruption institutions. While public awareness has been raised across the region, there remains scope for governments to co-operate more effectively with civil society groups on anti-corruption issues.

Table 0.16. **Assessment in Dimension 17: Anti-corruption policy**

Dimension 17	ALB	BIH	KOS	MKD	MNE	SRB
Average	1.8	1.7	1.6	2.4	2.7	2.6

Overarching insights

Across these 17 policy dimensions, a series of common challenges and recommendations can be identified. Taken together, these cross-cutting challenges represent a formidable set of obstacles to economic growth in the participating SEE economies, ranging from labour market deficiencies to inadequate infrastructure and human resource challenges. In recognition of these obstacles, the *2018 Competitiveness Outlook in South East Europe* offers a set of strategic recommendations (see last section) which aims to reinvigorate regional productivity by fostering inclusive economic growth and sustainable development.

Crucially, these insights should not be treated as a series of stand-alone challenges and recommendations, but should be understood as part of a wider set of regional reforms – while also accounting for the various nuances of the six individual economies. The *2018 Competitiveness Outlook* is therefore an essential change-management tool for policy makers and citizens alike, combining an unparalleled breadth of coverage with clarity of analysis to deliver guidance on economic reform.

Cross-cutting challenges

- **Lack of co-ordination in policy design and weak implementation monitoring**

  Across the policy dimensions, the SEE economies generally have a comprehensive set of policy frameworks in place; however, policies often lack coherence and are hobbled by weak institutional co-ordination. Moreover, implementation is frequently affected by insufficient funding or limited institutional capacities, as well as an absence of robust monitoring and evaluation systems.

- **Human capital and labour market deficiencies**

  Education systems in the assessed economies are characterised by low rates of enrolment in early childhood education and a high percentage of students who are not developing the skills required to integrate into the job market. Similarly, labour markets in the economies generally exhibit high rates of unemployment, especially among the youth, as well as high levels of long-term unemployment, persistent gender gaps, and a substantial informal sector.

- **Inadequate transition towards a knowledge-based society**

  In order to escape the middle-income trap, the SEE economies need to transition towards higher value-added products and services that include greater innovative and knowledge-based content. Insufficient financial support for R&D, weak support for technology diffusion and weak linkages between businesses and academia are further aggravated by a lack of incentives for business creators and endemic "brain drain". Here, digitalisation can act as a driver of productivity.

- **Difficulty in business financing and misalignments in the tax system**

  Enterprise growth is often challenged by frequent changes in legislation, which undermines their ability to plan for the long term. Small and medium-sized enterprises face the greatest difficulties in accessing finance. Entrepreneurship is further hampered by steep regulatory barriers related to restructuring and liquidation proceedings. Businesses are also affected by inefficiencies in tax incentives, while their employees face high tax burdens on their income, ultimately leading to further informality.

- **Uneven playing field for economic actors**

  Existing policy measures and institutional settings often have unintended consequences and lead to unfair market competition. Challenges include poor enforcement of competition policy; regular government interference – including corruption – which undermine international competition rules; insufficient anti-corruption co-ordination and enforcement; sub-optimal governance of state-owned enterprises; tax avoidance and evasion; and public administrations with significant room for improvement.

- **Insufficient regional trade, transport and energy connectivity**

  The SEE regional market faces a number of challenges in trade, transport and energy connectivity. Trade barriers affect business operations and the exchange of goods and services, as well as capital and FDI flows. Additional obstacles include an underdeveloped regional electricity market characterised by high vertical integration and an overall poorly developed transport infrastructure.

- **Lack of environmental sustainability in key policy fields**

  In the six SEE economies, the energy mix is highly dependent on fossil fuels that generate high carbon dioxide emissions and pollution, directly contributing to climate change and poor air quality. The economies lack economic instruments such as taxes and user fees to encourage efficient use of resources in key sectors such as agriculture. Framework conditions for green investment and innovation have not yet been developed.

Key recommendations

- **Develop and reorient strategies to ensure policy coherence and improve policy implementation, evaluation and monitoring**

  Greater inter-ministerial co-ordination is critical when designing policy frameworks that address a variety of policy areas. Frameworks should also build on international and OECD good practice. Moreover, policy frameworks could benefit from enhanced monitoring and impact assessment mechanisms to improve policy design and increase government accountability to businesses and citizens. In order to facilitate implementation, the SEE economies need to enhance the capacities and resources allocated to institutions in charge of implementation and enforcement, while ensuring that legal provisions are respected.

- **Invest in human capital formation and enhance labour market effectiveness**

  The six economies should increase participation in early childhood education by improving infrastructure and affordability. Moreover, efforts should be made to reduce skills mismatches, particularly in fast-growing sectors such as tourism. The SEE economies should continue to tackle labour market challenges through creating incentives to enter the formal economy, ensuring effective enforcement of labour regulations and raising awareness of the benefits of social protection and public services. Likewise, it is important to provide effective support to jobseekers while ensuring that they respect their obligations to actively search for work.

- **Support the transition to a knowledge-based, digitalised society**

  Governments should step up support to innovation and R&D and create incentives for businesses and individuals to unleash their creative potential. In particular, public procurement practices can be used to support innovation without additional budget outlays. Targeted low-budget instruments such as technology extension or innovation vouchers may generate more impact than high-ticket science and technology parks. Investment in digital skills development and awareness-raising campaigns for e-business adoption would significantly enhance the positive impact of digitalisation.

- **Facilitate business financing, broaden the tax base and address incentive problems**

  The assessed SEE economies should make it easier for businesses to access finance. This can include developing alternative financing instruments, such as venture capital and business angel networks, which could particularly benefit SMEs. Furthermore, improvements in the implementation of frameworks for insolvency restructuring and liquidation are needed to reduce the risk of bankruptcy for cash-constrained companies facing late payments by clients.

- **Create fair conditions for all market participants**

  While investment policy frameworks are fairly coherent, international competition rules need to be better implemented. Moreover, the economies should further strengthen FDI-SME linkages. They should also enhance the effectiveness of anti-corruption co-ordination and enforcement institutions, as well as whistleblower protection. Regional and international co-operation is vital to reduce tax evasion, while transparency for state-owned enterprises is needed to allow for fair competition. Similarly, a more open, transparent and effective public administration is required in order to ensure fair conditions for all market participants.

- **Improve regional trade, transport and energy connectivity**

  While the six SEE economies should continue investing in regional infrastructure, they should also focus on implementing technical standards and reform measures in the transport and energy sectors. Railway reforms and improvements in information systems, road safety and maintenance are also needed. Furthermore, the economies should improve both internal and external border agency co-operation to re-engineer and extend the use of innovative automation tools. In the energy sector, stronger institutional capacity will be required to realise current energy market reforms, ensure unbundling of vertically integrated enterprises and facilitate third-party access.

- **Strengthen environmental and sustainability policy practice**

  To secure long-term competitiveness, the assessed SEE economies should fully align their energy policy frameworks with climate change objectives. They should enhance policy implementation by defining roles and responsibilities for vertical and sectoral actors for water and land management. The use of economic instruments such as taxes and user fees should be adapted to encourage the efficient use of natural resources and eliminate environmentally harmful energy subsidies. Finally, the economies should strengthen policy frameworks to promote green investment and innovation.

Note

1. There are no youth unemployment data for Kosovo from 2015-16.

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Chapter 1.

Investment policy and promotion in South East Europe

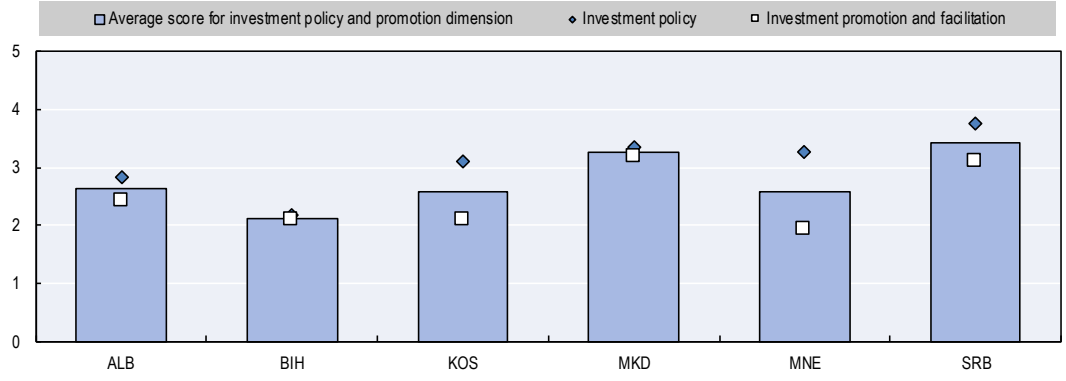
This chapter on investment policy and promotion assesses the policy settings, strategies, processes, and institutions in six South East European economies. After a brief overview of trends and performance in foreign direct investment in South East Europe (SEE), this chapter then focuses on two essential sub-dimensions. The first sub-dimension, investment policy, covers market access and exceptions to national treatment, investor protection, and intellectual property rights in the assessed economies. The second – investment promotion and facilitation – examines their strategies and institutional framework, investment promotion activities, investment facilitation services, and measures to promote linkages between foreign and domestic firms. It includes suggestions for enhancing the policies in each of these sub-dimensions in order to improve overall investment policy and promotion, which in turn would foster the competitiveness of these economies.

Main findings

A sound investment policy and promotion framework is at the heart of an economy's competitiveness. It supports economic growth and sustainable development by meeting the needs of both investors – foreign and domestic – and society more broadly (OECD, 2015a). All six assessed South East European (SEE) economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia – actively promote private investment as a key engine of economic development. Foreign direct investment (FDI) inflows have increased substantially over the past two decades, as investment climate reforms have contributed to making the region an increasingly attractive destination for foreign businesses.

The six SEE economies have relatively sound investment policy frameworks and coherent institutional frameworks for investment promotion and facilitation (Figure 1.1). Most have slightly higher scores in investment policy than investment promotion and facilitation. These reflect the results of successful reforms to open their economies and improve the regulatory framework for investment, while highlighting the need to further strengthen the investment promotion institutions, reinforce co-ordination within government and enhance the developmental impact of FDI.

Figure 1.1. **Investment policy and promotion: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

Progress has been made on several fronts over the past two years. SEE economies have modernised their investment policy framework by adopting new investment and investment-related laws, including on arbitration and intellectual property (IP) rights. Recent or pending justice reforms in several economies are expected to strengthen investor confidence. Efforts to streamline business establishment procedures have been noteworthy and several investment promotion agencies (IPAs) have been modernised or restructured to improve how they conduct their key functions. However, the economies

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

have yet to make progress on enforcing contracts promptly and adequately, raising awareness of IP rights, further empowering IPAs, granting incentives more cautiously, and promoting linkages between foreign and domestic firms.

Achievements

All the economies have taken a clear pro-investment stance and provide open and non-discriminatory environments for foreign investors. Remaining restrictions on FDI are below the OECD average; they are not unusual and do not constitute a major impediment to foreign investment.

Sound legal frameworks for investment are provided, including for property and IP rights protection. Investor protection standards are high and expropriations of companies are rare and subject to sound and predictable rules. IP laws and regulations follow international practice and are becoming aligned with the European Union's standards.

The economies have well-established IPAs that conduct the core functions of investment promotion and facilitation. They have designed sound investment promotion strategies with well-delineated priorities and targets, and most economies are putting increasing efforts into proactive promotion and investor outreach.

Setting up a company is, in most cases, easy and predictable. Procedures to start a business have been streamlined and are generally transparent and straightforward. The authorities also maintain a constructive dialogue with the private sector to inform it of pending reforms, collect feedback on legislative proposals and discuss challenges faced by investors. Some economies provide focused aftercare services to identify and support opportunities for business expansion.

Remaining challenges and key recommendations

- **Further improve the clarity, transparency and predictability of the regulatory framework for investment.** For example, 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 the discriminatory conditions which apply.
- **Systematically ensure prompt legal procedures and consistent interpretation of the law, especially when it comes to enforcing commercial contracts.** There is a significant backlog of court cases, and reports of regular political interference. Judges would benefit from additional training to deal with commercial and IP cases.
- **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.** IP-related institutions currently lack capacity to fully enforce IP rights and conduct awareness-raising activities.
- **Give IPAs adequate resources and capacity to conduct key investment promotion and facilitation functions, such as investor targeting and aftercare.** Sectoral competences need to be reinforced, and institutional co-ordination enhanced, to avoid activities overlapping and to ensure that obstacles faced by investors are promptly removed. Incentive regimes are often complex and incentives are mostly granted without (at least publicly disclosed) cost-benefit analyses.

- **Take steps to enhance the impact of FDI by creating linkages between foreign investors and domestic firms.** Authorities in the SEE economies should further support small businesses and develop comprehensive business linkage programmes. IPAs should increasingly integrate matchmaking into their activities and align their FDI promotion strategy with local linkage opportunities.

Context

Investment is a crucial ingredient of economic growth and sustainable development. Raising investment levels is not a goal in itself, as investment may sometimes have negative effects on economic welfare or on the environment. Under the right conditions, however, it can raise overall output through factor accumulation and by introducing new techniques and processes which boost productivity and – ultimately – standards of living. In most countries, domestic investments usually dominate, but FDI inflows can provide additional advantages beyond their potential contribution to the capital stock by serving as a conduit for productivity gains through greater competition and the local diffusion of technology and expertise (OECD, 2015b).

While there is no one-size-fits-all solution to creating an enabling environment for investment, some guiding principles and elements of a good investment climate are internationally recognised as important building blocks to support overall competitiveness. A fair, transparent and predictable regulatory framework for investment, for instance, is one critical determinant of investment decisions and their contribution to development. It is particularly important for foreign investors who may have to function with regulatory systems, cultures and administrative frameworks that are very different from their own. Uncertainty about their lawful rights and obligations raises risks for investors, affecting their cost of capital and reducing investment opportunities. Similarly, investment promotion and facilitation measures can help to make an economy's investment climate more attractive and maximise the contributions of FDI to development, but their success depends on the quality of investment-related policies (OECD, 2015a).

This chapter draws on internationally recognised principles and policies, as documented in the OECD *Policy Framework for Investment* (OECD, 2015a),[1] a comprehensive policy tool to assess an economy's investment climate, and to compare and assess investment policy and promotion activities in the region. It also uses the OECD *FDI Regulatory Restrictiveness Index* (OECD, 2017b) to measure and benchmark statutory restrictions to foreign investment in the region.

Investment, by its very nature, touches upon a number of other policy areas. Investment policy – like competitiveness – is an issue requiring policy responses that cannot easily be covered within a single government department or agency. Investors expect public policies and services to be seamless and responsive to their needs, and not defined by separate administrative structures. Coherence is particularly important in regulation, which is one of the main pillars of an effective investment policy (OECD, 2015a). This chapter therefore relates to all other dimensions of this *Competitiveness Outlook*, but it has particularly close links with the following chapters:

- **Chapter 2. Trade policy and faciliation** is particularly relevant, given the importance of the increasingly inter-related trade and investment nexus, and in the context of global value chains and the discussion on trade and/or investment restrictiveness.

- **Chapter 4. Tax policy** is crucial, as host governments need to find the right balance between providing an attractive tax regime to investors and ensuring that sufficient revenues are raised to improve the broader investment climate.
- **Chapter 7. Education and competencies** affect the availability of adequate skills, which drives foreign investment decisions. They also are a prerequisite for creating linkages with the local economy.
- **Chapter 9. Science, technology and innovation** link to investment, not only in the context of the IP regime (an important condition of a sound investment climate), but also in relation to technology and knowledge transfers – a key expected benefit for the host economy.
- **Chapters 11 and 12.** The quality and availability of **transport and energy** affect an economy's investment attractiveness and can also constitute important destinations for FDI.
- **Chapter 17. Anti-corruption policy** plays a key role, especially as regards the quality and independence of the justice system and the need for investors to know that their contractual rights will be upheld promptly and satisfactorily by local courts.

Investment policy and promotion assessment framework

The investment policy and promotion dimension examines the extent to which governments have established competitive investment policy and investment promotion. Without seeking to be exhaustive, it considers two broad sub-dimensions:

1. Investment policy: to what extent are the economies open to FDI and how does the legal framework for investment protect investors and uphold the IP rights regime?
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 investment and the promotion of business linkages?

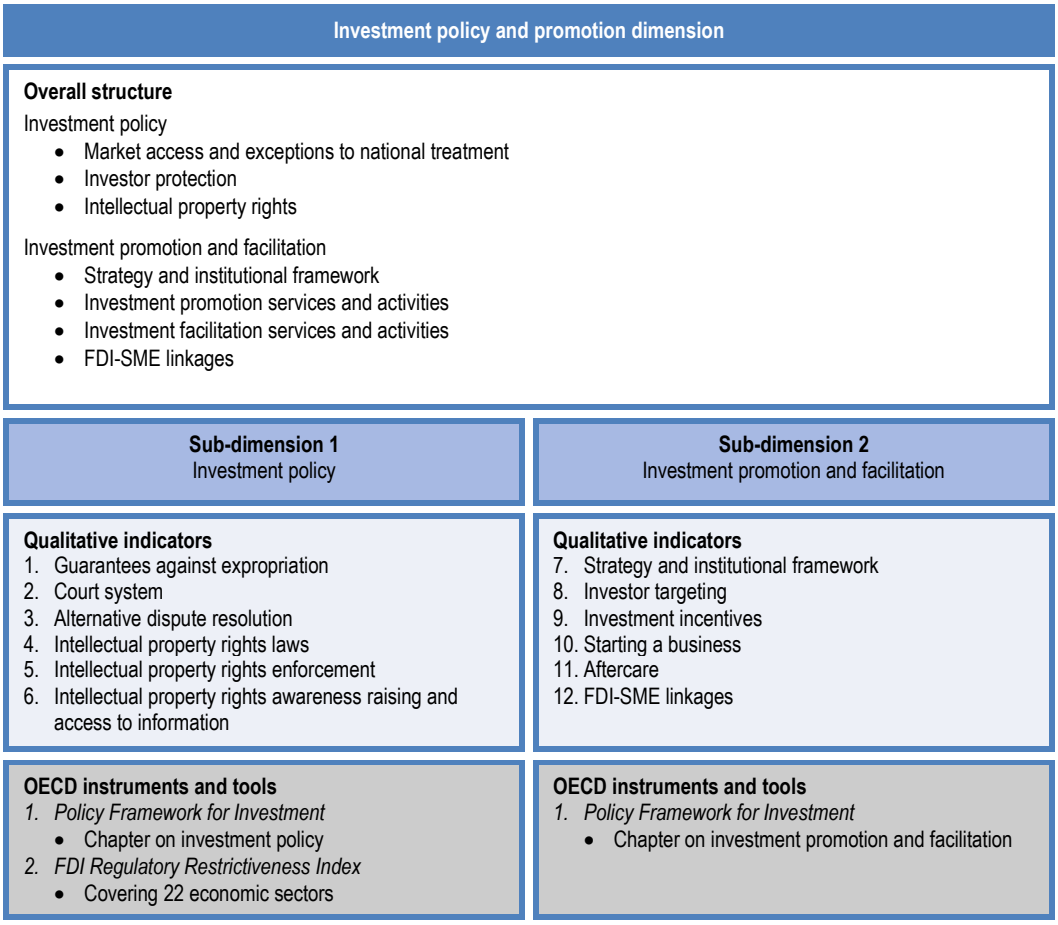
Figure 1.2 shows how the sub-dimensions and their constituent indicators make up the investment policy and promotion assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Qualitative indicators are based on the OECD's *Policy Framework for Investment*. They have been scored in ascending order on a scale of 0 to 5,[2] and are summarised in Annex 1.A1. For more details on the methodology underpinning this assessment please refer to the methodology chapter. The statutory restrictions on the foreign direct investment indicator is based on the *OECD FDI Regulatory Restrictiveness Index.*

FDI performance in SEE economies

Levels of FDI inflows into the economies increased substantially throughout the 2000s, as a response to the move from centrally planned to market-oriented economies. Flows increased by 20-27% a year in economies such as Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia (UNCTAD, 2017). Liberalisation reforms, measures to improve the business climate, privatisation

programmes and deepened economic ties with the European Union (EU) have contributed to making SEE an increasingly attractive investment destination, primarily for investors from EU countries and the Russian Federation.

Figure 1.2. **Investment policy and promotion assessment framework**

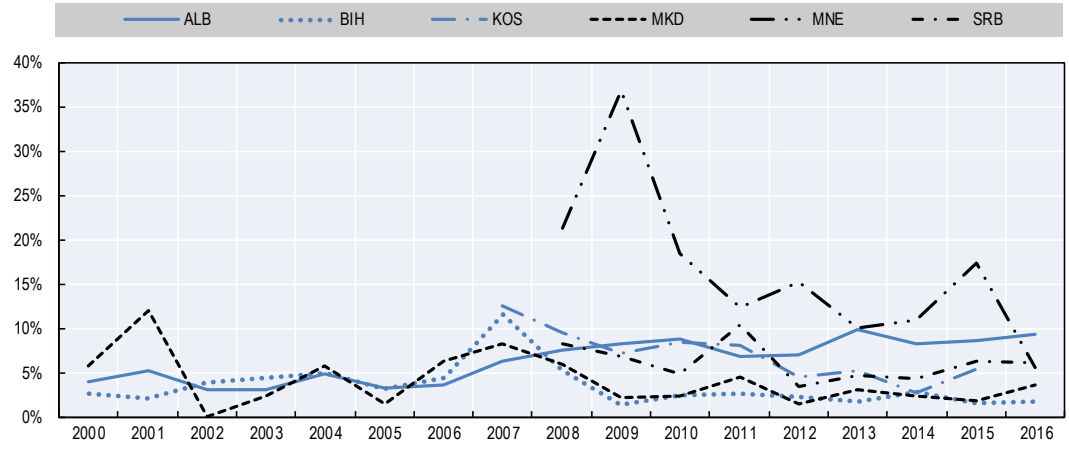


Note: SME – small and medium-sized enterprises.

Since 2013 SEE economies have been attracting around USD 5 billion of foreign investments annually (Figure 1.3), about half of which has gone to Serbia each year, given its relatively large economy.[3] In relative terms, Montenegro and Albania have been the leading economies for FDI inflows measured as a percentage of gross domestic product (GDP), whereas the lowest ratios in 2016 were in Bosnia and Herzegovina (1.7%) and the Former Yugoslav Republic of Macedonia (3.6%). In 2016, however, Montenegro's FDI flows fell by two-thirds compared to the previous year, thus lowering its ratio of FDI to GDP significantly.

FDI stocks represented over 40% of GDP in the six economies in 2016. Compared to the EU and to the peer economies of Croatia and Slovenia, FDI as a proportion of GDP is high in Montenegro (108%), Serbia (76%) and Kosovo (55%), and on a par with or slightly below the EU and Croatia (but higher than Slovenia) in the Former Yugoslav Republic of Macedonia (47%), Bosnia and Herzegovina (43%) and Albania (41%) (Figure 1.4). These figures reflect the important role that FDI plays in the SEE economies.

Figure 1.3. **FDI inflows as a percentage of GDP (2000-16)**

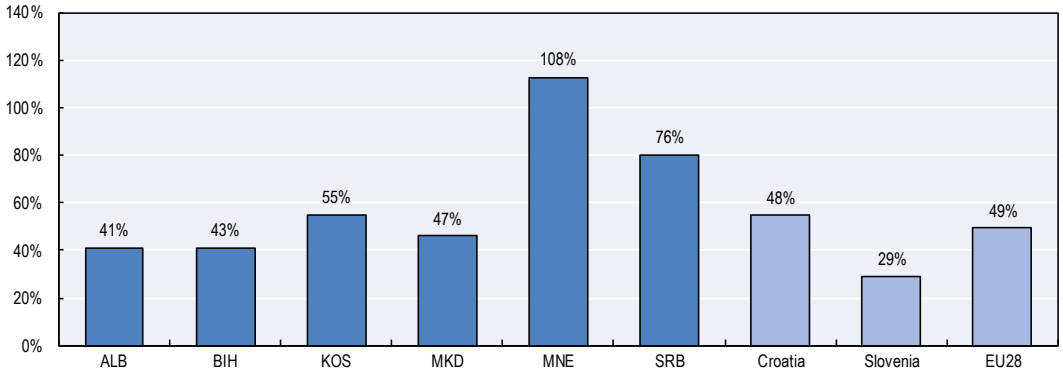


Note: Data for Kosovo are available from 2007 to 2015; data for Montenegro and Serbia are available from 2008.

Sources: UNCTAD (2017), *World Investment Report 2017: Investment and the Digital Economy*, http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782; for Kosovo: World Bank (2017b), *World Development Indicators 2017*, https://openknowledge.worldbank.org/handle/10986/26447.

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Figure 1.4. **FDI stock as a percentage of GDP (2016)**



Note: Data for Kosovo are from 2015.

Source: UNCTAD (2017), *World Investment Report 2017: Investment and the Digital Economy*, http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782; IMF (2017), *IMF Data* (database), www.imf.org/en/Data.

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For the past two decades, foreign investment in the SEE economies has primarily come from Western Europe (Austria, Germany, Italy, the Netherlands and Switzerland) and the Russian Federation (Table 1.1). Investment in the region also comes from neighbouring countries such as Croatia, Greece, Slovenia and Turkey as well as North America.

Table 1.1. **Top five investing countries**

Share of FDI stock (2015)

ALB		BIH		KOS		MKD		MNE		SRB	
Greece	30%	Austria	20%	Turkey	11%	Netherlands	22%	Russian Fed.	13%	Netherlands	21%
Netherlands	17%	Serbia	17%	Germany	9%	Austria	12%	Italy	12%	Austria	14%
Turkey	9%	Croatia	17%	Switzerland	7%	Greece	11%	Cyprus[1,2]	11%	Cyprus	10%
Austria	8%	Russian Fed.	8%	Slovenia	7%	Slovenia	9%	Serbia	5%	Russian Fed.	6%
Italy	5%	Slovenia	7%	Austria	6%	Hungary	5%	Netherlands	4%	Germany	5%

Notes: 1. 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.

Source: IMF (2017), *IMF Data* (database), www.imf.org/en/data.

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Although the sectoral distribution of FDI varies across the six economies, financial services and telecommunication account for large shares of foreign investment, notably as a result of privatisation. Financial intermediation accounts for 17-28% of the FDI stock across economies, while transport and communications account for 2-28%.[4] Manufacturing is the leading sector for FDI in the Former Yugoslav Republic of Macedonia (36% of FDI stock), Serbia (32%), Bosnia and Herzegovina (28%) and, to a lesser extent, in Kosovo (12%). This is because EU investors have located export-oriented activities in these economies to serve their home markets while benefitting from lower production costs. Evidence from the Former Yugoslav Republic of Macedonia and Serbia suggests that special economic zones (SEZs) in these two economies significantly contributed to the recovery of manufacturing FDI in the post-crisis period (OECD, 2017a). Construction is also an important sector in Kosovo (11% of FDI stock), Serbia (7%) and the Former Yugoslav Republic of Macedonia (5%).

Serbia has been able to attract a considerable amount of foreign investment. The manufacturing sector is diversified, with projects in the automotive industry (e.g. Fiat, Michelin), in the electronics industry (e.g. Siemens, Gorenje), in information and communications technology (ICT, e.g. Microsoft, IBM) and in the food (e.g.Nestlé) and textile (e.g. Benetton) industries. In the Former Yugoslav Republic of Macedonia, metal product manufacturing represented 8% of FDI stock in 2015. Steel companies Duferco and ArcelorMittal both operate there as well. Multinational enterprises from Germany, Italy, the United Kingdom and the United States have established automotive component manufacturing activities in the Technological Industrial Zone of Skopje (OECD, 2017a; UNCTAD, 2012). Once an important industrial centre in Yugoslavia, Bosnia and Herzegovina was able to revive its metal industry and successfully attract projects in the auto-part manufacturing and agro-processing sectors (UNCTAD, 2015).

In Albania, natural resource-based activities are among the top three sectors for FDI (26% of the FDI stock), along with financial intermediation (27%) and transport, storage and communication (28%). Greek companies accounted for almost one-third of its 2015 FDI stock. Albania is also an important investment destination for Turkish and Italian small and medium-sized enterprises (SMEs) in the energy and the tourism sectors

(Mejdini, 2016). Montenegro has attracted large investments from the Russian Federation over the past decade (13% of FDI stock).[5] Its main FDI sectors are commodities (aluminium), real estate and tourism. Kosovo has been attracting investments primarily in real estate, renting and business activities (34% of FDI stock); financial intermediation (17%); and manufacturing (12%). Investments from Turkey account for the largest share of FDI stock (11%), with over 500 Turkish companies carrying out business activities, particularly in the construction sector.

More recently, investors from the People's Republic of China (hereafter "China") and the Middle East have also been taking an interest in the region. Chinese companies have invested in large energy, infrastructure and manufacturing projects in Albania, Bosnia and Herzegovina and Serbia. For example, in 2016 an agreement was signed with a Chinese consortium to construct a lignite power plant in the Bosnian town of Tuzla, a project of over USD 740 million. The same year, China Everbright Limited – an international investment and asset management company based in Hong Kong, China – acquired all the shares in International Tirana Airport. Middle Eastern countries, on the other hand, are looking to realise property investment in SEE. In 2016, the publicly owned Investment Corporation of Dubai acquired the Porto Montenegro luxury resort for about USD 200 million. In Bosnia and Herzegovina, investors from the Gulf are investing in the property market, building malls, holiday resorts and residential buildings (The Economist, 2016). One of the largest projects is the USD 2.6 billion investment by Dubai-based Buroj Property Development to build an entire touristic city in the Bjelašnica Mountains.

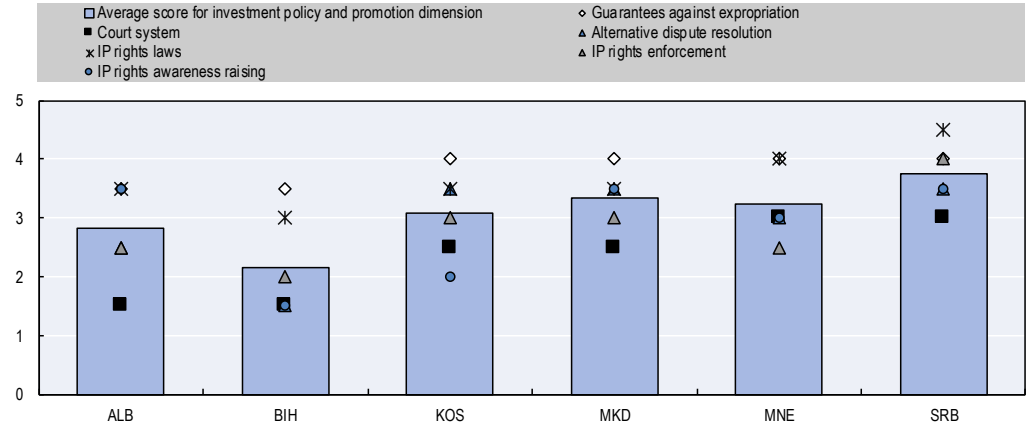
Investment policy

The legal framework for investment is the cornerstone of an enabling investment environment. Investment policy refers to the laws, regulations and policies relating to the admission of investors; the rules once established; and the protection of their property. But it also refers to the goals and expectations for investment's contribution to sustainable development. The non-discrimination principle (explained below), the degree of openness to foreign investment, the protection of investors' property rights, and mechanisms for settling investment disputes are some of the critical elements underpinning a good investment policy. These elements are covered here in three sections: 1) market access and exceptions to national treatment (assessed through the measurement of statutory restrictions to FDI); 2) investor protection (assessed through the guarantees against expropriation, court system and alternative dispute resolution indicators); and 3) intellectual property rights (assessed through the intellectual property right enforcement and awareness raising indicators). The first element was assessed using the OECD *FDI Regulatory Restrictiveness Index* (OECD, 2017b), while the latter two were assessed using qualitative indicators. Figure 1.5 summarises the scores for these qualitative indicators for the six SEE economies.

Markets are open and exceptions to national treatment are limited

An open and non-discriminatory investment environment is a central tenet of an attractive investment climate. It helps to ensure that all investors are treated alike in like circumstances, irrespective of their ownership. One of the concepts derived from the principle of non-discrimination in the context of foreign investment is that of national treatment, which requires that governments treat foreign-owned or foreign-controlled enterprises no less favourably than domestic enterprises in like situations (OECD, 2015a).

Figure 1.5. **Investment policy: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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No economy, including SEE and OECD economies, accords market access or national treatment to foreign-owned enterprises in their territories across the board. Despite the potential benefits of FDI being generally accepted across the SEE governments, and FDI attraction having become an important policy tool to finance development in many economies, concerns over the loss of national sovereignty and the protection of national interests continue to lead governments to discriminate or impose statutory restrictions on foreign direct investments. While there have been great FDI liberalisation efforts in manufacturing industries, where governments have more readily accepted the benefits of FDI, some services and primary sectors still remain partly off limits to foreign investors, although this varies greatly across economies.

This section uses the OECD *FDI Regulatory Restrictiveness Index* to assess and benchmark market access and exceptions to national treatment. This index gauges the level of restrictiveness of an economy's statutory measures on FDI by looking at four main types of restrictions: 1) foreign equity limitations; 2) discriminatory screening and approval mechanisms for foreign investment; 3) restrictions on the employment of key foreign personnel; and 4) other operational restrictions (e.g. restrictions on branching and capital repatriation or land ownership) (see Box 1.1). The index is not a full measure of the investment climate – a range of other factors come into play, including how FDI rules are implemented. Nonetheless, FDI rules are a critical determinant of an economy's attractiveness to foreign investors, and benchmarking such policies helps governments to see how they compare with their peers in terms of the restrictiveness of their FDI regimes.

Overall, openness to FDI varies greatly across economies and regions (Figure 1.6). Larger economies and those in the Asia-Pacific region tend to be more restrictive on average. The assessed SEE economies, in contrast, are collectively and individually among the most open to FDI as measured by the OECD *FDI Regulatory Restrictiveness Index*. All six SEE economies covered – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia – maintain only a handful of restrictions, making their FDI regimes less restrictive than that of the average OECD economy. They also compare favourably against the average of the 22 EU Member States covered by the index. As such, the rules concerning foreign investors on their own are unlikely to constitute a major impediment to attracting investments in most of the SEE economies.

Box 1.1. 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 one to compare FDI policies and identify potential areas for reform. 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 countries 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 main services (transports, 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).

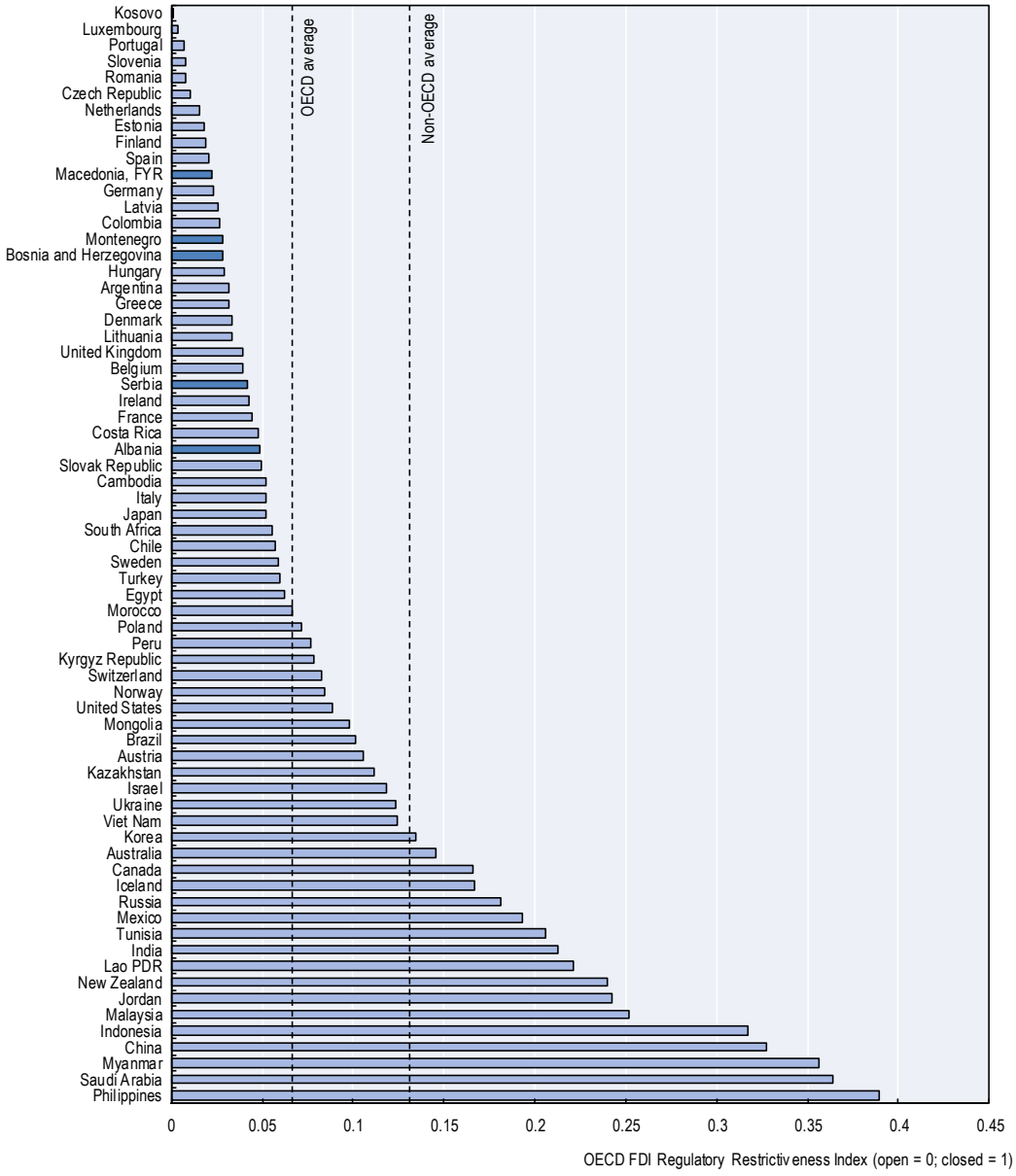
Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is the average of the 22 individual sectoral scores. The discriminatory nature of measures, i.e. when they only apply to foreign investors, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. For OECD and non-OECD country 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 et al. (2010), *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 distribution of restrictions by sector is largely consistent across the SEE economies (Figure 1.7), and generally in line with OECD practices. No sector stands out as unusually restrictive. Foreign equity restrictions, which are typically the most common form of restriction across all economies covered by the index, are little used by SEE economies. When they exist, they are mostly concentrated in a few service sectors, notably transport (e.g. in Albania, Montenegro and Serbia) and media (e.g. in Bosnia and Herzegovina, Montenegro and Serbia).[6] Albania also restricts foreign ownership in fisheries.

These are all sectors which commonly face FDI restrictions in OECD and non-OECD economies. In some of the SEE economies, such as in Montenegro and Serbia, there are also ownership restrictions on foreign investment in legal services, as there are elsewhere.

Figure 1.6. **OECD *FDI Regulatory Restrictiveness Index* (2016)**



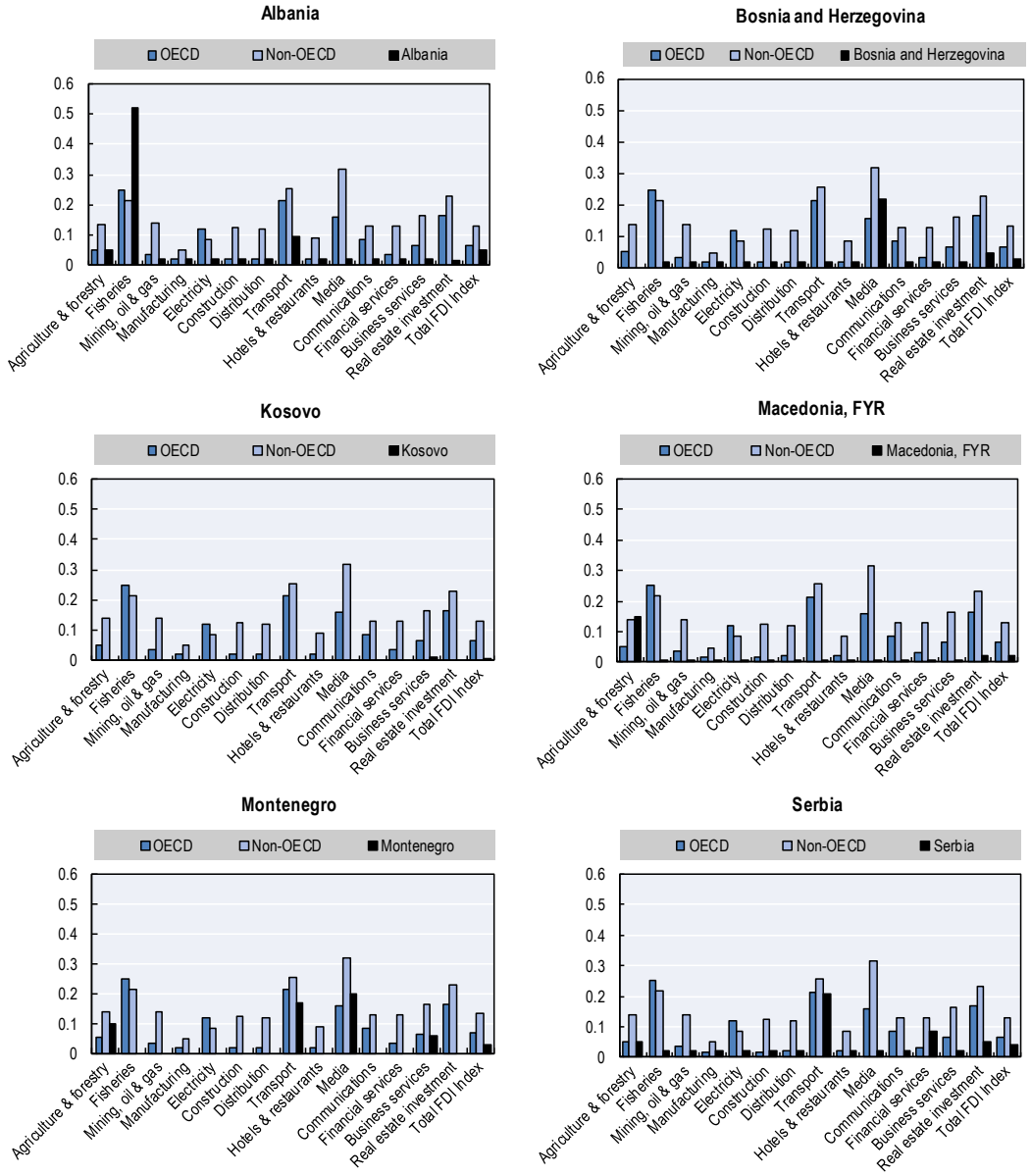
Note: The OECD *FDI Regulatory Restrictiveness Index* only covers statutory measures discriminating against foreign investors (e.g. foreign equity limits, screening and approval procedures, restriction on key foreign personnel, and other operational measures). Other important aspects of an investment 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 as of December each year.

Source: OECD (2017b), *FDI Regulatory Restrictiveness Index* (database), www.oecd.org/investment/fdiindex.htm.

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Figure 1.7. **OECD *FDI Regulatory Restrictiveness Index*: SEE economies versus OECD and non-OECD, sectoral distribution (2016)**

(open = 0; closed =1)



Note: The OECD *FDI Regulatory Restrictiveness Index* covers only 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 as of December each year.

Source: OECD (2017b), *FDI Regulatory Restrictiveness Index* (database), www.oecd.org/investment/fdiindex.htm.

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As services are an increasingly vital input to other sectors, limited productivity in service sectors may lead to barriers to competition that may in turn indirectly constrain productivity growth in downstream sectors. Such concerns may be somewhat limited for some SEE economies. In some cases, their domestic legal framework has been reformed to accord equal treatment to foreign investors from Member States of the European Union or, to a lesser extent, from the United States.[7] This is most often observed in the transport, legal services and real estate sectors. Foreign lawyers in Kosovo, for example, are subject to a reciprocity condition to be able to establish a law firm, unless they are from EU Member States or the United States. In some other cases, preferential market access and treatment of investors may also exist in accordance with commitments under bilateral agreements, albeit not transposed into the domestic legal framework.

In all the SEE economies, FDI in manufacturing sectors is allowed without restrictions, except in security-related sectors (e.g. arms, ammunition) in some cases. Sometimes a horizontal measure applies across the board, such as restrictions on the acquisition of land for business purposes by foreign investors. No economy in the region makes use of discriminatory screening and approval mechanisms for regulating the entry and operations of foreign investors.

Another relatively restrictive sector in the assessed SEE economies and elsewhere is real estate. In the case of the SEE economies, however, existing discriminatory restrictions are mostly limited to real estate ownership by legal entities established abroad, which is either prohibited or subject to reciprocity (e.g. in Bosnia and Herzegovina, Serbia and the Former Yugoslav Republic of Macedonia, except for EU and OECD investors in the latter case) or other operational requirements (e.g. in Albania for commercial property). In most cases, such restrictions can be circumvented by establishing a legal entity in the territory. In other regions, in contrast, restrictions often impinge on locally established foreign-owned investors too. In Montenegro and Kosovo, there are no restrictions on foreign ownership of real estate assets.

A similar regime applies to foreign investors in the agriculture sector in Albania and Serbia, which prohibits foreigners from owning agricultural land, unless they incorporate their businesses locally. More restrictive regimes apply in Montenegro and the Former Yugoslav Republic of Macedonia. In the former, established foreign-owned enterprises are also not allowed to own agricultural land, but long-term leases are available. In the Former Yugoslav Republic of Macedonia, foreign investors are not allowed to own agricultural land and the leasing of agricultural land by foreigners and foreign-owned established enterprises is subject to reciprocity or approval from the Ministry of Justice, in consultation with other ministries. In this case too, long-term leases are possible. In the case of state-owned agricultural land, however, foreign-owned established entities also have the right to apply for their allocation under long-term leases under the same conditions as domestic investors. In Bosnia and Herzegovina, ownership of agricultural land is not permitted for either domestic or foreign investors, while in Kosovo, there is no particular impediment to foreign ownership of agricultural land.

As with real estate investments, foreign ownership of land for business operations is often subject to reciprocity considerations or even minimum capital requirements, as in Albania, for example. These restrictions can likewise be circumvented by establishing a local legal entity. Kosovo and Montenegro impose no restrictions on foreign ownership of land for business purposes.

Improving the legibility of the legal framework for foreign investors would be a welcome step towards improving the overall investment climate. None of the six economies, for instance, has established a foreign investment negative list clearly delimiting the sectors where foreign investment is prohibited or conditioned and outlining which discriminatory conditions apply. Foreign investors still need to review myriad sectoral laws and regulations to understand the market access and treatment conditions applicable specifically to them; often there is no English translation at all – and sometimes official online sources do not even offer the regulations in the original language. While any possible lack of clarity is supposedly less of a concern for investors more familiar with the practices in the region, they make the regime relatively more opaque for potential new investors.

Investor protection is improving

Investor protection is offered across 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, 2015a). 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.

Guarantees against expropriation without fair compensation are among the most crucial investors' rights. Protection should be guaranteed in the regulatory framework through provisions establishing transparent and predictable procedures for expropriation decisions as well as for determining financial compensation. The six SEE economies have all introduced core protection standards in their regulatory framework for investment, with guarantees ensuring that investors' rights will be respected and that their property will be protected against unlawful expropriation (Figure 1.5). While some economies have included such provisions in their expropriation law, others have covered property protection in their investment law or elsewhere. All of them explicitly stipulate that expropriations can only occur for public purposes – with clear definitions of their scope – and with prompt, effective and fair compensation. In Kosovo, the foreign investment law covers both direct and indirect expropriation, as well as any equivalent measure.

The Former Yugoslav Republic of Macedonia and Serbia have unified investment laws covering both foreign and domestic investors, which offer all investors the same core protection provisions, regardless of their origin and nationality. While Albania is currently in the process of unifying its investment law, Bosnia and Herzegovina, Kosovo and Montenegro have kept a specific law for foreign investments. A single omnibus investment law is preferable, however, not only to promote the creation of a single, non-discriminatory regime governing both domestic and foreign investment, but also for the purposes of clarity. All six economies have also signed a large network of bilateral investment treaties, which constitute an additional layer of protection for foreign investors. Authorities should ensure that property protection provisions in their national laws are consistent with international standards of protection, so as to avoid creating legal gaps between national and international frameworks.

In practice, this assessment found that the business community does not perceive unlawful expropriation to be a major concern in SEE economies. There have been some disagreements over amounts of compensation in the past, but the only expropriation cases

relate to infrastructure projects, and those involving foreign companies are extremely rare. In most of the economies, risks for companies are mostly related to the unpredictability of the legal framework, inconsistent application of laws and, at times, modification of existing contracts with foreign companies by the authorities. Similar concerns are raised over land or property ownership, especially in Albania, Bosnia and Herzegovina and, to a lesser degree, Serbia, where disputes can arise due to the lack of clarity of titles and cadastres (US Department of State, 2016; UNCTAD, 2015). While this does not lead to proper expropriation risks, it weakens the overall environment for property protection and sends a less reassuring signal to prospective investors.

The court system has a fundamental role in enforcing contracts and in settling disputes. In contrast to the sound legal frameworks for property protection, the efficiency and reliability of the justice system constitute a greater challenge for investors, whether in terms of the length and inefficiency of procedures, judges' lack of capacity or political interference in court decisions.

In most of the six SEE economies, court systems often lack sufficient resources and adequately trained judges who can handle specialised commercial cases (Figure 1.5). Procedures for enforcing contracts are often overly bureaucratic and cumbersome, and contract disputes are often not resolved quickly or cost-effectively enough. As a consequence, all six SEE economies have significant backlogs of cases, which are likely to restrict companies from investing or expanding their activities in the region. The private sector and independent sources also regularly report a lack of judicial independence, corruption, political pressure and nepotism in the justice system, particularly in Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia (US Department of State, 2016).

Recent justice reforms have greatly improved judges' capacities and independence in Montenegro and Serbia, although the administration of justice remains rather slow (EC, 2016e, 2016f). The creation of specialised commercial courts in these two economies has allowed for the more efficient management of business disputes, although this does not necessarily lead to the timely enforcement of contracts and dispute settlements. All of the other economies, except Kosovo, have specialised divisions or units in their administrative or civil courts dealing with commercial cases. Kosovo used to have a specialised division for cases involving foreign investors but it was closed at the end of 2014 as part of broader justice reforms. The authorities are currently considering reopening it.

Loopholes in the implementation of rule of law principles in Albania remain a concern for the business community. A pending comprehensive justice reform, supported by the international community, is high on the government's reform agenda and is expected to improve the efficiency and autonomy of the judiciary. Smaller-scale reforms to make the court system more efficient and responsive to the needs of the business community are also being implemented in Bosnia and Herzegovina (e.g. digitalising some procedures in the broader context of e-government initiatives), the Former Yugoslav Republic of Macedonia (e.g. training judges, streamlining procedures) and Kosovo (which has plans to reopen a specialised division for cases involving foreign investors).

All six SEE economies should duly implement further reforms to achieve more predictable, fair and transparent contract enforcement, which is a key building block of a sound investment policy framework. This should ensure proper implementation of the rule of law and enhance predictability in commercial relationships by assuring investors that their contractual rights will be upheld promptly by local courts.

Alternative dispute resolution mechanisms are often favoured by the business community to bypass the common difficulties of bringing dispute cases before domestic courts, such as delays in resolving cases, and judges' lack of technical knowledge on commercial matters, as discussed above. In most OECD countries, arbitration plays a primary role as an alternative dispute resolution mechanism, either to settle disputes between foreign investors and host states (i.e. international investment arbitration) or to resolve disputes between two or more businesses (i.e. private commercial arbitration).

The use and recognition of arbitration as an alternative dispute resolution mechanism to settle business disputes varies greatly across the six SEE economies (Figure 1.5). Commercial arbitration is relatively well institutionalised and commonly used in the Former Yugoslav Republic of Macedonia, Kosovo and Serbia, which have all adopted an arbitration law in line with international practice. These three economies have effective private arbitration centres located in their local or foreign chambers of commerce. Montenegro has also recently enacted an arbitration law, although arbitration is still not widely used. Albania, where arbitration is also fairly commonly practised, is in the process of preparing a stand-alone arbitration law. In contrast, arbitration is not yet frequently used in Bosnia and Herzegovina.

Mediation is also increasingly used and practised, especially in chambers of commerce, to settle business disputes. Some of the SEE economies, such as Albania and the Former Yugoslav Republic of Macedonia, are in the process of implementing a grievance mechanism or a business ombudsman to settle disputes, or to avoid emerging conflicts between investors and public authorities escalating into a formal investment dispute.

All six SEE economies have 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. They have all 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).[8] By virtue of their adherence to the New York Convention, foreign arbitral awards are enforced in the six economies, although delays can often be lengthy. There are only a few known cases of investor-state disputes being brought before international arbitration and they mainly involve large investors.

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

Effective intellectual property (IP) registration systems and their efficient implementation are crucial components of a sound investment climate. FDI can be an important conduit for technology transfer among economies, and the strength of the IP regime can influence the willingness of foreign technology holders to invest. The protection granted to IP needs to strike a balance between the need to foster innovation and competitive markets on the one hand, and society's interests in having new affordably priced products on the other (OECD, 2015a).

All six SEE economies generally have sound **intellectual property rights laws and regulations** (Figure 1.5), which are in line with international practice. With the exception of Kosovo, they are all members of the World Intellectual Property Organization 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 five to ten years. Furthermore, almost all of them have recently amended some, or all, of their IP laws and regulations to further align them with EU standards and requirements and to better protect IP rights-holders: Kosovo in 2015, the Former Yugoslav Republic of Macedonia in 2015 and 2016, Serbia in 2015 and 2016, Montenegro in 2016, and Albania in 2016 and 2017. Bosnia and Herzegovina's IP laws are somewhat older; the latest amendments were made in 2010. According to the European Commission (2016), Serbia's and Montenegro's IP laws are well aligned with the EU *acquis*,[9] while the other four economies still need improvements in some areas.

Although the SEE governments are well aware of the stakes of having a strong IP policy and have developed sound IP regimes, proper **intellectual property rights enforcement** remains a much greater challenge (Figure 1.5). IP-enforcement institutions generally lack human and financial resources, and trademark counterfeiting and design infringement problems persist in all six SEE economies. Many of them have recently amended their IP laws or issued new ones (see above). The challenge for officials lies in their capacity to adjust to the new legal requirements to properly implement these laws. Successful legal reforms require a strong corresponding emphasis on enforcement mechanisms if policies and laws are to have a tangible and positive impact.

Serbia has established enforcing institutions with specialised units that deal with IP issues in different parts of the administration (e.g. police, customs, market inspectorate, tax administration, medicines and medical devices inspectorate). It has also established a permanent co-ordinating body to help improve enforcement records. It has brought IP cases under specialised courts since 2015. The Former Yugoslav Republic of Macedonia has also recently set up a co-ordinating body for IP rights enforcement, but it still lacks the resources to fulfil its duties effectively. Although IP cases are not handled by specialised courts, investors seeking protection for their brands are generally satisfied with the responses they get from the relevant institutions (US Department of State, 2016).

IP policy is still at an early stage in Kosovo. Customs enforcement of IP rights is particularly challenging, as most counterfeit goods are imported rather than produced locally. Market inspectorates are in charge of enforcing IP rights but they are not sufficiently well equipped and the State Intellectual Property Council lacks an active co-ordinating role (EC, 2016c). Montenegro has had an Intellectual Property Office in place for almost a decade, but it is understaffed, has not fully fulfilled its co-ordinating role and has a low enforcement record. IP protection cases are nevertheless handled in specialised commercial courts.

In Albania, numerous institutions are involved in enforcing IP protection, but with little co-ordination and a poor enforcement record. The General Directorate of Patents and Trademarks is responsible for patents and trademarks, while Market Surveillance Inspectorates have recently been established to deal with copyright requirements. However, as of mid-2017 they were still at the recruitment and training phase and not yet functioning. Bosnia and Herzegovina has not yet designed a national strategy to enforce IP rights or an inter-ministerial body to co-ordinate IP rights enforcement (EC, 2016b). The institutions in charge lack the staff, capacity and resources to be fully efficient.

Intellectual property rights awareness raising and access to information play an important role in a broader IP policy. However, with a few exceptions, there is generally little awareness of IP rights and obligations, either among the general public or the six economies' judiciaries.

In Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, strengthening public awareness is a core component of national IP strategies (Figure 1.5). The relevant institutions have been relatively active in awareness-raising activities, but the budget for awareness raising often remains too low to give satisfactory results and provide the expected impact. Measures have also been implemented to improve access to IP-related information, such as the IP rights helpdesk in Albania, which helps businesses get up to date with relevant legislation, and the establishment in 2015 of an information system for a patent register in Montenegro.

In Kosovo and Bosnia and Herzegovina, IP institutions regularly organise ad hoc awareness-raising workshops on IP rights and protection matters, but they lack the resources and capacities to do so on a systematic or far-reaching basis. The level of IP awareness remains low in these two economies.

The way forward for investment policy

The relatively open environment for foreign investors in the assessed SEE economies and the clear pro-investment stance taken by governments are very positive aspects of the investment climate. The remaining restrictions on FDI are not unusual and should not constitute a major impediment to foreign investment. **Any restrictions in services sectors should be systematically assessed** for their potential implications for economy-wide productivity.

All six SEE economies have sound legal frameworks for investment overall, including for property protection. **Improving the clarity and predictability of their respective legal frameworks for investment**, especially for foreign investors, would greatly help further improve the overall investment climate. No economy 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, for instance. The lack of readily accessible information on these matters in English and online hinders the legibility of the legal framework for foreign investors. Having clear and easy access to all laws and regulations that govern investment could have a very positive impact on promoting an economy as a safe and attractive investment destination.

All six SEE economies should **strengthen their efforts to make their court systems more efficient, more competent and fully independent from the executive**. This would greatly improve the investment and business climate and reduce their reputational risks as investment destinations. Implementation of laws is at times inconsistent or involves lengthy procedures. Having prompt procedures and consistent interpretation of the law is especially crucial when it comes to enforcing commercial contracts. Albania should move ahead with its comprehensive justice reform and Bosnia and Herzegovina should dedicate more effort to improving the rule of law and easing the process of enforcing contracts. Kosovo could consider re-implementing, within its court system, a specialised division for commercial cases, open to both foreign and domestic investors. Where specialised commercial courts are not in place, judges need adequate training to sensitise them to the specificities of commercial cases.

More systematic and prompt enforcement of foreign arbitral awards by domestic courts is needed. Bosnia and Herzegovina and Montenegro need to put more effort into promoting arbitration as a recognised alternative dispute resolution mechanism. Bosnia and Herzegovina could also consider introducing an arbitration law aligned with international standards. Those economies that are setting up a business ombudsman (or grievance mechanism), or considering doing so, could learn from Korea's success (Box 1.2).

Sound legislation for IP protection is in place, but **further emphasis is needed on enforcing IP rights and raising IP awareness**. Enforcing institutions should be adequately staffed and trained in all six economies. Co-ordinating bodies should be established in Albania, Bosnia and Herzegovina and Kosovo, while those in the Former Yugoslav Republic of Macedonia and Montenegro should be given more resources. More resources should also be allocated to IP awareness-raising activities and access to information in all six economies.

Box 1.2. **Good practice: The Office of the Foreign Investment Ombudsman in Korea**

The Office of the Foreign Investment Ombudsman (OFIO) was created within the Korea Trade-Investment Promotion Agency in 1999 during rapid liberalisation of the foreign investment regime. OFIO focuses on post-investment services for foreign investors and provides on-site consultation in areas covering finance, taxation, accounting, intellectual property rights, construction and labour. Through its Home Doctor System, OFIO resolves grievances reported by foreign investors, not only directly by sending experts who are licensed and experienced to business sites, but also by taking pre-emptive measures to prevent future grievances by encouraging systemic improvements and legal amendments.

In cases where systemic changes are required, OFIO reports to the government's highest foreign investment authority, the Committee on Foreign Direct Investment. OFIO also uses other channels such as the Regulatory Reform Committee and the Presidential Committee on National Competitiveness to push for government interventions or changes in the enforcement decrees of relevant laws. Over 4 700 cases have been reported to OFIO during the past decade and many of them have prompted systemic changes and government interventions. As the system has matured, the resolution ratio – which was around 25% in the beginning – improved to reach over 90% in 2007.

Source: InvestKorea (n.d.), InvestKorea, www.investkorea.org/en/index.do.

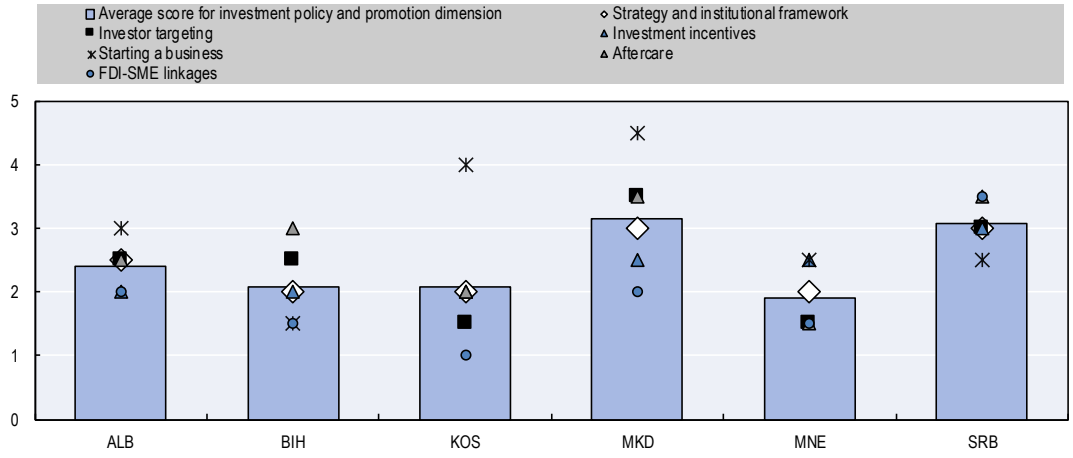
Investment promotion and facilitation

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 (OECD, 2015a). Effective investment promotion and facilitation requires a careful calculation of how to employ resources most effectively to attract FDI, make it easy for investors to establish or reinvest, and ensure that these investments create linkages with domestic companies and contribute to local economic development.

The investment promotion and facilitation sub-dimension is assessed through six qualitative indicators (Figure 1.8). They are analysed below in four sub-sections, which look at: 1) strategies and institutional frameworks; 2) investment promotion services and activities (assessed through the investor targeting and investment incentives indicators); 3) investment facilitation services and activities (assessed through the starting a business and aftercare indicators); and 4) FDI-SME linkages.

As the scores indicate, the quality of the institutional framework for investment promotion and facilitation varies across the region. Strategies to promote and attract FDI are well established, but there is scope to enhance their implementation further, as well as to increasingly integrate business linkages into these strategies and into the respective investment promotion and facilitation activities.

Figure 1.8. **Investment promotion and facilitation: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933702915

Investment promotion strategies and institutional frameworks are in place

When establishing a formal structure to conduct investment promotion activities, most jurisdictions choose to establish an investment promotion agency (IPA) – although many functions can also be carried out by existing public structures. One size does not fit all and different forms of IPAs and institutional settings for investment promotion can match different government objectives. To be efficient and fulfil their missions, IPAs should have a clear mandate and be adequately staffed and funded (OECD, 2015a). As highlighted in the investment policy section, private investment should be recognised as a key component of governments' overall strategy for economic development.

All six SEE economies have created a national IPA with a mandate to promote and facilitate inward FDI. However, the IPAs vary in their objectives in terms of attracting investment, and the adequacy of their resources to achieve these objectives. Overall, economies could do more to strengthen their IPAs' capabilities, increase resources and improve co-ordination with other relevant authorities.

The IPAs in the six economies differ in their mandates as well as in their levels of human and financial resources (Table 1.2). The Albanian Investment Development Agency (AIDA), the Kosovo Investment and Enterprise Support Agency (KIESA) and the Development Agency of Serbia (RAS)[10] have the widest scope of activities, as their mandates encompass export promotion and SME development, in addition to investment promotion. The Former Yugoslav Republic of Macedonia's IPA (Invest in Macedonia) undertakes both investment and export promotion, while the Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA) and Montenegrin Investment Promotion Agency (MIPA) focus solely on investment promotion. Staffing levels do not necessarily reflect these differences, however. For example, KIESA has only 18 employees, which makes it challenging for the agency to fulfil all its functions thoroughly. Apart from FIPA and Invest in Macedonia, all of the agencies are somewhat understaffed given their objectives and expectations. Budget constraints are a common challenge for IPAs in many other regions as well.

Table 1.2. **Investment promotion agencies: Number of employees and mandates**

	Number of employees	Investment promotion	Export promotion	SME development	Regional development
ALB (AIDA)	28	✓	✓	✓	
BIH (FIPA)	32	✓			
KOS (KIESA)	18	✓	✓	✓	
MKD (Invest in Macedonia)	82	✓	✓		
MNE (MIPA)	5	✓			
SRB (RAS)	70	✓	✓	✓	✓

Source: OECD compilation based on national sources.

StatLink http://dx.doi.org/10.1787/888933702953

Most of the IPAs have annual strategic plans and objectives that are aligned with national investment strategies, as well as an obligation to report annually to their governing authority on their activities and spending. Some of the IPAs have achieved a more sophisticated level of planning – with detailed target objective definition – and monitoring (i.e. seeking feedback on their performance). The Former Yugoslav Republic of Macedonia and Serbia have clear target sectors in their strategic plans, which enable them to focus their resources accordingly. AIDA conducts annual surveys as part of its monitoring process. On the other hand, KIESA does not have a formal strategy in place and does not conduct systematic reporting activities. Overall, all the agencies would benefit from assessing their performance more systematically against clearly defined strategic goals and using internal and external evaluation processes (such as internal reporting on objective-related performance indicators and investor satisfaction surveys).

Cases of successful investment attraction often highlight the importance of a whole-of-government approach. Effective co-ordination mechanisms among the various authorities involved in investment promotion are of strategic importance. Co-ordination should be effective both horizontally, i.e. with different line ministries and other relevant government organisations; and vertically, i.e. with local government authorities and sub-national agencies. The latter is particularly important for investment facilitation.

Most of the economies try to ensure effective horizontal co-ordination. In the Former Yugoslav Republic of Macedonia, investment promotion activities are undertaken jointly by the IPA and the Directorate for Technological Industrial Development Zones (DTIDZ), with clear co-ordination mechanisms and a common client relationship management tool to facilitate the exchange of information. In the other economies, horizontal co-ordination remains comparatively weak. In Kosovo and Montenegro, communication channels could be improved between the IPA and line ministries as well as other key stakeholders (e.g. Economic Chambers in Kosovo and the Secretariat for Development Projects and the National Investment Commission in Montenegro).

As regards vertical co-ordination, all economies would benefit from reinforcing the means and mechanisms to enable smooth communication between their IPA and other relevant public organisations. In Albania, where the IPA also has a role as a one-stop-shop for strategic investments, there is room for improvement on this aspect. In Bosnia and Herzegovina, there is a lack of co-ordination between FIPA and numerous bodies involved in FDI attraction activities (UNCTAD, 2015). In particular, there is no formal co-operation mechanism between FIPA and the Ministry of Economic Relations for Investment Promotion of the Republika Srpska, which also undertakes investment promotion.

At the regional level, the six SEE economies are committed to improving co-ordination to design and implement a joint investment reform agenda. An important objective of the Multi-Annual Action Plan for a Regional Economic Area in the Western Balkan Six is to improve the region's attractiveness to investors. To this end, the economies foresee a common platform for investment promotion.

Investment promotion measures and activities need further strengthening

Effective investment promotion draws on the strong points of an economy's business environment to highlight profitable investment opportunities. As examined below, it also deals with more specific measures to attract FDI that respond to national development objectives, including systematic targeting of potential investors and the granting of well-designed and transparent financial and non-financial incentives.

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. It refers to direct marketing techniques for targeting potential investors from specific industries, activities, companies and markets, in line with national priorities. It is the opposite of reactive promotion, in which IPAs answer investor-initiated inquiries. A clear strategy is needed to guide the IPAs' investor-targeting activities, as there is a risk associated with focusing on specific sectors or "picking winners" if these decisions are based on political agendas, rather than on carefully crafted economic rationales.

Although IPAs in the six SEE economies usually have identified economic sectors and markets for FDI attraction, they tend to spend most of their time and resources on reactive promotion. As examined below, a few of them – notably the Former Yugoslav Republic of Macedonia and Serbia – have put in place more sophisticated mechanisms to target potential investors in a proactive and systematic manner. Some of the SEE economies also tend increasingly to use their network of embassies and representations abroad for investment promotion purposes (e.g. Bosnia and Herzegovina, Serbia).

The Former Yugoslav Republic of Macedonia has a well co-ordinated targeting strategy in place. DTIDZ and, to a lesser degree, Invest in Macedonia, regularly reach out to potential investors in the economy's priority industries. This includes efforts to attract high value-added manufacturing investors into its special economic zones (OECD, 2017a). The two agencies are assigned geographical areas for their targeting activities, but also rely on sectoral knowledge. This system seems to avoid the duplication of activities and is supported by a common client relationship management system. However, the system is also complex (e.g. five ministers without portfolio also have a role in attracting investors) and risks not maintaining an optimal distribution of sector competences.

RAS has designed a new investment promotion strategy for Serbia and has adjusted targeting activities to its new institutional set-up. It has identified sectors for FDI attraction based on Serbia's competitive advantages, giving priority to projects that have a potential beneficial impact on SME development, export promotion and regional development. It has also defined objectives for investor targeting with expected values, and systematically follows up missions abroad.

In Albania, AIDA's staff members have been allocated sectoral competences to conduct investor targeting in priority sectors. However, the number of staff is currently insufficient to make it a systematic activity. In Bosnia and Herzegovina, FIPA also conducts some limited targeting. However, the bulk of its efforts are dedicated to image building, as providing a comprehensive and consistent message to investors is a key

challenge in an economy that is often perceived as fragmented. Overseas missions are thus mostly aimed at country branding and promoting key economic sectors in general. There is nonetheless an established mechanism to follow up FIPA's overseas missions. Investment generation and targeting in both Albania and Bosnia and Herzegovina mostly focus on specific, ready-made projects, usually prepared by other ministries. This is a common approach in the region, despite a gradual shift towards sector-wide promotion. It makes a good selling point for some specific investors, but targeting should not be limited to this practice, as the majority of businesses appreciate more flexibility as to where and how their investments will be channelled.

Kosovo and Montenegro have smaller agencies which conduct general marketing campaigns to promote the image of their economies and their key investment sectors. As in the other five SEE economies, sectors and markets are identified relatively well and included in government strategies, but IPAs have less capacity to conduct comprehensive and systematic investor outreach.

Investment incentives can be defined as measures to influence the size, location or industry of an investment project, by affecting its relative cost or by altering the risks attached to it (OECD, 2004). Tax incentives for investment are widely used in numerous regions, including SEE, to stimulate investment in general and FDI in particular. While the evidence tends to indicate a limited investment response to a lower tax burden relative to the revenue forgone, governments need to build their incentive schemes on a strong overall investment environment and embed them in a coherent and long-term national development strategy to ensure their optimal use (OECD, 2015a). This indicator does not evaluate the suitability of each of the incentive regimes, however; instead it looks at whether they are non-discriminatory, transparent and well co-ordinated.

All six SEE economies provide tax incentives to investors, equally to both foreign and domestic investors in most cases (Figure 1.8). Incentives usually aim to attract investors in specific sectors or to remote areas, or simply stimulate job creation and high value-added projects. Governments should make sure they provide a uniform incentives regime for domestic and foreign investors to ensure a level playing field for all businesses. A simple and predictable tax regime provides greater clarity for investors, leaves less space to discretionary decisions and is easier for the tax administration to manage. This is the case in Serbia, where only one tax break exists, and for which the criteria are simply based on the number of people employed and the amount invested. Additional incentives are provided for specific sectors and in special economic zones (OECD, 2017a).

In other economies, such as the Former Yugoslav Republic of Macedonia and Montenegro, the incentive schemes are more complex and multi-layered (Box 1.3); additional incentives are provided by DTIDZ in the Former Yugoslav Republic of Macedonia and Montenegro (OECD, 2017a) and by municipalities in Montenegro. In the case of Albania and the Former Yugoslav Republic of Macedonia, some incentives are granted following case-by-case negotiations and are consequently not always publicly available – although they are in principle under the scrutiny of parliament. In Kosovo, incentives are usually granted automatically, but the rates can be discretionary at times and adjusted through by-laws. In Bosnia and Herzegovina, eligibility criteria for incentives are well-defined, but the regime is overly complex and distinct incentives are applied in the different sub-national entities, with little national oversight.[11] This not only makes the overall incentive scheme rather confusing for investors, but it may also lead to harmful internal and regional tax competition. In all these economies, the renewal of incentives is often permitted without appropriate scrutiny.

Box 1.3. **Zone incentives in the Former Yugoslav Republic of Macedonia**

The Former Yugoslav Republic of Macedonia offers zone investors a variety of tax and non-tax incentives. These include corporate tax exemptions, exemption from personal income tax for zone employees and exemption from customs duties for equipment and spare parts. All tax incentives are offered uniformly across all zone investors. Furthermore, tax incentives are zone-specific and thus available only to investors who have zone status.

The zones also offer non-tax incentives, including the provision of on- and off-site infrastructure and services. Most non-tax incentives are granted to all investors, but some are only offered on a selective basis depending on factors such as the size of the investment and the number of people employed. Most investors have noted the benefits of being able to design and build facilities according to their exact specifications inside the zones. The provision of immediate good-quality power and utility connections is another important incentive for locating inside the zones.

In addition, the zones offer one-stop-shop services (issuing building and operational permits, customs outposts in the zones, zone infrastructure maintenance and upgrades), aftercare, business opportunity analysis (identifying project-specific location factors, cost analysis, identifying supplier bases and detailed due diligence), and opportunities to connect with domestic enterprises through a supplier database.

Since most of these incentives are zone-specific, they offer considerable advantages to investors inside the zones. It is therefore not surprising that the zones have played an important role in attracting significant manufacturing investment to the economy since their establishment in 2007. Today they account for a large share of all manufacturing FDI inflows, domestic manufacturing activity and exports (40%). However, key questions remain over the cost-effectiveness of the zone policies, how sustainable zone investments will be once the incentives expire, and how spillovers from these investments can be strengthened through backward linkages, education and skills.

Source: OECD (2017a), "Tracking special economic zones in the Western Balkans: Objectives, features and key challenges", www.oecd.org/south-east-europe/SEZ_WB_2017.pdf.

To increase transparency and good governance, tax incentives should be included in the main body of tax law and under the authority of the tax administration. All tax incentives are integrated in the main tax law in Serbia, whereas they are included in by-laws or sectoral laws in the other SEE economies. In the Former Yugoslav Republic of Macedonia, incentives are divided between the Profit Tax Law and the Law on Technological Industrial Development Zones. In Bosnia and Herzegovina, tax incentives for investment are included in the separate entities' laws. While the oversight of investment incentives is the responsibility of the tax administration in all six economies, co-ordination issues may occur when IPAs, zones authorities or municipalities have the authority to grant or negotiate separate incentives.

Investment incentives can mean forgoing significant revenue and depriving governments of sufficient resources to devote to areas reinforcing overall competitiveness and making growth more inclusive and sustainable, such as education, health and infrastructure. It is thus important for authorities to conduct a thorough analysis of the effectiveness and cost-efficiency of tax incentives (and the way they are designed) to distinguish between beneficial and wasteful tax incentive programmes. The Bosnian and Serbian authorities are the only ones to report undertaking proper cost-benefit analyses, but neither has made them publicly available. While statements on tax expenditures are publicly released on a regular basis in the region, none highlights the beneficiaries of tax incentives.

Effective co-ordination among tax policy makers and IPAs, as well as local authorities, is crucial for assessing the costs and benefits of incentives and to identify options for their smarter use and better design. Governments should also conduct such evaluations systematically *ex post* to assess the extent to which, and at what cost, tax incentives meet their intended objectives. This is currently not the case in these SEE economies. Going forward, it is also important to address the harmful race to the bottom tax competition that is taking place in the region via the use of tax incentives.

Progress has been made with regard to investment facilitation services and activities

Investment facilitation includes all the support that authorities can provide to reduce potential obstacles once an investor has decided to invest. It begins as soon as an investor shows interest in a location. Aftercare measures are also part of facilitating investment, as they can influence a company's decision to maintain or expand its activities. Aftercare is grounded in a solid public-private dialogue that may eventually lead to policy reforms.

Most of the six SEE economies have undertaken reforms over the past few years to facilitate investment by reducing the cost of **starting a business** (Figure 1.8). This is illustrated by the progression by five of the economies up the rankings of the annual World Bank *Doing Business* survey (World Bank, 2017a). To achieve this improvement, governments focused on simplifying regulations and streamlining processes at back-office level, establishing agencies as one-stop-shops or single windows for business registration (and even beyond in some cases), using IPAs to make it easier to navigate through the different requirements and procedures, and offering online registration services.

The economies have worked to streamline their regulations and reduce the number of steps and fees associated with registering businesses. For example, Serbia has simplified its procedures to deal with construction permits, starting a business, registering property and paying taxes. Kosovo has reduced the number of steps in its business registration procedure and removed the minimum capital requirement and all administrative fees. Montenegro is currently working to streamline its specific procedures contained in its sectoral regulations. In Bosnia and Herzegovina, regulations remain fairly complex, as they differ among the main sub-state entities. Moreover, within the Federation of Bosnia and Herzegovina, regulations and procedures vary from canton to canton. According to the *Doing Business* survey, the Former Yugoslav Republic of Macedonia's process to establish a business entity is the most straightforward in the region and the economy ranks fourth out of 190. This is the result of years of reforms, and work is continuing to reduce the administrative burden on businesses still further.

Establishing a one-stop-shop (OSS) or single window is a good practice to facilitate investment. This provides a single entry point to obtain information and undertake administrative procedures, and can significantly cut down investors' transaction costs. However, to be truly effective and avoid creating "one-more-shop", back-office procedures need to be streamlined. All of the economies have established agencies to offer an OSS, either at national or sub-national level: the National Business Centre in Albania, the Kosovo Business Registration Agency, the Central Register in the Former Yugoslav Republic of Macedonia, the Central Register of Business Entities in Montenegro and the Serbian Business Registers Agency. In Bosnia and Herzegovina, there is no such agency at the state level, but a single business registration agency started operations in the Republika Srpska in 2014.

All these agencies are separate entities, which means that the OSS is not located within IPAs. Few of the SEE IPAs act as a one-stop-shop, except in Albania, where AIDA hosts a dedicated OSS for strategic investment projects that benefit from a fast-track business set-up process. In Serbia, RAS acts as the co-ordinator of all administrative processes, interfacing with local authorities for projects of national significance. In other economies, the IPAs' role of facilitating the administrative procedures to start a business is limited to centralising and providing the necessary information to foreign investors, and redirecting them to the relevant authorities.

Most of the agencies which act as OSSs gather together all the procedures involved in registering a business. However, they can also go beyond business registration and group a wider range of services under the same roof. In Albania, the National Business Centre's services include – in addition to business registration – tax registration, social insurance, health insurance and employee registration, all through a single application procedure. In Montenegro, companies can apply for licences and permits at the same time as they register. The Former Yugoslav Republic of Macedonia is currently creating an OSS that will provide services for business registration, licensing and permit delivery. It is expected to be in operation by 2020.

Albania has also launched an online service for registration and electronic notifications of balance sheets and financial reports. To register online, companies need to have an electronic signature and go through an authentication process. The website is not available in English, however, making it less user-friendly for foreign investors. Currently, most companies still choose to register in person. Although they do not offer online registration services, Kosovo, Montenegro and Serbia have put the registration forms online – but in Serbia, forms are only available in Serbian.

Aftercare includes a broad set of measures to keep existing investors satisfied and encourage them to expand their activities or reinvest in new ones. It has increasingly become a key function of IPAs worldwide, as helping investors overcome the challenges they face in their daily operations is at least as important as attracting new investments, and is often also less costly from an IPA perspective. Effective aftercare is primarily about maintaining a regular and constructive dialogue with the private sector – either through formal dialogue platforms or targeted individual field visits – to collect feedback from businesses on recurrent issues affecting their activities and involve them in policy design and reform. Dialogue between the public and the private sectors is usually open and regular in all six SEE economies, but more sophisticated and proactive aftercare measures vary greatly from one economy to another (Figure 1.8).

Governments in the SEE economies have increasingly recognised the value of maintaining an open dialogue with the business community and have all made improvements in this area. All six economies have established effective public-private dialogue platforms (e.g. the Foreign Investors Council or National Economic Council) that attract high-level attention and meet on a regular basis, both to inform the private sector of planned policies and to collect investors' feedback on proposed reforms or existing challenges. In most of the economies, these platforms involve large multinational enterprises (MNEs), but governments could consider extending dialogue mechanisms to all types of businesses, including SMEs.

While most of the economies have a legal obligation to publish draft laws on their websites before they are adopted, e-consultation platforms to collect feedback on legislative proposals have been established in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia. In all six SEE economies, however,

consultations are not conducted systematically and often leave stakeholders with a very limited period of time to provide comments (e.g. only seven days in Serbia). In practice, the public-private dialogue platforms described above are usually preferred for discussing new laws in the region. They do not provide access to all potentially affected stakeholders, however, and should thus be supplemented with effective and systematic online consultation mechanisms with longer deadlines for feedback.

Targeted aftercare activities can also have a potentially large impact on retaining investors or encouraging reinvestment. They can also provide opportunities to strengthen foreign investors' links to local suppliers and encourage them to increase their roles in MNEs' supply chains (see section on FDI-SME linkages below). There is evidence that longstanding foreign investors, who know the local context better, are more inclined to use domestic suppliers instead of sourcing internationally (Farole and Winkler, 2014). Aftercare thus supports the double purpose of anchoring foreign investors more firmly in the local economy and enhancing their positive spillovers.

In the Former Yugoslav Republic of Macedonia, the Directorate for TIDZ is particularly active in providing tailor-made aftercare services to the foreign investors located in its special economic zones, in order to identify potential challenges and explore expansion opportunities (OECD, 2017a). The government has also established the Learning from the Business Community initiative, which includes field visits and discussions with companies, focusing mostly on domestic and smaller businesses. In Serbia, aftercare services include mechanisms to explore reinvestment opportunities, remove obstacles to business expansion and identify local suppliers. Both economies also have online databases of domestic suppliers, but Invest Macedonia and RAS could make more systematic use of surveys to ensure that the challenges faced by companies of all sizes are well understood.

In Bosnia and Herzegovina, the authorities are strengthening aftercare both at state and entity levels. Representatives of FIPA and of the Republika Srpska's Ministry of Economic Relations have established a contact point for investors in each municipality to track reinvestment opportunities and plans and discuss investment climate challenges. FIPA conducts regular company visits throughout Bosnia and Herzegovina; however, while it forms good partnerships with municipalities and cantons, horizontal and vertical co-ordination remains the key challenge for effective responses to investors' concerns. In Albania, aftercare is a relatively new function for AIDA, although it has started conducting surveys with foreign investors and some ad hoc field visits. AIDA is also training staff members in municipalities on business facilitation matters. Aftercare still remains too focused on informing investors about AIDA's services, however, and better co-ordination with relevant ministries and agencies is needed to ensure that obstacles faced by investors are more systematically addressed.

In Kosovo and Montenegro, IPAs have more limited staff and resources to conduct extensive field visits and company interviews. KIESA nevertheless surveys 300 companies in Kosovo every year and submits an aftercare report to the Economic Council for advocacy purposes. In Montenegro, while MIPA offers barely any aftercare, the Secretariat for Development Projects carries out some related tasks. Interactions with the business community are mostly conducted through its Foreign Investors Council. Overall, targeted aftercare activities should focus on the investors who have the greatest propensity to expand their activities and on those with the highest developmental impact (notably in terms of job creation and linkages with the local economy), especially in those economies where the IPA's resources are limited. The focus should be on the same sectors as those chosen for investor targeting.

Identifying recurring problems faced by investors through aftercare should ultimately contribute to policy advocacy by IPAs, which can be a powerful instrument to bolster reforms and enhance the business environment by leveraging the private sector's feedback. In most of the economies, aftercare is used for policy advocacy purposes, but rarely on a systematic basis. Any policy reforms generated by these activities remain ad hoc. The private sector reports that authorities in the region are usually open to receiving comments when designing new laws, but they do not systematically take them on board.

There is scope to enhance FDI-SME linkages

Backward FDI-SME linkages occur when domestic firms become suppliers or sub-contractors to MNEs. They are the channel through which FDI spillovers can be maximised, owing to the productivity gains resulting from the transfer of knowledge and technology from foreign affiliates to domestic companies (Farole and Winkler, 2014; UNCTAD, 2010).[12] Creating such linkages can foster the potential embodied in local SMEs, but also serves the purpose of attracting and retaining investment, as it allows foreign investors to be more firmly anchored in the local economy, to adopt a longer-term investment strategy and to be inclined to reinvest or expand activities.

FDI-SME linkages are determined by a large number of factors, but depend first and foremost on the availability and capacity of domestic companies. An important first step is to create a business environment that is favourable for both domestic and foreign firms, supplemented by sound SME development policies and programmes to maximise their absorptive capacities. Other more proactive measures can also be taken by governments in general and IPAs in particular to encourage linkages and interactions between MNEs and SMEs – and attract FDI with a higher spillover potential.

Linkages between foreign investors and domestic firms are relatively rare in the six SEE economies (Figure 1.8). This is largely explained by the lack of capacity among local suppliers, but is also due to the nature of the FDI which, in many cases, is natural-resource based or export-oriented and geared towards global value chains. Governments do not seem to view creating business linkages as a top priority – except for Serbia, which has made it an objective of its investment promotion strategy. Serbia has a comprehensive national SME development strategy in place, implemented by both RAS and the SME department within the Ministry of Economy. RAS occasionally organises "meet the buyers" fairs to promote business partnerships and arranges more focused matchmaking meetings on request. A database of 3 000 potential suppliers is also available to foreign investors.

RAS is increasingly taking advantage of the merger of its investment promotion and SME development functions, as illustrated by the launch in 2017 of its supplier development programme aiming to support local suppliers in meeting MNE requirements in terms of production processes, quality standards, quality control and managerial practices. This programme is an important step forward, as opportunities to create linkages mainly depend on the availability of an adequate domestic supply-side capacity. The extent to which SMEs are capable of responding to the needs of MNEs determines their ability to serve as domestic suppliers.

In Albania, SME development focuses almost exclusively on formalising small businesses and providing them with financial schemes. AIDA is the main SME support agency, but its linkage activities remain occasional and not yet well co-ordinated. In the Former Yugoslav Republic of Macedonia, there is reportedly a tendency by the government to prioritise foreign investors rather than local firms. Obstacles to SME

development are not well identified and government activities on this matter are too dispersed. Although AIDA and Invest in Macedonia only conduct matchmaking activities occasionally, databases of potential local suppliers are available to MNEs in both economies (e.g. listing 650 suppliers in the Former Yugoslav Republic of Macedonia).

In Bosnia and Herzegovina, many activities are undertaken at the entity and local level to support SMEs, but there is no strategy at the national level, and only limited support for promoting linkages with foreign investors. Similarly, there are few initiatives to encourage FDI-SME linkages in Montenegro and Kosovo, where matchmaking initiatives are mostly driven by the private sector. Montenegro has a distinct agency dedicated to SMEs (NASME) and linkages are mostly encouraged through creating business zones to support SME incubation and cluster development. KIESA has a mandate to support SME development but synergies with its investment promotion activities are limited.

Governments in the six SEE economies could consider better aligning their FDI attraction strategy with national development objectives and existing local absorptive capacities. This is being done in Serbia, where RAS has redesigned its FDI attraction strategy in line with other development objectives, including regional development and linkage creation. In contrast, the Former Yugoslav Republic of Macedonia has decided to target high value-added FDI projects that support a competitive environment, even if they are less likely to generate linkages with domestic firms. AIDA and KIESA could take more advantage of having both functions – investment promotion and SME development – under the same roof to help create FDI-SME linkages. They could align their investment promotion and SME development strategies and objectives to ensure that they are mutually reinforcing.

The way forward for investment promotion and facilitation

There is scope to **ensure that IPAs' capacities and resources are better aligned with their mandates.** All six SEE economies have well-established IPAs, although their mandates, resources and capacity to influence government decisions vary greatly. While the Former Yugoslav Republic of Macedonia and Serbia have a coherent and well co-ordinated strategy to target and attract FDI, Kosovo and Montenegro have fewer resources at their disposal to conduct proactive promotion. IPAs in Albania and Bosnia and Herzegovina have improved greatly – but several key functions, such as investor targeting and aftercare, are still at an early stage of development.

A sectoral approach to investment promotion should be fostered in the future. While KIESA and MIPA should focus their investor targeting activities on a few well-identified economic sectors, AIDA, FIPA, Invest in Macedonia and RAS should increasingly move away from the promotion of ready-made projects towards sector-wide promotion and internalise solid sectoral competences.

Investment incentives are widely used in the region and **all six governments need to make more efforts to ensure that companies operate on an equal footing** and are fully aware of what to expect and under which conditions.

Some minor procedural issues for starting a business remain to be addressed in some economies. Starting a business is generally not complicated, with the notable exception of Bosnia and Herzegovina, where a complex and uncoordinated institutional framework makes it complicated and cumbersome for new investors to establish. A single window for business registration or an online registration system should be established, and measures taken to improve clarity and transparency for prospective investors. Kosovo, the former Yugoslav Republic of Macedonia, Montenegro and Serbia should

also consider establishing online business registration, while Albania should make its system available in English.

More systematic approaches to aftercare services should be introduced in the six SEE economies. Aftercare services in Albania, Bosnia and Herzegovina, Kosovo and Montenegro should be reinforced, notably through more regular surveys, interviews and company visits, and enhanced inter-agency co-ordination allowing for swift government responses to investor concerns. Canada and the United Kingdom offer interesting examples of international good practice in this area (Box 1.4). All six economies need to make efforts to include domestic and small businesses more systematically in their consultations with the private sector and ensure that the feedback collected leads to effective policy reforms.

Government strategies should ensure that FDI serves the purpose of local economic development by creating linkages with SMEs. More efforts are required by all the SEE governments – though to a lesser degree in Serbia, which is more advanced in this area – to establish comprehensive business linkage programmes that include sector-specific training for SMEs and regular matchmaking with foreign affiliates. Bosnia and Herzegovina, Kosovo and Montenegro should also make supplier databases available to foreign investors. IPAs such as AIDA and KIESA, which also include SME development, should maximise synergies between their departments. Others should strengthen co-ordination with SME-related institutions and consider focusing their promotion efforts on sectors and activities that can generate more linkages.

Box 1.4. Good practice: Aftercare in Canada and the United Kingdom

Invest in Canada's aftercare programme

Invest in Canada's aftercare programme regularly follows up with investors throughout the duration of their investment projects. The Department of Foreign Affairs, Trade and Development's network of investment officers overseas undertake regular "back-to-back outcalls" to targeted investors, to discuss project status and needs for other services and support. These often involve an ambassadorial-level meeting at investor headquarters, and an Invest in Canada or regional IPA meeting with the CEO and top management of the investors' local subsidiaries.

These visits allow Invest in Canada to maintain dialogue and a good relationship with investing companies after the investment decision at both the operational level, where investors are dealing with operational and administrative hurdles, and at the headquarters level, where larger investment/reinvestment decisions are often made. They also help detect investor irritants, which may hinder smooth operations and become potential obstacles to reinvestment.

UK Department for International Trade's key account management

The UK Department for International Trade has set up a key account management system for target companies that have been identified as important for the country's economic growth. The Department for International Trade builds relationships and exchanges with different branches and agencies of government to be able to consider the priorities and needs of major investors. Strategic relationship management techniques are used to create a collective understanding of the target company's operations, and to establish common, long-term strategies with regard to major investors to promote positive impacts on the UK economy.

To co-ordinate the relationship, and to improve the communication between investors and government, major companies have dedicated account teams tasked with responding to investor queries, providing information about government services, and co-ordinating contact with relevant government departments.

Source: OECD (2015b), "Strengthening Chile's investment promotion strategy", www.oecd.org/daf/inv/investment-policy/chile-investment-promotion-strategy.htm.

Conclusions

All six SEE economies have taken a clear pro-investment stance and made the promotion of investment, including FDI, a key objective of their national development objectives. The economies provide a relatively open and non-discriminatory environment for foreign investors, with fewer restrictions on FDI than the OECD average. Those restrictions which remain are neither unusual nor a major impediment to foreign investment. The regulatory framework for investment, including for property and IP rights protection, is well aligned with international good practice throughout the region. Investor protection standards are high and expropriations of companies are rare and subject to sound and clear rules. Alternative dispute resolution mechanisms are commonly used in some economies and increasingly so in others. With a few exceptions, establishing a business in the SEE economies is easy and predictable, as procedures have been streamlined and simplified. Authorities maintain a constructive and regular dialogue with the private sector to inform it of pending reforms, collect feedback on legislative proposals and discuss investment climate challenges.

On the other hand, the investment policy framework still lacks clarity and predictability, especially for foreign investors. No economy in the region has established a foreign investment negative list to clearly delimit the sectors where foreign investment is prohibited or conditioned. Laws and regulations can still be inconsistently applied and involve lengthy procedures when disputes arise. The efficiency of the court systems and their independence from the executive should be strengthened, and judges should be better trained in commercial and IP cases. Enforcement of IP laws is not yet systematic enough and further efforts could be made to increase awareness of IP rights and improve access to information. The quality of the institutional framework for investment promotion and facilitation varies across the region, but often lacks effective co-ordination within governments. Strategies to promote and attract FDI are securely in place, but IPAs frequently lack adequate staff and resources. The SEE economies should take better advantage of their open interactions with the private sector to push for effective investment climate reforms. The way forward in investment policy and promotion should also focus on enhanced regional co-operation improve the overall investment climate in the region and promote it as a single investment destination.[13] Finally, further efforts should also be made to enhance the developmental impact of FDI by creating linkages between foreign investors and domestic firms. IPAs could, in this regard, increasingly integrate business linkages in their activities and align their promotion strategy accordingly.

Notes

1. For further information, see www.oecd.org/investment/pfi.htm.
2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
3. Between 47% and 52% depending on the year.
4. Calculation methods for sector shares in total FDI stocks vary according to data availability for each economy (data come from central banks). No data are available for Montenegro.
5. This figure may be underestimated, as Russian investment might be coming through offshore centres.
6. In the Former Yugoslav Republic of Macedonia, foreign ownership in radio and TV broadcasting is permitted, except in the case of an investment by a legal person whose founders are foreign persons registered in countries where, according to their legislation, it is not permitted or not possible to establish the origin of the initial capital. These investors may not conduct broadcasting activities and may not acquire shares in a broadcasting company in the Former Yugoslav Republic of Macedonia.
7. The legal framework in the six economies is likely to be more liberalised in the future for foreign investors from EU Member States, notably for those economies that recently concluded the Stabilization and Association Agreement (SAA) with the EU. The SAA constitutes the framework of relations between the European Union and the respective SEE economies, and serves as the basis for an eventual accession process to the European Union. Besides establishing a free trade area between the European Union and the economy concerned, the SAA also identifies common political and economic objectives and encourages regional co-operation. Under SAA negotiations, countries generally commit to progressively bring their legislation in line with EU regulations, including ensuring the same treatment for EU investors as its own nationals.
8. Kosovo is not officially a signatory member of the New York Convention but has unilaterally recognised it, and the enforcement of foreign arbitral awards will be implemented in conformity with the Convention.
9. According to the European Commission, the *acquis* is the body of common rights and obligations that is binding on all the EU Member States. Candidate economies have to accept the *acquis* before they can join the European Union and make EU law part of their own national legislation.
10. RAS is the result of the recent merger of the former Serbia Investment and Export Promotion Agency and the National Agency for Regional Development.
11. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and

the Republika Srpska are taken into account in the Competitiveness Outlook 2018 assessment, when relevant. The Brčko District is not assessed separately.

12. FDI spillovers encompass various long-lasting structural benefits that foreign investments can bring to the host economy, be they on the quality of the workforce, the competitive environment in the economy or the creation of supply chain linkages with domestic firms.

13. Progressive harmonisation and integration of investment policies would reportedly lead to increased intra-regional and foreign direct investment flows to the region. This priority has been recognised through the ongoing "Berlin Process" and was included in the last regional agenda, endorsed as a Multi-Annual Action Plan by the Western Balkan prime ministers during the Western Balkan Six Trieste Summit in July 2017.

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Annex 1.A1.
Investment policy and promotion: Indicator scores

Table 1.A1.1. **Investment policy and promotion: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Investment policy						
Guarantees against expropriation	3.5	3.5	4.0	4.0	4.0	4.0
Court system	1.5	1.5	2.5	2.5	3.0	3.0
Alternative dispute resolution	2.5	1.5	3.5	3.5	3.0	3.5
Intellectual property rights laws	3.5	3.0	3.5	3.5	4.0	4.5
Intellectual property rights enforcement	2.5	2.0	3.0	3.0	2.5	4.0
Intellectual property rights awareness raising	3.5	1.5	2.0	3.5	3.0	3.5
Investment promotion and facilitation						
Strategy and institutional framework	2.5	2.0	2.0	3.0	2.0	3.0
Investor targeting	2.5	2.5	1.5	3.5	1.5	3.0
Investment incentives	2.0	2.0	2.0	2.5	2.5	3.0
Starting a business	3.0	1.5	4.0	4.5	2.5	2.5
Aftercare	2.5	3.0	2.0	3.5	1.5	3.5
FDI-SME linkages	2.0	1.5	1.0	2.0	1.5	3.5

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Chapter 2.

Trade policy and facilitation in South East Europe

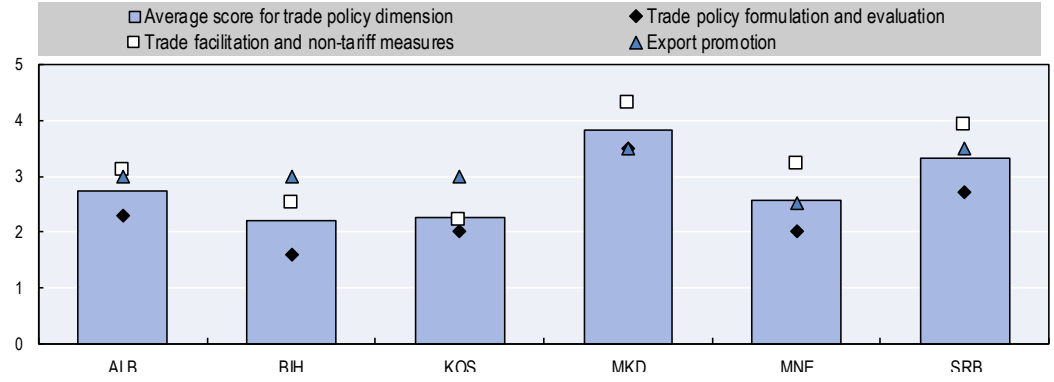
This chapter on trade policy and facilitation assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of trade performance in South East Europe (SEE), including exports of goods and services, trading partners, and the evolution of regional and international trade, the chapter focuses on four key sub-dimensions. The first sub-dimension, trade policy formulation and evaluation, analyses government capacities for designing, implementing and evaluating trade policy, including institutional co-ordination, public-private consultations, and monitoring and evaluation mechanisms. The second, trade liberalisation, examines international agreements and domestic laws liberalising trade. The third, trade facilitation, considers whether non-tariff barriers (technical barriers, sanitary and phytosanitary measures) are hindering trade, and how far trade facilitation measures are being implemented. Finally, the export promotion sub-dimension analyses how efficiency and effectiveness of the institutional and operational settings for export promotion. 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.

Main findings

A well-designed trade policy facilitates cross-border economic activity, and is very important for an economy's competitiveness. Trade liberalisation measures provide access to larger markets, enabling larger economies of scale and efficiency gains. Greater access to markets also brings greater competition from international firms in domestic markets, leading in turn to increased competition and improved allocative efficiency[1] (OECD, 2015). Furthermore, open, predictable and transparent trade policies are necessary if countries are to stay competitive in a world where global value chains (GVCs) are a dominant feature of trade.

The progress of the six reviewed South East Europe economies (Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia) against the trade policy and facilitation dimension varies considerably (Figure 2.1). Overall, they perform more strongly in trade facilitation, reducing non-tariff barriers and export promotion. Weaker areas relate to trade policy formulation and evaluation. This finding partly reflects the measures that these South East Europe (SEE) economies have taken to integrate themselves into the world trading system, and partly weak capacities for evaluation and monitoring. The Former Yugoslav Republic of Macedonia and Serbia lead the region with relatively advanced trade policy implementation systems. Albania and Montenegro have trade policy frameworks in place, but they are not yet monitoring their implementation, while Kosovo and Bosnia and Herzegovina still need to further strengthen their policy frameworks.

Figure 2.1. **Trade policy: Dimension and sub-dimension average scores**



Note: See the methodology chapter for the information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

Since the 2016 *Competitiveness Outlook* assessment, the SEE economies have made progress in the areas of inter-institutional co-ordination and public-private consultations but they have not improved their evaluation and monitoring capacities. In terms of

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

non-tariff measures, the economies have taken positive steps to reduce technical barriers to trade, but the incomplete implementation of sanitary and phytosanitary measures remains the main obstacle for further trade expansion. The remaining elements of the current framework cannot be compared with the previous *Competitiveness Outlook* because this edition has prioritised other services sectors for analysis and has included an additional sub-dimension on export promotion.

Achievements

Trade policy institutional frameworks are functioning well. The inter-institutional co-ordination of trade policy formulation is solid in most economies, usually through 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 majority of the economies have recently established trade facilitation committees.

The six SEE economies have made progress in removing technical barriers to trade. The institutional frameworks for standardisation and accreditation have been strengthened and the rules, procedures and operations of the standardisation and accreditation bodies are aligned overall with international and European Union (EU) practices. Most of the economies have adopted more than 80% of European Standards. However, many economies still have room to improve their conformity assessment infrastructure.

The SEE economies are relatively well integrated into the world trading system. All are signatories of the Central European Free Trade Agreement (CEFTA), through which they have achieved full tariff liberalisation on trade in manufactured products and agricultural goods. Albania, the Former Yugoslav Republic of Macedonia and Montenegro are also *World Trade Organization* (WTO) members.

Export promotion agencies/bodies have been established in all SEE economies. Their work is focused on promoting overall exports, while support services are primarily provided to small and medium-sized enterprises (SMEs) and established exporters.

Remaining challenges and key recommendations

- **Further remove non-tariff barriers to trade**. Economies in the region have been less successful in reducing non-tariff barriers related to the implementation of sanitary and phytosanitary (SPS) measures than they have been at implementing technical standards and regulations and trade facilitation measures. Capacities for risk-based control, both for inland and for border inspection, are still being developed. The majority of economies need to develop a variety of risk assessment tools and to connect up the information systems of the various SPS agencies.
- **Strengthen mechanisms for evaluating the impact of trade measures and free trade agreements (FTAs)**. The units in place for trade analysis are usually understaffed and often lack adequate resources for conducting systematic impact assessments. *Ex post* monitoring of the impact of FTAs is rarely conducted in the majority of the economies and often no agency has been appointed to lead the monitoring exercise. Furthermore, high-quality statistical trade data are scarce.
- **Improve the transparency and effectiveness of public-private consultation mechanisms.** The SEE economies do not monitor how open and transparent these consultation mechanisms are and most of them do not make summaries of consultations on draft laws publicly available. More active involvement of the private sector in the trade policy implementation and evaluation phase is also needed.

- **Address regulatory restrictions to services trade**. Economy-wide regulations on corporations and barriers to the movement of people affect firms' ability to operate in the SEE economies. While the conclusion of Additional Protocol 6 to the CEFTA agreement[2] has eased the conditions for the movement of people among CEFTA economies, the requirements for people from outside the CEFTA economies remain restrictive. Easing conditions on the temporary movement of people would help to encourage innovation and knowledge transfer, and contribute to economic growth. Governments should also focus on improving regulatory transparency, as this affects all industries.

Context

Transparent trade policies facilitate trade and access to global value chains, which are highly effective means to integrate into the world economy and connect to modern technologies and skills (OECD, 2015; OECD/World Bank, 2015). When production is fragmented and goods and services cross borders many times, tariffs, non-tariff barriers and other restrictive measures affect domestic producers as well as foreign suppliers (OECD/WTO/World Bank, 2014). As trade involves exchanges of goods and services, and also ideas, good trade policies are an important conduit for the international transfer of technology and diffusion of innovation.

Fast and efficient customs and border procedures – along with well-functioning transport, logistics, finance, communications and other business services – are particularly important. Liberalised trade and investment regimes with streamlined and efficient customs procedures help to ensure inputs are competitively priced and trade costs reduced (OECD, 2015). The trade policy and facilitation dimension is therefore closely linked with other policy fields analysed in this *Competitiveness Outlook*:

- **Chapter 1**. **Investment policy and promotion**, in particular foreign direct investment (FDI), depends on an open, liberal trade regime with trade facilitation measures in place (Chakrabarti, 2001). Efficient customs administrations and reduced transaction costs facilitate domestic and international investment. Transparent, predictable procedures, together with impartial, uniform administrative border requirements, simplified clearance systems, harmonised administrative requirements, streamlined procedures, co-ordination, risk management and electronic customs clearance systems, can all lower transaction costs (OECD, 2005). On the other hand, evidence indicates that foreign investment abroad stimulates the growth of exports by the investing countries and, consequently, that this investment is complementary to trade (OECD, 1999).
- **Chapter 8. Employment policy** and trade are also interlinked. OECD research finds that more open goods and services markets stimulate job creation for both skilled and unskilled workers. Strategic policies to open the market include measures to help workers and communities adjust to a more competitive environment. Reducing tariffs and non-tariff barriers can provide new market opportunities for exporters. Reducing barriers to FDI in services is particularly effective in increasing demand for more highly skilled labour (OECD, 2011a).
- **Chapter 9**. **Science, technology and innovation,** and trade, mutually reinforce each other. Innovation gives birth to technological advantage; together with differences in factor endowments, these are the source of comparative advantage which in turn drives trade. Innovative and more productive companies export,

invest abroad or license their technologies to exploit the benefits of their innovations. Meanwhile, trade liberalisation contributes to the international transfer of technology and diffusion of innovation. New technologies can be transmitted across borders through different activities, such as trade in capital goods and intermediate goods and services, the movement of people and licensing agreements (OECD, 2008).

- **Chapter 11. Transport** and logistics can boost trade performance by making the delivery of goods easier, faster and safer. Manufacturing, agricultural and other sectors with high export intensity depend on being able to ship goods to consumers quickly, cost-effectively and reliably. Furthermore, research suggests that countries with better logistics performance tend to specialise more in manufacturing GVCs. Delays related 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).
- **Chapter 14. Agriculture** and trade policy are highly interdependent. Trade policies are key in determining participation in agricultural GVCs and the creation of domestic agricultural value added. Barriers to trade reduce engagement in GVCs as well as the domestic returns from agro-food exports. On the other hand, non-tariff measures based on more transparent and scientific arrangements can increase the domestic value added generated by exports (Greenville, Kawasaki and Beaujeu, 2017).

Trade policy and facilitation assessment framework

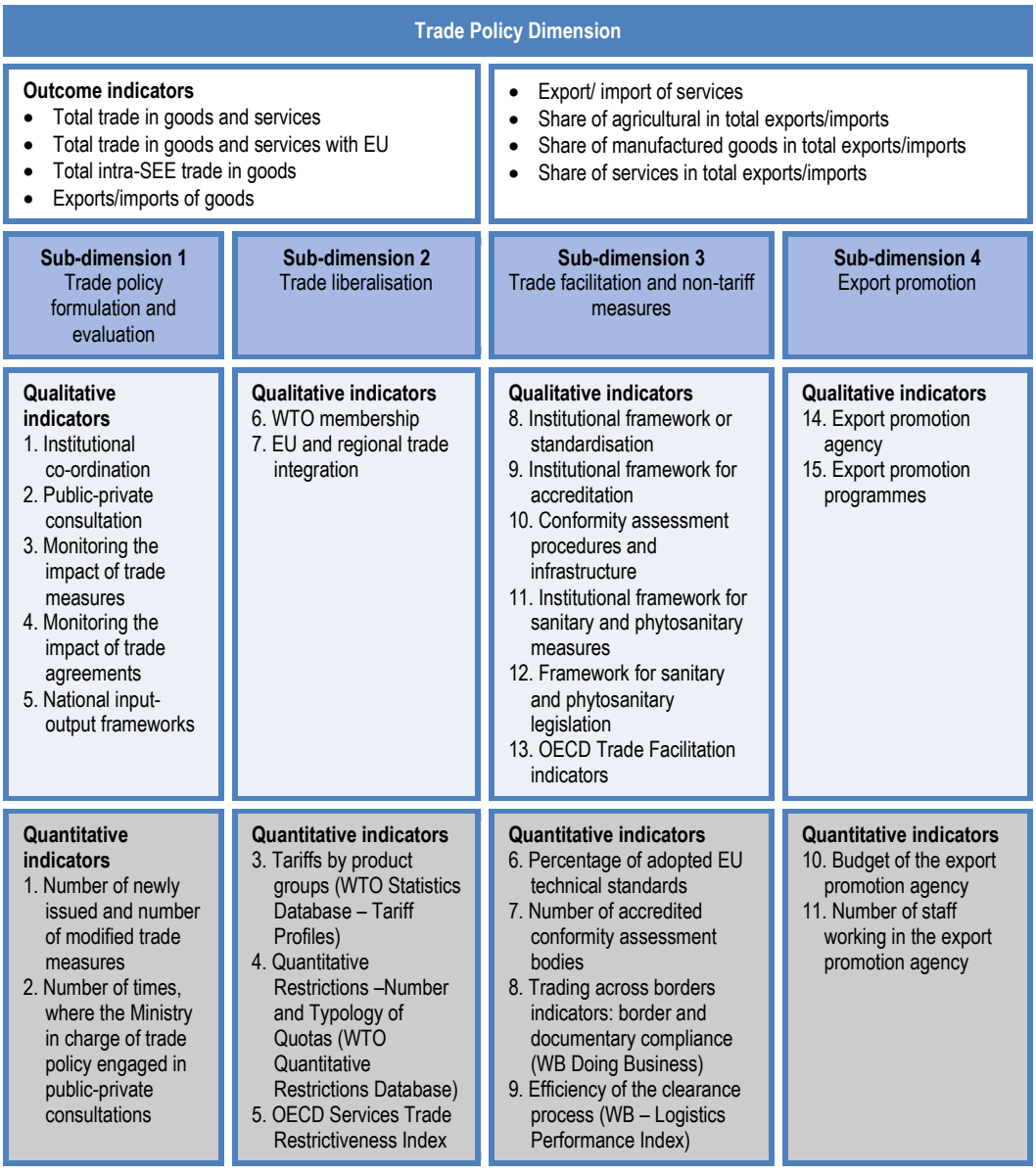
This chapter analyses aspects of the trade policy and facilitation framework in SEE by assessing the following four broad sub-dimensions:

1. Trade policy formulation and evaluation: what capacities do governments have to design, implement and evaluate trade policy and strategy?
2. Trade liberalisation: how liberalised is trade in goods and services? How well integrated are the SEE economies into the multilateral trading system?
3. Trade facilitation and non-tariff measures: to what extent do non-tariff barriers – technical barriers, sanitary and phytosanitary measures, administrative barriers and non-automatic import licences – hinder trade?
4. Export promotion: how efficient and effective are the institutional and operational settings for export promotion?

Figure 2.2 shows how these sub-dimensions and their constituent indicators make up the assessment framework for the trade policy and facilitation dimension.

Each sub-dimension is assessed through quantitative and qualitative indicators collected by the OECD (except the trade liberalisation sub-dimension, which only uses quantitative indicators). The performance of the SEE economies has been scored in ascending order on a scale of 0 to 5, summarised in Annex 2.A1.[3] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 2.2. **Trade policy and facilitation assessment framework**

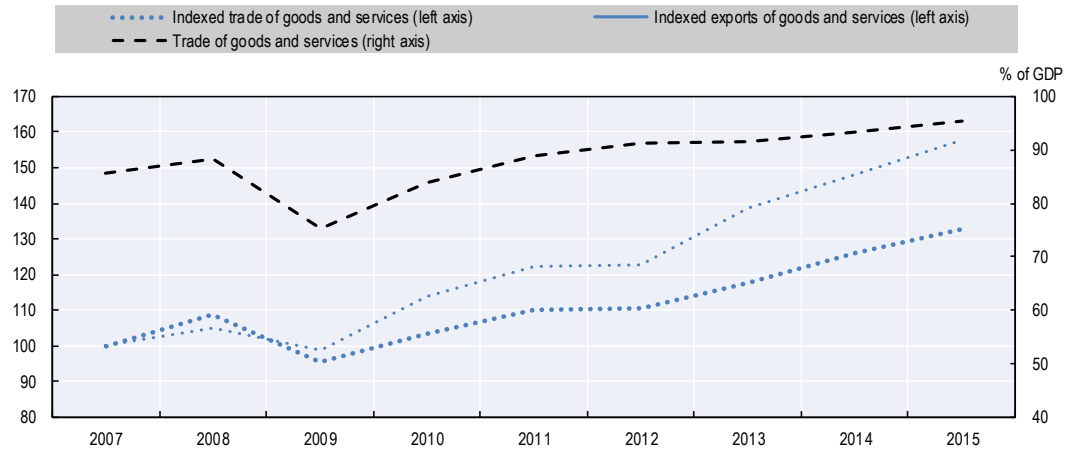


Trade policy performance in the SEE economies

The six SEE economies' total external trade in goods and services has been steadily increasing since the economic crisis, driven largely by the strong recovery of exports. In the period from 2007 to 2015, total trade increased by about 30%, while exports rose by almost 60%. Trade as a share of gross domestic product (GDP) has also been increasing, rising from 88% in 2008 to 95% in 2015 (Figure 2.3).

For the majority of the SEE economies, the European Union (EU) is the main trading partner, accounting for 70% or more of all trade. Germany and Italy account for one-third of all exports. Neighbouring economies (Bulgaria, Croatia, Romania and Slovenia) remain important export destinations, accounting for 15% of the assessed economies' exports (Figure 2.4).

Figure 2.3. **Key trends in external SEE trade in goods and services (2007-15)**

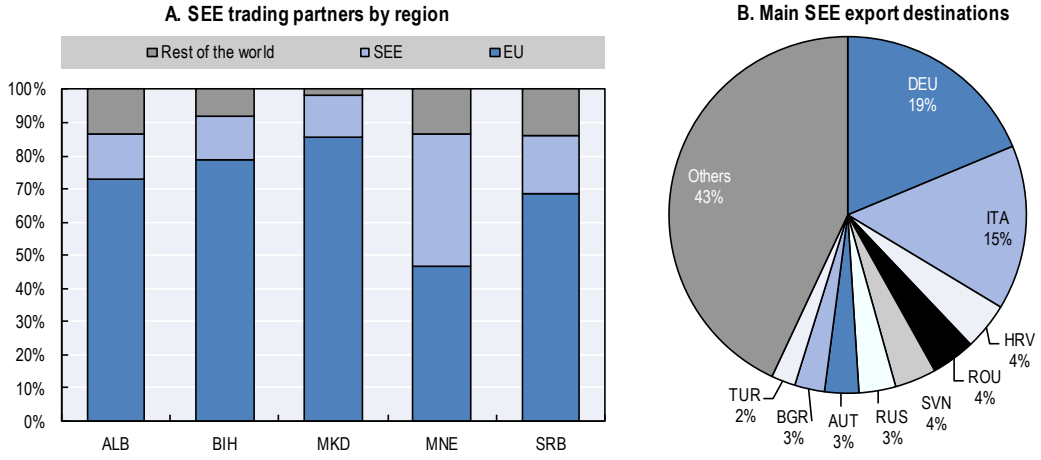


Note: External trade is calculated as the sum of total imports and exports of all SEE economies. Bosnia and Herzegovina data for 2015 have been estimated and will be updated when new data are available.

Source: World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Figure 2.4. **South East Europe's main trading partners and export destinations (2015)**



Note: Data for Kosovo are not available. AUT – Austria; BGR – Bulgaria; DEU – Germany; HRV – Croatia; ITA – Italy; ROU – Romania; RUS – the Russian Federation; SVN – Slovenia; TUR – Turkey.

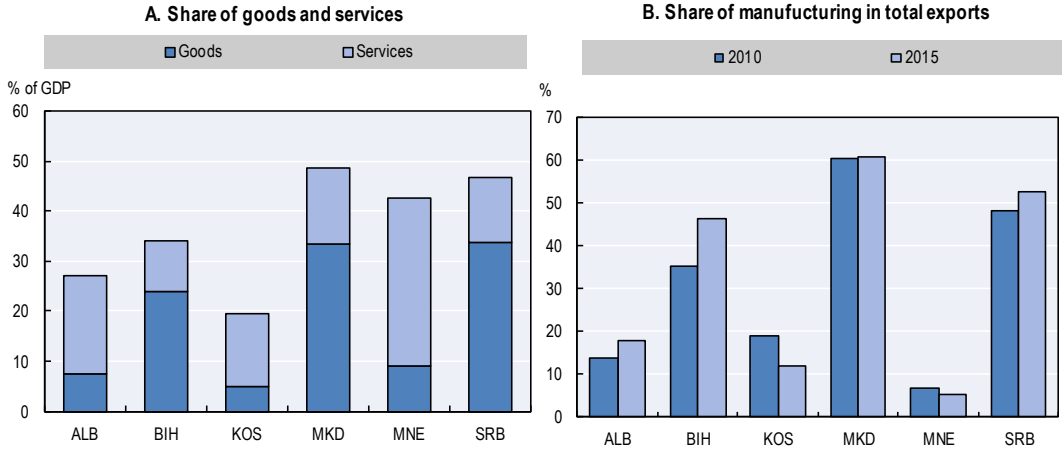
Source: UN (2017), *UN Comtrade Database*, http://comtrade.un.org/data.

StatLink http://dx.doi.org/10.1787/888933703029

As Figure 2.5.A illustrates, the Former Yugoslav Republic of Macedonia, Serbia and Montenegro are more export-oriented than the other SEE economies. Exports account for nearly 50% of GDP in these economies, compared to 30% or less in Albania, Bosnia and Herzegovina, and Kosovo. The sectoral composition of exports also varies among economies. In Albania, Kosovo and Montenegro services dominate exports, while Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia mostly export

goods (Figure 2.5.A). This also explains why the manufacturing share of total exports is significantly higher in these three economies than the other economies in the region (Figure 2.5.B).

Figure 2.5. **Export composition (2015)**



Note: In Figure 2.5.B, manufacturing is represented as a share of total exports, including goods and services. Statistical offices in the region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: Figure 2.5.A – World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators; Figure 2.5.B – Statistical offices of the SEE economies.

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The growth in manufacturing exports has been dominated by the automotive industry, fuelled by a considerable increase in foreign direct investment (FDI) in this sector over the past decade. Exports of machinery and transport equipment to the European Union, the region's main trading partner, have increased more than five-fold since 2007. Chemicals exports doubled over the same period, while exports of food and beverage products increased by 60%.

Intra-SEE trade in goods has been relatively stagnant over the past five years and has even declined slightly, from 11% of GDP in 2011 to around 10% of GDP in 2015 (Figure 2.6). Even though the SEE economies are all part of the Central European Free Trade *Agreement* (CEFTA), which has substantially liberalised regional trade, non-tariff barriers are still one of the most important impediments to intra-regional trade.

Over the same period, total international trade in goods for the six SEE economies increased from 66 to 71% of GDP. This growth reflects increased trade with EU economies as the SEE economies become more integrated into global value chains.

Trade policy formulation and evaluation

Global trade policy has steadily broadened its scope over the last decade and is no longer only focused on reducing tariffs and eliminating quantitative restrictions. It involves policies on issues ranging from the environment to employment protection (Hocking, 2004). This more holistic approach to trade has underlined the need for a sound institutional mechanism for co-ordination, consultation, monitoring and evaluation.

Figure 2.6. **Evolution of intra-regional and international trade in goods (2010-15)**



Note: Intra-SEE trade is calculated as the total of exports and imports of goods between the six SEE economies; total international trade in goods is calculated as the sum of exports and imports of SEE economies to/from all trading partners.

Source: For intra-SEE data: RCC (2017), "SEE2020 strategy targets and results", www.rcc.int; for international trade data: World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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First, trade policy makers and negotiators need to regularly co-ordinate different ministries, government agencies and institutions when formulating and implementing trade policy. Second, they need to consult a broad range of private and civil society actors, including non-government organisations (NGOs), to ensure that policy development is transparent and inclusive. And third, governments need to monitor and evaluate the impact of trade policy on the wider economy, including environmental and social impacts. In this respect, collecting high-quality statistical trade data is crucial to making informed policy decisions based on a comprehensive understanding of trade flows.

This section explores the trade policy formulation and evaluation sub-dimension. To that end, it examines five qualitative indicators of the effectiveness of a national framework for formulating, implementing and evaluating trade policy:

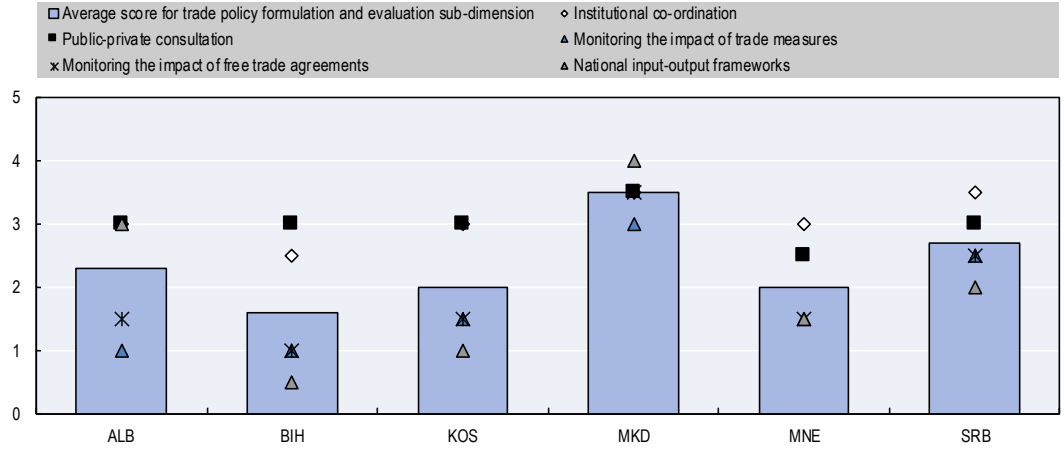
- The **institutional co-ordination** indicator considers whether there is a leading ministry co-ordinating the work of different stakeholders in trade policy while shielding trade policy from sectoral interests in order to facilitate coherent trade policy development. Institutional bodies include ministries (e.g. finance, agriculture, foreign affairs and industry), customs agencies, standardisation bodies and export promotion agencies.
- The **public-private consultation** indicator assesses whether there are effective private sector and civil society consultation mechanisms to address any potential impacts of new agreements and policies on business and civil society before they are adopted.
- **Monitoring the impact of trade measures** and **monitoring the impact of free trade agreements** (FTAs) indicators examine whether governments are closely assessing the outcomes of trade policy decisions and their impact on society and economy, as well as their cost-effectiveness. This could involve the use of

regulatory impact assessment (RIA) and other tools such as stakeholder engagement and *ex post* evaluation.

- The **national input-output frameworks** indicator looks at whether economies are able to make informed policy decisions based on a deep understanding of trade flows. Data needed to create national statistics, such as supply-use and input-output tables, are useful for production and demand analysis and help understand trade patterns more clearly.

Inter-institutional trade policy co-ordination and public-private consultation mechanisms are well developed in the SEE economies. However, most economies have weak monitoring and evaluation mechanisms to measure the impact of both trade measures and signed FTAs. The collection of high-quality statistical trade data also needs further reinforcement (Figure 2.7).

Figure 2.7. **Trade policy formulation and evaluation: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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The economy with the highest average score for this sub-dimension is the Former Yugoslav Republic of Macedonia (3.5), which demonstrates strong implementation across all indicators and growing monitoring and evaluation activities. Albania and Serbia score between 2 and 3, meaning that policy frameworks are adopted and implemented. A score of 2 or below in Bosnia and Herzegovina, Kosovo and Montenegro implies that policy frameworks are largely in place, but there is a need for further improvement of implementation activities.

SEE economies have strengthened their trade policy institutional frameworks

Most SEE economies have solid inter-institutional co-ordination of trade policy formulation (Table 2.1), usually through official committees, councils or working groups led by the trade or economy ministries. The work of these inter-ministerial committees is usually focused on the implementation and/or negotiation of regional and international commitments (CEFTA, WTO), facilitation of the EU accession process (through the preparation of relevant trade policy-related EU *acquis* chapters), and design/amendment of specific trade measures. They are also establishing co-ordination mechanisms to

address the more challenging areas of trade policy. For instance, Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro have established trade facilitation committees.

Table 2.1. **Trade policy formulation and evaluation: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Institutional co-ordination	3.0	2.5	3.0	3.5	3.0	3.5
Public-private consultation	3.0	3.0	3.0	3.5	2.5	3.0
Monitoring the impact of trade measures	1.0	1.0	1.5	3.0	1.5	2.5
Monitoring the impact of free-trade agreements	1.5	1.0	1.5	3.5	1.5	2.5
National input-output frameworks	3.0	0.5	1.0	4.0	1.5	2.0

Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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A trade policy strategy is not yet in place in all the assessed SEE economies and there are no specific action plans designed to improve trade performance. Inter-ministerial co-ordination and consultations with stakeholders (private sector and civil society) are used to complement each other mainly during the initiation and formulation stage, while more efforts are needed to involve the private sector more actively in the policy implementation and evaluation phase.

Public-private consultations differ in their transparency and levels of participation

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. Such 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, 2012). Governments in many economies also adopt legislation and/or horizontal guidelines in order to further improve the consultation process (e.g. Box 2.1. illustrates the case of the United Kingdom).

All of the SEE economies have formal instruments for consultation with the private sector and civil society, and they usually involve the most important stakeholders (domestic and foreign companies, business associations, logistics providers, trade unions, consumer groups, etc.). However, the economies differ as to the frequency of consultations, the depth of stakeholder participation in practice and the availability of information published online.

Apart from the newly established Trade Facilitation Committees, the following permanent advisory bodies are in place in the six SEE economies: an Economic Council in Albania; Export Councils in Bosnia and Herzegovina (one at the state[4] 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 Former Yugoslav Republic of Macedonia; a Council for Competitiveness in Montenegro and a National Convention on the European Union in Serbia.

In the Former Yugoslav Republic of Macedonia the widest range of stakeholders are involved in regular public-private consultations; a permanent advisory body discussing exclusively trade-related issues has been active since 2009 (the Advisory Council within customs); the relevant ministries also publish summaries of consultations on draft laws

(in the other economies only summaries of the consultations held through permanent bodies are publicly available).

In Albania and Serbia, formal and informal consultations take place regularly, draft laws are published in a timely manner and the comments of various stakeholders (citizens, NGOs, business organisations, chambers of commerce, etc.) are submitted online. In Bosnia and Herzegovina, Kosovo and Montenegro, more efforts are needed to ensure more frequent and broader private sector and civil society participation. Furthermore, they do not always provide the legally obliged advance notice in practice.

None of the SEE economies regularly evaluate how open and transparent their consultation mechanisms are and they do not use the information collected through mandatory consultations to estimate the impact of consultations on policy making.

Box 2.1. **Good practice: 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, 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), "Code of practice on consultation", Her Majesty's Government, www.bis.gov.uk/files/file47158.pdf; the Consultation Principles are available at UK Government (2016), "Consultation principles 2016", www.gov.uk/government/uploads/system/uploads/attachment_data/file/492132/20160111_Consultation_principles_final.pdf.

Monitoring and evaluation capacities could be improved

Regulatory impact assessment (RIA) and other tools, such as stakeholder engagement and *ex post* evaluation, all give governments an opportunity to evaluate trade-related impacts of laws and regulations. The RIA process allows OECD economies to consider trade impacts from different angles, including their effects on: 1) the overarching macroeconomic situation; 2) exports, imports, investment flows and international competitiveness; 3) interactions between domestic regulatory initiatives and the international regulatory environment; and 4) third countries. Box 2.2 illustrates Austria's approach to assessing trade impacts using RIAs.

When it comes to **monitoring the impact of trade measures**, the relevant ministries in the Former Yugoslav Republic of Macedonia and Serbia conduct both *ex ante* (RIAs) and *ex post* evaluations. The financial implications of the proposed measure are calculated for several years ahead in the Former Yugoslav Republic of Macedonia and the effect of the measure on the employment rate, imports and exports is evaluated. In Serbia, impact assessments are mainly conducted after implementation and primarily analyse the effects on trade rather than overall economic impacts. Neither economy assesses the impact of trade policies on the competitiveness of specific sectors.

Montenegro and Bosnia and Herzegovina (primarily in the Republika Srpska), primarily conduct RIAs, while Albania and Kosovo carry out impact assessments only sporadically. Moreover, the units in place for trade analysis in these four economies are usually understaffed and lack adequate budgets to conduct systematic impact assessments. Finally, the trade analysis tools used as a basis for impact assessments in all the assessed SEE economies usually do not include advanced quantitative and qualitative assessment approaches.

Overall, the SEE economies do evaluate in advance the costs and benefits associated with the legal commitments involved in FTAs, although the depth of analysis varies. However, the majority of the economies rarely **monitor the impact of FTAs** once they are implemented, and have often appointed no agency to lead the monitoring exercise. In practice, any monitoring that occurs is focused on ensuring the implementation of the FTA provisions, while the impact itself is seldom measured.

In the Former Yugoslav Republic of Macedonia, *ex post* evaluations are conducted on a more regular basis as part of its WTO membership, through CEFTA reports and the regular work of the Ministry of Economy. Serbia conducts *ex post* monitoring, but on an ad hoc basis. Both economies use the following indicators to assess the economic impact of FTAs: export and import statistical data and trends; applied tariffs; realisation of quotas; investments by FTA partners; the foreign trade ratio; rate of trade interconnections; and possible non-tariff barriers to trade.

Few economies have advanced in the collection of trade input-output data

National input-output frameworks (i.e. supply-use tables and symmetric input-output tables) are an important element of the in-depth analysis of trade flows and the assessment of an economy's degree of integration in global value chains. Currently, national statistics offices in most of the SEE economies are still at an early stage of collecting all the information needed to create input-output tables.

The Former Yugoslav Republic of Macedonia is the only SEE economy to regularly publish symmetric input-output tables[5] covering all sectors. In Albania, supply and use tables have been published (for the period 2009-13) but they do not yet cover all sectors.

Box 2.2. Good practice: Evaluating trade impacts through regulatory impact assessments in Austria

According to its official handbook for RIAs, the government of Austria is committed to evaluating the impact of proposed measures and alternatives in a number of areas, including their macroeconomic, financial, sectorial, environmental, social and administrative effects. The assessment of the trade-related impacts is a compulsory element of the overarching evaluation of macroeconomic effects. The methodology used to assess trade-related impacts differs across the different stages of the RIA process. To start with, the lead service drafting the RIA report needs to determine if a proposed measure is likely to have a significant macroeconomic effect on the Austrian economy. The guidelines require the lead service to separately model and roughly quantify the demand and supply-side effect. A significant demand-side effect is understood as a change in public or private demand, including imports of EUR 40 million – roughly equivalent to 0.01% of Austria's GDP – within one year of a projected and examined five-year period. A significant supply-side effect is understood as a change in EUR 40 million in value-adding activity, including exports or the creation or destruction of more than 1 000 jobs.

If the lead service finds that a proposed measure is likely to have a significant macroeconomic effect, it must draft an in-depth RIA report. The official handbook lays out a detailed methodology for doing so. It foresees distinct analyses of impacts on the 1) demand side; 2) supply side; and 3) Austria's international competitiveness. Each sub-analysis touches on international trade.

The demand-side effects are quantified and monetised in a five-step process.

1. The lead service must identify the potentially affected demand categories in accordance with Eurostat's ESA95 nomenclature. It must identify which types of investment (public, private, infrastructure, real estate, etc.), consumption (public, private), imports and exports are likely to be affected by a proposed measure.
2. It must assess the actual impact of a proposed measure on demand by category.
3. It must apply predefined multipliers to the predicted impacts per category in order to reflect indirect effects on other parts of the economy. An increase or reduction in demand in one economic sector should trickle down into other economic sectors. A government-wide harmonised econometric toolkit is provided to help with this.
4. It must evaluate econometrically the impact on labour markets and in particular on effective gender equality.
5. The government must present its findings in standardised tables, which highlight, amongst other things, whether the proposed law or regulation could alter the official GDP prognosis for the coming years.

The supply-side analysis is less standardised. It seeks to evaluate the mid- and long-term impacts of proposed measures on the availability of labour, capital and productivity, and thereby exports (drawing more on qualitative assessment approaches). The competitiveness analysis seeks to evaluate the impact of a proposed law or regulation on the international attractiveness of Austria and its economic competitiveness. To that end, the handbook suggests qualitatively assessing the likely effects of measures on tax burden, multilateral commitments, market access issues, recognition of foreign diploma, labour costs and wage bargaining, national infrastructure, intellectual property rights, legal and regulatory harmonisation and others. It is in this third section that lead services may assess the interactions between Austrian regulation and international regulation and related costs and benefits.

Source: Austrian Federal Chancellery, *Handbuch Wirkungsorientierte Folgenabschaetzung* (Handbook on Impact-oriented Impact Assessment, www.bka.gv.at/DocView.axd?CobId=49873.

The way forward for trade policy formulation and evaluation

The SEE economies could consider developing single strategies or action plans designed to improve trade performance, with clearly defined objectives, task milestones and responsibilities. These could be developed by their newly established trade facilitation committees encompassing representatives from all relevant institutions (e.g. ministries of trade, finance, agriculture, foreign affairs, industry, customs administration, quality infrastructure bodies, and sanitary and phytosanitary inspectorates). The committees would need to be given a broadened mandate to tackle all trade policy-related issues.

The mechanisms for evaluation and monitoring of implemented trade measures and signed FTAs could be improved. Ideally, a monitoring programme with adequate budget and staff could be introduced to allow for systematic evaluations. In the meantime, the analytical and econometric skills of existing staff in trade analysis units could be strengthened. Moreover, training could be provided in the use of various quantitative and qualitative approaches to measure impact.

Trade and regulatory policy makers could consider making good use of RIA procedures, in combination with stakeholder engagement and *ex post* evaluation. In particular, threshold and proportionality rules should be further defined to ensure that trade impacts are soundly assessed when necessary without overloading the RIA process. *Ex post* evaluations could be more systematically used and focus on assessing whether policy goals are achieved from the perspective of the overall regulatory framework (stock) with the least costs and least impacts (including for trade). Where trade impacts are substantial, the impact assessment methodology should be adapted to align with international standards and other relevant regulatory frameworks, such as the WTO standards, *World Customs Organization* (WCO) standards and EU standards (OECD, 2016a).

Furthermore, it will be important to **reinforce the collection of high-quality statistical trade data, especially national input-output frameworks.** This would help to include SEE economies in relevant international data collection exercises, such as the OECD Trade in Value Added (TiVA) database and the OECD Product Market Regulations Statistics.

Finally, the public-private consultation mechanism could be improved by making the summaries of consultations on draft laws publicly available and by regularly evaluating the degree of openness and transparency of the consultations (as an integral part of the regulatory impact assessment process). Moreover, in addition to the regulations currently in place, specific guidelines and principles on consultations with the private sector and civil society could be developed, which define the precise steps and criteria that need to be followed in the consultation process.

Trade liberalisation

Economies can benefit economically by liberalising trade and capitalising on areas of comparative advantage (Hoekman, English and Aaditya, 2002). It is ultimately the consumers who benefit the most because liberalised trade can help to lower prices and broaden the range of quality goods and services available. When undertaken unilaterally or as part of binding multilateral and preferential trade and investment agreements, trade liberalisation measures should, however, be complemented by appropriate employment, labour and education policies so that the benefits of trade can be shared.

The trade liberalisation sub-dimension explores the extent to which an economy has been integrated into global trade and the barriers to doing so through the assessment of the following subjects: 1) World Trade Organization (WTO) accession and alignment with WTO provisions; 2) the network of free trade agreements (at regional and bilateral level); 3) applied tariffs; 4) quantitative restrictions; and 5) the restrictiveness of trade in services (with a focus on road and rail freight sectors).

An economy's commitment to free trade and certain international standards through WTO membership increases foreign and domestic firms' confidence in investing, thereby increasing trade flows, growth and further investment opportunities. Regional trade agreements (RTAs) aim to increase co-operation over trade policy and boost trade flows among groups of two or more partners.

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; increased domestic and foreign competition, complemented by effective regulation, can enhance economic performance (Hoekman, English and Aaditya, 2002).

The SEE economies have become more integrated into the world trade system

Half of the SEE economies have **World Trade Organization membership** (Albania, the Former Yugoslav Republic of Macedonia and Montenegro). The remaining economies, although not yet members, have committed to follow WTO rules under their obligations as signatories of the Central European Free Trade Agreement (CEFTA). Bosnia and Herzegovina, and Serbia are currently negotiating accession to the WTO and have made progress implementing the required institutional and legislative provisions, while Kosovo has yet to apply for membership.

In terms of **a network of free trade agreements** integrating EU and regional trade, as EU accession candidates or potential accession candidates, all the SEE economies are in the process of bringing their legislation into line with the EU *acquis* through the application of the Stabilisation and Association Agreement (SAA).[6] The SAA chapter on the free movement of goods provides for the establishment of a free trade area between each candidate or potential candidate and the European Union, and facilitates trade by encouraging the adoption of EU product standards and procedures. In addition, the autonomous trade preferences granted by the European Union to SEE economies allow nearly all exports to enter the European Union without customs duties or limits on quantities.

Regionally, the Central European Free Trade Agreement, signed in 2006, has helped the SEE economies to achieve full tariff liberalisation on trade in manufactured products and agricultural goods, and to establish a negotiating framework for eliminating non-tariff barriers (NTBs). In parallel, the negotiations of the Additional Protocol 6, which aim to achieve a significant level of liberalisation of trade in services, have been successfully concluded. The protocol also includes an annex on "temporary movement of natural persons", which further facilitates movement of professionals within CEFTA. Moreover, necessary preparatory activities are going on for concluding mutual recognition agreements of professional qualifications in a number of selected professions (currently in the health and construction sectors). CEFTA Parties also successfully adopted, in May 2017, the Additional Protocol 5 – an ambitious text that foresees obligations for trade facilitation which go beyond the WTO Trade Facilitation Agreement in many aspects, and the relevant EU *acquis* in some. It provides a legal basis for the electronic exchange of documents among the authorities of the CEFTA Parties involved in

clearance of products, and will enable the mutual recognition of border documents and authorised economic operator programmes.[7]

More recently, at the 2017 Western Balkans Summit in Trieste, the economies of the region committed to developing a Western Balkans Regional Economic Area. The aim is to use the CEFTA legal framework and individual SAAs to foster gradual and progressive rule-based economic integration in the areas of trade, investment, mobility and digital transformation that ultimately will enable the unobstructed flow of goods, services, investment and highly skilled labour throughout the region.

As for bilateral FTAs, all the SEE economies have an agreement with the European Free Trade Association (EFTA) and Turkey (except Kosovo, which does not have one with EFTA). Montenegro and Serbia have signed the largest number of FTAs and are the only ones to have FTAs with the Russian Federation (Table 2.2).

The trade policy frameworks of SEE economies are generally open to foreign goods and foreign markets. The average **applied tariffs** for agricultural and industrial products are largely in line with EU levels. Furthermore, **quantitative restrictions** on imports and exports for economic reasons have been abolished.

Table 2.2. **Bilateral trade agreements involving the SEE economies**

Economy	Bilateral free trade agreements
Albania	EFTA, Turkey
Bosnia and Herzegovina	EFTA, Turkey
Kosovo	Turkey (signed, to be ratified)
Former Yugoslav Republic of Macedonia	EFTA, Turkey, Ukraine
Montenegro	EFTA, Russian Federation, Turkey, Ukraine
Serbia	Belarus, EFTA, Kazakhstan, Russian Federation, Turkey

Source: WTO (2017), *Preferential Trade Agreements* (database), http://ptadb.wto.org.

Reducing regulatory barriers to trade in services is particularly important for the SEE economies

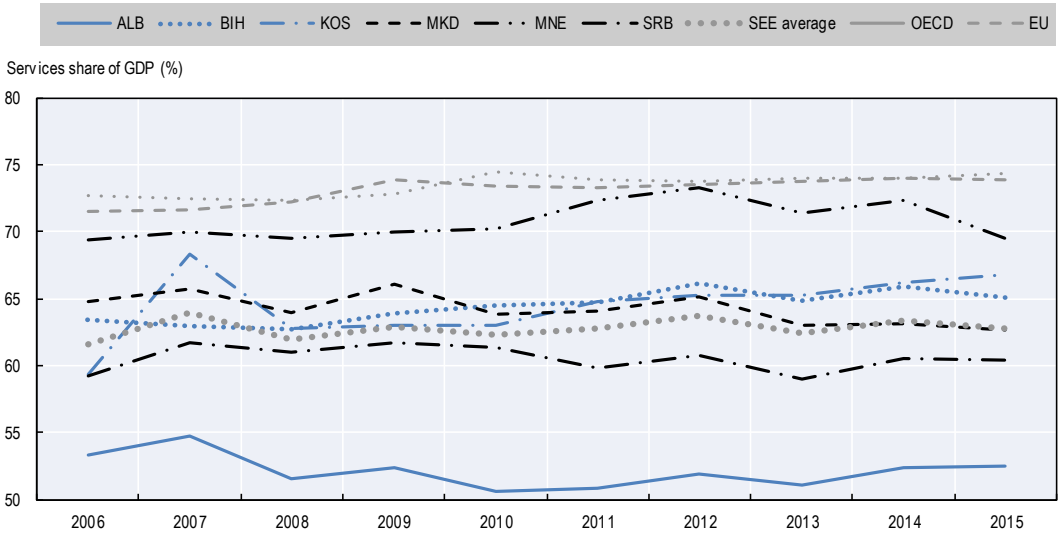
Services contribute close to two-thirds of GDP in the SEE economies (Figure 2.8), which underlines how strongly economic growth, innovation and job creation depend on effective policies on services that promote open and competitive markets.

Land transport services, particularly road and rail freight transport services, play an important role in market integration in the region and are intermediate inputs for other kinds of trade, in goods as well as services (such as distribution and logistics). They underpin manufacturing industries as they move parts and components to the assembly line and final products to end users. Low transport costs and timely transport services improve the competitiveness of products and encourage export growth. Barriers to transport services can inhibit these processes and raise costs for firms and customers.

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). 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. On average, barriers to road freight transport can raise prices by up to 3%, and up to 20% in other transport and logistics services sectors.

Restrictions on services trade also limit export volumes at home, while also limiting the ability of manufacturing industries to reach a larger number of foreign markets. Analysis has shown that restrictions on road freight transport have the strongest inhibiting effects on exports in various key industries such as automotive, electrical equipment and chemicals (OECD, 2017a).

Figure 2.8. **Contribution of services to GDP in the SEE economies (2006-15)**



Source: World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

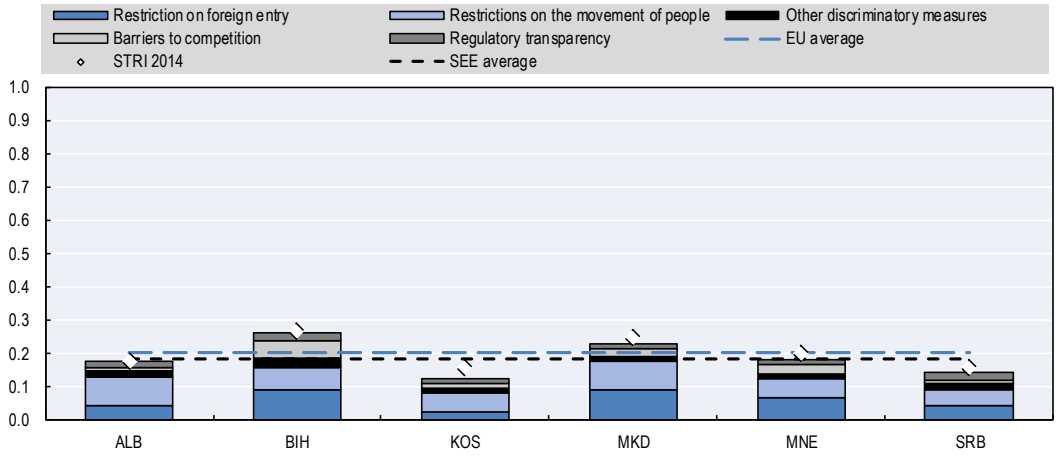
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The OECD Services Trade Restrictiveness Index (STRI)[8] was used to evaluate the SEE economies' policies for road and rail freight transport services. Information was collected from existing laws and regulations, and indices were calculated for four years (2014-17). 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). The indices are presented in Figures 2.9 and 2.10 below.

Figure 2.9 shows that the level of restrictiveness towards third countries in road freight transport services is relatively low with an average of 0.18, which is slightly below the average of EU countries. There are, however, some variations in the scores across the SEE economies, which range between 0.12 and 0.26. Most of the assessed economies have lower indices in 2017 than they did in 2014, as a result of reforms that have liberalised services trade. The most significant reduction is shown in Kosovo where reforms on the public procurement laws in 2016 have eased the conditions for foreign bidders to participate in public tenders. In the other economies, reforms mainly covered measures that apply across the economy, including the lowering of requirements for the temporary movement of services suppliers (the Former Yugoslav Republic of Macedonia and Montenegro) and easing of the administrative burden and time taken to register businesses (Serbia).

Figure 2.9. **Restrictions to road freight transport services in the SEE economies (2017)**

STRI score



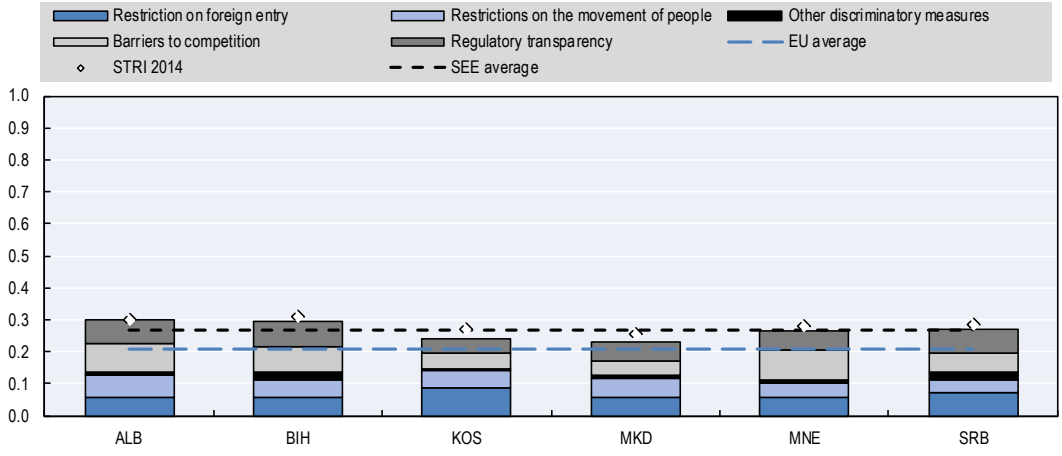
Note: The OECD Services Trade Restrictiveness Index (STRI) for this sector covers only services supplied through commercial establishments and the accompanying movement of people. The OECD STRI indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the OECD STRI regulatory database, which records measures on a most favoured nations basis. Preferential trade agreements are not taken into account.

Source: OECD STRI assessment of road and rail freight transport services in the SEE economies for this *Competitiveness Outlook*.

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Figure 2.10. **Restrictions to rail freight transport services in the SEE economies (2017)**

STRI score



Note: The OECD Services Trade Restrictiveness Index (STRI) indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the OECD STRI regulatory database which records measures on a most favoured nations basis. Preferential trade agreements are not taken into account.

Source: OECD STRI assessment of road and rail freight transport services in the SEE economies for this *Competitiveness Outlook*.

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The indices in rail freight transport services range between 0.23 and 0.30, with an average of 0.27 (Figure 2.10). The SEE average in this sector is considerably higher than the EU average. Barriers to competition contribute substantially to the score in all the SEE economies, together with economy-wide restrictions on market entry, movement of people and regulatory transparency. Compared to 2014, the 2017 STRI indices have lower values in most SEE economies indicating a shift towards the liberalisation of these services over time. Most liberalisation consisted of economy-wide measures such as easing conditions for the temporary movement of people providing services, and reducing the administrative requirements for setting up businesses.

General business regulations and barriers to the movement of people affect firms' ability to operate

The STRI captures the limitations and restrictions on entry into a country's markets faced by commercial establishments, as well as behind-the-border regulations for corporations that are burdensome for foreign services suppliers. The STRI also identifies barriers that affect the temporary movement of people who travel to the host economy as intra-corporate transferees,[9] contractual services suppliers or independent services suppliers.

There are a number of areas where the SEE economies could improve their regulations on corporations. Four of the six economies limit foreign firms' acquisition or use of land and real estate (Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia), affecting their ability to establish offices in the host economy. Such limitations are particularly important in the rail freight transport sector, particularly for those wanting to own and operate terminals. Furthermore, in Bosnia and Serbia, the general rules on public procurement across sectors disadvantage third-country bidders by offering price preferences for local bidders. These advantages are also granted by some economies to bidders from signatories to the CEFTA Agreement or, where relevant, bidders from EU Member States under the terms of an SAA, and are applied in accordance with the provisions of those agreements. Other conditions further affect operations for foreign firms across sectors, such as minimum capital requirements, which are of strategic importance in the road freight transport; the lack of adequate public consultation on new laws and regulations; and burdensome procedures for obtaining business visas.

Restrictions on the movement of people, such as quotas or labour market tests, can delay the establishment of firms and raise their operating costs. While important progress has been made in easing the conditions for the movement of people between CEFTA economies through the conclusion of Additional Protocol 6 to the CEFTA Agreement, people from outside the CEFTA economies face restrictive requirements. Three of the SEE economies apply quotas on work permits issued to third-country nationals (Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Montenegro), although intra-corporate transferees are generally exempt in all three economies. Labour market testing is also applied throughout the SEE economies, meaning that work permits for third-country foreigners are only issued if no suitable local worker can be found. In Albania and Serbia, however, intra-corporate transferees are exempt from labour market testing altogether. Durations of stay vary significantly across the region, and remain below international best practice in most of the SEE economies.

Impediments to road and rail freight transport services should be addressed

The STRI for road transport services identifies barriers that affect commercial establishments, but does not cover arrangements enshrined in bilateral or plurilateral agreements on cross-border transport services. Hence, the indices and measures described below relate only to services supplied through a locally established road transport company.

In the SEE economies, licences for operating through a commercial establishment are generally granted using transparent criteria. Although price regulation of transport services is not common, it can be observed in Bosnia and Herzegovina in both entities. Professional qualifications are important in road transport, particularly for truck drivers, who must obtain certificates demonstrating their professional competence. However, three of the SEE economies (Albania, Kosovo and Serbia) either have no procedures in place to recognise certificates obtained abroad, or limit that recognition to training undertaken in an EU country.

The regulatory environment for foreign investment in rail freight transport companies is open and non-discriminatory across the SEE economies. As part of the alignment of the region's rail transport framework with the EU rail transport *acquis*, vertical separation between the infrastructure manager and the services suppliers has been gradually introduced in all six economies. Nonetheless, the process of implementation is yet to be completed in some of them.

As shown in Figure 2.10 above, barriers to competition are major contributors to the STRI results in rail transport services across the SEE economies. Competitiveness is affected by government ownership of the main rail transport operators throughout the region. Furthermore, in Albania, Bosnia and Herzegovina, and Montenegro, the government can also overrule the decisions of the rail regulator. Additionally, transfers and trade in infrastructure capacity are commonly prohibited in all six economies. Allowing exchanges of infrastructure capacity could contribute to reducing congestions on the network.

Access to the rail network hinges on transparent access conditions and fees. While infrastructure managers are required to publish relevant documents about these conditions, implementation of this requirement is still lagging behind in some economies. In Bosnia and Herzegovina, and Serbia, for instance, the law requires the publication of a Network Statement containing the relevant information needed for operators to apply for authorisations to access the network, but no such document has been issued yet. As for road transport services, where qualifications are required to enter a profession (e.g. truck driver), qualifications obtained abroad are not recognised in Albania, Kosovo or Serbia, with the exception of certain qualifications obtained in an EU Member State.

The way forward for trade liberalisation

Significant improvements have been made among the SEE economies to liberalise services trade through the conclusion of CEFTA Additional Protocol 6 in December 2016. Nonetheless, there is room to broaden such efforts beyond regional trade agreements. The STRI analysis in this section has provided some insights into where domestic reforms could help to attract new businesses and improve competitiveness.

The STRI shows that over the past few years there have been numerous changes that have helped reduce the barriers to trade in services towards third countries across the SEE region. It will be important to continue this process by **improving the transparency of regulation affecting all industries**.

Easing conditions on the temporary movement of natural persons 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 which apply to foreign services suppliers.

In both road and rail transport sectors, the remaining barriers to market entry and competition will need to be reduced. Further efforts could be made to increase competitiveness, particularly in rail freight transport services, by ensuring that the recently introduced reforms on vertical separation are implemented fully and ensure equal access conditions to the network for all providers.

Trade facilitation and non-tariff measures

The SEE economies have achieved full tariff liberalisation in trade in manufactured and agricultural products since CEFTA came into force in 2006. Although has this led to an increase in trade flows, different adoption rates for international and EU standards are creating new difficulties in the form of non-tariff barriers (NTBs). NTBs can be much more harmful in blocking trade flows than tariffs because they are technically and politically challenging to detect, analyse and remove. Consequently, lowering or dismantling them is important for enabling international trade.

To remove NTBs, a co-ordinated approach between government institutions and the private sector is needed. Standards, technical regulations, sanitary and phytosanitary (SPS) measures and conformity assessment procedures can all give rise to non-tariff barriers to trade. They are intended to achieve legitimate public policy objectives, such as those related to national security, public health and safety, and environmental protection. However, they may explicitly or implicitly become barriers to trade when they are enforced non-proportionally, arbitrarily, or through testing and certification requirements that are unclear or not easily accessible to foreign manufacturers or producers.

This section considers the trade facilitation and non-tariff measures sub-dimension (Figure 2.11) by assessing the following areas:

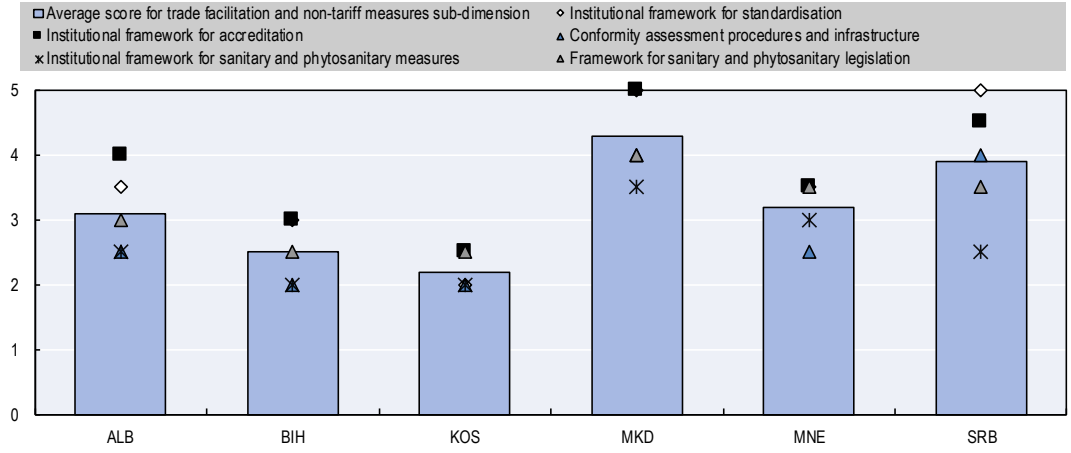
- Technical barriers to trade indicators assess the **institutional framework for standardisation, the institutional framework for accreditation**, and the economies' capacity and competence in **conformity assessment procedures and infrastructure**. To certify that goods meet certain technical regulations and standards, they must go through a range of conformity assessment procedures such as inspection, certification, calibration and testing. If technical standards are too stringent, not applied transparently or not publicly available they become technical barriers.
- The sanitary and phytosanitary indicators evaluate the **institutional framework for SPS measures** and **framework SPS legislation** in place to support effective and legitimate SPS measures, which are necessary to ensure food safety and protect the health of animals and plants.
- The **OECD trade facilitation indicators**[10] include customs and administrative procedures at the border. While some administrative procedures may be necessary, burdensome export or import requirements may hinder trade. Consistent, predictable, simple and transparent customs and border procedures facilitate trade.

The SEE economies have taken steps to remove non-tariff barriers (Figure 2.11). They all perform relatively well against the technical barriers to trade indicators (especially in accreditation and standardisation), while some further efforts are needed in

conformity assessment procedures. The greatest room for improvement in all the economies lies in the implementation of sanitary and phytosanitary measures, and to a lesser extent trade facilitation measures.

The Former Yugoslav Republic of Macedonia and Serbia are leading the region with average scores of over 3.5. This implies that policy frameworks are in place, implementation is advanced and some monitoring and evaluation activities are taking place. With a score of around 3, Albania and Montenegro are implementing policy frameworks to reduce NTBs but their monitoring and evaluation activities could be improved. In Bosnia and Herzegovina, and Kosovo, which score just over 2, frameworks and implementing activities are only in place for half of the qualitative indicators.

Figure 2.11. **Trade facilitation and non-tariff measures: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process. SPS – sanitary and phytosanitary.

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The SEE economies have strengthened their institutional frameworks for standardisation and accreditation

The priority for the national standardisation bodies in all economies is to adopt European Standards as their national standards and to withdraw conflicting national standards. Four economies (Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia) have adopted more than 80% of European Standards.

The principles of voluntary standardisation are recognised and fully reflected in the SEE economies' **institutional framework for standardisation** through their national standardisation bodies' structure and operations. The national standardisation bodies of the Former Yugoslav Republic of Macedonia and Serbia are now members of the European Committee for Standardization (CEN) and CENELEC (European Committee for Electrotechnical Standardization) and participate in their technical committees according to national priorities. The other economies' bodies, except for Kosovo's, are affiliates and have observer status in the technical committees according to national priorities. They are hindered from more active participation by financial constraints and limited government support.

The SEE economies' **institutional frameworks for accreditation** comply overall with the requirements of Regulation (EC) 765/2008 of the European Parliament and of the Council, which sets out the requirements for accreditation and market surveillance relating to product marketing. In order to achieve harmonisation with Regulation (EC) 765/2008, most of the economies have amended or adopted a new law on accreditation.

Many bilateral agreements have been concluded between the national accreditation bodies (NABs) of the SEE economies. The Former Yugoslav Republic of Macedonia has been the most active in this area – its NAB has bilateral agreements with all the SEE economies. These agreements allow for the exchange of accreditation-related information and documentation, joint seminars and conferences, mutual training of staff, exchange of assessors and technical experts, etc. At the domestic level, most SEE economies have good co-operation between their NAB and their national metrology institute, national standardisation body and market surveillance authority.

Most SEE economies are signatories of the European Accreditation Multilateral Agreements (EA MLA) or Bilateral Agreements (EA BLA) of the European Co-operation for Accreditation.[11] Currently the Former Yugoslav Republic of Macedonia and Serbia have signed the EA MLA covering the greatest number of areas. Albania's NAB has only signed an EA MLA for testing laboratories, while the NAB of Bosnia and Herzegovina has an EA BLA for testing, calibration and inspection. Montenegro plans to submit a formal application for the status of EA MLA for testing, calibration, certification and inspection in 2018.

Many economies need to improve their conformity assessment infrastructure

Easy access to adequate physical facilities for testing and inspection is the main condition for a cost-effective conformity assessment system that benefits an economy's businesses. While no economy needs or can afford these facilities in all areas, the prioritisation of sectors should be taken seriously and be based on a careful assessment of the economy's potential and existing needs.

The Former Yugoslav Republic of Macedonia and Serbia have satisfactory physical capacity and competence to carry out conformity assessment in many priority sectors, and enough accredited conformity assessment bodies (Table 2.3). Their needs and priorities in conformity assessment are well established and the designation procedure is fully implemented.

In the remaining economies, a limited number of priority sectors are covered by a sufficient number of accredited conformity assessment bodies. The designation procedure is established but not fully implemented; and in some instances (Bosnia and Herzegovina, and Kosovo) there is no systematic definition of national conformity assessment infrastructure needs.

Implementation of SPS measures and inspection procedures needs to be further strengthened

In terms of the **institutional framework for sanitary and phytosanitary measures,** SPS agencies in many of the SEE economies suffer from lack of staff, sometimes inadequate equipment for inspection and restricted financial resources. Quality systems in the agencies are under development or planned, which will further improve their functioning and efficacy. In Albania and Kosovo, the competences of the SPS agencies still overlap, leading to inspection duplication.[12]

Table 2.3. **Number of accredited conformity assessment bodies in the SEE economies (2017)**

Type	Method	ALB	BIH	KOS	MKD	MNE	SRB
Accreditation of laboratories	Testing, calibration ISO/IEC 17025	40	69	33	80	21	300
	Medical analyses ISO 15189	4	1	/	6	/	12
Accreditation of certification bodies	Certification of products EN 45011	/	/	/	6	1	20
	Certification of persons ISO/IEC 17024	3	/	/	/	/	6
	Certification of management systems ISO/IEC 17021	3	/	/	4	1	15
Accreditation of inspection bodies	Inspection ISO/IEC 17020	13	25	8	100	6	123
Total		63	95	41	196	29	476

Note: ISO/IEC – International Organization for Standardization/International Electronic Commission; EN – European Standards.

Source: Economy-specific data provided by national accreditation bodies in the region as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

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Framework sanitary and phytosanitary legislation is fully developed in most of the SEE economies and intensive work on harmonising framework laws (including transposition of secondary legislation) has been undertaken across the economies. All economies assess the impact of legislation on food safety on an ad hoc basis, using different methods.

Although all of the economies have framework laws and sub-laws to regulate risk management and analysis, they are still not well implemented in practice (Table 2.4). The economies are still developing their capacity for risk-based control (both for inland and for border inspection). Only the Former Yugoslav Republic of Macedonia has advanced further in this area by implementing the system in practice and by developing numerous tools for risk-based inspection. Other economies are at an early stage in developing risk assessment tools, which include categorising food business operators according to risk, checklists, guidelines, databases and various registers. Furthermore, the SEE economies are still developing their information systems and are not yet able to connect the various SPS agencies and the laboratories.

Planning of inspections is sometimes driven solely by financial capacity rather than reflecting the needs laid out in annual and multi-annual action plans.

Table 2.4. **Trade facilitation and non-tariff barriers sub-dimension: Technical barriers to trade and SPS measures**

	ALB	BIH	KOS	MKD	MNE	SRB
Institutional framework for standardisation	3.5	3	2	5	3.5	5
Institutional framework for accreditation	4	3	2.5	5	3.5	4.5
Conformity assessment procedures and infrastructure	2.5	2	2	4	2.5	4
Institutional framework for SPS measures	2.5	2	2	3.5	3	2.5
Framework SPS legislation	3	2.5	2.5	4	3.5	3.5

Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

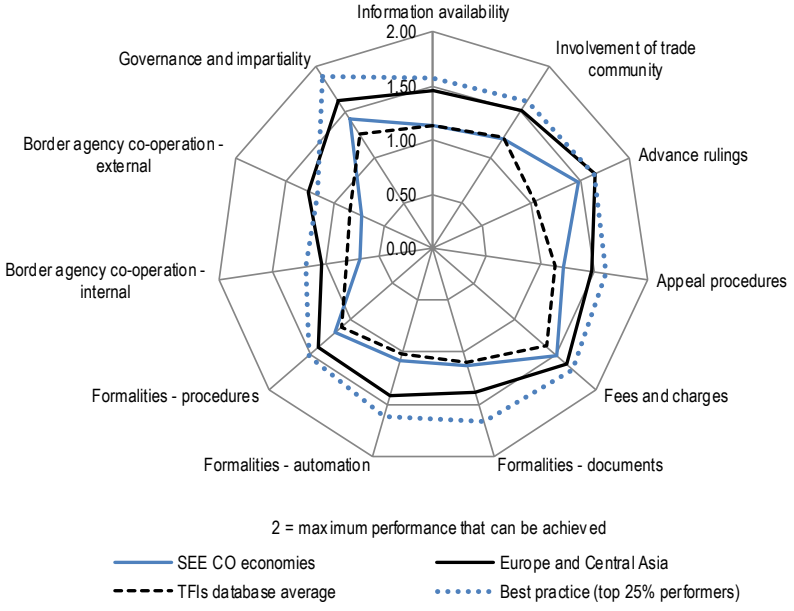
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Further implementation of trade facilitation measures could increase trade flows

The implementation of CEFTA has seen the SEE economies make significant progress in addressing trade facilitation issues. Of particular benefit has been the conclusion of Additional Protocol 5 to the agreement, which provides a legal basis for the electronic exchange of documents among the authorities of the CEFTA Parties involved in clearance of products. Nevertheless, the results of the OECD trade facilitation indicators for SEE economies highlight a number of areas for further improvement.

According to the 2017 OECD trade facilitation indicators (TFIs) database, the SEE economies perform better or on a par with the average performance of all the economies covered (Figure 2.12). The SEE economies are close to worldwide best practice and the Europe and Central Asia average performance in the areas of advance rulings and fees and charges, but performance across the remaining TFI areas remains below worldwide best practice. The most challenging areas across the board for the SEE economies are those concerning internal and external border agency co-operation. As the TFI database average shows, however, most countries worldwide find it a challenge to achieve both domestic and cross-border co-operation.

Figure 2.12. **SEE average performance against the OECD trade facilitation indicators (2017)**



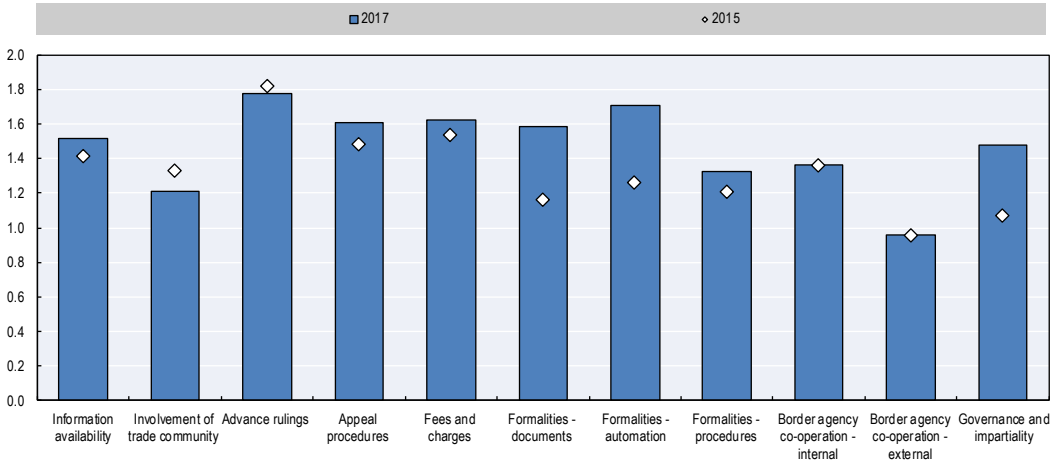
Source: OECD (2017b), *Trade Facilitation Indicators* (database), www.oecd.org/trade/facilitation/indicators.htm.

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A comparison of the SEE trade facilitation performance in 2015 and 2017 reveals several important trends (Figure 2.13). While the most notable improvements in the SEE average performance are in the areas of simplification and harmonisation of documents, automation, and governance and impartiality, there were only marginal improvements in the areas of information availability, appeal procedures, fees and charges, and streamlining of procedures. Their performance in the other areas did not change, with the exception of

the involvement of the trade community, where they lost some ground relative to other economies across the globe.

Figure 2.13. **Comparing the OECD trade facilitation indicators for South East Europe (2015 and 2017)**



Note: The time comparison displayed is based on the same components covered both by the 2015 and the 2017 trade facilitation indicators (TFI) series, excluding the additional variables which were inserted in the most recent set. The figure does not include Kosovo, as data are not available for 2015.

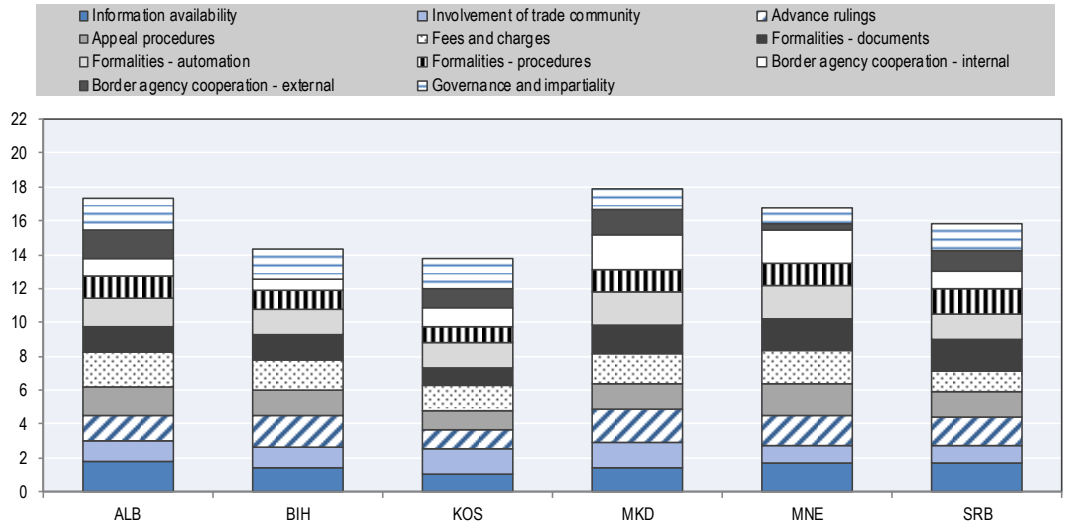
Source: OECD (2017b), *Trade Facilitation Indicators* (database), www.oecd.org/trade/facilitation/indicators.htm.

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The performance of the individual SEE economies is far from homogeneous (Figure 2.14). Each of the six economies covered has areas of high and low performance. The most pronounced disparities within the group appear to be in the areas of information availability, advance rulings, fees and charges, simplification and harmonisation of documents, automation, border agency co-operation, and governance and impartiality. Their performance seems more homogeneous in the involvement of the trade community, appeal procedures and streamlining of procedures.

All the economies publish the basic steps for importation, exportation and transit procedures relatively widely, as well as the rates of duties and taxes applied. Albania and Serbia also provide summary guides and specific highlights on importation, exportation and transit procedures. All the SEE economies make at least some of the required forms and documents for the procedures of border agencies available online. Only Serbia appears to have new web functions in place such as a specific page for professional users or the publication of user manuals. There are wide differences among the SEE economies regarding the availability of information on classification and valuation rules, appeal procedures, and agreements with third countries, either through paper or online publication. While Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Montenegro provide specific web pages for advance rulings, only the Former Yugoslav Republic of Macedonia has an interactive interface allowing the online filing of advance rulings requests.

Figure 2.14. **OECD trade facilitation indicators in the SEE economies (2017)**



Source: OECD (2017b), *OECD Trade Facilitation Indicators* (database), www.oecd.org/trade/facilitation/indicators.htm.

StatLink http://dx.doi.org/10.1787/888933703219

All the SEE economies maintain one or more enquiry points and offer the opportunity to submit questions about customs-related issues, either by phone or via an online form. However, the timeliness of response from enquiry points appears to be problematic: only in Bosnia and Herzegovina, and Kosovo, are the hours of operation fully aligned with commercial needs, and only Albania and Montenegro have service charters establishing a standard response time to enquiries received.

All six economies hold specific public consultations when introducing or amending trade-related laws, regulations and administrative rulings of general application. In addition, Albania and the Former Yugoslav Republic of Macedonia have structures for regular consultations between traders and the respective administrations. All economies, with the exception of Former Yugoslav Republic of Macedonia, have well-established guidelines and procedures in place to govern the public consultation process. The scope of consultations has also been widened, with new types of audiences enjoying access to consultations: Albania, Bosnia and Herzegovina, and Kosovo seek to involve at least four stakeholder groups. Drafts are available before a rule enters into force, and stakeholders can comment on them in Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia.

While all the SEE economies have a legal basis for issuing advance rulings, they vary considerably over the timeliness of these rulings, the use of the system by traders and the publication of advance rulings of general interest. Although the right to appeal is widely available, the overall timings of the appeal mechanisms – including providing sufficient time to contest a decision and prepare and lodge an appeal, and avoiding undue delays in rendering decisions – appear to be the most challenging aspect for the economies as a whole.

With respect to fees and charges, 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 page of fees and charges on its

customs website. In the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, customs administrations charge fees for answering enquiries and providing required forms and documents. However, all the economies now provide adequate time between the publication of new or amended fees and charges and their coming into force. Several provisions relating to penalties appear to remain especially challenging for Albania, Kosovo and Montenegro.

The relevant border agencies carry out periodic reviews of documentation requirements in Albania, Kosovo, Montenegro and Serbia, but these economies are still working on simplifying unduly time-consuming or costly requirements for traders. All of the SEE economies could make further efforts to simplify and harmonise documents, as reflected by the number of documents currently requested for import and export, as well as the average time needed to complete these documents. The majority of the economies have made noticeable improvement in accepting copies of documents, but it is still the exception and depends on the type of goods, the circumstances and the agency.

In all SEE economies, IT systems capable of electronic data interchange – essential for simplifying documentation requirements and reducing the complexity of document submission – are either being put in place or are already functional. The economies are still in the early stages of harnessing the power of IT systems to clear import and export procedures electronically, however. Other challenges for automating administrative procedures at the border include: pre-arrival processing and its application in an automated environment (currently only in the process of implementation in Kosovo, Montenegro and Serbia); integrating a system for the electronic payment of duties into the automated declaration/cargo processing system (only implemented in Albania and the Former Yugoslav Republic of Macedonia); and the application of digital certificates and signatures (only implemented in the Former Yugoslav Republic of Macedonia).

Customs controls are currently supported by an automated risk management system in Albania, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia. More information would be needed to discern whether this automation works reliably and consistently. Other border controls, such as sanitary and phytosanitary controls, do not yet appear to be supported by an operational risk management system. Having such a system in place would be a pre-requisite for using risk management co-operation and the systematic sharing of control results among neighbouring economies in order to improve risk analysis and the efficiency of cross-border controls.

The Former Yugoslav Republic of Macedonia made progress between 2015 and 2017 in adopting supportive measures to speed the processing of perishable goods, including giving them priority when scheduling physical inspections, providing adequate storage conditions and separating release from clearance. Work in these areas is underway but incomplete in Albania, Bosnia and Herzegovina, Kosovo, Montenegro and Serbia.

Authorised operator (AOs) initiatives are also underway: Albania, the Former Yugoslav Republic of Macedonia and Montenegro provide additional trade facilitation measures to trusted traders who meet compliance criteria or are at low risk of non-compliance. Kosovo and Serbia appear to have already developed AO schemes based on relevant international standards. However, the limited coverage of the current programmes can be explained by the lack of transparency in the criteria for qualifying as an AO, the complicated procedures involved in submitting and reviewing applications for AO status, the long delays in granting such certification, as well as the few and narrow types of benefits granted to AOs.

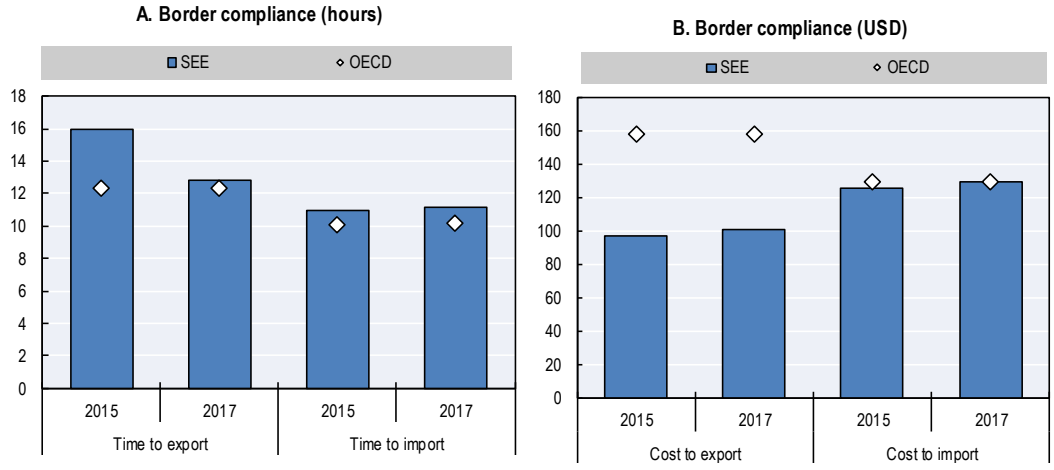
The importance of introducing single windows is recognised, but they are still at the planning or early implementation stages in Albania, Bosnia and Herzegovina, Kosovo and Montenegro. This highlights the complexity of the efforts needed to create them.

This assessment found that the SEE economies have made significant progress in setting up an explicit co-ordination strategy for domestic agencies involved in managing cross-border trade. So far, only the Former Yugoslav Republic of Macedonia has also established an inter-agency co-ordination body. The region has also made progress in co-ordinating inspections, but only border agencies in Kosovo and Montenegro share the results of inspections and controls. Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Kosovo also promote co-ordinated/shared use of infrastructure and equipment. That said, the development of interconnected or shared computer systems and real-time availability of pertinent data, as well as interagency collaboration on certifying AOs, are still incomplete in all the SEE economies.

Co-operation with border agencies in neighbouring and third countries appears even more challenging than domestic border agency co-operation. Only Bosnia and Herzegovina, Kosovo and Serbia have made progress between 2015 and 2017 in aligning border agencies' working days and hours, as well as procedures and formalities.

The World Bank's *Doing Business* report shows that between 2015 and 2017 the SEE economies improved their border compliance[13] in terms of the time involved in exporting. The economies are now in line with the OECD average of 12 hours (Figure 2.15). The time and costs involved in importing have remained stagnant, but are still close or at the OECD average. Finally, when it comes to the average cost of exporting, the SEE economies perform better than the OECD average, at USD 100 (compared to the OECD average of USD 160).

Figure 2.15. **The costs of border compliance (2015 and 2017)**

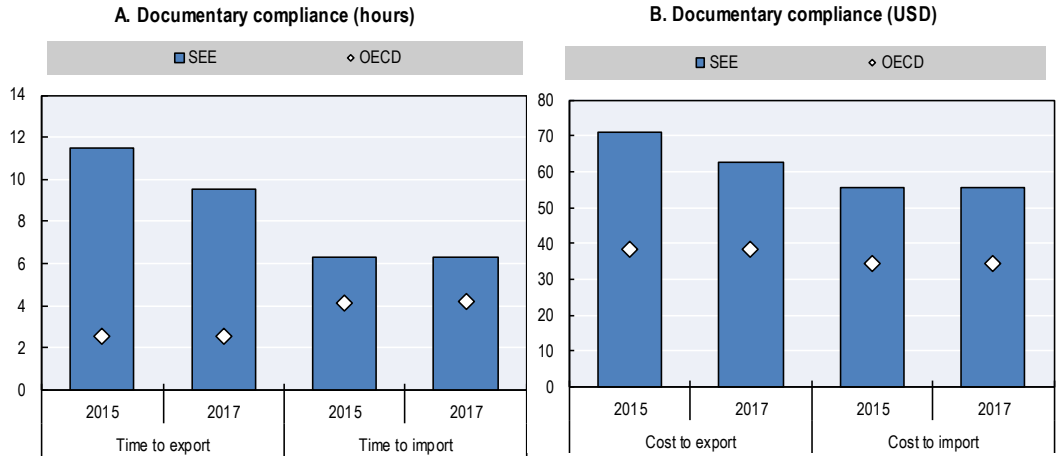


Source: World Bank (2017b), *Doing Business Data* (database), www.doingbusiness.org/data.

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The economies' performance in documentary compliance could be improved, however, in both the time and costs for exporting and importing (Figure 2.16). They particularly need to be make efforts to lower the time to export – although it fell between 2015 and 2017 to around nine hours, it is still three times longer than the OECD average.

Figure 2.16. **The costs of documentary compliance (2015 and 2017)**



Source: World Bank (2017b), *Doing Business Data* (database), www.doingbusiness.org/data.

StatLink http://dx.doi.org/10.1787/888933703257

The World Bank *Logistics Performance Index* finds that the SEE economies score on average 2.4 on a scale of 1 to 5 (with 5 being the most efficient) for perceptions of customs clearance efficiency – a full point below the EU average of 3.5 (World Bank, 2017c). These relatively low scores for clearance efficiency reflect widespread inefficient customs practices, such as burdensome import procedures and high levels of corruption at borders. Bosnia and Herzegovina, and Serbia are closer to the OECD average than the other economies and are the only ones which made a slight improvement between 2012 and 2016.

The way forward for reducing non-tariff barriers and facilitating trade

SEE economies should continue to further reduce non-tariff barriers to trade, especially regarding SPS measures. This would include further developing the capacities for risk assessment and management amongst all border agencies. **Proper implementation of risk-based inspection will be especially important** to avoid the repeated sampling and testing of products. This will reduce the time and cost of both importing and exporting. This would require the SPS agencies in all the SEE economies, except the Former Yugoslav Republic of Macedonia, which has advanced in this field, to provide regular training on risk analysis to their inspectors. They also need to do more to develop the necessary risk assessment tools (such as checklists and guidelines, registers, databases and categorising food business operators according to risk levels).

Information systems should be further developed and should be able to interconnect different SPS agencies and laboratories. Until more comprehensive databases are developed, the SEE economies could develop minimum indicators of product risk by estimating the basic risk levels of products and identifying reliable producers. This basic risk assessment, combined with certificates and results from accredited laboratories, could help reduce the frequency of physical checking, sampling and re-testing.

In economies where there is still an overlap of competences among the SPS agencies (Albania and Kosovo) leading to duplication of inspection, **sanitary and phytosanitary inspection procedures could be simplified** and the burden of inspection reduced where

several inspectorates enforce control over the same product/operation. They should also ensure a clear division of responsibilities in inspections.

In terms of trade facilitation measures, the SEE economies need to make the biggest efforts in improving both internal and external border agency co-operation. Regarding the latter, concerted efforts will be needed to continue to adapt border agencies' business hours to the needs of trade. Aligning procedures and formalities with partner economies may require border processes to be re-engineered to ease data exchange, and greater use of automated tools in cross-border agencies. Furthermore, in accordance with the Multi-annual Action Plan for a Regional Economic Area developed at the 2017 Western Balkans Summit in Trieste (MAP, 2017), it will be important to adopt and implement a regional strategy for joint risk management and joint border controls (as specified in CEFTA Additional Protocol 5).

Export promotion

Proactive export promotion policies can help economies diversify their exports by encouraging trade in goods for which they have a comparative advantage. Export promotion may create learning opportunities that result in new forms of comparative advantage, and therefore attract export-oriented investment. Moreover, a study on the impact of export promotion agencies (EPAs) and their strategies suggest that on average EPAs have a strong and statistically significant impact on exports (Ledermann, Olarreaga and Payton, 2006). It estimated that for each USD 1 of export promotion, there is a USD 40 increase in exports.

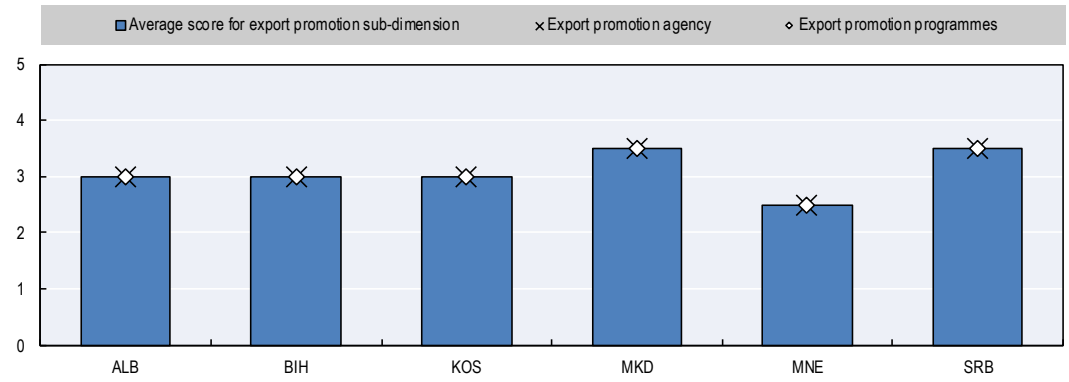
This section considers the export promotion sub-dimension by assessing the following qualitative indicators (Figure 2.17 and Table 2.5):

- The **export promotion agency** indicator looks at the presence and efficiency of such agencies, which can be instrumental in improving the penetration of local companies in foreign markets. Export promotion agencies should ideally be flexible, autonomous institutions operating with political support at the highest level and have links with both the public and the private sectors (see Box 2.3 for an example from Chile). Furthermore, the agency's programme of work should be concentrated on products and industries where medium-term competitiveness can be established and sustained, and where markets with significant growth potential can be identified.
- The **export promotion programmes** indicator assesses the range of available programmes, their comprehensiveness and co-ordination, and how well they are funded. Export promotion programmes comprise various services, ranging from economy image-building (including promotional events and policy advocacy), export support services (including training, regulatory compliance and information on trade finance, customs), to marketing (including trade fairs and exporter missions), and market research and publications.

Export promotion agencies and programmes are in place but their capacity and scope vary

The SEE economies have all established **export promotion agencies** or bodies focusing mainly on promoting exports overall. In Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia the agencies' work also has a broad sectoral orientation. In all the economies these agencies' support services are primarily provided to SMEs and established exporters.[14]

Figure 2.17. **Export promotion: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Table 2.5. **Export promotion sub-dimension: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Export promotion agency	3.0	3.0	3.0	3.5	2.5	3.5
Export promotion programmes	3.0	3.0	3.0	3.5	2.5	3.5

Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Export promotion agencies need to have independence, protecting them from political pressure when establishing priorities and giving them the power to advocate more freely for public policies that favour exporters. They should have long-term funding and sufficient control of their resources if they are to be held accountable for achieving results.

In the SEE economies, only two agencies are autonomous and have adequate human and financial resources for implementing export promotion activities: the Agency for Foreign Investments and Export Promotion of the Former Yugoslav Republic of Macedonia, and the Development Agency of Serbia. In Bosnia and Herzegovina, the Export Promotion Agency, which operates within the Foreign Trade Chamber, has full operational autonomy, but its co-operation with competent institutions at the entity level could be further strengthened, and the programmes and capacities of the entity-level institutions also need further improvement.

In the remaining economies, these agencies are either not fully independent or have insufficient budgets and staff. Although the Albanian Investment Development Agency is autonomous, it currently has only two specialists employed in the export sector of the SME and Export Department. Kosovo's Investment and Enterprise Support Agency operates under the Ministry of Trade and Industry and has partial operational autonomy, with two employees working on export promotion. In Montenegro the main body responsible for export promotion is the Department for Competitiveness Enhancement and Export Promotion, which is an integral part of the SME Directorate (Ministry of Economy). It has three employees.

All the economies have **export promotion programmes** which usually provide the following: trade policy information and commercial intelligence, representation at major trade fairs, export promotion and marketing activities. However, the agencies rarely help

domestic enterprises to conform to standards (including SPS requirements) in key export markets. Furthermore, financial support programmes are poorly developed in most of the economies except the Former Yugoslav Republic of Macedonia and Serbia, where SMEs can benefit from export credit guarantees and export credit insurance (and other types of financial support) provided by the Macedonian Bank for Development Promotion and Serbia's Export Credit and Insurance Agency.

Although the export promotion agencies in the region report on their activities annually, overall there is a lack of independent monitoring of achieved deals and targets. Furthermore, the services provided are not evaluated for their effectiveness in increasing exports.

Box 2.3. **Good practice: Export promotion in Chile (ProChile)**

ProChile has 14 offices in Chile and 59 trade offices or trade representative offices in 38 countries around the world, making it one of the most robust export trade promotion agencies in Latin America.

Chile's export promotion programme traditionally targets sectors of comparative advantage. The country's export mix consists largely of commodities, especially consumer commodities for which branding can be very effective (seafood, fresh produce, processed foods, wines and beverages). However, in recent years a successful diversification campaign has extended export promotion to the fields of nano-technology and medical equipment, spurred in part by an effective marketing campaign.

A hallmark of Chile's success has been its co-financing arrangements for exporters. ProChile co-finances company export plans on a case-by-case basis during its annual Export Grant Competition. Additionally, Chile offers up to 50% financing opportunities for companies who take part in foreign trade shows.

Chile leads the way in export-orientated growth in Latin America, and has emerged as a regional model in the last decade. ProChile has helped forge fruitful international partnerships and economic agreements abroad, including a free trade deal with the United States and the Political and Economic Partnership Agreement with the European Union.

ProChile is a high performing public-private entity which attracts high-skilled and motivated employees. At a minimum, a university degree in commerce or industrial engineering is required. The professional and business orientated culture at ProChile sets an example for other export promotion agencies.

Source: ProChile (n.d.) ProChile website, www.prochile.gob.cl.

The way forward for export promotion activities

The capacity of EPAs in the SEE economies could be strengthened, both in terms of specialised staff and a dedicated budget for implementing export promotion activities. In terms of independence, the agencies operating in Kosovo and Montenegro could gain further autonomy.

The programme of work of all agencies in the SEE economies could **focus more on large firms that are not yet exporters**, rather than on only providing support to SMEs and established exporters. In economies where the agencies do not yet have a sector orientation (Albania, Kosovo and Montenegro), priority sectors should be selected from market research that identifies the best sectors at home and the best regional markets abroad. This could be done in close consultation with sector organisations that would help

identify specific needs and determine which companies could benefit most from government assistance.

The variety of export promotion services could be broadened and financial support programmes introduced where not in place (Albania, Bosnia and Herzegovina, Kosovo and Montenegro). The latter could include export credit guarantees, export credit insurance, export working capital and other types of financial support. Economies in the region could also consider implementing a co-funding programme to provide financial assistance to individual companies for developing their export strategies and plans.

All the SEE economies would benefit from introducing a monitoring mechanism to regularly evaluate their export promotion programmes for effectiveness in increasing exports. One of the tools that could be introduced is a formal customer relationship management system that would track export results, assess client satisfaction and lessons learned. This would benefit all the SEE economies.

Conclusions

The six assessed SEE economies are relatively well integrated into the world trading system. They have taken steps to remove technical barriers to trade by aligning standardisation and accreditation systems with international good practice. The economies have also made efforts to strengthen their institutional frameworks for trade policy formulation and public-private consultation.

However, non-tariff barriers related to sanitary and phytosanitary measures and regulatory barriers to trade in services are still restricting import and export volumes in the six economies. Furthermore, evaluation and monitoring capacities (both for the impact of trade measures and signed FTAs) are currently weak.

As they move forward, the SEE economies need to focus on reducing non-tariff barriers arising from the application of sanitary and phytosanitary measures and strengthening their capacities for risk-based control. Moreover, they could further reduce the barriers to trade in services by improving regulatory transparency, which affects all industries, and easing conditions on the temporary movement of natural persons. Finally, analytical and econometric skills for impact measurement could be strengthened.

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. See http://cefta.int/wp-content/uploads/2016/05/newsletter14-31march.pdf.
3. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale:

a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

4. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

5. Symmetric input-output tables are product-by-product or industry-by-industry matrices combining both supply and use into a single table with identical classification of products or industries, applied to both rows and columns.

6. For more information about SAAs see EC (n.d.).

7. For details see CEFTA Secretariat website (CEFTA, 2016) and the March 2017 newsletter http://cefta.int/wp-content/uploads/2016/05/newsletter14-31march.pdf.

8. The OECD Services Trade Restrictiveness Index (STRI) is a unique, evidence-based diagnostic tool that inventories trade restrictions in 44 countries for 22 services sectors, allowing countries to benchmark their services regulations relative to global best practice, identify outlier restrictions, and prioritise reform efforts (OECD, 2017a). Composite indices quantify restrictions across five policy areas, with values 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. Land transport services were selected as a priority by the CEFTA Parties for the 2017 OECD STRI exercise given that SEE Competitiveness Outlook project could not cover all service sectors. Previously, the STRI methodology was applied in 2013 to assess the regulatory restrictiveness of professional and construction services.

9. Intra-corporate transferees work for an enterprise established in the territory of a Member [of the WTO] and are transferred to the enterprise's commercial presence in the territory of another Member in the context of the supply of a service, often as executives, managers or specialists.

10. The trade faciliation indicators (TFIs) identify areas of action and enable the potential impact of reforms to be assessed (scored from 0 to 2). These OECD indicators cover the full spectrum of border procedures for more than 160 countries across income levels, geographical regions and development stages. Estimates based on the indicators provide a basis for governments to prioritise trade facilitation actions and to mobilise technical assistance and capacity-building efforts for developing countries in a more targeted way. The TFIs also provide a tool for countries to visualise the state of implementation of various policy areas and measures included in the WTO Trade Facilitation Agreement, to monitor their progress since 2012 and to make comparisons with other countries or groups of countries of interest. See www.oecd.org/trade/facilitation/indicators.htm.

11. The European Accreditation Multilateral Agreement (EA MLA) is a signed agreement between the EA Full Members whereby the signatories recognise and accept the equivalence of the accreditation systems operated by the signing members, and also the reliability of the conformity assessment results provided by conformity assessment bodies accredited by the signing members. A Bilateral Agreement (BLA) between an EA Associate Member and EA has the same purpose and bilateral

signatories to the EA MLA shall meet the same requirements as EA FULL Members. The mark of an EA MLA signatory on certificates and test reports issued by accredited conformity assessment bodies acts as a "passport to trade". The confidence this accreditation brings eliminates the need for suppliers to be certified in each country in which they sell their products or services, and therefore provides the framework for goods and services to cross borders in Europe and throughout the world. For more details and the scope of EA coverage, see EA (2017).

12. In Albania, there is an overlap of competences (in secondary legislation and in practice) between the National Food Authority, Agricultural Directorate, Public Health Directorate, State Health Inspectorate and local government agencies. In Kosovo, there is a degree of duplication of inspections in the mandate of the Inspectorate within the Food and Veterinary Agency and the mandates of the Sanitary Inspectorate (within the Ministry of Health) and the Institute of Agriculture of Kosovo.

13. Border compliance reflects the time and cost associated with complying with the economy's customs regulations, with regulations relating to other inspections that are mandatory in order for the shipment to cross the economy's border, and with handling at the port or border.

14. The findings of this sub-dimension are also in line with the findings on the internationalisation of SMEs in the *2016 SME Policy Index for Western Balkans and Turkey* (OECD, 2016b).

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Annex 2.A1.
Trade policy and facilitation: Indicator scores

Table 2.A1.1. **Trade policy and facilitation: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Trade policy formulation and evaluation						
Institutional co-ordination	3.0	2.5	3.0	3.5	3.0	3.5
Public-private consultation	3.0	3.0	3.0	3.5	2.5	3.0
Monitoring the impact of trade measures	1.0	1.0	1.5	3.0	1.5	2.5
Monitoring the impact of free trade agreements	1.5	1.0	1.5	3.5	1.5	2.5
National input-output frameworks	3.0	0.5	1.0	4.0	1.5	2.0
Trade facilitation and non-tariff measures						
Institutional framework for standardisation	3.5	3.0	2.0	5.0	3.5	5.0
Institutional framework for accreditation	4.0	3.0	2.5	5.0	3.5	4.5
Conformity assessment procedures and infrastructure	2.5	2.0	2.0	4.0	2.5	4.0
Institutional framework for sanitary and phytosanitary measures	2.5	2.0	2.0	3.5	3.0	2.5
Framework sanitary and phytosanitary legislation	3.0	2.5	2.5	4.0	3.5	3.5
Export promotion						
Export promotion agency	3.0	3.0	3.0	3.5	2.5	3.5
Export promotion programmes	3.0	3.0	3.0	3.5	2.5	3.5

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Chapter 3.

Access to finance in South East Europe

This chapter on access to finance assesses the policy settings, strategies, process and institutions in six South East European economies. After a brief overview of access to finance performance, including non-performing loans and the share of credit going to small and medium-sized enterprises (SMEs), the chapter then focuses on three essential sub-dimensions. The first sub-dimension – the policy, regulatory and institutional framework – considers the strategic foundations that support SMEs in accessing finance. The second, access to bank finance, considers the economies' banking systems and the policy measures in place to address market failures in credit lending to small businesses. The third sub-dimension –alternative financing tools – looks at the framework supporting non-bank financing tools, from factoring and leasing to venture capital and access to stock markets. The chapter includes suggestions for policy enhancements in each of these sub-dimensions in order to widen access to finance and in turn help to foster greater competitiveness.

Main findings

Small and medium-sized enterprises (SMEs) play a significant role in the six South East Europe (SEE) economies assessed here – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia. Their role in overall economic activity is greater than European Union (EU) SMEs: although they make up on average 99.7% of all enterprises in the SEE economies, compared to 99.8% in the 28 EU Member States (EU-28), they employ 73.8% of the workforce (66.8% in the EU-28) and generate 63.9% of value-added (57.4% in the EU-28).[1] Despite their overall importance to economic development, SMEs' contribution to growth and competitiveness is limited by their constrained access to sources of external finance (Beck and Demirgüç-Kunt, 2006). Improving access to finance for SMEs could thus increase their contribution to competitiveness, job creation and inclusive development.

Policy reforms in the six SEE economies have improved access to finance for SMEs in recent years. As a result, the assessed SEE economies achieve an average score of 2.6 across the three sub-dimensions in the 2018 *Competitiveness Outlook* (Figure 3.1). They have developed asset registers and credit information systems, and implemented legislation covering insolvency and timely payment. However, domestic credit lending to the private sector remains stagnant, as it has been since the onset of the 2008 financial crisis. Rising levels of non-performing loans (NPLs) are a major concern for policy makers in the region as banks become increasingly risk averse. The result is that banks impose high collateral requirements and rely on fixed assets, making it difficult for many SMEs to qualify for loans. Moreover, while legal and regulatory frameworks have improved, enforcement remains difficult.

Alternative finance is not yet a common funding option in the region for most SMEs. The supply of factoring and leasing products has fallen since the financial crisis, while demand from SMEs has remained low. Equity-based financing options remain underdeveloped, with limited government support for venture capital and business angel networks, and little access to stock markets by SMEs. This gap in alternative financing mechanisms is a key challenge for policy makers in the region, as it not only prevents SMEs from diversifying their funding portfolios – it also prevents new and growth-oriented SMEs from accessing enough finance to meet their needs.

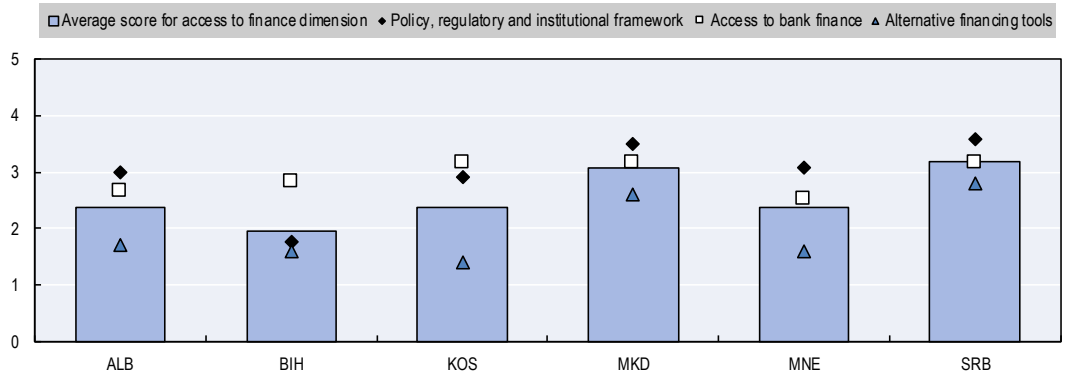
Comparison with the 2016 assessment

All six of the SEE economies have made gradual progress in the areas assessed under this dimension since the 2016 *Competitiveness Outlook,* although it should be noted that due to differences in the assessment methodology, the economies' scores here are not directly comparable. Some economies, notably Kosovo and Albania, have improved their insolvency legislation since the last assessment. Kosovo also launched the Kosovo Credit Guarantee Fund in 2016 to mitigate risks and enhance credit in the region, although the results of the new initiative have yet to be tested. Some economies (the Former Yugoslav Republic of Macedonia, Montenegro and Serbia) are working to improve the venture capital and business angel network ecosystem, notably by drafting laws on investment

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

funds and co-investment funds. Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia remain the only SEE economies that allow non-regulated entities to provide credit information.

Figure 3.1. **Access to finance: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Achievements

All of the SEE economies have taken steps to establish institutional and regulatory frameworks for access to finance. They have developed frameworks for timely payments and insolvency and also made progress in developing asset registers and credit information systems.

Efforts have been made to improve insolvency frameworks to tackle lengthy bankruptcy procedures and reduce administrative backlogs. Progress has also been made in delineating between liquidation and restructuring, and introducing clear priority schemes.

All of the SEE economies have implemented SME financing support programmes. These are primarily credit guarantee schemes and grants or loans at reduced interest rates.

Remaining challenges and key recommendations

- **Complete the implementation of legal frameworks for ensuring timely payments and managing insolvency.** Despite various efforts to reduce them, lengthy processes and legal backlogs make restructuring and liquidation burdensome for bankrupt SMEs and increase the risk of bankruptcy among cash-constrained SMEs facing late payments.
- **Reduce the high collateral requirements in most of the SEE economies.** More efforts are needed to create security rights over movable assets.
- **Support alternative financing instruments across all of the SEE economies.** While factoring and leasing are technically developed, the markets have shrunk since the financial crisis and uptake by SMEs remains small. Government support for venture capital and business angel networks is limited in the region and access to stock markets for SMEs constrained.

Context

Helping small and medium-sized enterprises (SMEs) to access finance is important for promoting entrepreneurship, and ultimately for an economy's competitiveness, growth and employment creation.[2] External finance, whether acquired through bank loans, grants, or investments from private individuals or investment firms, enables enterprises to meet their working capital requirements, start up, finance growth projects, purchase assets or restructure debts, while preserving their own resources.

SMEs often face greater obstacles than bigger firms in gaining access to external financing, a phenomenon that is known as the SME financing gap (OECD, 2006). Some of these obstacles originate from the relationship between lenders and borrowers, which can involve asymmetric information and moral hazard problems. While they exist in all lending relationships, these obstacles are amplified by the limited capitalisation of small enterprises. They result in market failures – notably credit rationing – as the supply of credit falls short of demand, despite the creditworthiness of some of the unserved borrowers or their ability to pay a higher interest rate. Other financing obstacles originate from small enterprises' lack of investment or credit readiness, due to their inadequate or non-existent business planning, accounting practices or book keeping, and lack of awareness and knowledge about financing options and instruments. SMEs also face the same challenges as larger enterprises in the form of deficient regulatory and legal frameworks, significant informality in an economy, underdeveloped financial and banking systems, and financial shocks.

Closing the SME financing gap is complex and requires actions on many fronts, from building adequate institutions and legal frameworks to developing public support programmes targeted at the needs of SMEs. The cost of inaction is high: lack of access to adequate and timely finance impedes the creation of new companies and the day-to-day operations and growth of existing ones.

The access to finance topic is closely linked to other policy areas and dimensions assessed in this report. It is of particular relevance to the following chapter:

- **Chapter 9. Science, technology and innovation** in the private sector is dependent on access to finance, enabling researchers and innovators to access the market place. This is particularly relevant in the seed and early financing stage, where entrepreneurs try and test new ideas that could become an innovative business success.

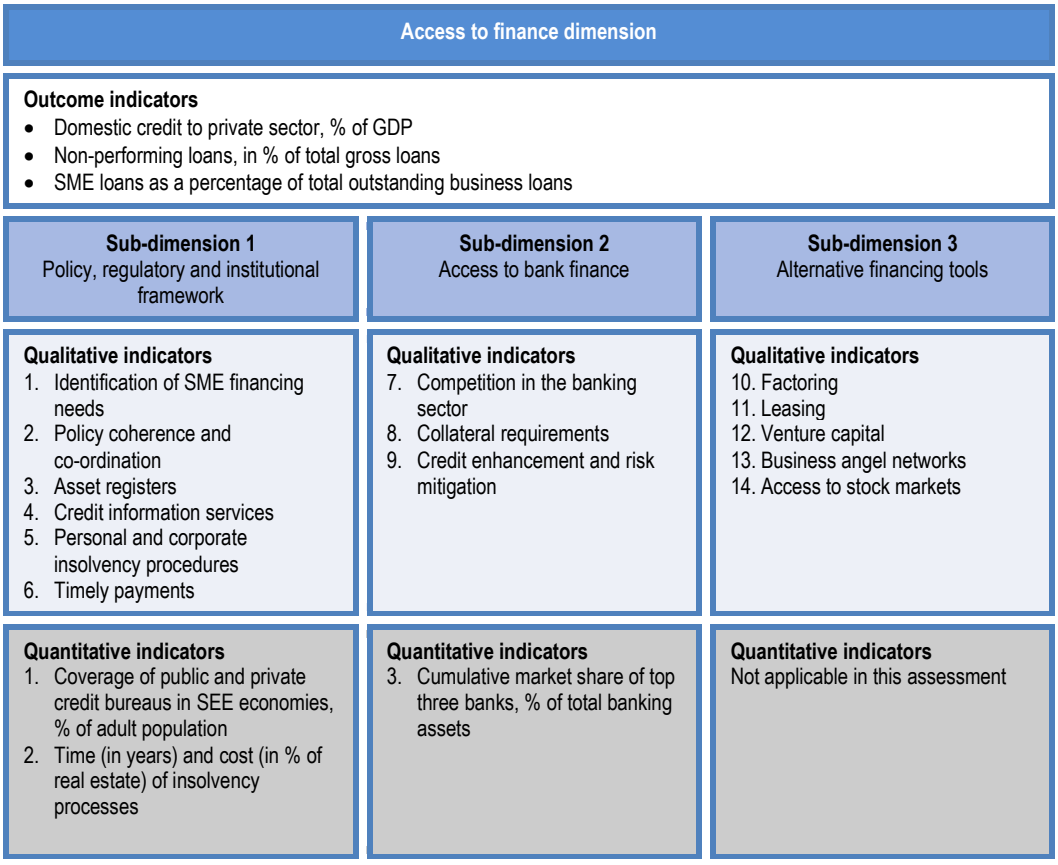
Access to finance assessment framework

This chapter outlines a framework for examining how government policies can help SMEs to access various types of financing by overcoming the gaps described above. Doing so supports the implementation of the sixth principle of the Small Business Act for Europe, an overarching framework for EU policy on SMEs: "Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions" (Ramadani and Schneider, 2013). In addition, 10 of the 14 qualitative indicators (Figure 3.2) match the *SME Policy Index* access to finance framework (OECD et al., 2016). The chapter also builds on the G20/OECD High-Level Principles on SME Financing, which were designed with the support of the G20 finance ministers and central bank governors (OECD, 2015a). This assessment also included questions from a draft survey designed to develop effective approaches to implementing these principles. Without seeking to be exhaustive, the assessment considers three broad sub-dimensions which are critical for access to finance:

1. Policy, regulatory and institutional framework: do the SEE governments systematically build awareness of SME financing needs? Are SME financing policies designed coherently and co-ordinated effectively? Are asset registration and credit information systems in place? Are legal frameworks established to ensure timely payments and well-regulated bankruptcies?
2. Access to bank finance: have the SEE economies enabled adequate access to bank finance through a competitive banking sector, non-excessive collateral requirements and credit enhancement and risk mitigation efforts?
3. Alternative financing tools: have the SEE governments supported the development of alternative SME financing tools? Are mechanisms in place that have different levels of risk and return and that meet SMEs' needs for various activities and development stages?

Figure 3.2 shows how the three sub-dimensions and their constituent indicators make up the access to finance assessment framework. The sub-dimensions are assessed through a mixture of quantitative and qualitative information, with quantitative data stemming from national or international statistics. Qualitative information was collected by the OECD through comprehensive questionnaires that were completed by public officials and independent consultants. The performance of SEE economies has been scored in ascending order on a scale of 0 to 5, summarised in Annex 3.A1.[3] For more details on the methodology underpinning this assessment, please refer to the methodology chapter.

Figure 3.2. **Access to finance: Dimension and sub-dimension average scores**



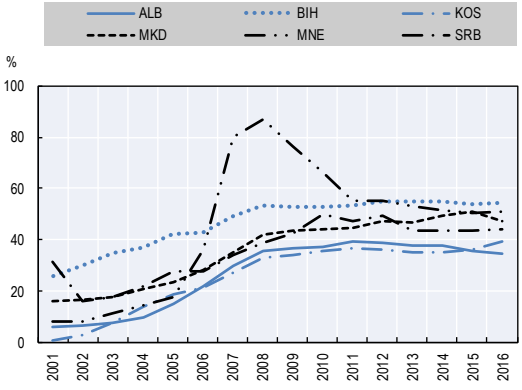
Access to finance performance in SEE economies

Following a boom in the years leading up to the global financial crisis, from 2008 onwards banks across the six SEE economies have undergone a process of deleveraging, marked by unfavourable credit conditions. While domestic credit to the private sector, a proxy indicator for the depth of financial intermediation, grew strongly in the period 2001-08 – on average by a total of 18% – it then contracted slightly, by approximately 1% on average between 2009 and 2016. Montenegro saw the most pronounced boom and contraction of domestic credit of the six assessed SEE economies: domestic credit to the private sector represented 87% of gross domestic product (GDP) in 2008, but had contracted to 51% in 2016 (Figure 3.3.A).

Credit contraction after the financial crisis has translated into a significant increase in non-performing loans (NPLs) in the six SEE economies. Between 2007 and 2013 the average share of NPLs in the economies more than tripled from 5.1% of total loans to 17.6% (Figure 3.3.B). In response, those economies with the highest share of NPLs (Albania, Montenegro and Serbia) have developed comprehensive action plans on NPLs to tackle the deficiencies in the credit market. Although the proportion of NPLs has fallen in most SEE economies since 2013, they remain a major concern, particularly in Albania, where 18.3% of loans were still in default or close to default in 2016. Only six other countries included in the World Bank's *World Development Indicator* database had a higher share of NPLs (World Bank, 2017b). The high share of NPLs in the SEE economies may be linked to the substantial economic weight of SMEs: representing 63.9% of total private-sector value added compared to 57.4% in the European Union (OECD, 2015b).

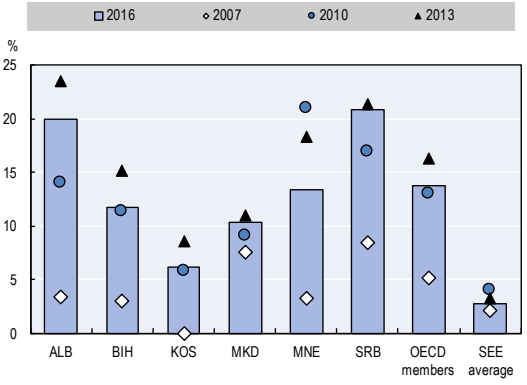
Figure 3.3. **Key banking sector indicators**

A. Domestic credit to the private sector (2001-16)
% of GDP



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B. Bank non-performing loans (2007, 2010, 2013, 2016)
% of total gross loans



StatLink http://dx.doi.org/10.1787/888933703428

Note: World Bank data for 2006 are not available for KOS; data for 2016 are not available for KOS, MKD and MNE, so data from 2015 are used instead. For OECD members, data from 2008 replace unavailable data for 2007.

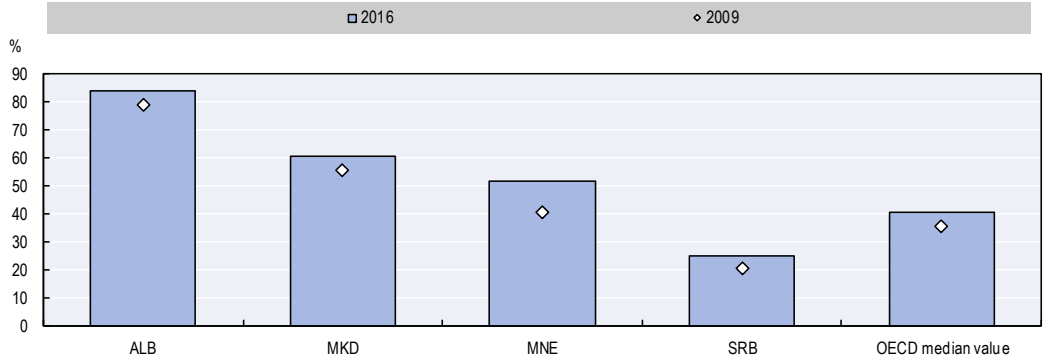
Source: World Bank (2017b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

Despite this poor loan portfolio quality since the financial crisis, SMEs' share of total business loans in the SEE economies grew, on average, from 49% in 2009 to 55.4% in 2016 and is higher than the median value of 40.8% among economies participating in the OECD *Scoreboard on SME Financing* (Figure 3.4; OECD, 2017). This positive trend

may be partly explained by the widespread use of interest rate subsidies by SEE governments, serving as a counter-cyclical tool against a potential credit bust. In Serbia, for example, data collected by the National Bank through a lending survey show that the interest rate for SMEs fell continuously from 10.9% in 2008 to 6.6% in 2016 (Podpiera, 2011). This is a faster rate of decrease than that experienced by large enterprises: the interest rate spread between large and small enterprises has fallen by 2.3 percentage points since 2008, to just 2.1% in 2015. This interventionist policy eased access to loans by cutting the cost of credit for enterprises, particularly SMEs, in times of severe financial distress. Research by the International Monetary Fund, applying model simulations, suggests that Serbia's credit subsidy did indeed prevent a deeper recession in the aftermath of the financial crisis (Podpiera, 2011).

Figure 3.4. **SME loan shares (2009 and 2016 or latest available data)**

SME loans as % of total outstanding business loans



Note: SME loans are defined as loans of less than EUR 1 million in MKD and MNE. In Serbia, SME loans are defined according to the national SME definition. No data available for Bosnia and Herzegovina or Kosovo. The OECD median value is based on 34 economies participating in the OECD's *Scoreboard on SME Financing* (OECD, 2017), which includes OECD member and non-member countries.

Source: Data provided by SEE governments; OECD (2017), *Financing SMEs and Entrepreneurs 2016*: *An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2017-en.

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Despite recent growth in credit availability, an assessment of the six economies' SME financing needs conducted by the European Investment Bank (EIB) in 2016 still found a substantial loan gap across the six SEE economies. In particular, the last *SME Policy Index* assessment found that SMEs with a riskier profile or lacking assets encounter substantial difficulties in accessing lending (EIB, 2016).

The EIB assessment points to significant gaps in the supply and demand of alternative financing mechanisms in the SEE region. Leasing has contracted since the financial crisis, as the banks focused on their own lending products when financial markets became tighter; most leasing firms in the region are subsidiaries of banks and were not considered core markets (EIB, 2016). For example, in Albania in 2010 the outstanding leasing portfolio was ALL 7.6 billion (Albanian lek; EUR 57 million), compared to ALL 6.1 billion (EUR 46 million) in 2016.[4]

The largest gap in finance supply and demand was in equity financing. Bosnia and Herzegovina, Kosovo, and Montenegro have no formal institutions providing equity financing, and the supply in the other three economies is very small. Serbia has the largest equity financing market in the region, but it makes up only 0.2% of GDP (EIB, 2016).

The demonstrated financing gap in the SEE economies results from constraints on both the supply and demand sides. On the supply slide, frequent issues arise from a lack of available credit, punitive interest rates and unattractive market opportunities, while on the demand side, a lack of entrepreneurial training, ineffective business strategies and inadequate private assets all hamper business growth. Although demand-side barriers represent an important constraint on access to finance, supply-side barriers, including high upfront collateral requirements, are often responsible for immediate restrictions on credit. Ultimately, both demand- and supply-side constraints on finance should be addressed through strategic policy interventions.

Policy, regulatory and institutional framework

This sub-dimension examines the state of play in the six SEE economies of the various strategic, legal and institutional foundations needed to support SMEs in their quest for finance. To do so it uses six qualitative indicators (Figure 3.5):

The **SME finance needs** indicator examines the extent to which the SEE governments have taken steps to understand the various obstacles SMEs face in accessing finance. It also assesses whether governments have made efforts to improve their evidence base on SME financing, for example by making statistical information available that is disaggregated by enterprise size.

The **policy coherence and co-ordination** indicator looks at the extent to which public SME financing programmes have mechanisms in place to ensure their financial additionality, cost effectiveness and user friendliness. It also looks at intra-governmental co-ordination and monitoring and evaluation practices.

The **asset register** indicator looks at the first of two important institutional arrangements for loan financing: whether the SEE economies have registration systems in place for fixed and movable assets which can be used as security for loans.

The **credit information services** indicator covers the second institutional arrangement: the credit information systems which help banks access information on borrowers.

The **insolvency procedures** indicator focuses on the frameworks and regimes SEE economies have in place to handle legal procedures for cash-strapped businesses, including creditor rights.

The **timely payments** indicator analyses whether appropriate steps have been taken by the government to encourage timely payments in commercial transactions and public procurement.

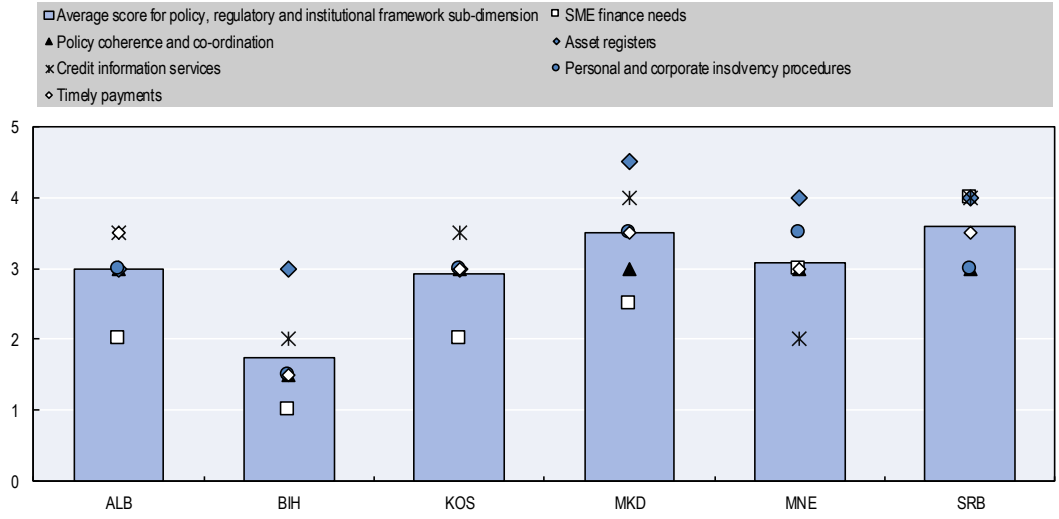
The average score across these indicators for all six assessed SEE economies is 3, indicating that the policy, regulatory and institutional basis for access to finance is generally sound. Of the three sub-dimensions assessed (Figure 3.2), this is where the six SEE economies perform most strongly.

SME financing needs could be better identified

Public programmes to support SMEs' access to finance are justified by the financing gaps discussed above, which are hindering the growth of smaller enterprises. Such programmes aim to achieve a market-optimal equilibrium that would not be possible without intervention. However, as for any other public programme, SME financing policies need to follow certain standards and practices before, during and after implementation, to

avoid inefficient allocation of government funds. Thus, supply-side interventions require a high degree of monitoring to ensure the fluidity and ease of credit markets.

Figure 3.5. **Policy, regulatory and institutional framework: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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The SEE governments have made rather limited efforts to systematically identify SME financing needs and the main gaps in the SME financing environment. Although they are aware of the issues, notably through external studies such as the EIB's region-wide assessment in 2016 and surveys and analysis conducted by the governments themselves, they could increase their efforts (EIB, 2016). One significant reason for the evidence gap is that most SME economies lack statistical information on SME financing as the data are not disaggregated by enterprise size. Data on the stock and flow of SME loans, interest spreads between large and small enterprises, collateral requirements for SMEs, and non-performing loans would help to build a better understanding of SME-specific financing gaps to identify suitable and evidence-based SME financing policies.

Serbia is most advanced in developing SME financing indicators (Figure 3.5) and is the only one of the six economies to participate in the OECD's *Scoreboard on SME Financing* (see Box 3.1 below). There are signs of improvement, however: the Former Yugoslav Republic of Macedonia, Montenegro and Serbia are planning measures to assess SME financing needs, but these strategic objectives had not yet been implemented at the time of this assessment.

Policy co-ordination and monitoring could be strengthened

The SEE economies are making efforts to ensure policy coherence and co-ordination in designing programmes to support SME financing, but there is room for improvement (Figure 3.5). All six have developed a number of support schemes to improve SMEs' access to finance. Most of these programmes involve direct support, through the provision of either grants or loans at subsidised interest rates. Some of the SEE economies also use

government-backed credit guarantee schemes to unlock credit by mitigating the risks preventing commercial banks from lending to small businesses.

The policy frameworks for SME financing programmes in the SEE economies are usually contained in their broader horizontal SME and entrepreneurship policies. However, since its national Strategy for SME Development expired in 2011, Bosnia and Herzegovina has lacked a strategic SME policy framework at the state level.[5] Since then, responsibility for SME development has lain mostly with the sub-national entities, which have all developed separate strategic frameworks. It is currently uncertain whether the state will develop a new strategy in the near future. This would be important, to at least mandate a role for the state in the overall co-ordination of SME policy making in Bosnia and Herzegovina. As well as offering a better chance of policy coherence, this would certainly improve alignment of support programmes across the economy, while keeping the main responsibility for SME development with the entities.

Many new support programmes throughout the region were not developed using measures to ensure their financial additionality. This means that it is not entirely clear whether new programmes are reaching viable enterprises that would otherwise not have had access to finance or would have accessed it only under more onerous conditions. Policy makers could also do more to ensure the cost effectiveness and user friendliness of new programmes.

The situation is similar for monitoring and evaluation (M&E) efforts to track the progress of existing programmes against objectives defined before implementation begins. While basic M&E mechanisms are already in place, regular *ex ante* and *ex post* evaluation is needed to meet international good practice standards, such as those established by the G20-OECD High-level Principles on SME Financing (OECD, 2015a). These should be based on clearly defined, rigorous and measurable policy objectives and impacts, and should be conducted in co-operation with financial institutions, SME representatives and other stakeholders. Moreover, governments in the SEE economies rarely systematically assess the impact of SME financing programmes on job creation, SME development and other economic indicators.

The recently launched Kosovo Credit Guarantee Fund is a regional example of policy design which includes elements of financial additionality assessments, good M&E practices and institutionalised co-ordination mechanisms among government, participating commercial banks and international donors.[6] Nevertheless, the policy is still in its infancy and has yet to be rigorously tested.

Access to asset registers could be improved

Asset registers and credit registries/bureaus (discussed in the next section) are two important institutions that help to level the playing field in lending relationships by providing information on the creditworthiness and business performance of SMEs. When this information is more limited for SMEs than for larger enterprises, banks can perceive SMEs as presenting greater risk. This can mean that SMEs have to meet high collateral requirements for secured transactions, and have more limited access to credit.

Effective asset registers are a fundamental part of the regulation of secured transactions, helping firms and entrepreneurs to access loans by offering proof of collateral. As well as fixed assets, allowing a broad set of movable assets (such as inventory, accounts receivable, livestock, crops, equipment, machinery and intangible assets) to be used as collateral allows businesses to make use of more of their assets to obtain credit for

growth. This is particularly important for SMEs, which often possess less land and real estate than large enterprises and struggle to meet financial institutions' collateral requirements. Asset registers are also instrumental for financial leasing activities, enabling businesses to use vehicles, equipment or real estate in exchange for monthly payments.

All six SEE economies have cadastral systems to register land and real estate, and record its value and ownership, as well as any existing pledges over the asset. The systems are generally centralised and unified, which helps to avoid multiple use of the same asset. In Bosnia and Herzegovina, however, registration of fixed assets is handled separately by the two entities and the last *SME Policy Index* assessment found there was still need for harmonisation (OECD et al., 2016).

Cadastral information is not yet available online in Albania, the Federation of Bosnia and Herzegovina, and the Republika Srpska, making it significantly more complicated to access the data. Moreover, Albania's cadastre does not yet cover the whole territory, although it is making efforts to provide both online access and full coverage within the next few years.[7] Kosovo has made noteworthy progress in improving the usability and accessibility of data since the last assessment by making data available online on the Geoportal platform. In Serbia a project supported by the World Bank aims to improve the efficiency, transparency, availability and reliability of its real-estate management system.

All six SEE economies have a registration system for movable assets, but these are often less developed than those for fixed assets, particularly in terms of documentation, accessibility and transparency. Notably, this assessment found that there were many fewer pledges of movable assets registered than of fixed assets across the region, implying that secured transactions over movable assets are still less common. Private-sector representatives also point out that banks in the SEE economies are more risk averse due to a rise in NPLs since the financial crisis. They are consequently more cautious about accepting movable assets as collateral.

While all of the economies have a database of movable assets, Albania and Serbia do not yet fully allow for online registration for information searches. In Kosovo the pledge registry is hosted abroad and rather difficult for the public to use. According to a survey on collateral registers in 35 economies conducted by the International Finance Corporation and the World Bank, Kosovo had the lowest ratio of information searches to new registrations, indicating that users largely use the register for movable assets as part of a process to obtain credit rather than as a risk-management tool to help make lending decisions (de la Campa, Downes and Hennig, 2012). The ratio was also low in Albania and Serbia. Searches only exceed registration in Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia, implying that the register is a more important factor in lending decisions in these two economies than in their regional peers.

High fees can undermine access to registers for movable assets – they should be limited to the level required to cover the operation of the system. In Kosovo, business representatives have pointed out that flat fees are disproportionate and undermine credit growth. The type of registration can also affect the cost of registering assets, as well as facilitating or complicating the registration process. Document registration requires firms to report the underlying security documentation, while a notice-based system only records basic information on the parties involved, asset characteristics and value. A notice-based register is hence much more affordable to administer and has lower archival costs. Of the assessed SEE economies, Albania, and Bosnia and Herzegovina are the only ones to have established a notice registration system, while the remaining four economies still rely on document-based systems (de la Campa, Downes and Hennig, 2012).[8]

The coverage of credit information services could be expanded

Credit information services compile data on the credit histories of borrowers who are active in a financial system. They help to improve risk management for lenders by decreasing information asymmetries on the default risk of all borrowers. Public credit bureaus are usually managed by the central bank, mainly for supervisory purposes, while private credit bureaus are often established by financial institutions.

All of the SEE economies have either a public or private credit information system in place, or both, but their coverage varies widely (Table 3.1). Here, coverage refers to the share of the population for whom public or private credit information is available. Serbia, which only has a private credit bureau, and the Former Yugoslav Republic of Macedonia, which has both private and public credit information systems, has achieved nearly full coverage of the entire adult population with their credit information services.[9] In Albania, Kosovo and Montenegro, in contrast, less than 40% of the adult population is covered. These three economies only have a public credit information system in place – countries lacking a private credit information system typically tend to have a lower coverage than those with private credit bureaus or hybrid systems. On the other hand, public credit information systems are in the hands of policy makers, who can optimise the use of the data to meet public objectives. In OECD economies, 67% of the adult population is covered by private and 12% by public credit information systems.

Table 3.1. **Coverage of public and private credit bureaus in SEE economies (% of adult population)**

	ALB	BiH	KOS	MKD	MNE	SRB	OECD
Coverage of public credit registry	38.9	37.6	38.1	40	30.8	/	12.1
Coverage of private credit bureau	0	10.4	0	94.5	/	100	67.1

Source: World Bank (2017a), *Doing Business: Measuring Business Regulations* (database), www.doingbusiness.org.

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Credit information systems in all six SEE economies include both positive and negative information on borrowers, for example on defaults, timely payments and outstanding loan amounts. Keeping positive information is important for borrowers to establish a supportive credit record and allows lenders to better identify creditworthy borrowers. On the other hand, some credit information systems in the SEE economies have not established key rights for borrowers, for example their right to object to their information being collected. This is a particular concern in Bosnia and Herzegovina, which is the only economy in which the legal framework does not grant borrowers access to their own data, and where credit information services are only available to financial institutions. Montenegro is lagging behind in establishing a comprehensive database, as current regulations do not ensure that at least two years of historical data are distributed. The remaining economies have clear definitions for how long data should be kept – usually at least five years.

With the exception of Bosnia and Herzegovina – and the Former Yugoslav Republic of Macedonia for its private credit bureau – the SEE economies have not yet developed legislation that allows non-regulated entities to participate in providing data. Data from retailers or utility companies – for example on the timely payment of an electricity bill – can help borrowers build a positive credit record. This is particularly important for SMEs which are often constrained from accessing credit by their lack of credit history. Albania and Serbia are currently making efforts to include data from non-bank entities.[10]

The SEE economies could also improve their credit information systems by offering credit scores as value-added services, which make it easier for banks and financial institutions to assess the creditworthiness of potential borrowers. So far, only Serbia offers credit scores, but efforts in this direction are being made in Albania and the Former Yugoslav Republic of Macedonia.

Insolvency procedures are in place, but are long and costly

When it comes to personal and corporate insolvency procedures, all of the SEE economies have functioning insolvency laws that govern formal procedures for financially distressed companies (Figure 3.5). Kosovo, which lacked a legal framework at the time of the last assessment, passed a law on bankruptcy in 2016. Albania also passed a new bankruptcy law in the same year to improve its legal framework, with the main objective of tackling lengthy bankruptcy procedures. In Bosnia and Herzegovina insolvency is regulated at the entity level and there is no national framework. While a law is in place in the Republika Srpska, the adoption of a more modern bankruptcy law in the Federation of Bosnia and Herzegovina has been delayed.

Corporate insolvency frameworks in the SEE economies make a distinction between liquidation and reorganisation, which is important to allow cash-constrained but viable enterprises to be restructured, while providing for the smooth liquidation of failing ones. However, while all of the SEE economies have a legal basis for corporate bankruptcy procedures, most lack regulation for personal bankruptcy. This leaves individuals and self-employed debtors unprotected from creditors if they cannot pay their financial obligations. Montenegro is the only economy in the region with a separate legal framework for personal insolvency, while the new law on bankruptcy in Albania also covers personal procedures to some extent. Serbia has been working to develop a personal insolvency law, but the drafting process seems to be currently on hold.

One of the main priorities of a modern insolvency mechanism should be to protect creditor rights by ensuring that they can reclaim the money that is owed to them by the debtor. In this regard, legal frameworks should include clear priority schemes so that secured creditors are paid before unsecured ones, as well as before tax and employee claims. This is not yet the case in either Bosnia and Herzegovina's entities for defaults outside an insolvency procedure and business liquidation; nor in Albania and Kosovo when a business is liquidated (World Bank, 2017a).

A second aspect in ensuring the rights of creditors is to allow for out-of-court settlements, which can help achieve quick enforcement and avoid lengthy, costly and burdensome court proceedings. This has not yet been established in the entities of Bosnia and Herzegovina. It is also important to strike a balance between creditors' rights and debtors' interests when regulating automatic stays of debt collection once a judicial process has been launched. While automatic stays help the debtors to recover and enable creditors to collect their claims during reorganisation proceedings, good practice standards usually set a time limit for the stay. Automatic stays on enforcement are not yet included in insolvency regulations in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia or Serbia, but Kosovo has defined a 120-day time limit for the automatic stay in its new bankruptcy law.

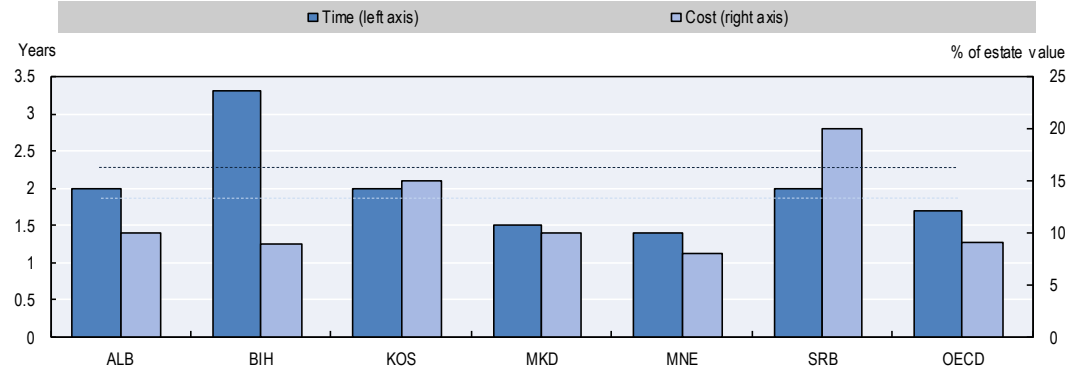
Besides protecting creditor rights, insolvency regimes should support healthy companies and offer a second chance for honest entrepreneurs. The SEE economies largely lack any government-supported programmes to give second chances to entrepreneurs who have undergone non-fraudulent bankruptcy, but some of the economies which are

currently revising their legal frameworks are working on better policies in this area (e.g. Albania and the Federation of Bosnia and Herzegovina). Training and other support programmes targeted at these entrepreneurs – on topics such as assistance with access to finance, preparing guidelines for re-starters, second-chance coaching and education – could be a good option for any SEE economies that are eager to develop an entrepreneurial culture that gives entrepreneurs a better chance to succeed.

While good practice standards might be in place on paper, they mean nothing without effective implementation. Representatives of government, the private sector and civil society across the SEE economies highlighted significant delays in legal insolvency proceedings as a key challenge. This view is supported by quantitative evidence stemming from the World Bank *Doing Business* indicators on resolving insolvency: the SEE economies lag behind OECD countries in terms of the time and cost involved to complete insolvency proceedings (Figure 3.6). On average, an insolvency proceeding in the SEE region takes 2 years and costs 12% of the value of the debtor's estate, compared to 1.7 years at a cost of 9.1% of the estate's value in OECD member countries. In Serbia, insolvency proceedings costs 20% of the estate and in Bosnia and Herzegovina they take 3.3 years to complete. This makes in-court insolvencies a rather burdensome process for creditors and debtors in the region. Many of the SEE economies have made efforts to tackle this issue, for example in the form of recently adopted legal frameworks. However, it is difficult to draw any conclusion on the success of these efforts. In Serbia, for instance, a working group which was formed to deal with continued legal backlogs since the adoption of the 2014 bankruptcy law has become inactive for the time being.

Figure 3.6. **Time and cost of insolvency proceedings**

Time in years (left-hand scale) and cost as % of estate value (right-hand scale)



Source: Data provided by SEE governments and adapted from OECD (2017), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2017-en.

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Legal frameworks for timely payments could be better enforced

As the G20/OECD High-level Principles on SME Financing recognise, laws on insolvency and timely payments are fundamental elements of a sound and sustainable business climate in which SMEs can prosper (OECD, 2015a). SMEs are particularly vulnerable to late payment or non-payment by customers, often forcing them to seek external finance in order to cover cash flow gaps or to cut back investment and hiring plans.

For SMEs, a lack of timely payments can mean the difference between solvency and bankruptcy. This costs valuable jobs every year and is a threat to a healthy entrepreneurial climate. The economic crisis has aggravated this situation, as credit lines and bank loans have become less available. In response, the G20/OECD High-level Principles on SME Financing recommend governments to design, implement and enforce norms discouraging late payments, including in cross-border trade, and to ensure clear and appropriate payment terms for SMEs (OECD, 2015a). The European Union passed the Late Payment Directive to protect European businesses, particularly SMEs, from late payment and to improve their competitiveness (EU, 2011). The main provisions of this directive include definitions of payment deadlines for business-to-business and government-to-business transactions, automatic entitlements to interest for late payments, and compensation for recovery costs.

All of the assessed SEE economies except the Republika Srpska have a legal framework for late payments in place (Figure 3.5), and they are aligned overall with the EU Late Payment Directive 2011/7/EU. All the legal frameworks cover clear and appropriate payment terms in both commercial transactions and public procurement, and hence encourage timely payments to SMEs. In accordance with the EU directive, the economies' late payment laws limit contractual freedoms to some extent, requiring public authorities to pay within 30 days for the goods and services they procure or, in exceptional circumstances, within 60 days. Enterprises have to pay their invoices within 60 days, but there are certain exceptions. The laws also include automatic entitlement to interest for late payment and/or compensation for recovery costs caused by delayed payments. In Albania, where new bankruptcy laws have recently come into effect, priority schemes are firmly in place determining the sequence in which competing claims on collateral will be satisfied when a debtor defaults.

However, public bodies are not required to publish late payment reports; this undermines accountability for late payments by public procurers. Moreover, while there are legal provisions to prevent unfair contractual terms, more could be done to help SMEs to challenge unfair contractual terms through support from commercial parties and public bodies. Efforts to enhance co-ordination across borders to prevent late payments in cross-border transactions are very limited or non-existent in most cases. More co-ordination is recommended as cross-border trade is frequently affected by late payments. Finally, the private-sector representatives who participated in this assessment noted that there is limited enforcement of timely payment provisions, or of insolvency legislation.

The way forward for the policy, regulatory and institutional framework

To ensure coherent SME financing policies, **SEE economies could increase their efforts to co-ordinate policies**. Bosnia and Herzegovina could consider introducing a state-level policy framework to improve the co-ordination of existing and future SME financing policies across the state and entity levels.

All the SEE economies could intensify their efforts to conduct SME financing needs assessments in co-operation with relevant stakeholders (e.g. central banks and financial supervisory authorities, financial and research institutions, and SME representatives). This is particularly relevant to Albania, Bosnia and Herzegovina, and Kosovo which currently lack initiatives in this area.

Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, and Montenegro **should improve their statistical information on SME financing** to help build a better evidence base and a better understanding of SME financing needs

and challenges by public institutions. The *OECD Scoreboard on Financing SMEs and Entrepreneurs* is a useful tool for evaluating and monitoring SME financing needs (see Box 3.1).

All of the economies should perform more regular *ex ante* and *ex post* evaluation of SME financing support programmes, based on clearly defined, rigorous and measurable policy objectives and impacts across the SEE region.

Box 3.1. SME financing indicators and the OECD Scoreboard on Financing SMEs and Entrepreneurs

The OECD Scoreboard on Financing SMEs and Entrepreneurs monitors financing trends through a set of core indicators, selected on the criteria of usefulness, availability, feasibility and timeliness. This includes indicators on the allocation and structure of bank credit to SMEs (e.g. outstanding SME loans compared to total loans), the extent of public support for SME finance (e.g. the amount of government loan guarantees), credit costs and conditions (e.g. interest rates for SMEs compared to large enterprises), non-bank sources of finance (e.g. venture and growth capital investments) and on financial health (e.g. SME non-performing loans). Most of the indicators are derived from supply-side data provided by financial institutions, statistical offices and other government agencies, supplemented by national and regional demand-side surveys.

The 2017 edition of the Scoreboard covers 39 countries, among them OECD member and non-member countries, and includes detailed profiles on each participating economy. Serbia is the only SEE economy participating in the Scoreboard thus far. The indicators form a comprehensive framework for policy makers and other stakeholders to evaluate the financing needs of SMEs and entrepreneurs and to design policy support programmes on the basis of prior analysis.

Source: OECD (2017), *Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard*, http://dx.doi.org/10.1787/fin_sme_ent-2017-en.

Some elements in the design of asset registers could be further improved. For instance, Albania and Serbia could improve online access to their movable assets register by establishing a full online system for registrations and searches. Those economies currently relying on document registration could consider introducing a notice-based system to facilitate registration mechanisms.

The design of credit information services in the SEE economies could also be improved. Bosnia and Herzegovina could consider making services available to the public as well as financial institutions. The other economies could continue their efforts to include data from non-regulated entities, such as retailers or utility companies, to help borrowers build a positive credit record. Montenegro is advised to build a more comprehensive credit information database by including in regulations the requirement to keep at least two years of historical data. Wider use of credit scores would help improve value-added credit information services in most of the SEE economies.

The Republika Srpska should take steps to finalise its legal framework for late payments, which is currently still lacking. Moreover, most of the SEE economies could consider introducing requirements for public bodies to publish late payment reports and enhance the support given by commercial parties and public bodies to challenge unfair contractual terms. Most importantly, the **SEE governments should continue their efforts to fight legal backlogs in the enforcement of timely payment and insolvency legislation**.

Access to bank finance

Bank lending is the most common source of external finance for all kinds of SME activities: starting up a company, meeting regular cash-flow and working capital requirements, expansion, innovation, and internationalisation. In traditional lending arrangements, the creditor relies on the debtor to repay the loan amount at the end of the lending period, in addition to a regular interest payment. However, as detailed in previous sections, important market failures in the assessed economies mean that the SME sector is under-served by private financial intermediaries. This sub-dimension looks at various features that constrain SME's access to traditional lending, as well as support measures to help overcome gaps in SME financing. It does so using three qualitative indicators (Figure 3.7):

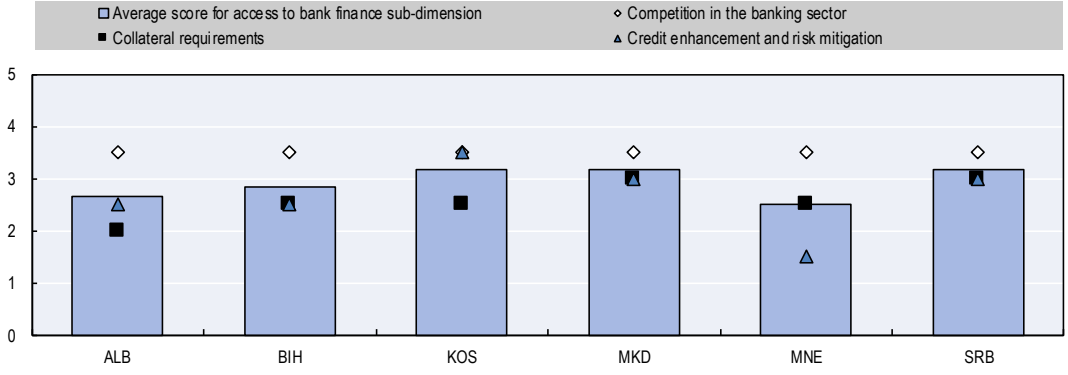
The **competition in the banking sector** indicator looks at entry requirements for foreign banks as well as possible favourable conditions for state-owned banks.

The **collateral requirements** indicator analyses the strictness of collateral and provisioning requirements in terms of value, the types of collateral accepted and the degree of flexibility for smaller loan sizes. In combination with the asset registers indicator in the policy, regulatory and institutional sub-dimension, it helps to understand whether the key factors for secured transactions are in place.

The **credit enhancement and risk mitigation** indicator examines whether governments have introduced measures to improve banks' capacity to lend to SMEs, for example by developing credit guarantee schemes targeted at creditworthy SMEs which would not be able to access finance otherwise.

The average score across these indicators for all six assessed SEE economies is 2.9, indicating that access to bank finance is somewhat well developed (Figure 3.7), although there is significant room to enhance lending practices.

Figure 3.7. **Access to bank finance: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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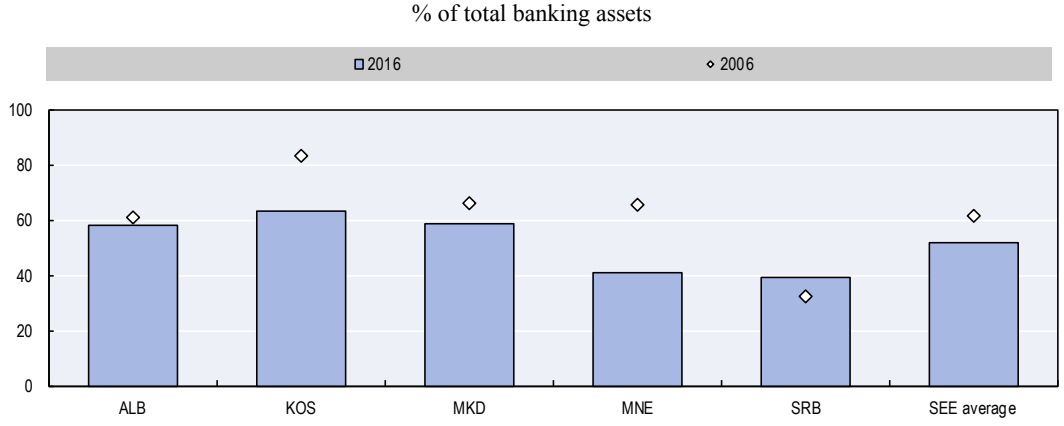
Competition in the banking sector has grown and new entrants face no significant barriers

The supply of credit in any given market is an important feature of the overall financial health of an economy, but in the SEE region constraints on traditional lending remain an obstacle to SME growth and development.

A healthy lending environment is marked by favourable conditions for competition, allowing new banks, whether domestic or foreign, to enter financial markets and grow. In nearly all of the SEE economies the cumulative market share of the three largest banks – a proxy indicator of the level of competition in the banking sector – has decreased over the past decade, indicating a more competitive market.

In 2006 the three largest banks represented on average 62% of the total banking sector in the six SEE economies: by 2016 this had fallen to 52% (Figure 3.8). In Montenegro, bank concentration decreased most significantly, making its banking sector one of the least concentrated of the assessed economies. While Serbia's banking sector is also relatively diverse, it is the only economy where bank concentration increased between 2006 and 2016. Kosovo has the most concentrated banking sector, although the market share of the three largest banks fell from over 80% in 2006 to nearly 60% in 2016, signalling a positive development for bank competition.

Figure 3.8. **Cumulative market share of the top three banks (2006 and 2016)**



Note: Data for Bosnia and Herzegovina not available. Statistical offices and ministries in the region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: Government statistics offices.

StatLink http://dx.doi.org/10.1787/888933703523

While state-owned banks can benefit from favourable marginal lending rates, lower borrowing costs in the financial market and undue political influence, there are no or very few state-owned banks in the SEE economies. Moreover, there are no notable legal restrictions on starting up and operating banks, be they foreign or domestic, such as licensing procedures which go beyond what is needed for prudential regulation, limitations on foreign ownership of banks or special screening and approval procedures. Foreign-owned banks now dominate the financial sector, accounting for some 60% of activity in the region and up to 80% in Montenegro.

Although asset registers help SMEs to secure loans, collateral requirements remain onerous

As discussed in the previous sub-dimension, a well-functioning registration system for immovable and movable assets makes it easier for companies to provide collateral to secure loans and eases credit restrictions by improving creditor protection. Even so, if collateral requirements remain excessive, SMEs are still constrained in their access to credit.

Although functioning registration systems are in place in all six economies, collateral requirements remain very strict. According to respondents to the *World Bank Enterprise Surveys* from 2013, in Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro, around 90% of loans required collateral, compared to an average of 78% for all 156 surveyed economies (World Bank, 2017c). One of the reasons for this high proportion is the economic significance of SMEs in the SEE economies, as they are more likely to have to provide collateral for loans than larger companies. Moreover, the value of collateral needed for a loan significantly exceeded 200% in each of these four economies, on a par with the global average of 205.4% but more than the OECD average of 159.5% (World Bank, 2017c). In Kosovo, banks required nearly three times the value of the loan as collateral, which is the third highest value globally, after Nepal and Thailand. Only in Bosnia and Herzegovina and Serbia were collateral requirements below the global average. Indeed in Serbia, the average collateral required was 54% of the value of the loan, well below the OECD average (OECD, 2017).[11]

As mentioned above, enabling SMEs to use a wide range of fixed and movable assets to secure loans can strengthen their access to traditional bank financing. In economies where IP is well developed, intangible assets, such as intellectual property, patents, or brands and trademarks, can ease access to lending, particularly for knowledge-based companies and are routinely used as collateral in the United States and the EU. However, expanding the use of intangibles as collateral is not free from potential risks and should therefore be considered carefully, according to the G20/OECD High-level Principles on SME Financing (OECD, 2015a). In the SEE economies, although most legal frameworks allow secured creditors to create and enforce their rights over movable assets including intangibles, real estate and land remain the most common collateral for loans. Increased risk aversion, which is partly still a consequence of the financial crisis, has made banks even more reluctant to accept movable assets as collateral. This is a barrier to bringing valuable assets into productive use. The SEE economies have also yet to introduce flexible procedures or provisioning requirements for smaller loans of under EUR 20 000; doing so could make loans more accessible for SMEs.

Credit guarantee schemes reduce the risk of lending to SMEs, but may be too small to have an impact

Governments have various tools to mitigate the risks of lending to SMEs, thereby increasing the credit available to them. For example, credit guarantees, where the guarantor compensates a predefined share of an outstanding loan if the borrower defaults, are a commonly used risk-mitigation tool, particularly in the aftermath of the financial crisis. Credit guarantees can help SMEs qualify for credit even if they lack credit history or fail to meet high collateral requirements. Other tools such as credit insurance or subsidised interest rates can have a similar credit-enhancing effect.

The six SEE economies have developed various risk-mitigation and credit-enhancement mechanisms which vary in scope and funding structure (Figure 3.7). Some economies currently only have donor-funded credit guarantee schemes and government involvement in the implementation is often limited. In Albania, for instance, the Italian-Albanian Programme for SME Development includes a loan guarantee of up to 60% of the loan amount, which is funded by the Italian government but implemented and monitored by both governments in close co-operation. The size of the scheme is however rather small. In Bosnia and Herzegovina both entities have developed self-funded credit guarantee schemes, although these do not cover the whole territory. The Rebublika Srpska's scheme is larger than Albania's and includes credit lines for various target groups including start-ups, agricultural activities and export-oriented companies. In the Federation of Bosnia and Herzegovina only some cantons have developed credit guarantee schemes, but a federal guarantee scheme is currently in the planning stage. Serbia is also in the process of developing a new guarantee fund under the "Serbia window" of the Western Balkans Enterprise Development and Innovation Facility. Montenegro is planning to launch a credit guarantee scheme in 2017 under the EU Competitiveness of Enterprises and SMEs Loan Guarantee Facility which is accessible to most of the SEE economies. In the Former Yugoslav Republic of Macedonia, the Macedonian Bank for Development has a credit line with a guarantee scheme, as well as various guarantee programmes administered by the United States Agency for International Development (USAID).

Kosovo is the economy which has made the largest improvement in this area since the last *Competitiveness Outlook* assessment. In late 2016 the government, the Central Bank, financial institutions, donors and the SME community launched the Kosovo Credit Guarantee Fund (KCGF), which was enabled by a specific law approved by the Assembly and signed by the President shortly before the scheme became active. The KCGF's objectives are to increase lending by local financial institutions to micro enterprises and SMEs, create jobs, and enhance opportunities for under-served economic sectors. Initially the government of Kosovo and USAID together contributed EUR 7.3 million, but they plan further capital commitments over the coming years to a total of EUR 22 million (OECD, 2017). Only registered companies can participate in the KCGF to encourage firms to formalise. Lending decisions are made by financial institutions based on clearly defined eligibility criteria set by the KCGF in conjunction with international lending institutions, and the scheme is regularly monitored and evaluated through *ex post* evaluation mechanisms, supervised by the Board of Directors which is composed of government and donor representatives. Currently the scheme does not focus on specific sectors because of its prior objective of becoming self-sustainable, but once this has been achieved the plan is to target specific groups such as export-oriented companies, female-led businesses, rural companies and innovative firms.

In past years, several guarantee schemes in the region, such as those in Montenegro and Serbia, have failed to become self-sustainable or have not had a noticeable impact on SME lending and were thus abolished. High administrative costs often explain why credit guarantee schemes operate inefficiently. The SEE economies which are currently planning new credit guarantee mechanisms should therefore ensure that they are designed following good practice. Based on a sample of 76 partial guarantee funds across 46 countries, Beck, Klapper and Mendoza (2010) found that publicly operated schemes with lending administered by financial institutions was a cost-effective solution in most emerging and developing economies. This means it is the lenders who assess the creditworthiness of the borrowers being guaranteed, using the credit appraisal infrastructure already in place for the conventional credit market. To ensure the financial

stability and additionality of the scheme, lenders should select creditworthy SMEs that would not be able to access finance without the guarantee. Schemes could focus on specifically under-served target groups, such as innovative or female-led SMEs, or specific sectors such as agriculture or rural areas. Monitoring and evaluation should be conducted regularly to ensure that financial partner institutions are applying healthy lending practices and the schemes are cost-effective, and to measure what effect they are having on the lending environment.

Besides credit guarantee schemes, a few other risk-mitigation instruments are in place in the SEE economies, notably credit insurance and subsidised interest rates. The Macedonian Development Bank and Serbia's Export Credit and Insurance Agency both provide credit insurance to protect export-oriented companies against non-payment in the event of default or political instability. All six of the SEE economies apply subsidised interest rates to push the cost of credit below market prices for all borrowers. However, interest subsidies can create market distortions and should therefore be considered carefully. In particular, the economies should analyse the costs and benefits as well as the risks of subsidised interest compared with other credit-enhancement and risk-mitigation tools such as credit guarantee schemes, which are a less distorting public intervention.

The way forward for access to bank finance

Despite functioning asset registration systems, collateral requirements in many of the SEE economies remain high. For this reason, **SEE economies could ease security rights over non-fixed assets and weigh the benefits of expanding the use of intangibles as collateral against the potential risks**. The economies could also consider introducing more flexible definitions of collateral and provision requirements for smaller loans.

The SEE economies should reconsider the use of subsidised interest rates given their market-distorting effects. While subsidies did help prevent a larger credit crunch during a period of financial distress, a more sustainable policy solution for the longer term could be the wider use of credit guarantee schemes.

Public credit guarantee schemes should be designed based on international good practice standards such as those outlined by the World Bank and the Financial Sector Reform and Strengthening Initiative (World Bank, 2015). They should involve reasonable administrative costs and be targeted on under-served SMEs, such as innovative, female-led or export-oriented businesses. New schemes should include regular monitoring and evaluation to assess whether their objectives are being achieved.

Alternative financing tools

Alternative financing mechanisms are crucial for overcoming gaps in bank financing, as well as to help SMEs find adequate funding models for their individual business projects. Growth-oriented and innovative SMEs in particular need tools with a higher risk-return spectrum than the traditional offerings (such as bank financing) that are generally better suited to companies with stable cash flow, modest growth, tested business models, and access to collateral or guarantees (OECD, 2015b). The global financial crisis further reinforced the need for SMEs to diversify away from dependence on bank finance, as credit markets around the world became tighter and rules more prudent. Financing instruments for SMEs and entrepreneurs on the credit supply side represent alternatives to traditional debt finance, with varying degrees of risk and return.

This sub-dimension examines alternative funding mechanisms through five qualitative indicators, which can be classified into two areas: low- and high-risk credit supply mechanisms (Figure 3.9).

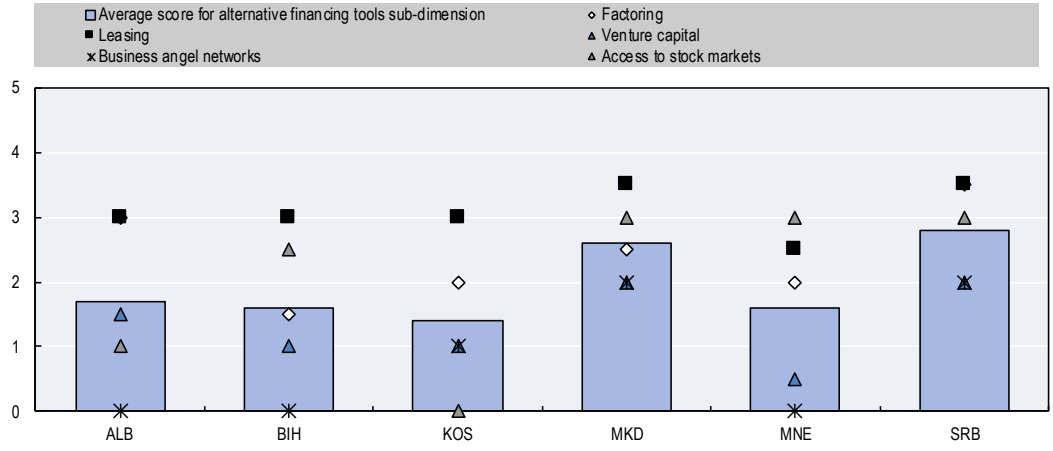
On the low-risk side, the **factoring** and **leasing** indicators examine whether the SEE economies have frameworks in place to enable the selling or assigning of account receivables or the leasing of assets to use or to own.

On the high-risk side, the **venture capital** and **business angel networks** indicators address the presence of private equity-based mechanisms for early stage financing, while the **access to stock market** indicator examines whether public equity is a financing option for SMEs.

Demand-side measures of business financing include improving financial literacy, entrepreneurial training and increasing small business profitability.

As Figure 3.9 shows, with an average score of 1.95, the SEE economies perform least well in this sub-dimension, indicating that they lack alternative options for funding beyond traditional lending mechanisms.

Figure 3.9. **Alternative financing tools: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933703542

Factoring is a viable source of alternative financing

Factoring and leasing (discussed in the next section) are alternative asset-based financing instruments which, unlike traditional lending, allow SMEs to borrow money based on the value of an underlying asset and not on their overall creditworthiness. Such asset-based financing methods can help overcome some of the issues SMEs struggle with in securing loans, such as high collateral requirements, weak insolvency mechanisms or an underdeveloped credit information infrastructure.

Most of the SEE economies have a regulatory framework in place for factoring, which allows a firm (the "seller") to sell or assign their account receivables to a specialised institution (the "factor"). This enables SMEs to sell their outstanding invoices from the sales of goods or provision of services to customers ("buyers"). The SME receives immediate cash from the factor, which it can use to meet its working capital requirements or finance an investment.

Albania, Serbia and the Federation of Bosnia and Herzegovina have all passed specific laws on factoring, in 2006, 2013 and 2016 respectively. In the Former Yugoslav Republic of Macedonia, factoring is regulated by the Law on Financial Companies which was passed in 2010 and since amended several times, most recently in 2015, in combination with a related regulation on factoring operations. In Montenegro the 2008 Law on Banks established a legal framework for factoring, leasing and the purchase of receivables. Both economies are currently developing a specific factoring law with support from the European Bank for Reconstruction and Development. In the Republika Srpska a law on factoring has been drafted but its adoption is delayed. In Kosovo factoring is allowed under the Law on Banks, Microfinance Institutions and Non-Bank Financial Institutions, but it lacks concrete regulation.

Besides providing a legal provision to sell and assign account receivables, the legal frameworks in most of the SEE economies explicitly define factoring as a financial service and require the factor to notify the debtor when receivables are transferred. The latter is crucial in establishing factoring as a three-party transaction (the seller, factor and debtor) and enables the factor to receive payment directly from the debtor, which is particularly important if the seller defaults. A discount rate of 1-10% is usually applied in a standard factoring transaction, although the discount rates in the SEE economies may vary (Klapper, 2006).

With most of the economies recognising factoring as a "sale and purchase", factoring differs from loans as the factored receivables do not form part of the bankruptcy estate. Instead they remain the property of the factor, who can continue to receive payment from the debtor. Consequently, factoring depends less on collateral laws and efficient judicial systems than traditional lending. It is therefore a viable alternative funding mechanism in emerging economies, including the SEE economies, where collateral requirements are rather excessive and contract enforcement is often seen as an issue (OECD, 2015b; Berger and Udell, 2006; Klapper, 2006).

Against this backdrop, in order to provide for a sound legal basis for factoring as a financial service, particularly with regard to transparency and legal certainty, those SEE economies currently lacking specific legislation or in the process of developing a specific factoring law should ensure that it: 1) allows companies to sell or assign accounts receivables and enforce the underlying contracts; 2) prohibits the transfer of future and bulk receivables or obliges the factor to notify the debtor when receivables are transferred; 3) recognises factoring as "sale and purchase", thus acknowledging that, in the event of the seller's bankruptcy, factored receivables are not part of the bankruptcy estate; and 4) ensures that both the factor's and creditors' interests are safeguarded.

A sound credit information system will also help inform factors of customers' creditworthiness and assess their credit risk. As noted above, most of the SEE economies have well-developed credit bureaus or registries, although coverage is sometimes rather limited and their design could be improved.

Factoring can also play an important role in financing SME activities through supply chain mechanisms. In "reverse factoring", SMEs only sell the invoices of selected customers with a lower credit risk than the SME itself, usually large accredited domestic or foreign firms (OECD, 2015b). Governments can take actions to support supply chain factoring mechanisms, for example through electronic matchmaking platforms or by offering SMEs assistance and training. These efforts could also target SMEs participating in global value chains, allowing exporting SMEs to sell account receivables from their

foreign customers for cash. However, none of the six SEE economies has yet taken steps to support such supply chain or trade finance factoring mechanisms.

Leasing is not yet fulfilling its potential

Leasing is another common asset-based financing technique, in which the lessee finances the use or purchase of an asset such as equipment, machinery or real estate through regular payments over a specific period of time. Like factoring, leasing does not depend on strong enforcement mechanisms of bankruptcy rights as much as secured lending does, because the ownership of the asset remains with the lessor. In the case of finance leasing, ownership is only transferred to the lessee at the end of the contract. The lessee nevertheless takes on related risks, such as responsibility for maintenance and insurance throughout the whole leasing period. In operational leasing the asset is only rented out to the lessee for use during the leasing period and is not purchased at the end of the contract. Given the specific nature of leasing contracts, leasing can be a promising financing option for SMEs, particularly if they cannot meet banks' collateral requirements or do not have enough credit history to score high on creditworthiness. However, leasing can be rather costly for SMEs.

Leasing requires a legal and regulatory framework that allows for selling or assigning receivables, ensures transparency and protects the interests of all parties involved in the leasing transaction. All six of the SEE economies have developed a relevant regulatory framework, either in the form of a law on leasing generally or specifically on finance leasing (Figure 3.9). These legal frameworks regulate the conditions for leasing movable and immovable assets, as well as the rights and obligations of the parties in the lease agreement. In the Former Yugoslav Republic of Macedonia, the law on leasing does cover operational leasing but financial leasing companies must have a special permit to act as a lessor. All of the SEE economies also have established rules governing the repossession of the asset if the lessee defaults. These rules define the conditions under which lessees have to return the asset in case they are unable to meet their payment obligations. However, private-sector representatives in some of the SEE economies report difficulties in implementing these repossession rules. These difficulties are partly exacerbated by slow administrative processing and the lack of formal commercial courts.

Tax regulation may give leasing advantages or disadvantages over debt financing, but there is considerable debate on this topic in the literature due to a lack of conclusive empirical evidence (OECD, 2015b). Legislation in the SEE economies generally allows for depreciation of leased assets (e.g. in Albania and the Former Yugoslav Republic of Macedonia), but the rates vary across the region for different types of assets and information is lacking for some economies.

Regarding interest payments, however, leasing does have a tax disadvantage compared to traditional debt financing in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia, where value-added tax (VAT) is charged on interest payments for leasing but not for bank loans. Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia also have double property transfer taxes for finance-leased assets, as they charge property tax once when real estate is purchased by the lessor and again when ownership is transferred to the lessee at the end of the lease contract.

The take up of leases is low in comparison to loans – the outstanding portfolio of loans is many times larger than that of leases. In many of the economies, leasing volumes decreased dramatically for several years after 2009 – much more sharply than the volume of loans. Since most leasing companies were subsidiaries of banks, and most banks

considered leasing a non-core product, the leasing companies were quick to lose support from their parent companies and failed to develop durable leasing products (EIB, 2016).

Venture capital is held back by weak seed and early-stage financing infrastructure

Risk capital – in the form of private or public equity – is an important long-term financing source for projects that are considerably risky, but have potentially high rates of return. In contrast to other financing mechanisms, such equity finance instruments are characterised by the investor gaining an ownership interest in the enterprise in exchange for injecting financial resources. The investor fully participates in the entrepreneurial risk and success of the business, without any underlying security, unlike asset-based financing. Equity financing is particularly relevant for SMEs with a high risk-return profile, such as young, innovative and growing firms.

Venture capital is one form of private equity financing in which the enterprise obtains funds from wealthy individuals, investment funds or institutions in exchange for an ownership stake in the firm. In SME development, venture capital is mainly used to finance the seed and early expansion of high growth-potential and innovative firms. Venture capital is usually raised from a fund managed by a venture capital firm (general partners), which includes investments from limited partners in addition to management fees and coverage of operating costs of the fund.

The seed and early-stage financing infrastructure remains undeveloped in the SEE economies and consequently venture capital activity is very limited. None of the economies have any specific venture capital investment regulation (Figure 3.9), but their existing legal frameworks do not prevent private equity investments in seed, start-ups and early stage firms. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia are currently amending their laws on investment funds, co-investment funds and/or alternative investment funds to harmonise their legal frameworks with existing EU regulations in this area. Albania, Bosnia and Herzegovina, and Kosovo lack any legal framework on investment funds.

However, despite these rather weak legal frameworks for private equity investment, this assessment identified no regulatory barriers to venture capital investment. None of the six economies has established any special licencing norms, solvency or funding requirements, accounting requirements, or investment regulations. There are also no restrictions on investments in seed and early-stage ventures by particular types of institutions such as banks, pension funds or insurance companies, nor any limitations on the ability of these investors to operate as limited liability entities. The latter point is important as private equity firms usually receive capital from limited partners in the form of pension funds, insurance companies, hedge funds or wealthy individuals.

Given the lack of any strict restrictions on private equity investments, the absence of a developed venture capital system is somewhat surprising. One key impediment to venture capital activity in the SEE economies could be a lack of any venture capital tradition, potentially due to higher levels of risk aversion. A culture of risk-taking and self-confidence, social recognition for an entrepreneurial career, and regulations that ease market entry and exit are among the enabling factors for a critical mass of entrepreneurs to emerge (OECD, 2015b). Lack of awareness of the availability and functioning of equity products could further explain the limited role of private equity financing thus far.

More support for seed and early-stage financing through a wider use of demand-side and supply-side policy instruments could help build a more vibrant venture capital industry in the SEE economies. In fact, equity financing in general and venture capital in particular has gained importance in the strategic SME development frameworks of some of the assessed economies. In Serbia, for example, the SME Development Strategy and Action Plan 2015-2020 includes a full section on the development of new financial instruments, including venture capital and business angel investment. In the Former Yugoslav Republic of Macedonia the innovation strategy of 2012-20 and the entrepreneurial learning strategy of 2014-20 both announced support for young enterprises to access venture capital.

On the supply side, governments frequently offer tax incentives for risk capital private investors – such as tax deductions or relief – or invest directly in start-up companies through government funds, funds-of-funds and public/private co-investment funds. Some such concrete supply-side support for equity financing exists in the SEE economies, albeit limited and mainly donor-funded. For instance, the Enterprise Innovation Fund of the Western Balkans Enterprise Development and Innovation Facility is a prominent new financing instrument; its portfolio consists of innovative and technology-driven SMEs from the seed to expansion phase in the six SEE economies and Croatia (EIF, 2015). The European Commission, international financial institutions, governments of beneficiary economies and bilateral donors pulled together EUR 145 million of initial capital that should translate into around EUR 300 million of direct financing available for SMEs in the region. The fund's investors include financial and non-financial European institutions – the European Commission, the European Investment Fund and the European Bank for Reconstruction and Development – as well as the German development bank KfW. In June 2017 Serbia became the first SEE government to sign an agreement to join the fund, bringing the fund's size to over EUR 41 million.

On the other hand, none of the six SEE economies have established any co-investment schemes, in which public and private investors participate alongside each other. The government of the Former Yugoslav Republic of Macedonia is currently working to create one in the near future, but there was no clear timeline or details on this initiative at the time of this assessment. Given the limited role of SEE government support in the supply of equity financing overall, recent efforts to improve the legal basis for investment funds, co-investment funds and/or alternative investment funds in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia represent a positive step to promote young and innovative ventures. Albania, Bosnia and Herzegovina, and Kosovo could consider making similar efforts.

Unlike supply-side access to finance, which deals with the availability of credit, demand-side access to finance pertains to the entrepreneur and business itself. Demand for credit is generally linked to overall business performance, and is therefore dependent on market literacy and entrepreneurial training. Thus, alternative demand-side financing policy encompasses a wide array of business initiatives to help entrepreneurs better navigate financial opportunities.

According to the EIB's assessment of SME financing needs in 2016, the demand for equity products from SMEs is limited among the six SEE economies (EIB, 2016). Consequently, it could be worth making more efforts to tackle the demand side of the equity financing gap. For instance, business incubators can provide networking support to link entrepreneurs with prospective financiers as well as offering strategy advice, mentoring or workspaces. There are government-initiated incubators throughout the

region, but many of them are donor-funded and hence not self-sustaining. There are also private initiatives: the Serbian Private Equity Association is an example of an independent non-profit association which advocates for private equity and venture capital by developing educational programmes, delivering a series of professional networking events, conducting and publishing insightful research, and promoting best practice.

Other demand-side measures tackle the skills development of young innovative enterprises, notably through investor readiness programmes. Such programmes help to combat SMEs' aversion to equity finance, increase their investment potential and help them improve the way they present themselves to investors. While investor readiness programmes could be a promising mechanism to develop a more dynamic entrepreneurial culture in the SEE economies, only the Former Yugoslav Republic of Macedonia has planned any investor readiness programmes for the near future.

The taxation regime may also explain the limited development of SME public equity financing in the SEE region. This *Competitiveness Outlook* assessment found that there were tax-induced incentives for corporations to finance domestic investment with debt rather than equity (see Chapter 4). While interest payments are fully deductible from corporate income tax, the return on equity is not, which could further reduce the use of equity financing relative to debt.

Business angels are rare in the region

Business angels are high net worth individuals who invest their own money in promising business ideas of seed and start-up companies in exchange for equity stakes. Importantly, they also provide valuable management and business experience, which is not always the case with venture capital firms. This means angel investors offer important support for young firms beyond funding. Business angel networks "matchmake" angel investors and entrepreneurs and often provide platforms for exchanging services. Policy makers can support such networks, usually via tax incentives and public co-investment schemes.

The SEE economies have very little business angel activity, however, and the initiatives that do exist are mostly informal networks without any clear public support: this is particularly the case in Albania, Bosnia and Herzegovina and Montenegro (Figure 3.9). Sometimes business angel activities operate from abroad, for example the Kosovo Business Angel Network, which is a member of the European Business Angel Network, is organised outside of Kosovo. The Former Yugoslav Republic of Macedonia and Serbia are taking positive steps to develop public support for business angel investment. The Former Yugoslav Republic of Macedonia is currently reviewing the possibility of introducing tax incentives for business angel investors, but has not yet defined what form these incentives could take. Serbia has included support to business angel investment in its Development Strategy and Action Plan 2015-2020, but has not yet developed any concrete measures. Kosovo's Ministry of Industry and Trade held an international conference in September 2017 on angel investment and venture capital to bring together investors and entrepreneurs.

Some initiatives are increasing SMEs' access to the stock market

There are stock exchanges allowing companies to trade their equity publicly in all of the SEE economies (except Kosovo, which never launched its planned stock exchange). Bosnia and Herzegovina has two stock exchanges which are established and regulated separately by the two entities – the Sarajevo stock exchange by the Federation of Bosnia

and Herzegovina and the Banja Luka stock exchange by the Republika Srpska. In Albania, after a three-year hiatus, the Tirana stock exchange has been licensed by the financial supervisory authority and is set to open this year. The Former Yugoslav Republic of Macedonia has the oldest stock exchange in the region, established in 1996. Data from the World Bank Development database suggest that the market value of the SEE stock exchanges is mostly rather small: in 2011 the market capitalisation of listed domestic companies averaged 26% of GDP, ranging from 5.6% in the Former Yugoslav Republic of Macedonia to 77.3% in Montenegro (World Bank, 2017b). This compared to an average of 71% in OECD member countries (World Bank, 2017b). The concentration of public enterprises (which tend to be listed) in Montenegro's economy contribute to its particularly high capital market-to-GDP ratio.

Most of the existing SEE stock exchanges have a market reserved for companies with lower capitalisation and some of the governments have recently tried to promote the use of initial public offerings among SMEs. These markets are generally characterised by relaxed listing requirements that are easier for small enterprises to meet. The Former Yugoslav Republic of Macedonia has the most relaxed listing requirements, with a rather low minimum capital amount of EUR 250 000 for SMEs. Moreover, the stock exchange requires well-audited financial statements for the previous year and does not define a minimum number of shareholders for SMEs. Serbia launched Smart listing in 2016, including a set of measures to help SMEs access stock markets. However, at the time of this assessment, not a single SME had yet listed and further efforts will be needed to make Smart listing a success, such as greater publicity for the service. Serbia is also currently exploring launching a crowdfunding platform, particularly targeting companies in the information and communications technology sector.

Given the low levels of liquidity of capital markets in the SEE economies, regional efforts to link their stock exchanges together help to increase liquidity and improve access to stock markets for investors and local brokers. In 2014 the stock exchange in the Former Yugoslav Republic of Macedonia joined with the Bulgarian and Croatian stock exchanges to establish a dedicated platform called SEE Link, which also included stock exchanges in Ljubljana, Belgrade, Banja Luka and Sarajevo. Other stock exchanges in the region intend to join the platform in the near future.

The way forward for alternative financing tools

To close the existing financing gaps in the region, **the SEE economies should intensify their efforts to develop non-bank financing instruments**. Although all of the economies already have or are developing a decent legal framework for leasing and factoring, these asset-based financing tools still play a rather limited role. In particular governments could consider building awareness of these tools among SMEs to increase their uptake.

To promote the inclusion of SMEs in value chains, governments could also take action to support reverse factoring, such as **developing platforms to co-ordinate factoring services and facilitate matchmaking**. For instance, Mexico's state-owned development bank *Nacional Financier Banca de Desarrollo* (National Financial Development Bank; NAFIN) has developed such platforms in the context of its Production Chains Programme, in which it acts as a broker. NAFIN also offers financial training and assistance programmes for SMEs and all services are provided electronically, making access for all parties easier (OECD, 2015b).

The SEE governments could scale up their support for venture capital and business angel networks by further developing government funds, co-investment funds or funds of funds, as well as business incubators and/or investment readiness programmes. Box 3.2 gives an example of how Israel has encouraged venture capital and business angel investment.

SEE governments could also **do more to help SMEs access stock markets** through relaxed listing requirements, alternative SME platforms and promoting initial public offerings to SMEs.

Box 3.2. Good practice: Support for venture capital and business angel investment in Israel

In most countries, venture capital investments – defined as the sum of seed/start-up/early stage and later stage ventures – represent a very small share of GDP, on average less than 0.05% in OECD member countries in 2015 (OECD, 2016). Israel[1] is one of the few exceptions, with venture capital investment amounting to 0.38% of GDP in 2014. Behind the Israeli success story lies a strong government commitment to building a lively equity financing ecosystem, particularly since 1993 when the Yozma programme started. At that time the government invested USD 100 million in venture capital funds and technology start-ups, in addition to the USD 110 million contributed by foreign investors. Yozma offered foreign investors in these small funds insurance covering 80% of their risk as well as the option of buying out the government's share within five years.

Privatised in 1997, the Yozma programme is considered the "most successful and original programme in Israel's relatively long history of innovation policy" (OECD, 2010). Although it has now ended, the Israeli government continues to play an active role in supporting the Israeli venture capital industry. For example, in 2016 the Small and Medium Businesses Agency together with the Budget Department in the Ministry of Finance started to support two private equity funds (Peninsola and Kogito Capital), by covering some of their potential losses, depending on the size of the loss.

The Israeli government also implements policies to support business angel investment. In 2011 it passed the Economic Policy Law to introduce tax incentives for business angels investing in Israeli early-stage companies. The law allows foreign or Israeli-resident individuals to deduct from their total taxable income a qualifying investment of up to NIS 5 million (new Israeli shekels, USD 1.4 million) in shares of target companies over a period of three years, as long as they meet certain criteria in terms of revenue and research and development expenses. Furthermore, the initial investment is considered as a capital loss on the day of investment. In 2016 an amendment to the Economic Policy Law from 2011 was passed to allow start-ups and partnerships as well as target companies to qualify for the tax breaks.

1. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD (2016), *Entrepreneurship at a Glance 2016*, http://dx.doi.org/10.1787/entrepreneur_aag-2016-en; OECD/EC/ETF (2014), *SME Policy Index: The Mediterranean Middle East and North Africa 2014: Implementation of the Small Business Act for Europe*, http://dx.doi.org/10.1787/9789264218413-en; OECD (2010), *SMEs, Entrepreneurship and Innovation*, http://dx.doi.org/10.1787/9789264080355-en.

Conclusions

Given the importance of access to finance for SME growth and overall competitiveness, reforms are necessary to ensure that financial resources are available to enterprises at affordable interest rates. The SEE economies are making gradual progress in developing policies to support SME access to finance. Since the last assessment they have further developed the institutional and regulatory frameworks underpinning SMEs' access to credit: these cover asset registers, credit information systems and legislation on timely payments and insolvency.

Notwithstanding the progress in developing policy frameworks, significant challenges remain. One common challenge to the region is inadequate asset registers and credit information systems. Here, SEE economies could enhance their registration systems for movable assets by including intangibles and ensuring transparency, full online accessibility and reasonable fees. To achieve these aims, co-ordination between financial institutions, SEE governments and private citizens is required to both streamline credit services and build a culture of responsible borrowing.

Ultimately, diversifying access to finance with a combination of traditional bank lending and non-traditional financing (factoring, leasing and venture capital) is needed to unlock the full entrepreneurial potential of the region. The end result will be more competitive economies with fuller employment and greater opportunities for business growth.

Notes

1. This information is based on the European Commission's *SBA Fact Sheets 2016* for Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia (EC, 2016a, 2016b, 2016c, 2016d). No data are available for Bosnia and Herzegovina and Kosovo.
2. While there is no common definition of SMEs in the SEE region in terms of turnover or balance sheet, all the SEE economies define SMEs as those enterprises with fewer than 250 employees (OECD et al., 2016).
3. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
4. Data provided by the Albanian government. Due to lack of data on leasing, a more thorough analysis of the trends in the leasing market across the region could not be concluded. The figure reported refers only to leasing companies.

5. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

6. See www.fondikgk.org.

7. In Albania only 10% of the cadastral zones are not yet fully registered.

8. In contrast to the cadastre, the register for movable assets is unified and managed at state level by the Ministry of Justice in Bosnia and Herzegovina.

9. The National Bank of Macedonia reports that precise figures cannot be given, and cautions that 40% coverage of public credit registry is at best an estimate.

10. In Albania, loan data from non-bank entities are currently included in the credit register.

11. These data stem from a lending survey conducted annually by the National Bank of Serbia. Comparability with other OECD economies is limited due to the use of different methodologies, samples and questionnaires in the surveys.

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Annex 3.A1.
Access to finance: Indicator scores

Table 3.A1.1. **Access to finance: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Policy, regulatory and institutional framework						
SME finance needs	2.0	1.0	2.0	2.5	3.0	4.0
Policy coherence and co-ordination	3.0	1.5	3.0	3.0	3.0	3.0
Asset registers	3.0	3.0	3.0	4.5	4.0	4.0
Credit information services	3.5	2.0	3.5	4.0	2.0	4.0
Personal and corporate insolvency procedures	3.0	1.5	3.0	3.5	3.5	3.0
Timely payments	3.5	1.5	3.0	3.5	3.0	3.5
Access to bank finance						
Competition in the banking sector	3.5	3.5	3.5	3.5	3.5	3.5
Collateral requirements	2.0	2.5	2.5	3.0	2.5	3.0
Credit enhancement and risk mitigation	2.5	2.5	3.5	3.0	1.5	3.0
Alternative financing tools						
Factoring	3.0	1.5	2.0	2.5	2.0	3.5
Leasing	3.0	3.0	3.0	3.5	2.5	3.5
Venture capital	1.5	1.0	1.0	2.0	0.5	2.0
Business angel networks	0.0	0.0	1.0	2.0	0.0	2.0
Access to stock markets	1.0	2.5	0.0	3.0	3.0	3.0

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Chapter 4.

Tax policy in South East Europe

This chapter assesses tax policy in six South East European economies. It begins with a brief overview of the general features of the tax system including tax revenues and the balance of the tax mix. It also discusses tax policy assessment tools such as models to forecast future tax revenues, micro-simulation models and tax expenditure reporting. It then focuses on three key sub-dimensions. The first, tax policy, explores whether tax policy fosters an environment conducive to inclusive economic growth and how its design affects revenues raised, investment and competitiveness. The second sub-dimension, tax administration, assesses the efficiency of the tax administration. The third, international tax and tax co-operation, explores the extent to which the six SEE economies co-operate on tax matters with other economies and whether their international tax rules are aligned with international best practice. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions, which in turn would foster the competitiveness of these economies.

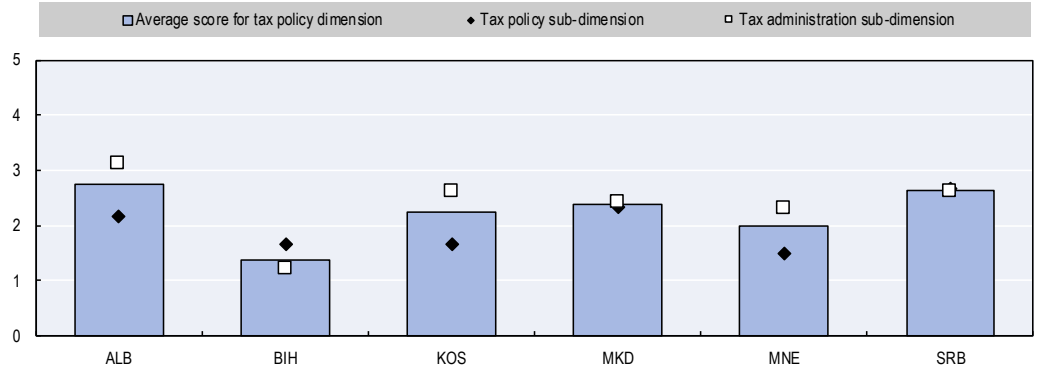
Main findings

Tax revenues have risen steadily throughout South East Europe (SEE) over the last decade, although they remain low in most of the six SEE economies assessed in this report: Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia. Some of the economies face challenges in raising sufficient tax revenues to balance their budgets and to invest in infrastructure, education and a well-developed social welfare system.

These six SEE economies impose relatively low corporate and personal income tax rates and offer generous corporate tax incentives. The tax mix is tilted towards indirect taxes and social security contributions (SSCs) which are levied at relatively high rates. The low tax burden on capital income aims to create a tax climate which is conducive to economic growth by stimulating domestic and foreign investment. However, high SSCs 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 ones. The high labour-income tax burden may help explain the economies' relatively large informal sectors. The limited role of personal income tax (PIT) reduces the ability of the tax system to redistribute income from richer to poorer households.

Figure 4.1 presents average scores for selected aspects of the tax policy frameworks and tax administration in SEE economies. The economies still need to strengthen their tax policy assessment tools and their tax administration. However, filing and payment procedures have become less complex, which has improved tax compliance. The international tax and co-operation sub-dimension was not scored in this assessment and is therefore not included in Figure 4.1. However, the assessment found that international tax rules in the SEE economies are not aligned with international best practices. The economies would benefit from enhanced regional and international co-operation to address tax avoidance and tax evasion and to better protect the domestic tax base.

Figure 4.1. **Tax policy: Dimension and sub-dimension average scores**



Note: The average takes into account the scores given to some of the tax policy framework and tax administration sub-dimension indicators. See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Comparison with the 2016 assessment

In general, the six SEE economies have improved their overall tax performance since the 2016 assessment. This is particularly the case for the tax administration sub-dimension. Overall, however, the scores remain relatively low, suggesting there are still opportunities to strengthen their tax systems.

Nevertheless, it should be taken into account that some areas that were scored in the previous edition of the report are only used for descriptive analysis in this edition. These include the general features of the corporate income tax (CIT) system, investment incentives, some features of the value-added tax (VAT) system and the international taxation framework. Therefore, the scores presented in this edition are not fully comparable with those in the previous edition of the report. In addition, changes in indicator scores do not always reflect actual policy or administrative improvements or deterioration over time: they may reflect increased understanding of the weaknesses in their tax system, which may translate into a lower score for some indicators. These factors help explain why the scores for some indicators are lower than those in the 2016 *SEE Competitiveness Outlook*.

Achievements

Tax revenues as a share of gross domestic product (GDP) have been increasing, although in most of the six SEE economies they remain below the OECD average.

The six economies have made significant efforts to strengthen their tax administration. Scores for key indicators in the tax administration sub-dimension have improved, particularly the areas of function and organisation, compliance assessment and risk management, and taxpayer services.

The implementation of a VAT registration threshold means that VAT administration can concentrate resources on larger businesses. VAT registration thresholds lower compliance costs for small businesses and ensure a more effective use of administrative resources and audit capacity.

The six SEE economies are working together to strengthen the functioning of their tax administrations. Tax administrations across the region are sharing experiences and exchanging information on best tax practices.

Remaining challenges and key recommendations

- **Evaluate the design of corporate tax incentives.** Corporate tax incentives are generous across the six SEE economies. As the economies already have low CIT rates – intended to create an attractive investment climate – there is little need for profit-based tax incentives to stimulate investment, such as tax holidays or targeted preferential rates. Profit-based tax incentives lower revenues from CIT without necessarily increasing investment significantly, and they also create negative spillover effects and tax avoidance opportunities. Existing profit-based tax incentives should either be turned into expenditure-based ones, such as accelerated or enhanced tax depreciation or investment tax credits, or be phased out altogether.
- **Analyse the combined impact of PITs and SSCs on labour market outcomes**. Despite relatively low PIT rates across the region, the economies levy high SSCs in order to finance their benefit systems. This results in a high tax burden on

labour income, which may have particularly strong negative impacts on low-skilled and low-income workers who might be priced out of the formal labour market. The economies should evaluate whether they could lower SSCs by increasing PITs and making it more progressive, introducing an earned income tax credit, and/or reducing SSCs for low-income earners.

- **Consider reducing the gap between taxes on labour and capital income.** This gap provides a strong incentive for entrepreneurs to incorporate their business and to earn capital instead of labour income. These challenges seem to have received little tax policy attention in the SEE economies.
- **Broaden the VAT base**. VAT in all the SEE economies is levied on a narrow tax base as a result of the widespread use of reduced rates and exemptions.
- **Develop tax policy tools to assess tax systems and their economic impacts**. Better tax revenue data, tools that assess the effective tax burdens on labour and capital, the implementation of micro-simulation models, and more systematic tax expenditure reporting are a priority for all six economies.
- **Continue to strengthen tax administrations to improve tax collection and compliance**. Further efforts in guaranteeing independence and transparency of the tax administration and strengthening taxpayer services should be a priority.
- **Bring informal workers and businesses into the tax base**. Strengthening the design of CIT and PIT must be an integral part of a strategy to encourage informal businesses to operate in the formal economy. Strengthening the tax administration will result in a broader tax base overall.
- **Bring international taxation rules in line with international best practice**. The six SEE economies have transfer pricing and thin capitalisation rules in place but they are not aligned with international best practice.
- **Evaluate the use of a worldwide tax system and implement measures to protect the domestic tax base**. The SEE economies might want to weigh the advantages and disadvantages of moving from a worldwide to a territorial tax system.
- **Strengthen co-ordination and co-operation among the economies in the region**. By working together, the six SEE economies would benefit from more effective tax enforcement and lower overall tax avoidance and evasion. Enhanced tax policy dialogue on CIT incentives, for instance, could help to create a more attractive investment climate across the region.

Context

Taxes provide governments with the revenue they need to finance public expenditure. A well-designed tax system contributes to an economic and social environment which is conducive to investment, innovation, work, risk-taking and entrepreneurship and ensures that individuals have the opportunity to develop and use their skills.

Tax systems should be designed to encourage inclusive economic growth. This implies sharing the benefits of increased prosperity and productivity among everyone, translating into an increase in well-being across society. Growth-enhancing tax reforms might come at the cost of meeting some equity goals. Inclusive economic growth

therefore means managing trade-offs between equity and efficiency and taking the distributional implications of tax policies and benefits into account (Brys et al., 2016). Tax and benefit policies that contribute to lowering poverty in the SEE economies will be conducive to economic growth within each economy and across the region.

A well-functioning tax system requires a strong tax administration, and results in low compliance costs and increased tax certainty for taxpayers, and low enforcement and administration costs for governments. Well-functioning tax administrations involve modern management and operational structures and good taxpayer services.

Tax systems should include well-designed international tax rules aligned with international best practice to facilitate domestic and international trade and investment. A well-designed tax system benefits from co-ordination and co-operation on international tax matters both within the SEE region and more widely.

This chapter examines the extent to which governments have established competitive tax systems. The tax dimension is linked to several other policy areas examined in this report, especially:

- **Chapter 1. Investment policy and promotion** and foreign direct investment are facilitated by a sound tax environment.
- **Chapter 5. Competition policy** is strengthened by transparent tax policies that help prevent tax evasion and avoidance, which would provide an unfair advantage for some firms over competitors.
- **Chapter 8. Employment** is affected by tax policies, which influence the choices made by participants in the labour market. For example, 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 9. Science, technology and innovation** is facilitated by predictable tax rates and credible policy commitments. Tax credits can be used to encourage business research and development spending, while environmentally related taxes encourage firms to innovate.
- **Chapter 13. Environmental policy** can be supported by tax-related incentives to help reduce environmental footprints.

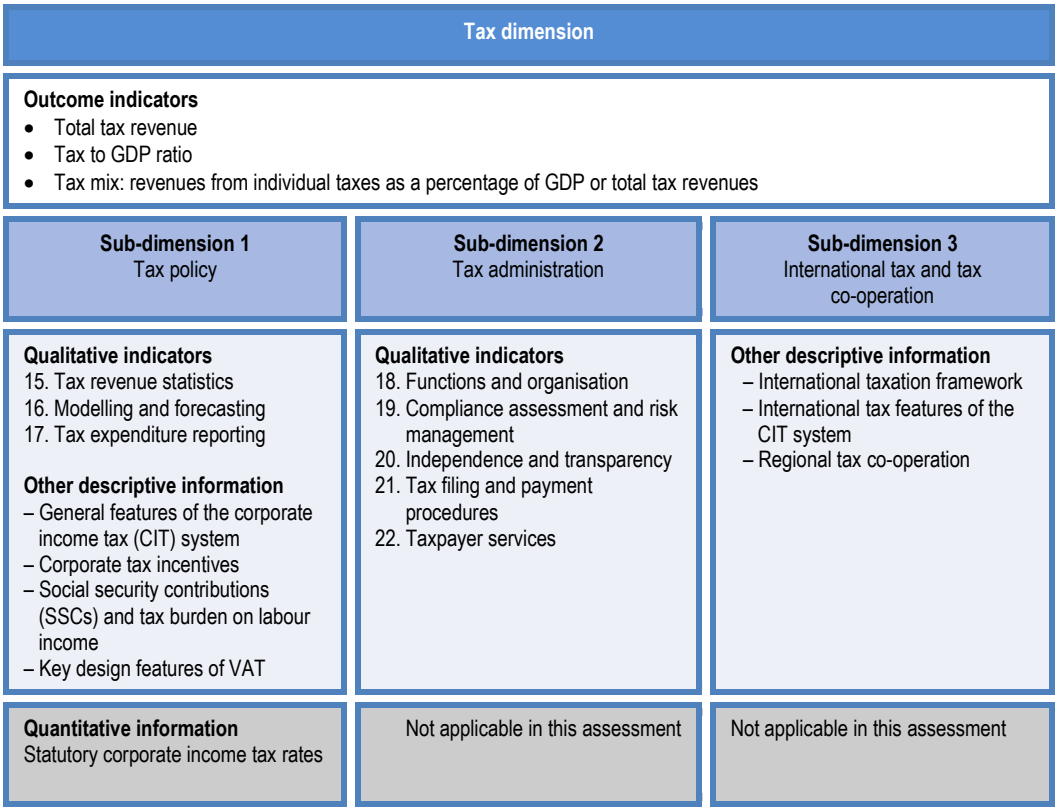
Tax policy assessment framework

The tax dimension in the *2018 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. Tax policy: does tax policy foster an environment conducive to inclusive economic growth? How does the design of tax policy affect the revenues raised? How does it affect investment and competitiveness?
2. Tax administration: what are the functions of the tax administration? How effectively are they able to ensure tax compliance?
3. International tax and tax co-operation: do the six SEE economies co-operate on tax matters with other economies, particularly in the SEE region? Are their international tax rules aligned with international best practice?

Figure 4.2 shows how the sub-dimensions and their constituent indicators make up the tax dimension assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information. Qualitative information was collected by the OECD through comprehensive questionnaires that were completed by public officials and independent consultants. Quantitative indicators are based on national or international statistics. Some of the areas discussed in the tax policy and tax administration sub-dimensions have been scored in ascending order on a scale of 0 to 5 summarised in Annex 4.A1.[1] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 4.2. **Tax policy assessment framework**

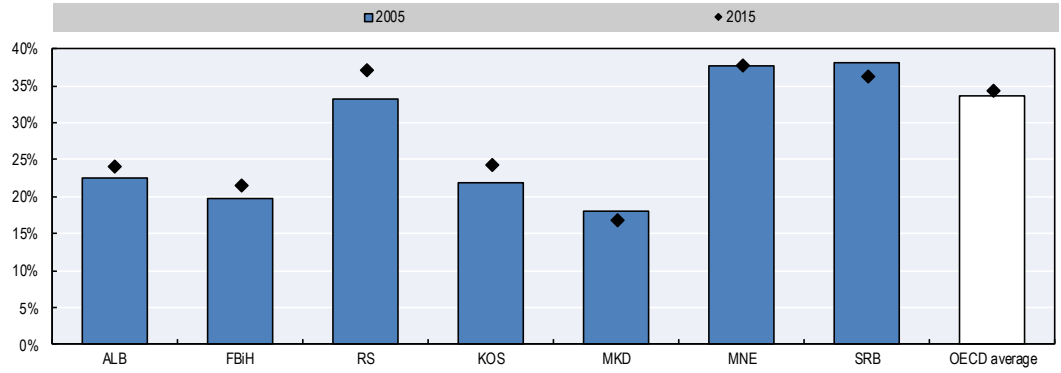


Tax revenues and the tax mix in SEE economies

Tax revenues increased as a share of GDP between 2005 and 2015 in most of the SEE economies (Figure 4.3). The revenues raised vary widely across economies, however. Revenues are particularly low in the Former Yugoslav Republic of Macedonia (16.7% of GDP) and the Federation of Bosnia and Herzegovina[2] (21.5% of GDP). On the other hand, in Serbia (36.2% of GDP), the Republika Srpska (37.1% of GDP) and Montenegro (37.6% of GDP) they are above the OECD average (34.3% of GDP).

Public debt is relatively high but budget deficits are relatively low in most SEE economies (see Table 4.1).

Figure 4.3. **Tax revenues as a percentage of GDP in SEE economies (2005 and 2015)**



Note: FBiH – the Federation of Bosnia and Herzegovina; RS – the Republika Srpska. For both entities in Bosnia and Herzegovina the data are for 2010 and 2015; for Kosovo and Montenegro, the data are for 2006 and 2015.

Source: Government statistical offices and ministries in the region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

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Table 4.1. **Debt level (in 2015) and budget deficit (in 2016) in the SEE economies**

% of GDP

SEE economy	Debt level	Budget deficit
ALB	72.7%	2.2%
BiH	44.2%	0.8%
KOS	< 20%	2.7%
MKD	47.8%	2.6%
MNE	65.7%	3.5%
SRB	74.7%	1.4%

Note: Data on debt levels for Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia were provided by the respective SEE governments. Budget deficit data for Albania, Bosnia and Herzegovina, and Montenegro came from EIU (2016); the budget deficit data for the Former Yugoslav Republic of Macedonia were provided by its government; the budget deficit data for Kosovo were obtained from Oxford Economics (2016).

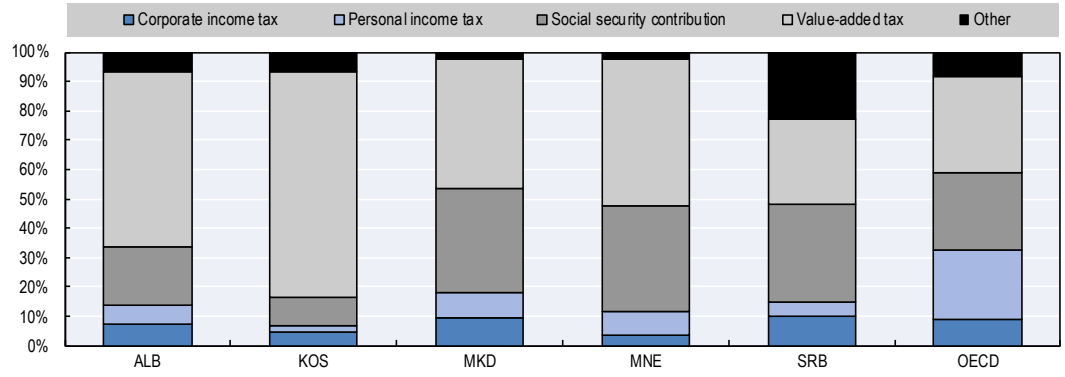
Source: EIU (2017), *World Economic Indicator Database,* www.eiu.com/home.aspx; Oxford Economics (2016), "Kosovo"; SEE governments.

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The tax mix for all of the economies differs significantly from the average tax mix in OECD countries (Figure 4.4). In the SEE economies, the tax mix is tilted towards SSCs and VAT, while PIT only raises a small amount of revenue. In 2015, only Albania and Kosovo collected less revenue from SSCs as a percentage of total tax revenues (20.2% and 9.5% respectively) than the OECD average (26.2% in 2014). The other economies raised over 30% of total tax revenues from SSCs. All the economies except Serbia raised more revenues from taxes on goods and services as a percentage of total tax revenues in 2015 than the 2014 OECD average of 32.6%. All the assessed economies raise very little revenue from PIT in comparison to the OECD average of 24%. In the SEE

economies this share ranges from 2% in Kosovo of total tax revenues to 8.8% in the Former Yugoslav Republic of Macedonia (Figure 4.4).

Figure 4.4. **Tax revenues as a share of total tax revenues (2015)**



Note: CIT – corporate income tax; PIT – personal income tax; SSC – social security contribution; VAT – value-added tax. The revenues included in the "other" category are not necessarily consistent across SEE economies; OECD average is for 2014. Information for Bosnia and Herzegovina is not available.

Source: OECD (2016a) *Revenue Statistics* (database), http://dx.doi.org/10.1787/ctpa-rev-data-en. Government statistical offices and ministries in the region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

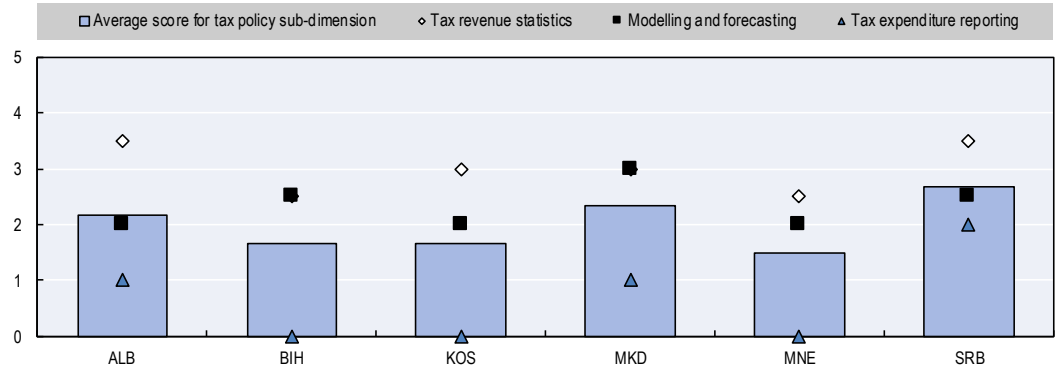
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The six SEE economies would benefit from shifting some of their tax mix away from SSCs towards other taxes. High SSCs distort labour markets and provide incentives for workers to remain in the informal sector. In addition, because SSCs are levied at the same rate for all income levels, they do not contribute to making the tax system progressive. Overall, raising more revenues from PIT while lowering SSCs could help make tax systems both more efficient and more progressive.

Tax policy

Tax policy aims at creating a competitive tax environment which encourages investment, work, risk-taking and entrepreneurship while raising sufficient tax revenues to finance public expenditure and ensuring that the tax burden is shared fairly across the population. The tax policy sub-dimension analyses the tax policy frameworks in the six SEE economies. This sub-dimension includes three qualitative indicators to assess the tax policy tools applied in SEE economies: 1) tax revenue statistics; 2) modelling and forecasting; and 3) tax expenditure reporting (Figure 4.5). This section also reviews general features of the CIT systems, including the CIT rates and revenues levied by governments and the corporate tax incentives introduced to stimulate investment. It also looks at other types of taxes, examining the levels 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 for the region was 2.

Figure 4.5. **Tax policy: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Tax statistics reporting and revenue forecasting occur but analytical capacity could be strengthened

The six SEE economies would benefit from further improvements in their statistical reporting in general and their **tax revenue statistics** in particular. The average score across the six SEE economies for this indicator is 3, which suggests that the tax collection agency routinely collects and calculates simple statistics on corporate taxation, and analyses with sufficient detail which types of business and industries pay CIT. The methodologies they use to collect and present tax revenue data vary from economy to economy, making the data hard to compare across economies, however. The OECD has developed a methodology that enables international comparison of tax revenues on a consistent basis (OECD, 2016a). The OECD Revenue Statistics methodology includes a conceptual framework which defines the concept of a "tax" and provides guidance for the classification of different taxes. The SEE economies would therefore benefit from participating in the OECD Global Revenue Statistics project, which would provide them with comparable tax revenue data.

Forward-looking effective tax rates on investment and wages should be basic inputs into economic and tax policy analyses. Most of the SEE economies perform simple calculations and tax statistics, but do not have well-developed effective tax rate models. Strengthening their analytical capacity would allow policy makers to be better informed and would ensure greater public-sector transparency and accountability.

All six of the assessed SEE economies use aggregate **modelling and forecasting** tools, which are important for estimating future tax revenues. These models are also regularly assessed. The average score across the six SEE economies for this indicator is however 2.3 (Figure 4.5), indicating that while the ministries of finance maintain aggregate tax revenue forecasting models for each main tax, there is insufficient analysis of the information or a lack of micro-simulation models.

None of the economies make widespread use of micro-simulation models. These models simulate taxes, SSCs and any social benefits, in order to predict the effects of a potential tax reform and current tax policies. Albania, Kosovo and Montenegro do not implement any micro-simulation models. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia have started to use micro-simulation models to assess their tax policies and reforms, although not yet on a regular basis. As a first step,

micro-simulation models could be developed to assess the distributional impact of VAT in SEE economies, following work that has been carried out in OECD countries (OECD/KIPF, 2014).

The SEE economies do not calculate the revenue forgone arising from **tax expenditure**. Across the six economies, the average for this indicator is 0.7 (Figure 4.5), reflecting the fact that tax expenditure accounting and reporting are not conducted at all (Bosnia and Herzegovina, Kosovo, and Montenegro) or only sporadically (Albania and the Former Yugoslav Republic of Macedonia). Serbia, the economy with the highest score, undertakes disaggregated tax expenditure accounting routinely.

Although there may be good reasons to provide targeted tax relief, in general tax subsidies generate distortions between different types of taxpayers and activities. They also make the tax system harder to administer and comply with, and they tend to make tax systems less equitable, as better-off individuals often benefit more from tax expenditure than poorer households. Tax expenditure is equivalent to direct government spending, but is less transparent to the public at large. None of the six economies prepare an annual tax expenditure report. This should become a regular practice for SEE economies.

Corporate income tax revenues are relatively high

Statutory CIT rates in the six SEE economies are low compared to the OECD average (24.7% in 2016), ranging between 9% and 15%: Albania and Serbia apply a 15% rate; Bosnia and Herzegovina, Kosovo, and the Former Yugoslav Republic of Macedonia levy a 10% rate; and Montenegro's standard rate is 9%.

Despite the low rates, revenues are not particularly low in all of the SEE economies. In 2015, the Former Yugoslav Republic of Montenegro reported CIT revenues of 2.2% of GDP, and they were 1.9% of GDP in Albania and Serbia and 1.2% in Kosovo and Montenegro.[3] The average in OECD countries was 2.8% in 2015 (OECD, 2016a). The fact that CIT revenues are not necessarily very low despite low tax rates and generous CIT incentives (see below) may be explained by high levels of investment and/or a high degree of incorporation by businesses, among other causes. For example, lower rates may act as incentives for business incorporation, allowing entrepreneurs to earn lower-taxed capital instead of higher-taxed labour income. Thus the low CIT rates may mean lower revenues from PIT and SSCs. More in-depth tax policy analysis would help to clarify these different issues.

A large informal sector means the tax burden is borne by a relatively small number of taxpayers

The tax burden in the six SEE economies is borne by a small number of taxpayers. The region has a large informal sector, although no exact figures for its size seem to exist. This limits the amount of tax revenue that can be raised, creates distortions between the formal and informal economy, and reduces the ability of the tax system to help reduce inequality.

Governments have a variety of tools available to them to bring more taxpayers into the tax system, including simplified tax regimes for certain types of individuals or businesses. They can also target their audit capacities at those agents who are more likely to evade taxes and operate in the informal economy. Focusing on entire value and business chains and using import and export information from customs effectively could be an integral part of approaches to gradually increase compliance across the SEE economies.

The SEE economies offer a wide range of corporate tax incentives

The six SEE economies all have generous profit-based corporate tax incentives. In Bosnia and Herzegovina, both entities grant a 30% reduction in corporate tax liability for investment in fixed productive assets if the investment exceeds 50% of taxable income (for the Republika Srpska) or 50% of corporate tax liability (for the Federation of Bosnia and Herzegovina). In the Former Yugoslav Republic of Macedonia, companies located in technological industrial development zones are exempted from CIT on their profits for ten years (certain limits are in place). Montenegro grants an eight-year tax exemption of up to EUR 200 000 of total tax liability to newly created corporations in underdeveloped areas. In Serbia, the profits on investment in fixed assets exceeding RSD 1 billion (Serbian dinar, about EUR 8 million) are exempted from CIT for 10 years if they create a minimum of 100 additional jobs.

Some of the SEE economies have expenditure-based CIT incentives, which reduce the cost of investment. For instance, Kosovo grants a deduction of 10% of the cost of an investment in a new asset. The Former Yugoslav Republic of Macedonia allows for immediate expensing of the total cost of new business-related investments in fixed tangible assets.

In light of the economies' low standard CIT rates, the policy rationale is weak for profit-based CIT incentives, including rate reductions, exemptions and tax holidays. 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 the costs for the tax administration, which has to monitor compliance with the incentives' eligibility criteria. They also create incentives for tax planning and evasion. For instance, taxpayers have an incentive to remain below the income thresholds which trigger higher taxation, potentially hindering the growth of those businesses. Tax incentives also create negative spillover effects and tax avoidance opportunities. Profit-based tax incentives should be avoided and the current tax incentives should be turned into expenditure-based tax incentives, such as accelerated or enhanced tax depreciation or investment tax credits, or phased out altogether. Instead of using CIT incentives, SEE economies may want to tackle the weaknesses in their investment climate directly, instead of compensating for them through their tax system. Such a strategy would integrate enhanced co-operation across the SEE region (see below)

The SEE economies make widespread use of presumptive and preferential tax regimes targeted at small and medium-sized enterprises (SMEs). In Albania, businesses with annual turnover below ALL 5 million (Albanian lek, about EUR 37 200) enjoy a 0% CIT rate, while for SMEs with turnover between ALL 5 and 8 million (EUR 37 200-59 400) the rate is 5%. In the Former Yugoslav Republic of Macedonia, a 0% CIT rate applies to entities with turnover below MKD 3 million (Macedonian dinar, about EUR 48 700) and there is a 1% tax on turnover for entities with gross incomes of MKD 3-6 million (EUR 48 700-97 400); entities in this category can choose to apply the preferential regime or be taxed under the general regime. Kosovo levies reduced CIT rates of between 3% and 9% – the rate varies with the type of economic activity – for SMEs with an annual turnover below EUR 50 000.

Such size-based thresholds are not necessarily an effective tool to support investment and may restrain growth. Size-based tax preferences give businesses incentives to remain below the threshold so as to continue benefiting from such targeted regimes, both in terms of reduced compliance costs and paying less tax (OECD, 2015a). They may encourage growing SMEs or larger companies to split into different companies to benefit from the

preferential tax treatment, or to deflate their revenues and inflate costs. Such regimes may also provide windfall gains to businesses that, for various reasons, may not be likely to invest and grow. Finally, when reduced rates are based on turnover, they tend to penalise low profit-margin businesses, which end up being taxed at a higher rate than businesses with a lower turnover but higher profits.

The marginal tax wedge on labour income is high despite relatively low personal income tax rates

In general, high SSCs encourage people to work in the informal sector, particularly where tax administrations are weak. High labour taxes in the formal sector may also push low-productivity workers into the informal sector or unemployment. SSCs increase the cost of employing workers and reduce workers' after-tax earnings. The greater the difference between total labour costs in the formal sector and after-tax disposable income for workers, the greater the incentive for employers and employees to avoid taxes by remaining or joining the informal economy. High levels of informality may in turn negatively affect productivity, growth and trust in government institutions (Box 4.1).

Box 4.1. **Main consequences of informality**

A large informal sector can have significant negative consequences for the economy. Workers employed in the informal sector have limited access to social protection, inadequate contracts, comparatively lower wages and are highly vulnerable when they lose their job or when they retire. High levels of informality may also reduce workers' access to training, exacerbating skills shortages. This ultimately generates greater inequalities. This is of particular concern in the SEE economies where inequality is already very high.

A large informal sector also affects productivity and growth. Production in the informal sector is often inefficient, either because firms stay too small to avoid being detected or because they use outdated production technologies. The relative cost advantages enjoyed by informal firms may allow them to stay in business even if they are not productive (Andrews et al., 2011). Firms operating in the informal sector also have more limited access to finance, which constrains investment, and to qualified labour.

A significant level of informal economic activity also has significant negative fiscal consequences. High levels of informality reduce the amount of tax revenue received by the government. Informal workers may also be receiving social benefits, adding to the unnecessary fiscal burden on the state. This is not so clear cut, however, as it can be argued that taxing the informal sector has limited revenue potential because informal workers and businesses tend to be poor and taxation would entail heavy collection costs.

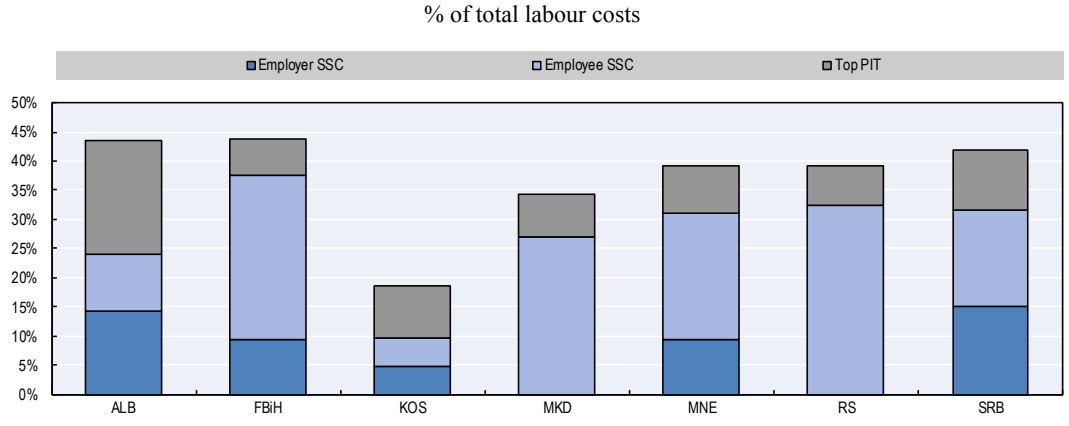
Finally, high levels of informality can erode formal workers' trust in public institutions and reduce their willingness to pay taxes, which may lower revenues through other channels. Importantly, the larger the informal sector, the more incentives people have to remain in or enter the informal sector as there is less fear of being sanctioned and they may view the informal sector as being tolerated.

The six SEE economies levy high SSCs but have relatively low PIT rates. The top PIT rates across the region range between 9% in Montenegro and 23% in Albania. Despite these relatively low PIT rates, high SSCs add up to a high overall tax burden on labour income. Employees in the SEE economies face SSCs ranging from 5% to 33% of their monthly gross income. In Albania and Montenegro, employees cannot deduct SSCs from taxable personal income, further increasing the tax burden on labour income. Employers must also make contributions ranging between 0% and 17.9% of their employees' salaries, which they can deduct as a cost from their taxable corporate income.

In three of the six economies – Albania, the Former Yugoslav Republic of Macedonia and Serbia – the average tax wedge for those at the bottom of the income distribution is highly regressive – hitting the poorest hardest. These economies impose a minimum amount of SSCs on earnings: workers who earn less than a minimum threshold have to pay the same contributions as those who earn at the threshold. This minimum contribution means that the average contribution rate is higher for very low-income workers. The thresholds are ALL 22 000 per month in Albania (about EUR 163), MKD 16 438 per month in the Former Yugoslav Republic of Macedonia (about EUR 267), and RSD 22 215 per month in Serbia (about EUR 181). Although these minimum contribution thresholds are set at low levels, they could still distort the labour market by discouraging low-income workers, in particular those working part-time, from joining or remaining in the formal sector.

The marginal tax wedges on labour income are relatively high due to the combined effect of PITs and SSCs in the SEE economies. In simple terms, the marginal tax wedge indicates the burden for every 1 additional unit of currency earned by an employee. Following the OECD *Taxing Wages* methodology (OECD, 2017a), the marginal tax wedge is calculated as the additional taxes – PIT, and employee and employer SSCs – which have to be paid when total labour costs increase with each additional currency unit. The marginal tax wedge is 43.6% in Albania, 43.8% in the Federation of Bosnia and Herzegovina, 18.6% in Kosovo, 34.3% in the Former Yugoslav Republic of Macedonia, 39.3% in Montenegro and in the Republika Srpska, and 41.8% in Serbia. Figure 4.6 presents marginal tax wedges levied at the income level where the top PIT rate is first levied.

Figure 4.6. **Marginal tax wedges at the income level where the top personal income tax rate starts being levied**



Note: Figure shows the marginal effective tax on wages levied at the threshold income level for the top rate of personal income tax (PIT). This means that the results presented apply at different income levels in different economies. The marginal tax wedge is broken down into the share of PITs, employees' social security contributions (SSCs) and employers' SSCs that have to be paid as a percentage of total labour costs; employee's SSCs are calculated as the income level where the top PIT rate hits first, augmented by the employer SSCs that have to be paid by the employer at that income level. Employees' SSCs are deductible from the PIT base except in Albania and Montenegro. As a result, the relative tax shares differ from the statutory PIT and SSC rates that have to be paid.

Source: OECD analysis following the *OECD Taxing Wages* methodology (OECD, 2017a).

StatLink http://dx.doi.org/10.1787/888933703675

Reducing tax wedges for low-income workers could improve incentives for employers to hire and declare workers and for employees to operate in the formal economy. Lehmann and Muravyev (2012) found evidence, based on a panel of Latin American countries, that a larger tax wedge increases informality and suggest that lowering the tax wedge might be one of the most effective instruments for reducing informality. The SEE economies should evaluate the effect on work incentives and labour demand by employers of the labour income tax wedges at different income levels.

Reducing SSCs for low-income workers would come at a budgetary cost, which the SEE economies would need to compensate for. They could fund some social benefits through general taxation, in particular those benefits where there is no clear link between the level of contributions and the level of benefits, such as family allowances or health insurance. Funding can also be raised through other taxes, including corporate income, consumption or property taxes. Some OECD countries (e.g. France through the *Contribution Sociale Generalisée*) partly finance their social security systems through such taxes.

The SEE economies would benefit from an in-depth analysis of the tax burden on labour income in their economies. The OECD carries out such an analysis for its member countries in its annual *Taxing Wages* report (see for example OECD, 2017a); the economies would benefit from a similar analysis of effective tax rates. *Taxing Wages* provides details of all the taxes levied on wage earnings. It covers PITs, employees' SSCs, employers' SSCs and payroll taxes net of cash benefits received by in-work families. The report illustrates how these taxes and benefits are calculated in each member country and examines their impact on household after-tax incomes. The results of this publication enable quantitative cross-country comparisons of tax burdens, total labour costs and the overall tax and benefit position of single individuals and families at different levels of earnings.

Businesses have a modest tax-induced incentive to finance investment with debt rather than equity

Corporations face a modest tax-induced incentive to finance domestic investment with debt in the SEE region. Interest payments are deductible from the CIT base but the return on equity is not, which creates a tax-induced incentive to finance investment with debt rather than equity. As the debt-equity bias increases with a higher CIT rate, and standard CIT rates are low in SEE economies, the debt-equity bias in SEE economies remains low. In all economies except Montenegro, dividends paid by a resident corporation to a domestic corporation are exempt from CIT (at the recipient level). The six economies tax the interest paid to resident companies as ordinary business income in the hands of the recipient and subject to the corporation's CIT rate.

The debt-equity bias in most of the SEE economies persists when taxes on capital income at the individual level are taken into account. Dividends paid by a domestic company to resident individuals are subject to a final withholding tax in Albania, the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia; i.e. no additional tax is levied on distributed dividends at the individual level for shareholders in these economies. In Bosnia and Herzegovina (both entities) and Kosovo dividends paid to resident individuals are exempt. Given the standard CIT rates and taxes on dividends in each economy, the combined statutory tax burden on dividends equals 10% in Bosnia and Herzegovina and Kosovo, 27.8% in Albania and Serbia, 19% in the Former Yugoslav Republic of Macedonia and 17.2% in Montenegro. Interest paid to resident individuals is subject to a final withholding tax in all economies. The final withholding tax rates are

15% in Albania and Serbia, 10% in Kosovo, and 5% in Montenegro. As a result, the tax burden on dividends is higher than on interest in all economies except Kosovo, where interest and dividends are subject to the same tax burden of 10%.

VAT rates are relatively high but levied on a narrow base

Raising additional revenues through VAT is less detrimental to economic growth than raising revenues through other taxes. 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 to economic growth after recurrent taxes on immovable property and before other property taxes and personal and corporate income taxes (OECD, 2010). VAT is therefore generally considered a comparatively efficient way to raise revenues. In addition, a well-designed VAT system can provide incentives for businesses to enter the formal sector and can help to reduce informality (Box 4.2).

The six SEE economies levy relatively high VAT rates on a narrow VAT base. Apart from Serbia, which has a relatively broad VAT base, the SEE economies have a long list of VAT-exempted goods and services. Standard VAT rates in the SEE economies range from 17% in Bosnia and Herzegovina to 18% in Kosovo and the Former Yugoslav Republic of Macedonia, 19% in Montenegro, and 20% in Albania and Serbia. The average VAT rate in the OECD is 19.2%. The VAT base is narrow because a wide range of goods and services are taxed at a reduced VAT rate or exempt from VAT altogether. The reduced VAT rate is 10% in Albania and Serbia, 8% in Kosovo, 7% in Montenegro, and 5% in the Former Yugoslav Republic of Macedonia.

Box 4.2. **How VAT can help to reduce informality**

VAT could help collect revenues from the informal sector. As discussed above, informality is a significant challenge across the SEE economies. In addition to being able to tax a wide range of economic activities, VAT creates positive "chain" effects by encouraging informal economic agents to become formal. The simplest way to tax the informal sector is through indirect taxes, i.e. by taxing the goods and services that informal businesses buy (Joshi et al., 2014). VAT functions in part as a tax on the purchases by informal operators from formal businesses as informal businesses have to pay at least some VAT on their inputs but are not entitled to VAT refunds (Keen, 2007). This does not require any active participation in the tax system (e.g. filing tax returns) and thus does not involve compliance cost issues (Joshi et al., 2014). VAT thus creates positive incentives for informal firms with actual or prospective dealings with formal firms to enter the formal tax system in order to be able to claim tax credits and recover the VAT on their inputs.

Most OECD countries (except Chile, Mexico, Spain, Sweden and Turkey) apply a VAT registration or collection threshold below which small businesses are not required to charge and collect the tax (OECD, 2016b). Of these, 16 have a relatively high VAT threshold (roughly based on a turnover of over EUR 26 000), while 13 have a relatively low one (EUR 1 300-26 000). Whether to establish a threshold or not – and the specific level of the threshold – depends on many design factors, including the level of administration and compliance costs, the audit capacity of the tax administration, the impact on incentives for businesses to grow, and the level and impact on informality. All these considerations make it difficult to identify the optimal threshold, which may vary across economies.

All six SEE economies have opted to apply VAT registration thresholds, and they are set relatively high. The threshold is around EUR 16 000 in the Former Yugoslav Republic of Macedonia, EUR 18 000 in Montenegro, EUR 25 000 in Bosnia and Herzegovina, EUR 30 000 in Kosovo, EUR 37 000 in Albania and EUR 65 000 in Serbia. 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. The level of 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 (OECD, 2016b). The SEE economies have chosen to concentrate their VAT administration capacities on larger businesses by setting rather high thresholds. This approach has many merits. As they continue to strengthen their tax administration capacity, they may consider gradually lowering registration thresholds over time.

A major concern with VAT systems is that they are perceived as regressive, although the evidence for this is mixed (Brys et al., 2016). Some studies have concluded that VAT is a regressive tax after analysing how much VAT people in different income groups pay as a share of their current income. In contrast, studies that measured the VAT burden as a share of current expenditure across either income or expenditure distributions found that VAT systems were relatively proportional, or even slightly progressive. The difference in results between the two approaches is driven by savings behaviour. Saving rates tend to increase with income, which means that higher-income households will tend to have proportionately less of their income subject to VAT because they spend less of their total income (in the current period) than lower-income households (OECD/KIPF, 2014).

Many countries have tried to address the perceived regressive nature of VAT by supporting the poor through exemptions or reduced rates. However, these are rarely well targeted (Box 4.3). The general recommendation for OECD countries is therefore to use direct cash transfers rather than reduced VAT rates to support low-income households if a well-functioning transfer system is in place (OECD/KIPF, 2014).

Many of the exemptions and reduced rates in the six SEE economies are not well targeted from an equity perspective (OECD, 2016b). They would benefit from broadening their VAT bases. VAT regimes across the SEE region provide for a long list of VAT-exempted goods and services; Serbia is the exception as it has a relatively broad VAT base. For example, all the economies exempt from VAT rents on residential property, education services and either healthcare services or the supply of medical products. In addition, Albania and Kosovo exempt newspapers, magazines and certain other types of printed materials. Albania also 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. Bosnia and Herzegovina and Montenegro exempt any activity that can be seen to be connected to the public interest. The Former Yugoslav Republic of Macedonia exempts the cross-border transport of people.

Box 4.3. The distributional effects of reduced VAT rates

Almost all OECD countries have one or more reduced VAT rates to support various policy objectives. A major reason for the introduction of a differentiated rate structure is to promote equity. Countries have generally considered it desirable to alleviate the tax burden on goods and services that form a larger share of expenditure of the poorest households (e.g. basic food, water). Countries also often decide to not tax medicine, health services and housing at high rates. Reduced VAT rates have also been used to stimulate the consumption of "merit" goods (e.g. cultural products and education) and other non-distributional objectives, such as promoting locally supplied labour-intensive activities (e.g. tourism) and correcting externalities (e.g. energy-saving appliances).

In general, VAT exemptions, zero-rates and reduced rates are not a well-targeted tool to support low-income households. Reduced rates that are implemented for the distinct purpose of supporting the poor (i.e. to address distributional goals) typically do have the desired progressive effect. For example, reduced rates for basic food in general provide greater support to the poor than the rich as a proportion of household income or expenditure. However, despite this progressive effect, these reduced VAT rates are an ineffective way to target support to poor households. At best, rich households receive roughly as much benefit – in absolute value – from a reduced rate as poor households and at worst they benefit vastly more. This is unsurprising as richer households can be expected to consume more, and often more expensive, products than poorer ones. Thus, while poorer households may benefit from reduced VAT rates on "necessities", the wealthier gain even more.

Well-functioning cash transfer programmes that cover the entire population are a more effective tool to compensate poor households for the VAT they have paid. It is more efficient and fairer to tax all goods and services at the standard VAT rate and compensate the poor directly through cash transfers (and/or reductions in PITs, etc.), especially if the standard VAT rate is not particularly high. It should be noted, however, that compensating all (and only the) losers of a reform through a transfer programme might in practice be very difficult to achieve.

The distributional arguments in favour of differential VAT rates may be more persuasive in countries which do not have the administrative capacity to provide more direct transfers to poorer households. In this situation, levying low or even zero rate VAT on the goods typically consumed by poorer households might be considered, at least in the short run.

Preferential VAT rates for social, cultural and other non-distributional goals benefit richer households considerably more. These tax provisions often provide so large a benefit to rich households that the reduced VAT rate actually has a regressive effect – benefiting the rich more both in aggregate terms and as a proportion of expenditure. For example, reduced rates on hotel accommodation and restaurant food benefit the rich vastly more than the poor, both in aggregate and proportional terms, in all OECD countries in which they are applied. Similar results, on a smaller scale, are found for reduced rates on books, and cinema, theatre and concert tickets.

Finally, VAT rates may not be the best policy instrument to correct negative externalities. Differential VAT rates may improve efficiency if it means that the private marginal costs of an activity are brought closer to the marginal costs for society. However, VAT is a blunt instrument for correcting environmental externalities, as it may be hard to target the actual source of pollution. For example, reduced rates on energy-saving appliances may boost demand and therefore stimulate the consumption of these goods. The reduced VAT rate may encourage consumers to shift from more to less energy-consuming items (replacing an old refrigerator with a new one, for instance). However, this may also lead to an increase in the purchase of energy-intensive products, e.g. replacing an old refrigerator with a new refrigerator and a freezer (Copenhagen Economics, 2007).

Source: OECD/KIPF (2014), *The Distributional Effects of Consumption Taxes in OECD Countries*, http://dx.doi.org/10.1787/9789264224520-en.

The way forward for tax policy

In order to raise more tax revenues, the six SEE economies could consider broadening their tax bases. This would allow them to balance their budgets, reduce debt levels and finance better public services and infrastructure to help drive continued economic growth. In doing so, the SEE economies should assess the efficiency and equity implications of their tax system. Overall, they should strengthen their tax systems in order to stimulate economic growth that is beneficial to taxpayers across the income distribution.

Maintaining low tax rates will require keeping tax systems simple and tax bases broad. The SEE economies could broaden the VAT base by **reducing VAT exemptions and taxing goods and services at the standard VAT rate**.

The CIT base could also be broadened. Given the very low CIT rates in the region, the rationale for implementing generous profit-based CIT incentives is weak. The SEE economies should therefore **evaluate their current tax incentives and avoid falling into the trap of a "race to the bottom" tax competition**. They should avoid profit-based tax incentives and turn the current incentives into expenditure-based tax incentives, such as accelerated or enhanced tax depreciation or investment tax credits, or phase them out altogether. Instead of relying on CIT incentives, the SEE economies may want to tackle the weaknesses in their investment climate directly, rather than compensating for them through their tax system.

Bringing more individuals and businesses into the formal economy should be a key priority for the SEE economies. A well-designed tax system can help to encourage businesses and households to operate in the formal economy. The SEE economies could introduce simplified tax regimes that apply to some types of individuals or businesses, or improve their design. They should also target their audit capacities at those agents who are more likely to evade taxes and operate in the informal economy. Focusing on entire value and business chains and effectively using the import and export information from customs could form an integral part of an effective approach to gradually increase compliance across SEE economies.

Despite low PIT rates, the SEE economies impose a high overall tax burden on labour income because of high SSCs. **Shifting the tax mix away from SSCs and towards other type of taxes may reduce market distortions** and provide incentives for workers to leave the informal sector. The SEE economies could also consider reducing the labour income tax wedge by introducing an earned income tax credit within the PIT and/or targeted SSC reductions for low-income workers. Albania, the Former Yugoslav Republic of Macedonia and Serbia should consider levying SSCs as a percentage of actual income rather than imposing minimum contributions below an earnings threshold. All six SEE economies could fund some social benefits through other taxes. They could also strengthen the role of PIT to make the tax system more progressive.

The SEE economies may want to strengthen their tax rules on fringe benefits in general and particularly the use of company assets for private purposes. Currently, manager-owners of closely-held corporations face a tax-induced incentive to consume out of their own business.

Corporations in all the SEE economies except Kosovo have a small tax-induced incentive to finance investment with debt rather than equity. **Economies may want to tax interest payments for individual tax residents at higher withholding rates** in order to tax interest and the return on equity more equally.

Finally, all six SEE economies would benefit from implementing micro-simulation models and systematic tax expenditure reporting. They should strengthen their tax policy assessment tools, including the development of corporate effective tax rate models and *Taxing Wages* models. These would allow the SEE economies to deepen their analysis of the combined impact of PITs and SSCs. The SEE economies could also improve their tax revenue data reporting, in particular by joining the Global OECD Revenue Statistics project which presents detailed, internationally comparable data on tax revenues across the world.

Tax administration

Sound tax policies and clearly drafted legislation are not enough to guarantee that tax systems are competitive. Governments must ensure the consistent and transparent implementation of tax policies and legislation through effective administration. Indeed, an efficient administration is critical to maximise tax compliance and revenue collection. From a business perspective, an efficient tax administration is also essential to limit the costs of complying with tax obligations. The tax administration sub-dimension assesses the efficiency of the tax administration in the six assessed SEE 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 the SEE economies are building effective tax administrations.

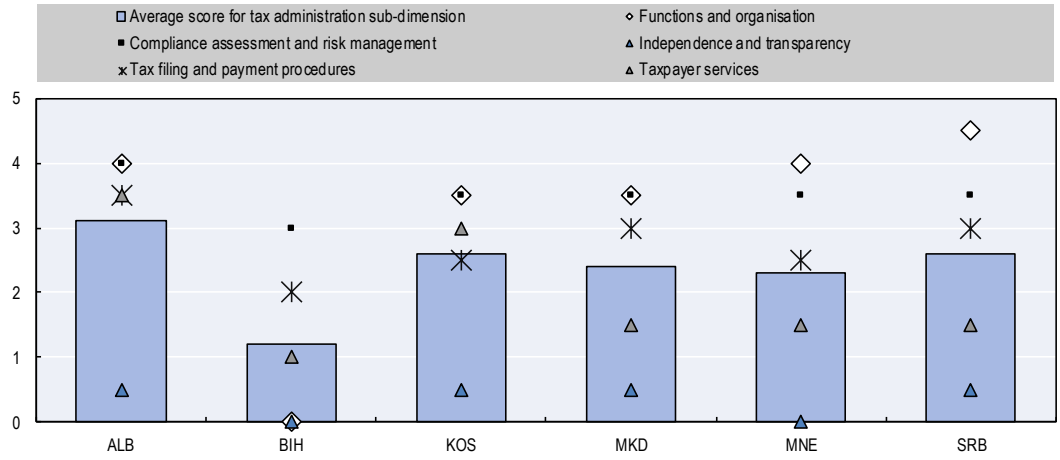
In general, all six economies have made significant efforts to strengthen their tax administration indicated by the fact that their average score is 2.4 for the sub-dimension overall (Figure 4.7). By strengthening their administration, the SEE economies aim to maintain low direct tax rates. They have made significant improvements in functions and organisation, compliance assessment and risk management, and taxpayer services. However, they may need to make more effort to secure the independence and transparency of their tax administrations as they continue to be autonomous or semi-autonomous bodies within their finance ministries and lack independent management boards. Such a reform might be difficult in certain economies as it goes against their constitutions (as for instance in Bosnia and Herzegovina).

Organisational structures and functions of tax administrations are more comprehensive

Organisational structure is an important factor in the operational efficiency and effectiveness of the tax administration as well as the delivery of services to taxpayers. One of the key factors that strengthens the efficiency of the tax administration is the presence of a unified tax administration which covers all taxes and all of the core tax administration functions.

Compared to the findings of the 2016 *Competitiveness Outlook*, the organisation and overall governance of most tax administrations covered in this report have improved. In this assessment, all the economies except for Bosnia and Herzegovina scored 3.5 or above for the functions and organisation indicator (Figure 4.7). In 2016, all the economies scored 3 except for Serbia.

Figure 4.7. **Tax administration: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933703694

Albania, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia have unified bodies with links to the collection of SSCs. In all these economies, the administrations are organised around either a function or a taxpayer approach, or a combination of both, and regular training is provided to tax administration officials. In Albania and Serbia, the tax administration is assessed to ensure that its tax administration functions are unified; in Serbia, this assessment has led to adjustments.

Compliance assessment and risk management have improved across all the SEE economies

To be efficient in monitoring compliance and managing risks, tax administrations should have an ongoing process in place that allows them to consider where the greatest compliance risks lie within their economy. This process should also allow the administration to determine the appropriate treatment or management of these risks. This process should include consideration of potential changes to and improvement of systems, and possible legislative change as well as audit intervention.

Since it is impossible to check every single taxpayer, risk-based selection is a key element of effective and efficient compliance programmes. This allows administrations to make effective trade-off decisions and use their scarce resources to best effect. As such it is important that the results of audit programmes are regularly assessed and reported – this helps to not only make sure that operations are transparent to the wider public, but also to inform and help improve the tax administration's overall risk management model.

Risk auditing efforts should make use of third-party reporting systems. All advanced economies make extensive use of third-party information reporting, whereby institutions such as employers, banks, investment funds, and pension funds report taxable income earned by individuals (employees or clients) directly to the government (Kleven et al., 2011).

All six of the assessed economies received a score of 3 or above for this indicator, reflecting moderate improvements and a proper understanding of the need for strong compliance assessment and risk management (Figure 4.7). However, the six SEE economies do not have particularly strong third-party reporting systems in place.

Developing such systems, especially in combination with a withholding tax regime, is a proven way for tax administrations to improve both tax compliance and their risk analysis, risk treatment and, where necessary, targeting of tax audits (OECD, 2015b).

Tax administrations are increasingly transparent but still lack independence

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. Independence is necessary to ensure that the tax system is not influenced by political actors who may seek to circumvent established tax laws or use taxation powers to discriminate against political rivals. By ensuring a transparent and independent tax administration, governments are making a credible commitment to taxpayers about the integrity of future tax procedures and signalling to the private sector that they will not abuse the power to tax.

Trust in the fairness of the tax administration (and also the wider tax system) is very important for maintaining and enhancing compliance and for the tax system's sustainability. It means enforcement must be visible and credible, taxpayers must be seen to be treated fairly and with respect, and adequate channels for queries and appeals must exist. Where trust in the fairness of tax administration breaks down or taxpayers feel detached from the social norms supporting the payment of tax, they may become disengaged, more prone to under-report or less concerned about errors. At worst, it may encourage some to take active steps to evade tax obligations. Corruption among tax collectors may deter individual taxpayers from paying taxes, or they may opt to pay a bribe or enter into the informal economy.

Tax administration offices across the six SEE economies still lack independence; however, they have taken important steps towards establishing transparency. In fact, the average score across the six economies is 0.3 for this indicator (Figure 4.7), reflecting that most of the economies lack a policy to ensure that the tax administration is independent. While none of the economies have policies in place to establish independent management boards, all the tax administrations have rules to deal with staff abusing tax collection powers. In Albania, staff abusing tax collecting powers are subject to the criminal code and the law on tax procedures, while in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia, employees of the tax administration are subject to disciplinary measures in cases of abuse of power. In Kosovo and Montenegro, staff have a code of ethics. All the economies have also introduced whistleblower protection rules (see Chapter 17) and Albania and the Former Yugoslav Republic of Macedonia have put in place monitoring procedures to ensure the transparency of the tax administration.

Tax filing and payment procedures have been streamlined

Complying with tax obligations requires businesses and individuals to have internal resources and/or access to external resources such as tax consultants and accountants. This can impose particularly burdensome costs on small and medium-sized business. Thus, streamlining and simplifying tax-compliance procedures helps to limit the burden imposed on businesses.

The six SEE economies reported that tax filing and payment procedures are reasonably quick and relatively simple. The average score for this indicator across the six SEE economies is 2.7 (Figure 4.7), reflecting that tax filing and payment procedures are relatively simple, tax return forms are kept straightforward, and that all of the economies have e-filing procedures available for most, if not all, taxes, which helps to simplify filing

procedures. All the economies make widespread use of e-filing. In Albania, e-filing is the only system available. E-payment is so far only available in the Former Yugoslav Republic of Macedonia and Kosovo. However, Kosovo does not have software for tax compliance available to taxpayers and Montenegro does not offer taxpayers easy background validation tests. The tax administrations in Serbia and the Former Yugoslav Republic of Macedonia, have no difficulty in verifying proper calculations and running background validation tests.

Most of the economies, except for Bosnia and Herzegovina and Serbia, report that they review their tax filing and payment procedures regularly to ensure that they are clear and transparent. However, these reviews are not performed by an independent body or carried out systematically. In Kosovo and Montenegro, these reviews have led to readjustments.

Taxpayer services vary across the SEE economies

Taxpayer services play a critical role in maximising voluntary compliance by providing taxpayers with the information and assistance they need to meet their tax obligations. Taxpayer services refer to the types of services that the tax administration offers to taxpayers. These typically include information and assistance, responding to in-person and telephone inquiries, handling appeals, and offering online filing and payment systems. Tax administrations should be using customer-centred techniques such as taxpayer segmentation (to differentiate between different groups of taxpayers) and opinion surveys, and guaranteeing that taxpayers are able to easily assess services.

Taxpayer services vary across the six SEE economies, ranging from 1 in Bosnia and Herzegovina, to 3.5 in Albania. The average across the six economies is 2 (Figure 4.7). All of the SEE economies except Albania implement customer segmentation models to better meet taxpayer needs. Both entities of Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia do not have easily accessible taxpayer ombudsmen. This is the only reason why these economies did not have a higher score for this indicator. Kosovo is the only economy not to conduct surveys of taxpayers' satisfaction with the services available, or to put any monitoring processes in place.

There is ample scope for all of the economies to use information technology (IT) tools more extensively to improve tax collection. Across OECD countries, higher spending on IT is associated with better performance-related indicators, such as e-filing, e-payment and lower tax collection costs (OECD, 2015b). Box 4.4 describes examples of innovative user design and engagement approaches in Singapore and Finland.

The way forward for tax administration

Strengthening the tax administrations of the six SEE economies would bring more taxpayers into the tax system and broaden their tax bases. This strengthening should support efforts to address tax evasion and ensure that timely and effective action is taken against those who deliberately set out to avoid or evade taxes. Strengthening the tax administration further would also be an efficient way to increase tax certainty, lower compliance and enforcement costs, increase tax revenues, and make the tax system more efficient and fair.

Box 4.4. Good practice: User design and engagement in Singapore and Finland

The Inland Revenue Authority of **Singapore** (IRAS) organised its first "Tax Hackathon" in September 2016. The aim was to co create taxpayer-centred experiences for SMEs, the self-employed and individuals. To ensure that the opportunity areas were practical and relevant to taxpayers' experiences, IRAS conducted several rounds of focus group discussions with both external and internal stakeholders. Around 70 participants collaborated with IRAS to brainstorm and build working prototypes relating to the opportunity areas. Over 3 days, the event developed 19 creative and innovative working prototypes such as record-keeping and expense-tracking mobile apps, personal tax dashboards, and "chatbots". The outcomes showcased the power of co-creation with the coming together of start-ups, developers, designers, tax and accounting professionals, industry experts, students and IRAS staff.

Tax **Finland** plans to support the development of its MyTax customer portal with a range of user-centred tools and services. To do this it will apply "compliance by design" and "customer experience management" as guiding principles. It will also bring together advanced analytic techniques, design thinking, user-centred design methods and user testing skills. To support this approach it is introducing these disciplines to other development areas. It has begun promoting awareness of service design and its benefits throughout the organisation (including idea and hypothesis testing through early and low-level prototyping and experimentation). It is also planning to establish professional capability in design thinking and user design to enhance the usability and accessibility of its products and services.

Source: OECD 2017), *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies*, http://dx.doi.org/10.1787/tax_admin-2017-en.

All of the economies need to continue their efforts to invest in human and IT resources to enhance the efficiency of their tax administration and to improve tax collection. They also need to strengthen their ability to access and use third-party data for greater efficiency, increased levels of compliance and improved targeting of interventions. Box 4.5 describes how Canada uses integrated risk assessment to decide its audit approach to large businesses, and Box 4.6 presents some examples of best practice from other OECD countries.

Box 4.5. Good practice: Integrated risk assessment in Canada

The Canada Revenue Agency (CRA) has implemented an integrated risk assessment system which allows the agency to consider risks among large businesses both at the economic entity level and at the legal entity level. This system links information from CRA databases and various forms with tax returns. It then applies risk algorithms to the data to score risks for the entire large business population. Taxpayers considered by the automated system to be a high to medium risk are further analysed by experienced integrated large business audit teams to determine their overall risk profile. The risk profile determines the audit approach taken. Those taxpayers considered high risk will be subject to a full compliance audit. Taxpayers in the medium-risk category may be subject to a full compliance or limited scope audit. Taxpayers considered low risk may be subject to a compliance assurance review to validate the low-risk ranking. The approach allows the CRA to focus its audit resources on high-risk large businesses while reducing the compliance burden for businesses associated with low risk.

Source: OECD (2017b), *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies*, http://dx.doi.org/10.1787/tax_admin-2017-en.

Tax administrations need to improve their relationships with taxpayers and seek to engage them in enhancing taxpayer services. This involves seeking taxpayers' assistance in making procedures as easy to comply with as possible, gathering better information on the causes of non-compliance and actively communicating information on tax requirements to businesses and households.

Box 4.6. Use of third-party information reporting requirements and best practices

In contrast to the high cost and low coverage achieved using traditional audit processes, comprehensive programmes for information reporting and matching can be an extremely effective tool to screen relatively large numbers of taxpayers' records. This helps to both detect non-compliance and encourage the correct reporting of tax liabilities. However, there are two pre-conditions if such arrangements are to be sufficiently efficient to make them attractive to revenue bodies: 1) electronic reporting by third parties of information reports; and 2) the use of a high-integrity taxpayer identifier to enable accurate matching of information reports with revenue body records.

Many countries require the mandatory reporting of payments of salaries and wages, and dividend and interest income (much of which is also subject to withholding taxes). However, use of mandatory third-party reporting varies substantially beyond these categories of payments. Other examples include:

- **Australia's reporting system for the building and construction industry:** an annual reporting regime introduced in July 2012 that requires details of payments made to sub-contractors in prescribed industries to be reported to the Australian Taxation Office on an annual basis.
- **Canada's contract payments reporting system:** annual reporting regime introduced in 1999 for payments in the building and construction sector and payments by government for services provided by business.
- **Ireland's system of third-party returns:** traders (including farmers), professionals and others carrying on a business (including non-profit bodies and government bodies) are required to automatically make third-party returns. Broadly, these include the following payment categories: 1) payments for services rendered in connection with the trade, profession, business, etc., whether paid on their own behalf or on behalf of someone else; 2) payments for services rendered in connection with the formation, acquisition, development or disposal of the trade or business; and 3) periodic or lump sum payments made for copyright. There is a prescribed list of exclusions to these requirements.
- **The United States' information reporting requirements:** the US tax code contains a very wide variety of transactions that must be reported to the Inland Revenue Service, generally in electronic format, for matching with tax records. In addition to wages and investment incomes, these transactions include agricultural payments, allocated tips, barter exchange income, brokers' transactions, capital gains distributions, non-employee compensation and fees, fishing boat crew member proceeds, fish purchases for cash, prescribed gambling winnings, real estate transactions, rents and sales of securities.

Source: OECD (2015b), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, http://dx.doi.org/10.1787/tax_admin-2015-en.

International tax and tax co-operation

International and regional co-operation over 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 allows economies to learn from each other's best practices.

The international tax and tax co-operation sub-dimension considers whether the tax codes of the six SEE economies include key international tax rules. It also examines whether the economies participate in international taxation frameworks and co-operate with other economies, particularly in the SEE region. The information in this sub-dimension is not scored, but it was analysed using descriptive information.

Preventing tax treaty abuse

Tax treaties provide certainty in the taxation of cross-border transactions and eliminate double taxation. They allow governments to improve investment conditions with selected investor countries, in line with general economic and trade policy considerations. All of the SEE economies except Kosovo have a broad tax treaty network with at least 30 tax treaties in place; Kosovo has 10 treaties.

The costs and benefits of signing double tax treaties should be weighed carefully. Double tax treaties can bring a range of advantages to an economy and to those investing in them, but they need to be carefully designed. The negotiation and implementation of double tax treaties can be complex and can absorb valuable administrative resources. As double tax treaties typically reduce withholding tax rates, they could provide a windfall gain for existing foreign investment and could therefore result in a loss of tax revenues. Whether a capital-importing economy benefits from signing a double tax treaty will depend largely on whether it realises enough gains from increased foreign direct investment to offset any tax revenue losses (IMF, 2014). Entering into more tax treaties would allow the SEE economies to negotiate lower withholding tax rates levied by other countries on payments made to SEE economies. This could allow them to raise tax revenues from taxing foreign-source active and passive income and would provide them with the tools they need to obtain information on the financial activities of their tax residents and their offshore investments. The latter objective can also be achieved through the Convention on Mutual Administrative Assistance in Tax Matters, which only Albania has signed.

In terms of its fiscal impact, "treaty shopping" is likely to be the most significant form of treaty abuse. Treaty shopping occurs when an entity that is not a resident of one of two contracting states unfairly obtains treaty benefits through an intermediary in one of the contracting states. To address this concern, Action 6 of the OECD/G20 Base Erosion and Profit Shifting Project (BEPS) (Box 4.7) resulted in a commitment to ensure a minimum level of protection against treaty shopping. It requires any party to a treaty to include in the preamble to their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. The SEE economies should ensure that their current and new tax treaties include a minimum level of protection against treaty shopping.

The SEE economies' tax systems do not yet meet international best practice

BEPS arises when businesses can exploit gaps and mismatches between different tax systems. BEPS negatively affects an economy's 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 administration 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. Box 4.7 sets out some details of the recommendations from the OECD/G20 BEPS project.

Currently, none of the six SEE economies is a member of the Inclusive Framework. Joining it would support the economies in their efforts to align their international tax rules with international best practices. It would facilitate implementation, and being subjected to peer review processes would provide them with further guidance and support. Membership of the international framework, and tax systems which are aligned with international best practices, would also strengthen tax certainty for international investors.

Box 4.7. **The Inclusive Framework on base erosion and profit shifting**

In 2013, OECD and G20 countries, working together on an equal footing, adopted a 15-point Action Plan to address BEPS. Beyond securing revenues by realigning taxation with economic activities and value creation, the OECD/G20 BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers. In 2016, the OECD and G20 established an Inclusive Framework on BEPS to allow interested countries and jurisdictions to work with OECD and G20 members to develop standards on BEPS-related issues and reviewing and monitoring the implementation of the whole BEPS Package. In January 2018, 111 countries had become members of the Inclusive Framework on BEPS.

The OECD/G20 BEPS project has produced a 15-point action plan including minimum standards, common approaches, best practices and new guidance in the main policy areas.

- Four minimum standards have been agreed upon in the areas of fighting harmful tax practices (Action 5), preventing treaty abuse (Action 6), country-by-country reporting (Action 13) and improving dispute resolution (Action 14). All participating countries are expected to implement these minimum standards and implementation will be subject to peer review.
- A common approach, which will facilitate the convergence of national practices by interested countries, has been outlined to limit base erosion through interest expenses (Action 4) and to neutralise hybrid mismatches (Action 2). Best practices for countries which seek to strengthen their domestic legislation are provided in the building blocks for effective controlled foreign company rules (Action 3) and mandatory disclosure by taxpayers of aggressive or abusive transactions, arrangements or structures (Action 12).
- The permanent establishment (PE) definition in the OECD Model Tax Convention has been changed to restrict inappropriate avoidance of tax nexus through commissionaire arrangements or exploitation of specific exceptions (Action 7) (OECD, 2017c). Follow-up work is being undertaken which will also provide further guidance on the attribution of profits to PEs. In terms of transfer pricing, important clarifications have been made with regard to delineating the actual transaction, and the treatment of risk and intangibles. More guidance has been provided on several other issues to ensure that transfer pricing outcomes are aligned with value creation (Actions 8-10).

Box 4.7. **The Inclusive Framework on base erosion and profit shifting** (*continued*)

- The changes to the PE definition, the clarifications on transfer pricing, and the guidance on controlled foreign company rules are expected to substantially address the BEPS risks exacerbated by the digital economy. Several other options, including a new nexus in the form of a significant economic presence, were considered, but not recommended at this stage given the other recommendations; plus VAT will now be levied effectively in the market country facilitating VAT collection (Action 1).
- A multilateral instrument is implemented to facilitate the modification of bilateral tax treaties (Action 15). The modifications made to existing treaties will address the minimum standards against treaty abuse as well as the updated PE definition.

At the February 2016 G20 Finance Ministers meeting, the Inclusive Framework for the global implementation of the BEPS project was endorsed, with a reiteration of the commitment to the timely implementation of the BEPS project and to continue monitoring and addressing BEPS-related issues for a consistent global approach.

Monitoring the implementation and impact of the different BEPS measures is a key element of the work of the Inclusive Framework. Members of the Inclusive Framework are developing a monitoring process for the four BEPS minimum standards as well as putting in place the review mechanisms for other elements of the BEPS package. The third session of the Inclusive Framework took place on 21-22 June 2017.

In July 2017, 70 countries and jurisdictions also joined the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the Multilateral Instrument, or MLI); this is a major first step towards updating the more than 3 000 bilateral tax treaties that are in place globally. The MLI covers treaty-related minimum standards that were agreed as part of the BEPS package. These standards relate to the prevention of treaty abuse (Action 6) and the improvement of dispute resolution (Action 14). Furthermore, the MLI enables the parties to implement other tax treaty measures developed in the BEPS project, e.g. mandatory binding arbitration, or measures against artificial avoidance of permanent establishment status through commissionaire arrangements. Recognising the need to accommodate a variety of tax policies, the MLI is a flexible yet robust instrument that provides optionality while not diverging from the minimum standards.

Source: OECD (2017d), "Inclusive Framework on BEPS: Progress report July 2016-June 2017", www.oecd.org/tax/beps/inclusive-framework-on-BEPS-progress-report-july-2016-june-2017.pdf.

International exchanges of financial information for tax purposes could be strengthened

The six SEE economies need to strengthen their international exchange of information relationships. They are not following the international trend of increased tax transparency through the exchange of financial account information. The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes is a multilateral framework open to both OECD and non-OECD countries, which has been carrying out work on transparency and exchange of information since 2000.[4] The Global Forum 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. Through both EOIR

and AEOI, economies reduce the extent to which individuals and companies are able to use offshore structures to avoid and evade taxes. The steady development of EOIR, as well as the introduction of AEOI, mark a step change in tax transparency, but there must be continued focus on the peer review process and on the development of the network of exchange of information agreements for these new systems to maximise their effectiveness.

Of the six economies, only Albania has signed the Convention on Mutual Administrative Assistance in Tax Matters and the Multilateral Competent Authority Agreement for AEOI (OECD/Council of Europe, 2011; OECD, 2017e). Albania and the Former Yugoslav Republic of Macedonia have 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.

Transfer pricing rules are mostly not in line with international guidelines

Transfer pricing rules prevent multinational enterprises from shifting profits into affiliated companies in lower-taxation territories. Most of the SEE economies, except for Serbia, have transfer pricing rules in place; however, there is scope to strengthen the rules and align them better with international best practices. Only Albania's transfer pricing rules are in line with the OECD Transfer Pricing Guidelines (OECD, 2017f). In both entities of Bosnia and Herzegovina, Kosovo, the Former Yugoslav Republic of Macedonia and Montenegro, the transfer pricing regimes do not impose any real obligations on taxpayers. The laws require taxpayers to compare transactions with associated entities to those taking place between independent parties, but no filing obligations are in place. The SEE economies would benefit from aligning with the OECD Transfer Pricing Guidelines which will require additional investment in the tax administration capacities.

The design of thin capitalisation rules in the SEE economies could be improved

Action 4 of the OECD/G20 BEPS Project established a common approach to the design of rules to prevent excessive interest deductibility. The BEPS project recommended implementing profit-based interest limitation rules (i.e. interest barriers) rather than those based on balance sheets; these should apply to both internal and third-party debt financing. The common approach is based on a fixed ratio rule which limits an entity's net deductions for interest, and payments economically equivalent to interest, to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA). Interest between 10% and 30% of EBITDA would remain deductible, while the excess interest could be carried forward indefinitely (OECD, 2015a). The common approach also includes a group ratio rule alongside the fixed ratio rule, which would allow an entity with net interest expense above a country's fixed ratio rule to deduct interest up to the level of the net interest/EBITDA ratio of its worldwide group; this group ratio also applies to both internal and third-party debt financing. Even though this approach is intended to reduce profit shifting rather than to correct the debt-equity bias, it does set a limit to the deductibility of interest and, therefore, indirectly reduces the corporate debt bias.

Although there is widespread use of thin capitalisation rules across the six SEE economies, they are not in line with the international best practice described above. Kosovo and Montenegro are the only economies without any thin capitalisation or interest limitation rules in place. In Albania, interest paid in excess of the interest rate officially publicised by the Central Bank and interest above a 4:1 debt-to-equity ratio is not deductible. However, Albania is planning to introduce a thin capitalisation rule in line

with the OECD/G20 BEPS Action 4: it will deny the deductibility of interest paid in excess of 30% of earnings before EBITDA. In Bosnia and Herzegovina, each entity applies a different thin capitalisation rule. The Federation of Bosnia and Herzegovina applies a 4:1 debt-to-equity ratio, which applies only to loans with related parties. In the Republika Srpska, interest in excess of 30% of earnings before interest and taxes is not allowed as a tax deduction. The Former Yugoslav Republic of Macedonia applies a 3:1 limitation rule to limit interest deductions paid over debt guaranteed or granted by a shareholder owning 25% or more of the capital of the entity; the ratio is calculated over the value of the participation the lender shareholder has in the entity. Serbia also applies a 4:1 debt-to-equity ratio but only for related entities, and a 10:1 debt-to-equity ratio for banks and leasing companies.

The SEE economies use a worldwide tax system for cross-border income

There are considerable international differences in the taxation of cross-border income. Worldwide taxation systems tax corporations on their worldwide income. In contrast, territorial systems tax only the income which has its source in the country. In practice, most countries apply a combination of both systems. In 2012, 28 of the 34 OECD countries had adopted a territorial tax system exempting most active earnings from tax if they were repatriated from subsidiaries incorporated in (some or all) host countries. OECD member countries commonly require 10% ownership of a foreign affiliate's shares to qualify for the territorial exemption. Most OECD countries with territorial tax systems exempt active income earned by foreign affiliates as well as gains on the sale of foreign affiliate shares. Some OECD countries with territorial tax systems limit their exemptions to affiliates resident in countries with which they have a tax treaty.

All of the SEE economies assessed here have adopted a pure worldwide tax system. Income earned abroad by resident corporations is brought into the CIT base in the SEE economies. Income earned abroad will have been taxed in the host country where the income has its source under that country's CIT and/or withholding tax rates when the payments are made to the SEE tax-resident corporation. The income is then taxed again in the SEE economy where the corporation is tax resident. In order to prevent double taxation, a tax credit is granted as a relief against double taxation across the SEE economies – except in Albania, where no unilateral relief is granted. As the CIT rates across the SEE region are low compared to the CIT rates in the rest of the world on average, any taxes paid at source are very likely to be higher than those payable in the SEE economies. As a result, the SEE economies are not very likely to raise much revenue from the taxation of foreign-source income.

Small open economies typically have territorial tax systems. The SEE economies are small open economies with a relatively low share of tax-resident businesses earning income abroad. The sort of full worldwide tax systems applied in all six economies have a high administrative cost without much likelihood of raising significant tax revenues.

The six SEE economies should consider introducing additional tax base protection measures. Across the six economies, the current CIT systems do not limit how much expense incurred to earn foreign-source income is deductible from the domestic CIT base. This may result in a significant tax revenue loss.

Regional tax co-operation has improved but more could be done

Some of the SEE economies have strengthened their tax collaboration with other economies in the region. Albania and Kosovo have worked 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. The Former Yugoslav Republic of Macedonia exchanges information with Albania, Bosnia and Herzegovina, Kosovo and Serbia.

The SEE economies would benefit from more 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, there are mutual benefits from intensifying information sharing and learning together.

The way forward for international tax and tax co-operation

The six SEE economies would benefit from joining the Inclusive Framework to work with OECD and G20 members to implement BEPS measures. Becoming members of the Inclusive Framework and implementing the BEPS minimum standards would support the economies in their efforts to align their international tax rules with international best practices. This in turn would allow them to strengthen tax certainty for international investors.

The SEE economies need to strengthen their international exchange of information relationships by joining the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes and implementing the two different international standards for the exchange of information for tax purposes: EOIR and AEOI.

All of the economies need to strengthen their transfer pricing rules in line with the OECD Transfer Pricing Guidelines. They should also improve the design of their thin capitalisation or interest limitation rules in line with international best practice, i.e. implementing profit-based interest limitation rules rather than balance-sheet based ones and applying them to both internal and third-party debt financing. The economies could adopt a fixed ratio rule which limits an entity's net deductions for interest and payments that are economically equivalent to interest on a percentage of its EBITDA.

The SEE economies may want to consider protecting their domestic tax base by ensuring that costs incurred in earning foreign-source income are only deductible from the corresponding foreign-source corporate income which is taxable in SEE economies.

The SEE economies need to strengthen their tax policy and analytical capacity; this includes assessing the revenues raised from taxing foreign-source (both passive and active) business income.

The SEE economies should strengthen their tax co-operation with OECD member countries and with economies in the region. Systematic co-operation across the region should lead to more effective tax enforcement and lower overall tax avoidance and evasion.

Conclusions

The six SEE economies have been strengthening their tax administrations. They have improved their compliance assessment and risk management, reduced tax complexity, and made paying taxes easier. These efforts are an integral part of their efforts to maintain their low corporate and personal income tax rate regimes. Nevertheless, they should continue to modernise their tax administrations in order to bring more informal actors within the reach of the tax system.

The SEE economies continue to face significant challenges from a domestic and international tax policy perspective. Their tax bases are narrow, particularly for VAT and CIT. High levels of SSCs impose high tax burdens on labour income and limit the role of PIT in reducing inequality. Their international tax rules do not follow international best practice. All six SEE economies need to strengthen their tax policy assessment tools, including improving their tax revenue statistics, effective tax rate analysis and tax expenditure reporting. They may need to redesign their wide range of corporate tax incentives and take steps to prevent falling into the trap of "race to the bottom" tax competition. Instead, they should strengthen their tax co-operation both within the region and more globally.

Notes

1. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
2. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately..
3. These data were provided by SEE governments.
4. For more information see www.oecd.org/tax/transparency/about-the-global-forum.

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Annex 4.A1.
Tax policy: Indicator scores

Table 4.A1.1. **Tax policy: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Tax policy						
Tax revenue statistics	3.5	2.5	3.0	3.0	2.5	3.5
Modelling and forecasting	2.0	2.5	2.0	3.0	2.0	2.5
Tax expenditure reporting	1.0	0.0	0.0	1.0	0.0	2.0
Tax administration						
Functions and organisation	4.0	0.0	3.5	3.5	4.0	4.5
Compliance assessment and risk management	4.0	3.0	3.5	3.5	3.5	3.5
Independence and transparency	0.5	0.0	0.5	0.5	0.0	0.5
Tax filing and payment procedures	3.5	2.0	2.5	3.0	2.5	3.0
Taxpayer services	3.5	1.0	3.0	1.5	1.5	1.5

StatLink http://dx.doi.org/10.1787/888933703732

Chapter 5.

Competition policy in South East Europe

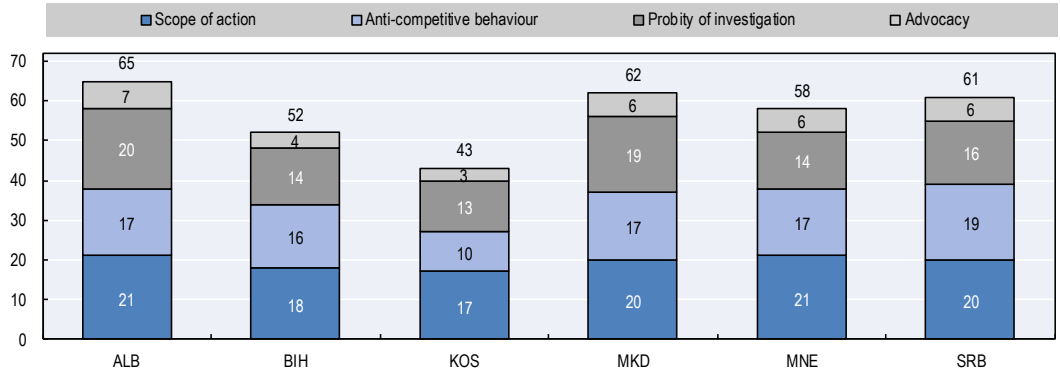
This chapter on competition policy assesses the policy settings, processes and institutions in six South East European economies. After a brief overview of competition performance in South East Europe, the chapter then focuses on four essential policy areas. The first policy area, scope of action, assesses to what degree the competition authority is invested by law with the power to investigate and sanction anti-competitive practices. The second, anti-competitive behaviour, describes the development of policy 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 which enforce competition law and the fairness of their procedures. The final policy area – advocacy – looks at further actions to promote a competitive environment. The chapter includes suggestions for enhancing the policies in each of these areas in order to foster the competitiveness of these economies.

Main findings

A competitive economic environment helps boost economic growth and increase living standards, thereby also helping to reduce inequality. It 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.

The six economies of South East Europe (Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia) appear to have in place most of the basic building blocks of a functional competition policy regime (Figure 5.1), although some gaps persist and enforcement records appear limited. Their major challenge for the future is to transform systems that look good on paper into working, nationally acknowledged enforcement regimes.

Figure 5.1. **Competition policy: Number of adopted criteria**



Note: The assessment in this chapter is based on the answers to the questions listed in Annex 5.A1, with each "yes" counting as an adopted criterion. The maximum number of adopted criteria is 68. See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933703751

Comparison with the 2016 assessment

Changes since the 2016 assessment are mixed. While the overall number of criteria adopted has increased for Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, they have decreased for Bosnia and Herzegovina, and Kosovo. Actual enforcement activity has not increased as much as would have been desirable. While scores for the scope of action policy area remain mostly the same, they have increased in most economies in the anti-competitive behaviour policy area. With regard to probity of investigation, the picture is more diverse, with small increases in some economies, and no changes or only a slight decrease in the others. In the advocacy policy area, the trend is positive in four out of the six SEE economies, but negative in the other two.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Achievements

The SEE economies have put all of the necessary major legal provisions in place for a competition law regime that works. The provisions for anti-competitive agreements and abuse of dominance are closely aligned with those in the Treaty on the Functioning of the European Union. The provisions on mergers also follow international standards.

Most authorities can and actually do conduct market studies and comment on the competitive effects of laws and regulations. The legal framework enables the SEE competition authorities to act as competition advocates in their economies.

Competition authorities are formally independent. Governments do not formally intervene in the decision-making process or give directions.

Remaining challenges and key recommendations

- **Improve the competition law enforcement record further.** Despite the established legal foundations of competition policy in the region, challenges remain in their systematic implementation. As the enforcement track record is one of the most important indicators of an effective competition regime, strengthening it is a priority for the competition authorities.
- **Put in place guidance for stakeholders on the competition authorities' enforcement practices.** Publishing explanatory documents that help businesses, their legal advisers and the public to understand how competition law is applied is an important aspect of enforcement practice. However, only half of the SEE competition authorities have published comprehensive sets of guidelines to that effect.
- **Ensure that competition authorities have sufficient resources.** In most of the SEE economies, financial and human resource constraints may limit the scope of action and the quality of work that can be expected.
- **Give more weight to competition authorities' recommendations.** When the competition authorities comment on barriers to competition in laws, regulations or industry sectors, these recommendations are not always taken into consideration.

Context

Competition, the process of rivalry between firms, is seen as the driving force of well-functioning markets. It can also drive productivity and economic growth, a finding underpinned by theoretical and empirical evidence. This evidence also suggests that countries with lower levels of product market regulation enable stronger competition and therefore tend to have higher levels of productivity growth (CMA, 2015; OECD, 2014a). An effective, and effectively enforced, competition law that safeguards the competitive process will facilitate and even enable productivity growth and will help distribute wealth more evenly. In addition to evidence that there is a general link between competition and productivity growth, studies show the direct effects of competition law itself, and of product market deregulation. Although it is difficult to distinguish the effects of individual policy changes, there are some studies showing that policies that lead to markets operating more competitively, such as enforcement of competition law and removal of regulations that hinder competition, result in faster economic growth (Ospina and Schiffbauer, 2010; Gutman and Voigt, 2014).

Competition can also improve equality. Market power may depress the income of the poorest 20% of the population by 12-21% (OECD, 2015a), mainly by keeping prices high. Competition law enforcement that prevents and reduces market power will help to bridge the gap between the richest and the poorest groups, facilitating a smooth transition into a competitive market economy.

However, on its own competition law is not sufficient – it can only be effective if it is properly enforced. This requires an adequately resourced and skilled competition authority, free to fulfil its mandate without political interference. This authority must have the necessary power and tools to uncover illegal practices and impose sanctions for infringements, to prevent or remedy mergers that may lead to reduced competition, and to advocate for a more competitive environment.

Analysis of competition policy in the SEE economies reveals significant links with other policy areas. A sound competition law and policy framework will increase productivity and encourage innovation, provide legal security to domestic and international investors, and help reduce unnecessary barriers to trade in state laws and regulations. In addition, public procurement frameworks need to consider competition and corruption prevention equally. This chapter has particularly close links to the following chapters:

- **Chapter 1. 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 that are applied according to best practices will create legal security that benefits investment decisions.
- **Chapter 2. 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 an 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). On the other hand, competitive markets 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, there are barriers to entry or exit, and important sunk costs or other market imperfections that might prevent foreign products or companies from reaching domestic markets.
- **Chapter 9. Science, technology and innovation** are facilitated by competitive environments. Yet the relationship is not simple; the empirical evidence shows that moderately competitive markets innovate the most, while both monopoly and highly competitive markets show lower levels of innovation. However, 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 et al., 2005).
- **Chapter 16. Public services.** As mentioned above, competition law can only fulfil its objectives when it is properly enforced. Law enforcement authorities should ensure fair and transparent application of the law by guaranteeing the right to a fair process, clear rules, consistent and predictable enforcement, and certainty as to the length of the enforcement procedures (OECD, 2015b).

- **Chapter 17. 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). 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.

Competition policy assessment framework

The analytical framework applied to the six SEE economies in this chapter differs from the approach used in the other chapters. It draws on a questionnaire developed by the OECD (see Annex 5.A1). The questionnaire includes 68 questions allocated into four policy areas that are widely agreed across the OECD as forming the foundations of a competition policy regime (Figure 5.2):

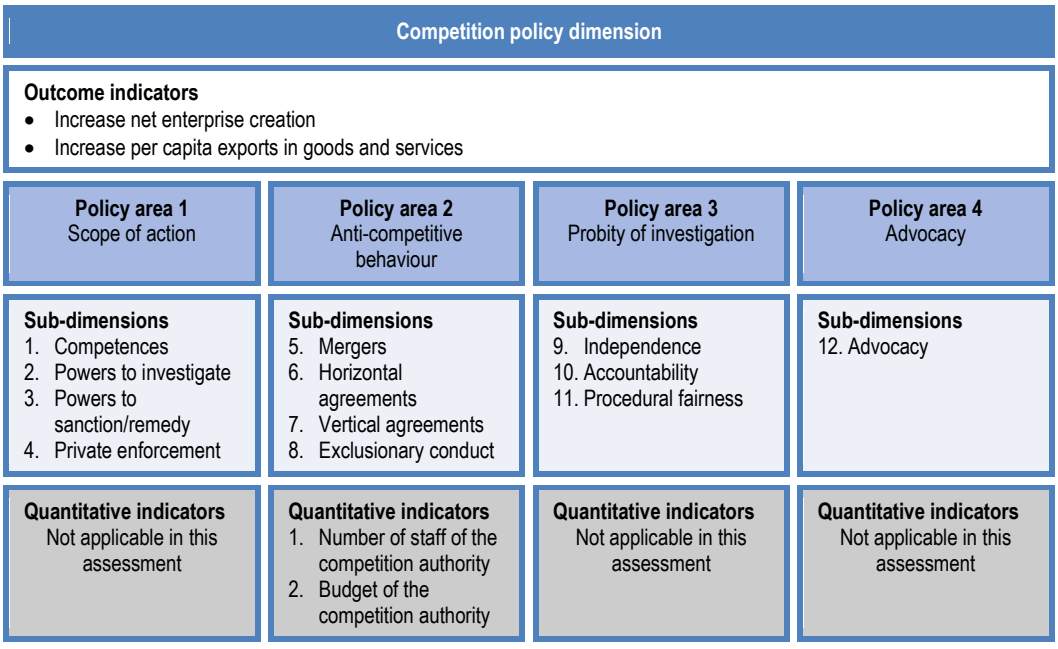
1. Scope of action: is the competition authority invested by law with the power to investigate and sanction anti-competitive practices? Does it have the remit to investigate, remedy, or block anti-competitive mergers? What is the authority's budget and number of staff?
2. Anti-competitive behaviour: how does competition policy prevent and prosecute exclusionary vertical and horizontal agreements and anti-competitive mergers? Which factors are taken into account when ascertaining if anti-competitive practices have taken place?
3. Probity of investigation: how independent and accountable are the institutions which enforce competition law? How transparent are they? How fair are their procedures?
4. Advocacy: what activities other than standard enforcement of competition law are used to further promote a competitive environment? Are market studies and reviews of new laws and regulations conducted for any distortionary impact on competition?

The questionnaire does not seek to create a complete and detailed account of competition policy regimes, but rather to broadly measure their scope and strength. It has a much stronger focus on the *de jure* characteristics of a regime than on its *de facto* enforcement and implementation.

Figure 5.2 shows how the policy areas and their constituent indicators make up the competition policy assessment framework.

Unlike the other chapters, where indicators are allocated a score from one to five, the assessment in this chapter is based on yes/no (coded as 1/0) answers to the 68 questions in the questionnaire listed in Annex 5.A1. 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 assessment also draws on OECD competition experts familiar with the SEE economies, and a 2013 comparative report on competition regimes in the Balkan region (Sofia Competition Forum, 2014).

Figure 5.2. **Competition policy assessment framework**



Competition policy performance in SEE economies

All competition policy and enforcement systems consist of essentially two components: 1) the legal instruments ("rules") governing both substance, competences and procedure; and 2) the administrative structures and processes through which the legal instruments are implemented (Lowe, 2008). Both components are necessary for the success of the system as a whole.

The weak points identified in the assessment are based only on answers to the OECD questionnaire. This does not examine approaches in depth, but verifies whether they incorporate certain important elements. A more detailed, impartial assessment of approaches would require in-depth analyses of some of the authorities' decisions. Peer reviews, such as those undertaken by the OECD or the United Nations Conference on Trade and Development (UNCTAD), could provide such insights (see for example OECD Country Reviews of Competition Policy Frameworks).[1]

All six SEE economies appear to have in place the basic legal instruments (laws, policy documents, etc.) required for functional competition policy regimes, though some gaps still exist (Figure 5.1). Law enforcement across the SEE economies, however, is very limited.

For enforcement, improvements could be made to ensure that the competition authorities in the six economies have all the most important powers and tools for enforcing competition law effectively and for protecting and fostering competition. In Kosovo and the Former Yugoslav Republic of Macedonia, for example, the competition authority could be given the power to advocate for competition, not just at central, but also at local government levels.

Enforcement activity could be strengthened across the region, particularly in Kosovo. Only the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have blocked or remedied an anti-competitive merger in the last five years. As for sanctions imposed

against cartels, only the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have imposed fines in the last five years; the other economies have imposed no, or only insignificant, fines. Only the competition authorities in Albania, Montenegro and Serbia have made use of unannounced inspections of the premises of firms being investigated.

Most SEE authorities (except Kosovo) apply at least some economic analysis when they assess mergers, anti-competitive agreements or abusive conduct.

The assessment also finds that stakeholders would benefit from more guidance on enforcement practices; to date competition authorities have published few or no guidelines on how they apply competition law provisions. A more active stance could also be taken by some authorities to advocate for competition. This relates to the assessment of laws and regulations and to advocacy to public procurement bodies to detect and prevent bid rigging. At the same time, most governments appear not to be particularly receptive towards the recommendations given by their competition authorities.

Scope of action

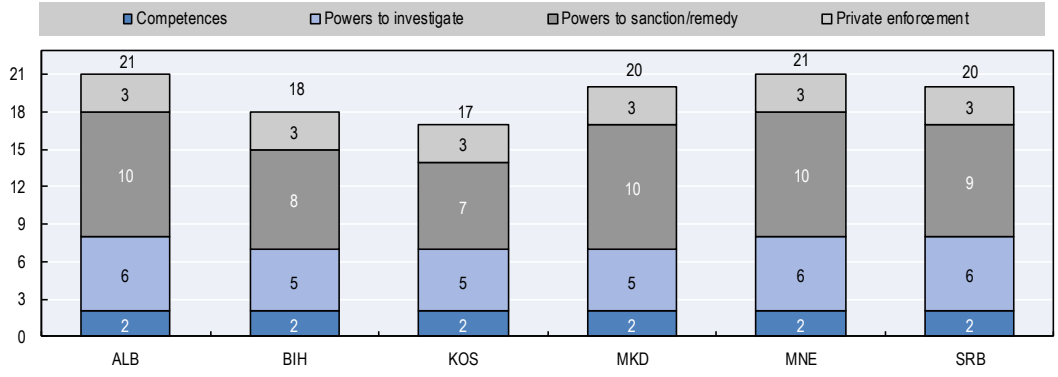
This section assesses the scope of the SEE competition regimes' powers to uncover, remedy, deter and penalise anti-competitive behaviour and mergers. This is assessed across four sub-dimensions (Figure 5.3):

The **competences** sub-dimension covers public and foreign firms' exemptions from competition law and the competition authority's financial and human resources.

The **powers to investigate** and **powers to sanction/remedy** sub-dimensions both encompass the statutory powers of the competition authority to investigate and punish competition law infringements and to investigate and remedy or block anti-competitive mergers.

The **private enforcement** sub-dimension assesses the extent of provisions for civil action by individuals, firms or groups of consumers seeking compensation for financial damage incurred as a result of competition law violations.

Figure 5.3. **Scope of action: Number of adopted criteria**



Note: The maximum number of criteria that could be adopted is 21. See the methodology chapter for information on the *Competitiveness Outlook* assessment process.

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The legal instruments are mostly in place, but lack implementation resources

All six SEE economies have the necessary **powers to investigate**, such as the legal right to request information from parties to competition proceedings (i.e. firms) and third parties when investigating possible antitrust infringements and mergers. They can also conduct unannounced inspections of the firms' premises. Yet, the assessment shows that competition authorities in the assessed SEE economies rely mainly on information requests, in spite of the fact that unannounced inspections ("dawn raids") are considered the most robust and valuable way of detecting and proving hard-core cartels. Out of the six economies, only the competition authorities in Albania, Montenegro and Serbia have made use of dawn raids in the last five years.

In terms of **powers to sanction/remedy**, in all the economies, competition authorities have the power to impose, or can ask a court to impose, interim measures while investigating an alleged antitrust infringement, because there is a concern that this may lead to irreversible damages. Likewise, all competition authorities can impose sanctions on a firm that hinders an investigation into an alleged antitrust infringement. The competition authorities in all the economies except in Kosovo have done so in the last five years. In line with this, all competition authorities can also impose, or ask the court to impose, remedies or a cease and desist order[2] on firms that have committed antitrust infringements. They also have the powers to impose, or ask a court to impose, sanctions on firms that have committed such infringements. This is also true for accepting or imposing remedies in order to clear a merger.

With the exception of Bosnia and Herzegovina, all of the competition authorities can also enter into settlements with the parties under investigation for alleged antitrust infringements and thus close the investigations. This **private enforcement** can be a way of finding a quick, efficient solution and avoiding long drawn-out investigations.

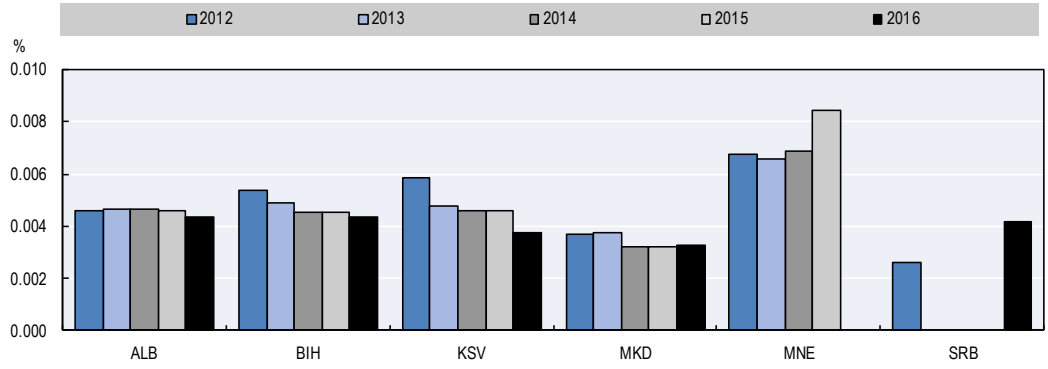
In terms of **competences**, none of the six economies exempt state-controlled or foreign companies from the scope of competition law, and the law also applies to foreign firms if their actions directly affect competition or consumers in the domestic market. Individuals, firms and groups of consumers in all the economies can bring legal action against firms that have committed an antitrust infringement and can seek redress for any harm they have incurred as a consequence.

In order to enforce competition law effectively, competition authorities need adequate financial and human resources. The budgets of the six competition authorities appear to have remained stable over the past five years (Figure 5.4). Apart from Serbia, staff numbers have also remained constant (Figure 5.5). It is difficult to say what an appropriate staffing and funding level for a competition agency is. There are no norms or widely accepted comparators. Some competition agencies from smaller European Union (EU) Member States like Austria, Latvia, Lithuania or Portugal have comparable staff and budget numbers (GCR, 2016). Given the variety of tasks a competition agency must address and the level of specialisation and experience that is required, it is doubtful whether this can be achieved with the staff levels around or below twenty, as in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro. Funding requirements are also increased by the need for increasingly sophisticated data-heavy investigations that can require the use of forensic information technology equipment and experts.

While effective competition enforcement comes at a cost, all the agencies that have conducted an assessment of the impact of their actions (OECD, 2014c) can usually show that they offer an excellent business case.[3] Every euro invested in an agency can be expected to generate many euros of consumer savings every year.

Figure 5.4. **Annual budget of competition authorities (2012-16)**

% of gross domestic product (GDP)

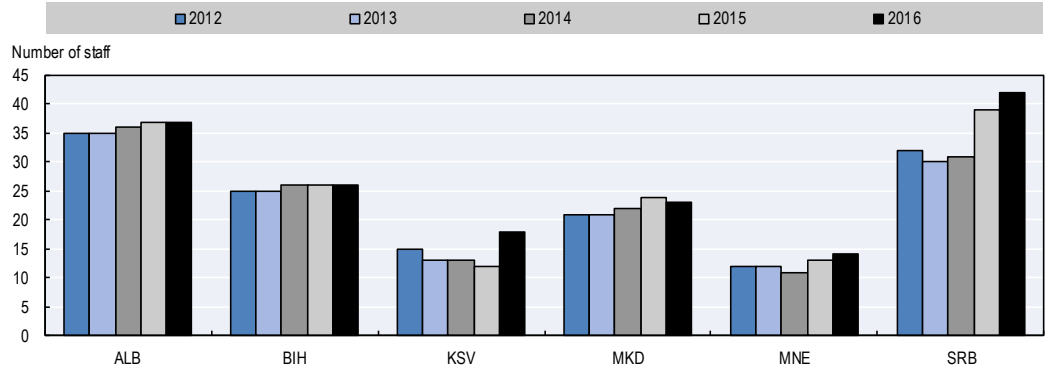


Note: Data not available for Montenegro for 2016, or for Serbia for 2013, 2014 and 2015.

Source: Albanian Competition Authority (2017), "Annual reports", www.caa.gov.al; Bosnia and Herzegovina Council of Competition (2017), "Annual reports", http://bihkonk.gov.ba/en; Kosovo Competition Authority (2017), "Annual reports", https://ak.rks-gov.net/?cid=2,11; Commission for Protection of Competition of the Former Yugoslav Republic of Macedonia (2017), "Annual reports", www.kzk.gov.mk; Montenegro Agency for Protection of Competition (2017), "Annual reports", www.azzk.me; Serbia Commission for Protection of Competition (2017), "Annual reports", www.kzk.org.rs/en/; EC (2017), *Main GDP Aggregates* (Eurostat database), http://ec.europa.eu/eurostat/data/database; Agency for Statistics of Bosnia and Herzegovina (2017), *Economic Statistics* (database), www.bhas.ba/saopstenja/2017/NAC_04_2016_Y1_0_BS.pdf.

StatLink http://dx.doi.org/10.1787/888933703789

Figure 5.5. **Annual staffing of competition authorities (2012-16)**



Source: Albanian Competition Authority (2017), "Annual reports", www.caa.gov.al; Bosnia and Herzegovina Council of Competition (2017), "Annual reports", http://bihkonk.gov.ba/en; Kosovo Competition Authority (2017), "Annual reports", https://ak.rks-gov.net/?cid=2,11; Commission for Protection of Competition of the Former Yugoslav Republic of Macedonia (2017), "Annual reports", www.kzk.gov.mk; Montenegro Agency for Protection of Competition (2017), "Annual reports", www.azzk.me; Serbia Commission for Protection of Competition (2017), "Annual reports", www.kzk.org.rs/en.

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The way forward for the scope of action area

The laws related to scope of action need to be complemented by better enforcement of the legal provisions and efficient use of the instruments at hand. Otherwise the SEE economies will not capture the benefits that a functioning competition law regime offers their societies. The shortcomings in enforcement and suggestions for changes are outlined in the next section on anti-competitive behaviour policy.

The SEE economies should improve both public and private enforcement of anti-competitive behaviour. Without improvements in public enforcement, the right to private actions to compensate for harm incurred through anti-competitive behaviour is currently meaningless: there is widespread agreement that effective public enforcement lays the foundations for effective private enforcement. The two are complementary, with public enforcement being a necessary condition for success (OECD, 2015b).

The SEE economies should provide their competition authorities with adequate financial and human resources. Rigorous enforcement will only be possible if the competition authorities have sufficient funding, which will also help to attract staff with the right qualifications. Funding for competition authorities could come from a variety of sources, such as the state budget, fines, fees, transfers from other national regulatory authorities, and tax revenues levied on companies (see Box 5.1 for some examples).

Box 5.1. **Good practice: Self-funded authorities in Turkey and Portugal**

The Portuguese Competition Authority (PCA) is financed by transfers from national regulatory authorities (NRAs), fees charged within the scope of the PCA's activities and fines imposed. The state budget can also be used as a last resort, but so far never has. Transfers from NRAs are the most important source of funds, accounting for around 81% of the PCA's total budget. Article 35 of the PCA's new by-laws foresees a range of contributions, between 5.5% and 7.0% of the total amount of the NRAs' revenues, and also sets a default rate of 6.25% of NRAs' revenues to be transferred to the PCA if the annual ministerial order setting out the rate is not adopted. The PCA also receives 40% of the fines imposed, while the remaining 60% goes to the state budget. In 2014, funding from fines accounted for 4% of the PCA's budget.

The Turkish Competition Authority (TCA) is funded by the state budget, tax revenues levied on certain companies and publications. Fines used to be a part of its funding, but the article granting it the right to 25% of the fines imposed was repealed in 2003. This was in response to criticism from companies that the authority tended to impose high fines in order to fund itself. In addition, while courts can approve or reject a decision of the TCA, they cannot decide specifically on the amount of the fine. This gives the TCA wide discretion on the level of fines imposed. Since its creation in 1997, the TCA has not received any funding from the state budget and following the change in 2003, it has relied entirely on tax revenues. The tax is 0.04% of the capital of all newly established partnerships with the status of incorporated and limited company, and 0.04% of the increased portion in case of capital increase.

Source: OECD (2016a), "Independence of competition authorities: From designs to practices", https://one.oecd.org/document/DAF/COMP/GF(2016)5/en/pdf.

Anti-competitive behaviour

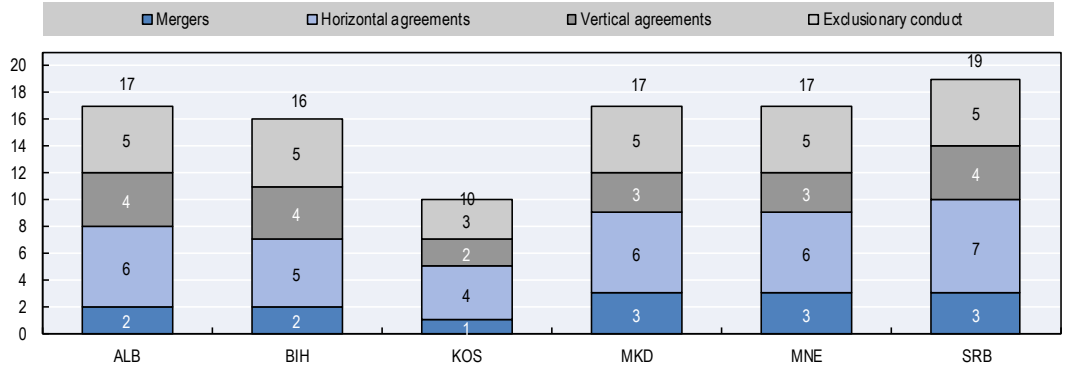
An effective competition law and policy regime ensures that anti-competitive behaviour is punished and anti-competitive mergers are remedied or blocked. An effective regime also requires that investigations of alleged antitrust infringements or

anti-competitive mergers include an assessment of the economic impact of each case and take into account any potential efficiency gains.

In order to prosecute competition law violations effectively, the competition authority not only needs formal powers to investigate and impose a sanction or remedy; it should also be adequately resourced and skilled. The anti-competitive behaviour policy area gauges those powers and resources across four sub-dimensions: 1) mergers; 2) horizontal agreements; 3) vertical agreements; and 4) exclusionary conducts (Figure 5.6). It assesses whether the anti-competitive behaviour is prohibited, what tools and practices the authorities have at their disposal when investigating allegedly anti-competitive behaviour, and their enforcement track record.

When it comes to the number of overall practices adopted for countering anti-competitive conduct, the picture across the six economies is one of contrast. Serbia meets all 19 criteria (see Annex 5.A1) and Albania, the Former Yugoslav Republic of Macedonia and Montenegro meet most of them, with Bosnia and Herzegovina close behind. Kosovo still needs to make up ground, with only 10 of the 19 criteria in place.

Figure 5.6. **Anti-competitive behaviour: Number of adopted criteria**



Note: The maximum number of criteria that could be adopted is 19. See the methodology chapter for information on the *Competitiveness Outlook* assessment process.

StatLink http://dx.doi.org/10.1787/888933703827

Anti-competitive agreements and mergers can be investigated but are rarely prosecuted

All competition authorities are empowered to investigate **mergers** and all analyse them to consider any efficiency gains that they may generate. Except for Kosovo, the competition authorities also include at least some form of economic analysis in their investigations. However, only the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have blocked or otherwise remedied one merger each in the last five years, while no mergers in the other three economies have prompted concerns over competition. Serbia reviews on average 100 mergers a year and the Former Yugoslav Republic of Macedonia and Montenegro around 30. Albania and Bosnia and Herzegovina review on average ten mergers a year, but Kosovo has reviewed only six in total over the last five years. Overall, the assessment indicates that the level of concern raised by mergers is low, with only three mergers prohibited or remedied in total in all jurisdictions over the last five years. While low intervention rates are not unusual, it should be kept in mind that merger control is an important instrument for preventing anti-competitive structures being

created, and to reduce the potential for competition law violations by powerful market players. It is much harder to prosecute and remedy such violations than to prevent the creation of market power in the first place.

Although anti-competitive **horizontal agreements** – which include cartels – are prohibited in all six SEE jurisdictions, the enforcement record is very similar to that observed for mergers. Except for Bosnia and Herzegovina, all have prosecuted at least one hard-core cartel within the last five years. However, in the last two years, only the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have had some enforcement activity in this area, involving prohibitions and/or imposing fines. The level of fines is still very low. In 2015/16 the average fine imposed in the nine completed cartel cases was EUR 125 000, with the total fines amounting to approximately EUR 1.1 million. Fines need to be high enough to both punish and act as a deterrent by sending a message to the wider business community. By way of comparison with other small economies, in 2015 Latvia and Lithuania together imposed fines totalling approximately EUR 26 million (Competition Council Republic of Latvia, 2015; Competition Council of the Republic of Lithuania, 2016). That all of the SEE economies have taken so little action (and some none at all) in the recent past is all the more worrying given that cartels tend to be quite common in most jurisdictions. While they are difficult to detect, once detected they are relatively simple to analyse and prosecute, as they mostly constitute plain "by object" violations.

One of the most important enforcement tools in hard-core cartel investigations is an unannounced inspection of the business premises and/or private residences of suspected cartel offenders. While all six economies have the legal right to conduct unannounced inspections, only three have done so in the past five years: Albania, Montenegro and Serbia. Nine inspections were carried out by Albania and six by Serbia in 2015-16.

All jurisdictions also have leniency programmes for cartel participants – schemes which offer partial or full immunity from sanctions to firms that reveal the existence or provide evidence of a cartel in which they are involved to assist a cartel investigation. In the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, leniency programmes have elicited at least one application in the last five years, though not in the other three economies. The underuse of this instrument may be explained by the limited levels of enforcement. Leniency programmes are only attractive to cartels if detection is likely and fines are high enough to pose a threat to their anti-competitive agreements.

An alternative path to successful cartel prosecution can be close monitoring of public procurement tenders and co-operation with public procurement authorities. Bid rigging, which is just another name for a hard-core cartel affecting public procurement, is a common phenomenon in public tender procedures and can increase purchase prices by 20% or more (Connor, 2016). Co-operation with public procurement bodies can help to prevent bid rigging in the first place and can also help to detect bid-rigging conspiracies, thus leading to successful cartel prosecution (see Box 5.2 for an example from Mexico). Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have all undertaken efforts to varying degrees to co-operate with and to educate public procurement officials. While the Former Yugoslav Republic of Macedonia and Montenegro seem to have only limited activities, Albania and Serbia actively communicate with public procurement bodies, provide training, and participate in public debate.

Box 5.2. Good practice: Fighting collusion in public tenders in Mexico

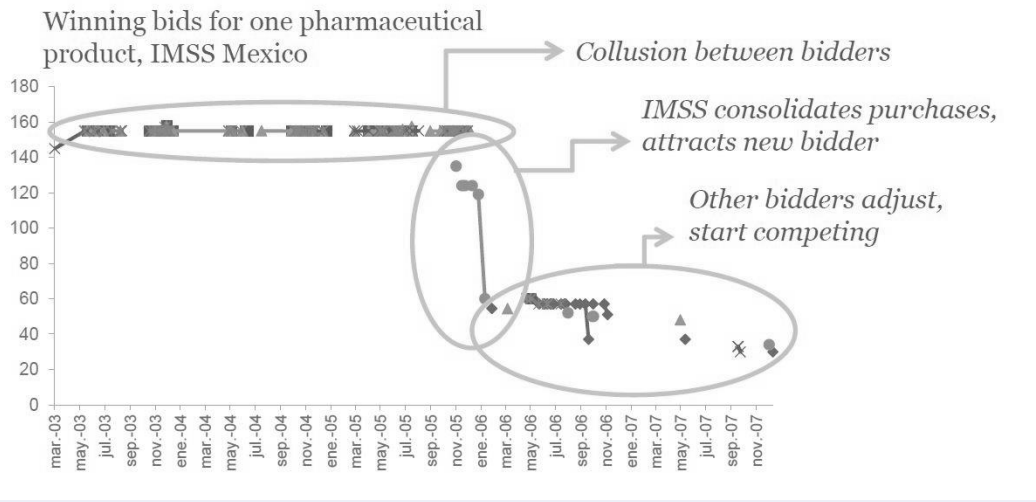
In 2011 the OECD conducted a comprehensive review of the integrity of the Mexican Institute of Social Security's (IMSS) procurement practices and provided training sessions to over 200 IMSS procurement officials. A report was released to the public in January 2012 which made over 30 recommendations in three main areas:

1. proposals for changes to the law (for example, removing requirements for meetings and other opportunities for bidders to learn about one another's bids)
2. proposals for changes to IMSS's procurement systems, such as consolidation of bids and changes to the auction system
3. training for procurement officials to raise awareness of bid rigging, the danger signs and when to call in the competition authority.

Figure 5.7 shows an index of prices for successful bids for a single high-volume drug. Different bidders are shown with different colours and shapes of data points. IMSS reduced its cost by 70% by consolidating purchases, but these savings were not achieved through "economies of scale". Instead, the larger volumes attracted a new bidder, who broke what was evidently an existing price-fixing agreement – i.e. bid rigging – among the incumbent bidders.

This one policy change has saved IMSS about USD 250 million annually. IMSS has estimated that its annual cost saving from all of the procurement reforms it undertook following OECD advice on fighting bid rigging is in the order of USD 700 million annually.

Figure 5.7. **Index of prices for successful bids for a single high-volume drug**



Source: IMSS (2015), "Informe al Ejecutivo Federal y al congreso de la Unión Sobre 2014-2015" [Report to the Federal Executive and the Congress of the Union 2014-2015], www.imss.gob.mx/conoce-al-imss/informe-2014-2015; Mena-Labarthe, C. (2012), "Mexican experience in screens for bid-rigging", www.competitionpolicyinternational.com/assets/Uploads/LabartheMAR-121.pdf.

Vigorous competition among suppliers helps governments attain this objective. However, the formal rules that govern procurement, the way in which an auction is carried out, and the design of the auction itself, can all act to hinder competition and help promote or sustain bid-rigging conspiracies. The Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012b) 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), 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. This includes identifying: 1) markets in which bid rigging is more likely to occur so that special precautions can be taken; 2) suspicious pricing patterns, statements, documents and behaviour by firms that procurement agents can use to detect bid rigging; 3) methods that maximise the number of bids; 4) best practices for tender specifications, requirements and award criteria; and 5) procedures that inhibit communication among bidders. These guidelines can be applied in a decentralised manner across the government at both national and local levels and can be used by public officials with no specialised training in economics or competition policy.

All six SEE economies prohibit anti-competitive **vertical agreements**, and their competition authorities – with the exception of Kosovo's – carry out economic analyses to determine whether agreements are likely to distort competition and to identify any offsetting efficiency gains. However, in the last five years, only Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Serbia have imposed sanctions on companies for vertical agreements.

Exclusionary conduct by dominant firms is prohibited in all six SEE jurisdictions. All, except Kosovo, carry out economic analyses to determine whether alleged anti-competitive conduct is likely to jeopardise competition or produce efficiency gains. In the last five years, all the jurisdictions except Kosovo have imposed sanctions on at least one firm for exclusionary conduct.

The way forward for anti-competitive behaviour policy

In general, low enforcement rates are a common feature of the six SEE economies. Bosnia and Herzegovina, and Kosovo appear to be particularly inactive. In the case of Kosovo, this may reflect the lack of a functional competition authority between November 2013 and the end of 2016. However, answers to the questionnaire reveal that enforcement measures in certain important areas of competition are sparse in most of the economies. As an economy's enforcement record is one of the most important indicators of effective competition law and contributes to the credibility of the enforcer in the eyes of the business community and policy makers, **governments would benefit from encouraging the competition authorities to actively enforce competition law and providing them with the resources to do so.** As competition regimes become more mature, the deterrent effect generated by the authorities' powers to investigate and sanction may reduce the need for very active enforcement.

Adequate resources would also help to attract qualified lawyers and economists to work for competition authorities. These authorities compete with the private sector, and while they may not be able to offer similar remuneration, they could use other means to attract staff. Excellent authority leadership and attractive options for gaining qualifications and training will help. In this way, even small authorities could be very active and successful.

In order to improve merger control, it should first of all be ensured that all mergers that meet the legal thresholds are duly notified to the authorities. These mergers should then be analysed using sound economic methods where necessary. The authorities should consider a prohibition decision as a realistic option in problematic

cases, if competition concerns cannot be appropriately addressed with remedies. If remedies are considered, preference should be given to structural merger remedies (OECD, 2011).

Priority should be given to boosting cartel enforcement. Cartels are the most clear-cut and undisputedly harmful competition law violation and they affect every country. It is highly unlikely that they do not affect the six SEE economies. On the contrary, small economies with limited openness to trade and small numbers of major economic actors seem to face an even higher risk of becoming victims of cartels than large open economies. While leniency programmes can help, they are not a silver bullet and require determined enforcement in the first place in order to be attractive at all. Given the severe lack of enforcement, leniency will not work in the SEE economies for some time to come.

Competition authorities and public procurement officials should receive training in the prevention and detection of bid rigging. Reducing cartel activity in public procurement and detecting cartels when they happen would mean large savings for the public budget and ultimately for tax payers and consumers, given that public procurement seems to be a preferred target for cartels (see the Mexico example in Box 5.2). The assessed SEE economies would therefore benefit significantly from focusing their enforcement activities on these areas. Successful co-operation with public procurement bodies will also help to improve SEE competition authorities' enforcement track record, their public recognition, cartel deterrence and the enforcement of cartels in other sectors of the economy. The Guidelines on Fighting Bid Rigging in Public Procurement (OECD, 2009) could be applied in a decentralised manner across governments at both national and local levels.

Closer co-operation among the SEE economies could help alleviate some resource constraints and strengthen their enforcement capacity. The SEE economies are relatively close geographically, in levels of economic and social development and, to some extent, in economic weight and language.

Pooling experience across the SEE economies could help the competition authorities achieve the critical mass that they are still building. For example, a formal arrangement between all the competition authorities could allow for regular sharing of experience among all staff levels (economists, lawyers, case managers, heads of division, etc.). The OECD inventory of international co-operation agreements between competition agencies (MoUs)[4] provides an overview of existing arrangements from which inspiration can be drawn. The six SEE economies, together with Bulgaria and Croatia, are already part of a region-wide initiative – the Sofia Competition Forum – which meets twice a year to share experiences. However, the forum's members could make their co-operation more operational, for example by carrying out joint projects – such as preparing policy papers or market studies – and share experience more widely with authorities' operational staff. This could be done either within the Sofia Competition Forum or through a separate initiative, perhaps by emulating the collaboration between Nordic competition authorities (Box 5.3). In the medium to long term, the Nordic initiative could also serve as a template for co-ordinating parallel proceedings and exchanging confidential, case-related information – on the condition that the requisite legal framework is in place.

Competition authorities in SEE economies could also exchange experiences and share good practices by regularly attending international events. The OECD-GVH Regional Centre for Competition in Budapest is a forum where competition authorities can meet and share good practices and receive training. Such events can be a highly effective way for the six competition authorities to ensure regular training for their staff.

Indeed, they are already regular participants in the centre's events and would benefit from actively continuing.

Box 5.3. Good practice: Co-operation among Nordic competition authorities

The Nordic competition authorities – from Denmark, the Faroe Islands, Finland, Greenland, Iceland, Norway and Sweden – co-operate closely and meet on an annual basis. Important components of the collaboration are sector inquiries and joint reports on competition issues of common interest. The authorities have produced a number of joint reports on competition in sectors ranging from telecommunications, energy, banking and the food market.

On 5 March 2013, the Nordic Competition Authorities published their tenth joint report, *A Vision for Competition: Competition Policy towards 2020*. The report aims to highlight how effective competition policy and effective competition authorities can help to address future challenges to economic growth and welfare in the Nordic countries. A strong message from the report is that there is considerable scope for strengthening the relevant legal instruments and making competition policy more effective.

Source: EC (2013), "The Nordic Competition Authorities: New joint report: A vision for competition – competition policy towards 2020", http://ec.europa.eu/competition/ecn/brief/02_2013/nor_rep.pdf.

Probity of investigation

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 informed properly of the allegations against them and in good time (OECD, 2012c). Freedom from political influence is a prerequisite of fair and equal competition law enforcement, to ensure that cases are brought or dropped only on their merit (OECD, 2016a).

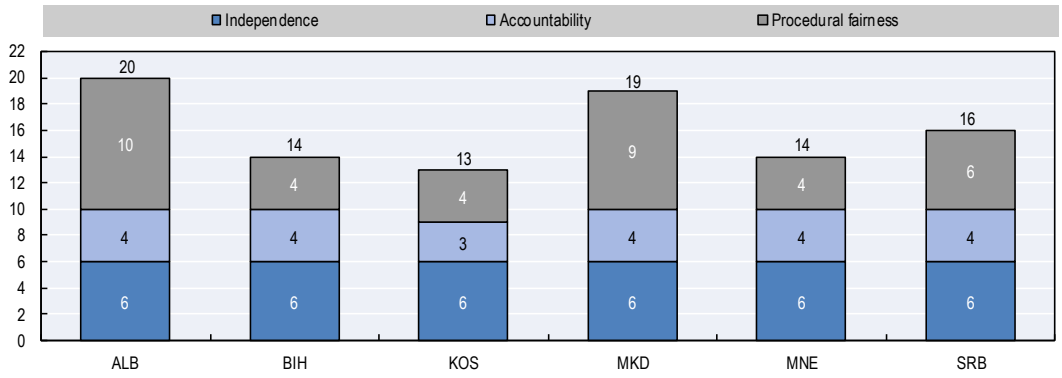
The probity of investigation policy area gauges the fairness of competition law enforcement and the degree to which competition authorities are independent and accountable. It involves three sub-dimensions: 1) independence; 2) procedural fairness; and 3) accountability. Together, these sub-dimensions assess the absence of government interference in investigations or decisions in antitrust 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.

Based on the overall scores, Albania and the Former Yugoslav Republic of Macedonia meet all or almost all of the criteria in the probity of investigation policy area. Bosnia and Herzegovina, Kosovo, and Montenegro, however, are currently seeking to catch up with the SEE average (Figure 5.8).

Competition authorities are formally independent and ensure due process, but could give companies better legal guidance

Independence is important for the effective enforcement of competition rules. It enables competition authorities to take decisions based solely on legal and economic grounds, rather than on political considerations (OECD, 2016a). It is also widely

Figure 5.8. **Probity of investigation: Number of adopted criteria**



Note: The maximum number of criteria that could be adopted is 20. See the methodology chapter for information on the *Competitiveness Outlook* assessment process.

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recognised that in order to ensure citizens' confidence and belief in a fair legal system and in those applying the law, it is important that procedures regulating the relationship between the public sector and citizens are, and are generally perceived to be, fair and transparent. Fairness and transparency are therefore essential for the success of antitrust enforcement, and regardless of the substantive outcome of a government investigation it is fundamental that the parties involved know that the process used to reach a competition decision was just (OECD, 2012c). Transparency can be enhanced through the publication of guidelines, regulations, practice manuals, substantive authority opinions and court jurisprudence, and the adherence to antitrust best practices of multilateral bodies (i.e. the OECD and the International Competition Network).

Competition authorities in all six SEE economies are formally independent**,** meaning that in the last five years, their governments have not given them any binding directions as to whether they should open investigations or impose sanctions. Nor have the governments overturned any decision by the competition authorities in that time. However, in Kosovo, the government did not appoint a functional competition council for almost three years (2013-16). The competition authority could not undertake any enforcement activity during this time, as no decisions could be taken. This must be considered as a serious violation of the principle of authority independence.

In terms of **accountability**, all six SEE competition authorities, except Kosovo, account for their activities and regularly publish reports on their activities and all decisions on infringements of antitrust legislation. Similarly, in all of the economies, decisions on antitrust infringements and mergers (whether taken by a competition authority or a court) can be subject to judicial review on substance and procedure.

To ensure **procedural fairness**, the competition authorities provide an opportunity for the parties under investigation for an antitrust infringement or a merger to consult them on significant legal, factual or procedural issues during the course of an investigation. Similarly, the parties have the right to be heard and present evidence before a decision is reached.

When it comes to giving businesses general guidance, half of the competition authorities do not provide any guidance other than the text of laws and by-laws – this is the case for Bosnia and Herzegovina, Kosovo, and Montenegro. Albania and the Former

Yugoslav Republic of Macedonia stand out for having published guidance on substantive analysis and calculating fines; Albania also has guidance on investigative procedures. Serbia has issued administrative guidelines on the calculation of fines and on investigative procedures, but not on substantive analysis. The absence of enforcement guidelines in the majority of the economies could be the result of insufficient enforcement, since guidelines are the fruit of experience, best national practices and case law.

The way forward for investigation probity

In order to ensure full independence of their competition authorities, governments should continue to refrain from giving any directions on cases. They also need to resist the temptation to interfere in more subtle ways, for example in budget allocation. Independence also hinges on competition authorities having sufficient resources and on the existence of a functional decision-making body at all times, with members being appointed on merit.

Publication of case decisions, annual reports and enforcement statistics would have a greater impact if they had more visibility and were more easily accessible on well-designed websites belonging to the competition authorities.

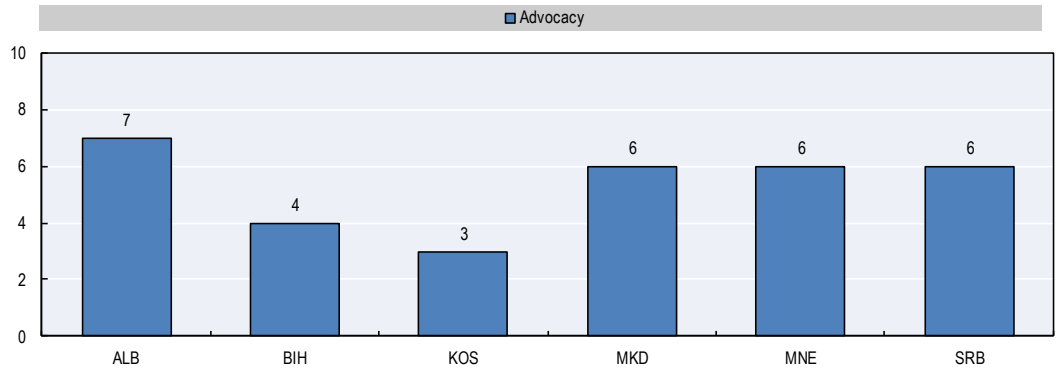
Stakeholders would benefit from more guidance on enforcement practices, as competition authorities have published few or no guidelines on how they apply competition law provisions. Until the SEE economies gain enough experience in enforcing competition law to develop national guidelines themselves, a good intermediary step would be to use existing EU guidelines. EU guidance notes are easily applicable to the substantive rules in the SEE economies' competition laws as the laws are all closely aligned with the EU *acquis*.

Advocacy

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 the government 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 affecting competitive market structures, business conduct or economic performance. Accordingly, the competition authority should be able to advocate for competition and contribute to the public policy discussion by assessing policies against barriers to competition and flagging potential threats for competition.

This section considers the capacity of the competition authority to advocate for a more competitive environment at 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. Figure 5.9 shows how the six reviewed economies score for the number of adopted criteria in the advocacy policy area.

Figure 5.9. **Advocacy: Number of adopted criteria**



Note: The maximum number of criteria that could be adopted is 8. See the methodology chapter for information on the *Competitiveness Outlook* assessment process.

StatLink http://dx.doi.org/10.1787/888933703865

All six economies advocate for competition to varying degrees, but lack resources

The competition authorities in all six SEE economies issue competition policy recommendations for laws and regulations at the central government level; four also do so at local government level. Except for Kosovo, all economies scrutinise new public policies that may affect competition, although they have insufficient resources to carry out thorough, effective assessments. As for anti-competitive behaviour, however, while the legal framework for scrutinising laws and regulations by the competition authorities is mostly in place, their actual activity and involvement differ widely. Albania stands out with its active competition assessment work. The Albanian competition authority enforces its right to review laws and regulations, has issued guidelines on the process, and reviews a large number of laws and regulations through its legal department. Only a limited number of its recommendations are successful though. In the other jurisdictions, the involvement of the competition authorities in the review of laws and regulations varies. The authorities rarely receive draft laws and regulations or on time; they have no specialised staff, manuals or guidelines; and the few recommendations they issue are seldom used. The public bodies/governments are under no obligation to respond publicly to the authorities' recommendations.

Market studies are another instrument that competition authorities can use to advocate for competition and to help them understand a market better. Market studies assess the level of competition in a particular sector, identify factors that prevent or distort competition, and issue recommendations to private firms and public bodies on how to improve competition in the sector concerned or help to determine enforcement priorities for competition authorities. The UK Consumer and Markets Authority uses market studies frequently and flexibly; its experience can help SEE economies fine-tune their processes (Box 5.4).

In the six SEE economies the competition authorities may conduct market studies; all except Bosnia and Herzegovina and Kosovo have done so in the last five years. Again, their actual activity levels differ. While Albania and Serbia are very active, other jurisdictions have only undertaken one market study within the last five years. None of the six governments is required to publicly respond to a recommendation in the market

study for how to address an obstacle or restriction to competition caused by public policy. Nevertheless, the governments of Montenegro and Serbia usually do.

Box 5.4. **Good practice: Using market studies in the United Kingdom**

In the United Kingdom, market studies are conducted under the Consumer and Markets Authority's (CMA) general review function in Section 5 of the Enterprise Act of 2002.

Market studies are one of a number of tools at the CMA's disposal to address competition or consumer protection problems, alongside its enforcement and advocacy activities. They examine the reasons why particular markets may not be working well, taking an overview of regulatory and other economic drivers, and patterns of consumer and business behaviour. They may lead to a range of outcomes, including: a clean bill of health, actions which improve the quality and accessibility of information to consumer, encouraging businesses in the market to self-regulate, making recommendations to the government to change regulations or public policy, taking competition or consumer enforcement action, or accepting an undertaking to change behaviours or divest. In the United Kingdom, other regulators can refer markets to the CMA for further investigation, and the Financial Conduct Authority has the power to conduct market studies in the markets it regulates.

In the experience of the Office of Fair Trading, and now the CMA, market studies have a number of unique benefits that make them a very flexible and cost-effective tool. These include their ability to identify and address the root causes of market failure, and the effective approach they offer of tackling regulatory and other government restrictions on competition. The Office of Fair Trading has made extensive use of market studies in specific circumstances: 1) when it suspected that a market was not working well, but there was no strong evidence that firms were breaking competition law; and 2) when it wanted to understand better why a market was not working well and whether it was due to regulatory restrictions. A list of all the market studies undertaken so far is available on the CMA website, together with the authority's policy documents in this area.

Source: OECD (2015d), *Competition and Market Studies in Latin America*, www.oecd.org/daf/competition/competition-and-market-studies-in-latin-america2015.pdf.

The way forward for advocacy

Conducting a competition assessment of laws and regulations, and market studies, can help to root a competition authority firmly in a country's political and economic landscape. An authority that raises its voice in a competent manner and on a regular basis against public or private restrictions of competition will not be overlooked, and can establish a competition mindset and culture within an economy. This will also strengthen the authority's standing and reputation when it enforces against anti-competitive restrictions by private firms.

As competition assessments and market studies are resource-intense activities that divert resources from the primary task of competition enforcement, **adequate funding and specialised staffing of the competition authorities will again be needed**.

The governments should ensure that their competition authorities are always involved in drafting or reviewing laws and regulations that have the potential to affect competition in a sector. The authorities should be given sufficient time to comment. Their recommendations should be taken seriously and the governments should commit to publicly explaining themselves when they do not follow the competition authority's recommendations.

The competition authorities should develop a sound process to guide their assessment efforts. The OECD's Competition Assessment Toolkit is a practical methodology to help competition authorities and other decision makers identify and

evaluate existing and proposed policies to see whether they unduly restrict competition (Box 5.5; OECD, 2016c). Where a detrimental impact is discovered, the toolkit helps to develop alternative ways to achieve the same objectives, with minimal harm to competition. The toolkit can be used in four key ways:

- as part of an overall, high-level evaluation of existing laws and regulations (either for the economy as a whole or for specific sectors)
- as part of a regulatory impact assessment process for new laws and regulations
- by competition authorities to structure their competition advocacy efforts
- by government bodies, particularly those engaged in the development and review of policies and materials for domestic use (for example, ministries that develop laws, or the competition authority when it evaluates the competitive impacts of regulations).

The toolkit can also be applied and adapted in a decentralised manner across government at both federal and state levels.

Box 5.5. **Good practice: Contribution of competition assessments to growth and productivity**

Australia was the first country to systematically review all of its laws and regulations for their impact on competition. In the mid-1990s, more than 1 800 state and federal laws and regulations were examined for unnecessary restraints on competition (Hilmer, 1993). The results led to a sea change in the performance of the Australian economy. The Productivity Commission that evaluated the outcome of the project found that on average GDP growth had been at least 2.5% above the estimated level without regulatory reform. Household incomes increased, employment rose, inflation dropped and the economy's overall resilience increased.

The OECD carried out the first in-country competition assessment review using its Competition Assessment Toolkit in Greece in 2013 (OECD, 2014b). The project was undertaken with the support of the Hellenic Competition Commission. It covered four sectors of the economy: retail trade, food processing, building materials and tourism. Together, they accounted for approximately 21% of Greek GDP. The project examined 1 053 pieces of legislation from these sectors: 555 provisions were found to be potentially harmful and were assessed further. This yielded 329 recommendations that could generate a total economic value of EUR 5.2 billion (2.5% of GDP), essentially in the form of increased consumer benefit or higher sector turnover.

Recommendations included:

- liberalising the distribution and the pricing of the retail of over-the-counter medicines, for instance by allowing the formation of retail chains and allowing supermarkets to sell over-the-counter medicines such as aspirin
- replacing some "command and control" regulations requiring foods to be sold in a certain way, or in certain packaging, with stronger requirements for information for consumers
- removing requirements to notify or seek approval for prices that might lead to inefficient market outcomes, or even assist illegal collusion under competition law (e.g. for hotel rooms and marinas)
- lifting barriers to entry in some sectors, such as for asphalt or fresh milk.

Two follow-up projects took place in Greece in 2014 and 2016. Romania (OECD, 2016d) and Mexico (OECD, 2018) have also joined up with the OECD to implement competition assessments, and a project is currently underway in Portugal, scheduled to finish in January 2018.

Source: OECD (2016d), *OECD Competition Assessment Reviews: Romania*, http://dx.doi.org/10.1787/9789264257450-en; OECD (2014b), *OECD Competition Assessment Reviews: Greece*, http://dx.doi.org/10.1787/9789264206090-en.

The SEE economies should incorporate the guidance on market studies that has been developed by the OECD and the International Competition Network (ICN) in order to inform the process and to ensure an efficient use of resources and results with good implementation prospects. The guidance given in the ICN's *Market Studies Good Practice Handbook* (ICN, 2016) can be easily adopted and implemented by the SEE economies. It builds on the best practices of the ICN's more than 120 members, and includes sections on:

- planning the information-collection process, including engaging in internal consultations
- organising research, taking into account spending constraints, and thinking of alternatives if initial efforts do not bring results
- methods for collecting information, with an emphasis on empirical evidence over qualitative evidence
- analysing information, e.g. considering if the information meets the authority's requirements and if it confirms the initial hypotheses, as well as possible steps for information verification
- safeguarding confidential information with information handling procedures.

Conclusions

Overall, the six reviewed SEE economies have most of the basic building blocks in place for a functional competition policy regime aligned with international standards. They have all adopted policies to prohibit anti-competitive behaviour and review mergers. They have also taken steps to support the enforcement of competition law. Competition authorities are formally independent and have most of the tools and powers that allow them to enforce competition law effectively.

Some challenges persist, however. The enforcement record is among the most important indicators of an effective competition regime – all six SEE economies have considerable room for improvement in that regard. Accordingly, the competition authorities could consider intensifying enforcement activity, in particular in the area of hard-core cartels and bid rigging in public procurement as a matter of priority. Governments should enable them to do so by providing adequate resources, and should continue to respect their independence. Guidance for stakeholders on enforcement practices could also be improved by publishing explanatory documents that help businesses, their legal advisers and the public to understand how competition laws are applied. In order to reduce public barriers to competition, market studies and competition assessment should be undertaken on a regular basis and governments should seriously consider the recommendations issued. More regional co-operation could help in all areas.

Addressing these challenges could improve the business environment in the six SEE economies and ultimately lead to increases in productivity, business integrity, new businesses and exports.

Notes

1. Available at www.oecd.org/regreform/sectors/countryreviewsofcompetitionpolicyframeworks.htm.
2. A cease and desist order is a document sent from the court or the competition authority to an individual or business to stop engaging in an illegal activity ("cease") and not take it up again later ("desist").
3. For instance, the Competition Council of Lithuania has averaged a ratio of direct consumer benefits to budget of at least 7:1 since 2012 (Competition Council of the Republic of Lithuania, 2017). The estimated consumer benefit generated by the EC Directorate-General for Competition, averaged between 0.1 and 0.2% of GDP, amounting to between EUR 14.21 billion and EUR 28.72 billion (DG Competition, 2017). The UK Consumer and Markets Authority calculated that for the period 2014-17 the estimated direct financial benefit to consumers of its activities was GBP 3.7 billion in aggregate, representing annual average consumer savings of GBP 1.2 billion. The ratio of direct benefits to cost was 18.6:1 (CMA, 2017). The Dutch Authority for Consumers and Markets generated savings for consumers of around EUR 760 million in 2016 (ACM, 2017).
4. Available at www.oecd.org/competition/inventory-competition-agreements.htm.

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Annex 5.A1.
Competition policy: Indicator scores

Table 5.A1.1. **Competition policy: Indicator scores**

Policy area: scope of action

Sub-dimension	Indicator	ALB	BIH	KSV	MKD	MNE	SRB
Competences	Does the competition law apply also to firms located outside your jurisdiction whose behaviour directly affects competition and/or consumers in domestic markets?	1	1	1	1	1	1
	In your jurisdiction, are state-controlled firms exempt from the application of competition law when conducting commercial activities in competition with private firms?	1	1	1	1	1	1
Powers to investigate	Can your competition agency compel (or ask a court to compel) firms investigated for a possible antitrust infringement to provide information?	1	1	1	1	1	1
	Can your competition agency compel (or ask a court to compel) third parties to provide information to help an investigation on an antitrust infringement?	1	1	1	1	1	1
	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)?	1	1	1	1	1	1
	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 (2012-16)?	1	0	0	0	1	1
	Can your competition agency compel (or ask a court to compel) merging firms to provide information to help it assess the merger?	1	1	1	1	1	1
	Can your competition agency compel (or ask a court to compel) third parties to provide information to help it assess the merger?	1	1	1	1	1	1
Powers to sanction/ remedy	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?	1	1	1	1	1	1
	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?	1	1	0	1	1	1
	Can your competition agency impose, or ask a court to impose, sanctions on firms that have committed an antitrust infringement?	1	1	1	1	1	1
	Can your competition agency, or a court, accept or impose remedies on firms in order to clear a merger?	1	1	1	1	1	1
	Can your competition agency impose, or ask a court to impose, sanctions on a firm that hinders an investigation on an alleged antitrust infringement?	1	1	1	1	1	1
	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 (2007-16)?	1	1	0	1	1	1
	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?	1	1	1	1	1	1
	Can your competition agency impose, or ask a court to impose, interim measures while performing an investigation of an alleged antitrust infringement because there is a concern that this may lead to irreversible damages?	1	1	1	1	1	1
	Can your competition agency, or a court, settle voluntarily with the parties investigated for an alleged antitrust infringement and thus close the investigation?	1	0	1	1	1	1
	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?	1	0	0	1	1	0

Table 5.A1. **Competition policy: Indicator scores** (*continued*)

Policy area: scope of action

Sub-dimension	Indicator	ALB	BIH	KSV	MKD	MNE	SRB
Private enforcement	Can individuals bring a legal action to seek damages from firms that have committed an antitrust infringement?	1	1	1	1	1	1
	Can firms bring a legal action to seek damages from firms that have committed an antitrust infringement?	1	1	1	1	1	1
	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?	1	1	1	1	1	1

Policy area: anti-competitive behaviour

Sub-dimension	Indicator	ALB	BIH	KSV	MKD	MNE	SRB
Mergers	Does the decision maker conduct an economic analysis of the competitive effects of mergers when investigating them?	1	1	0	1	1	1
	When assessing a merger can the decision maker consider whether the merger is likely to generate efficiencies?	1	1	1	1	1	1
	Has the decision maker blocked or cleared with remedies at least one merger in the last five calendar years (2012-16)?	0	0	0	1	1	1
Horizontal agreements	Are anticompetitive horizontal agreements (including cartels) prohibited in your jurisdiction?	1	1	1	1	1	1
	Does the decision maker conduct an economic analysis of the competitive effects of horizontal agreements when investigating them?	1	1	0	1	0	1
	When investigating an allegedly anticompetitive horizontal agreement can the decision maker consider any efficiency this may generate?	1	1	1	1	1	1
	Have sanctions and/or remedies been imposed on at least one cartel in your jurisdiction in the last five calendar years (2012-16)?	1	0	1	1	1	1
	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 (2012-16)?	1	1	0	0	1	1
	Does your jurisdiction have a leniency/immunity program for cartel participants (firms and/or individuals)?	1	1	1	1	1	1
	If yes, has the leniency program generated at least one application in the last five calendar years (2012-16)?	0	0	0	1	1	1
Vertical agreements	Are anticompetitive vertical agreements prohibited in your jurisdiction?	1	1	1	1	1	1
	Does the decision maker conduct an economic analysis of the competitive effects of vertical agreements when investigating them?	1	1	0	1	1	1
	When investigating an allegedly anticompetitive vertical agreement can the decision maker consider any efficiency this may generate?	1	1	1	1	1	1
	Have sanctions and/or remedies been imposed on at least one anticompetitive vertical agreement in your jurisdiction in the last five calendar years (2012-16)?	1	1	0	0	0	1
Exclusionary conducts	Are exclusionary conducts by dominant firms and/or by firms with substantial market power prohibited in your jurisdiction?	1	1	1	1	1	1
	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?	1	1	1	1	1	1
	Does the decision maker conduct an economic analysis of the competitive effects of exclusionary conducts when investigating them?	1	1	0	1	1	1
	When investigating an allegedly exclusionary conduct can the decision maker consider any efficiency this may generate?	1	1	1	1	1	1
	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 (2012-16)?	1	1	0	1	1	1

Table 5.A1. **Competition policy: Indicator scores** (*continued*)

Policy area: probity of investigation

Sub-dimension	Indicator	ALB	BIH	KSV	MKD	MNE	SRB
Independence	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 (2012-16)?	1	1	1	1	1	1
	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 (2012-16)?	1	1	1	1	1	1
	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 (2012-16)?	1	1	1	1	1	1
	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 (2012-16)?	1	1	1	1	1	1
	Have the government/ministers overturned a decision concerning the clearance of a merger at least once in the last five calendar years (2012-16)?	1	1	1	1	1	1
	B_2.6) Have the government/ministers overturned a decision concerning the prohibition of a merger at least once in the last five calendar years (2012-16)?	1	1	1	1	1	1
Accountability	Does your competition agency publish regularly a report on its activities?	1	1	0	1	1	1
	Are decisions that ascertain the existence of an antitrust infringement published by the relevant decision maker?	1	1	1	1	1	1
	Are decisions that block a merger or clear a merger with remedies published by the relevant decision maker?	1	1	1	1	1	1
	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?	1	1	1	1	1	1
Procedural fairness	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?	1	1	1	1	1	1
	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?	1	1	1	1	1	1
	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?	1	1	1	1	1	1
	Do parties have the right to be heard and present evidence before a decision on a merger is reached?	1	1	1	1	1	1
	Does your competition agency publish procedural guidelines or public documents explaining its investigative procedures?	1	0	0	0	0	1
	Does your competition agency publish guidelines that explain how abuses of dominance are assessed?	1	0	0	1	0	0
	Does your competition agency publish guidelines that explain how horizontal agreements are assessed?	1	0	0	1	0	0
	Does your competition agency publish guidelines that explain how vertical agreements are assessed?	1	0	0	1	0	0
	Does your competition agency publish guidelines that explain how mergers are assessed?	1	0	0	1	0	0
	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?	1	0	0	1	0	1

Table 5.A1. **Competition policy: Indicator scores** (*continued*)

Policy area: advocacy

Sub-dimension	Indicator	ALB	BIH	KSV	MKD	MNE	SRB
Advocacy	Does your competition agency (or another public body) advocate competition at central government level?	1	1	1	1	1	1
	Does your competition agency (or another public body) advocate competition at local or regional government levels?	1	1	0	0	1	1
	Are all new public policies that may have implications for competition subject to a competition assessment in your jurisdiction?	1	1	0	1	0.5	0.5
	In case 9.3 has been answered with "yes", is the competition agency involved in the competition assessment?	1	1	0	1	1	1
	Can market/sectoral studies be performed in your jurisdiction?	1	0	1	1	1	1
	If yes, has at least one market/sectoral study been performed in your jurisdiction in the last five calendar years (2012-16)?	1	0	0	1	1	1
	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?	1	0	1	1	1	1
	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?	0	0	0	0	0	0.5

Note: 1 – "Yes", criterion adopted; 2 – "No", criterion not adopted.

Chapter 6.

State-owned enterprises in South East Europe

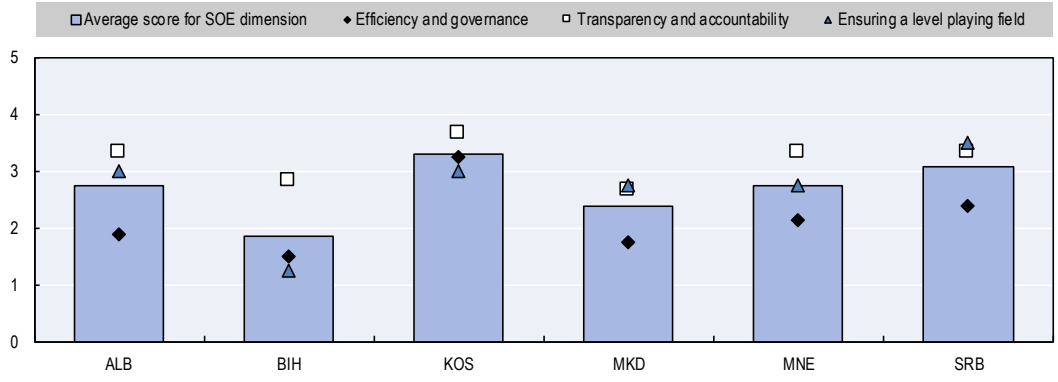
This chapter on state-owned enterprises assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of the state-owned enterprise (SOE) landscape in South East Europe, the chapter then focuses on three essential sub-dimensions. The first sub-dimension, efficiency and governance, examines the degree to which the state acts as an active and informed enterprise owner, and whether boards of directors in SOEs are sufficiently professional and autonomous to oversee the enterprises according to good corporate governance standards. The second, accountability and transparency, assesses whether SOEs and their government owners disclose information according to internationally accepted standards, and whether SOEs are accountable to minority shareholders. The third, ensuring a level playing field, examines the extent to which SOEs may be subject to unfair advantages, or disadvantages, in the marketplace due to their ownership. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions in order to improve SOE governance, which in turn would foster the competitiveness of these economies.

Main findings

The extent to which state-owned enterprises (SOEs) contribute to, or hamper, the competitiveness of an economy depends mostly on two factors: their efficiency and productivity. These determine the quality of the goods and services that they deliver to the rest of the economy, and the degree to which they compete unfairly with private enterprises and hence crowd out more competitive activities. In addition, the SOE sector should be transparent enough to provide competing enterprises with a fair overview of the prevailing market conditions. The present chapter assesses six South East Europe (SEE) economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia – according to these three performance categories.

Overall, SOE performance varies substantially across economies, depending mostly on the quality of public-sector governance and territorial cohesion, as well as on whether or not a given economy has engaged in recent SOE-related reforms. Two economies in particular have recently implemented reforms (Kosovo and Serbia) and, as a consequence, score above average (Figure 6.1). Conversely, Bosnia and Herzegovina[1] is less advanced in establishing a comprehensive approach to state ownership practices.

Figure 6.1. **State-owned enterprises: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

The present chapter marks the first time the *Competitiveness Outlook* has included a chapter on state-owned enterprises. A comparison with earlier assessments is therefore not possible. It is nevertheless worth highlighting that recent reforms in some areas have edged the assessed SEE economies towards internationally recommended good practices. Despite this progress, the overall quality of SOE governance and ownership practices among the six economies remains relatively weak by international standards – including compared to other European post-transition economies. To some extent this reflects the ongoing processes of privatisation in the region. Nevertheless, the fact that certain SOEs

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

are slated for future privatisation should not stop governments from taking appropriate measures to ensure their ownership rights and good governance while they still operate as SOEs.

Achievements

Financial disclosure and audit practices have improved in a number of jurisdictions. Large and economically important SOEs are increasingly expected to file financial reports consistent with International Financial Reporting Standards (IFRS), as laid down in corporate laws or in specific SOE legislation.

The assessed SEE economies have raised their auditing standards. Some of the economies in the region apply high standards of external audit to their SOEs, consistent with private-sector practices, whereas others continue to rely mostly on their state audit functions.

The economies have taken the first steps towards improving co-ordination of state ownership. A couple of economies have taken steps to ensure that the ownership of at least part of their SOE portfolios is exercised on a whole-of-government basis rather than by individual ministers or political communities.

The economies have introduced measures to ensure a healthier competitive landscape between SOEs and other firms. Partly as a consequence of their efforts to align themselves with European Union (EU) legislation, the economies have made changes likely to contribute to levelling the playing field. These include measures to ring fence, or unbundle, monopoly elements of SOEs' value chains.

Remaining challenges and key recommendations

- **Professionalise the state ownership function as a priority in all six SEE economies.** Most SOEs continue to be run by individual line ministries as extensions of the political powers of these ministries, which arguably leads to inefficiencies and conflicts of interest. The ownership of SOEs should be entrusted to state units with specific knowledge of corporate economy and law, and shielded from conflicts of interest with other government functions.
- **Foster clarity in financial and non-financial objectives for individual SOEs.** State-owned enterprises' financial objectives are not fully outlined in the assessed economies; at best they are often basic (e.g. "not to lose any money") and they do not ensure that the state obtains a reasonable return on its invested capital. Non-financial objectives are in most cases opaque or weakly defined. This needs to be addressed if SOE managers and those exercising the state ownership function are to be held properly to account for SOE performance.
- **Ensure governments engage in aggregate reporting on their SOEs**. An essential first step will be a recurrent mapping exercise, making it clear to governments, parliamentarians and the public which enterprises are in public ownership and why, and how they are performing. In the absence of such information, at best only an ad hoc and piecemeal approach to reform can be realised.
- **Strengthen protection of non-state investors further.** The protection of minority shareholders is also of concern in the private sector in a number of the assessed economies. The state needs to go beyond the requirements established by ordinary company law in this respect: there is a temptation to use the state's

shares to vote in shareholder meetings in pursuit of public policy objectives rather than in the interest of all investors. Whether and under what circumstances this may occur should be made clear to non-state investors at the time of their investment.

Context

State-owned enterprises (SOEs) are in many of the SEE economies the sole, or the main, providers of key public goods and services, such as water, electricity, transport, telecommunications and postal services. They generally also account for major shares of other parts of the commercial economy. Ensuring that they are productive and efficient is therefore crucial for economic development, public service delivery and the competitiveness of the whole enterprise sector. When governed transparently and efficiently, SOEs can correct market failures, improve public service delivery and play a role in creating fairer, more competitive markets.

However, governments need to establish strong SOE governance arrangements in order to maximise their contributions to development. In particular, it is important that SOEs have well-defined objectives, professional and independent boards of directors, and clear lines of accountability for their performance. Furthermore, SOEs can be particularly at risk of corruption and they often operate in sectors with large potential environmental impacts. Ensuring that SOEs respect their legal obligations, apply good standards of responsible business conduct, and take into account the environmental and social objectives of development are important elements of a strategy for ensuring high levels of competitiveness.

A separate, but related, issue is the competition between SOEs and private-sector companies. If, for instance, SOEs are unfairly advantaged due to their ownership, this can create severe market distortions, ultimately leading to the more productive companies being crowded out by less productive state-run competitors. This may occur where SOEs are subject to concessionary financing from the state, are exempt from competition and other regulation, have an "inside track" to win public procurement contracts, or are allowed to continue operating with rates of return that private investors would not accept.

Around the world, many countries have taken steps to improve the governance and performance of their SOE sectors, often taking as a benchmark the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2015a; the "SOE Guidelines"). The remainder of this chapter makes frequent reference to the *SOE Guidelines*, which are used as the basis for this assessment. This is further discussed below.

An analysis of SOE performance and governance in the assessed SEE economies reveals significant links with other policy areas. For example, a well-functioning SOE-based economy can be an important determinant of foreign investment, offering efficient infrastructure and other public services (OECD, 2015b). Weak governance of SOEs can involve them in corrupt transactions, including as recipients of bribes destined for policy makers (OECD, 2014a). Furthermore, the question of whether SOEs are treated on an equal basis with other companies is of great importance to competition policy frameworks (OECD, 2012). This chapter is therefore particularly related to the following chapters of this *Competitiveness Outlook*:

- **Chapter 1. Investment policy and promotion** is closely related to the role of SOEs in the economy for a couple of reasons. First, if the state has already occupied certain "strategic sectors", the scope for inward direct investment will be narrowed – which is of particular concern when the SOE incumbents are less

productive than their potential replacements. Second, the role of SOEs as infrastructure providers has direct repercussions for the quality of the investment climate in an economy.

- **Chapter 5. Competition policy** is particularly pertinent to SOE reform in the six SEE economies because they are implementing practices consistent with the EU Single Market. This has repercussions for the unbundling of economic activities in network industries (e.g. separating power grids from other functions), as well as the treatment of other market incumbents with lingering monopoly elements in their value chains.
- **Chapter 17. Anti-corruption policy** is directly relevant to SOE governance because poorly governed SOEs are particularly vulnerable to corrupt practices. OECD experience shows that a disproportionate share of bribes paid to public officials tend to pass via the procurement processes of large SOEs.

State-owned enterprise assessment framework

The state-owned enterprise dimension in the *2018 Competitiveness Outlook* analyses the policies and practices for SOEs in the assessed SEE economies. It considers three broad sub-dimensions based on the elements of the *SOE Guidelines* that are deemed particularly relevant for raising competitiveness in the regional context:

1. SOE efficiency and governance: does the state act as an active and informed enterprise owner, and are boards of directors in SOEs sufficiently professional and autonomous to oversee the enterprises according to good standards of corporate and commercial conduct?
2. Transparency and accountability: do SOEs and their government owners disclose information according to internationally accepted good practices? Are SOEs accountable to their minority shareholders (where such exist) as well as to the state?
3. Ensuring a level playing field: how does the state ensure that SOEs that are active in economic markets are neither advantaged nor disadvantaged by their ownership?

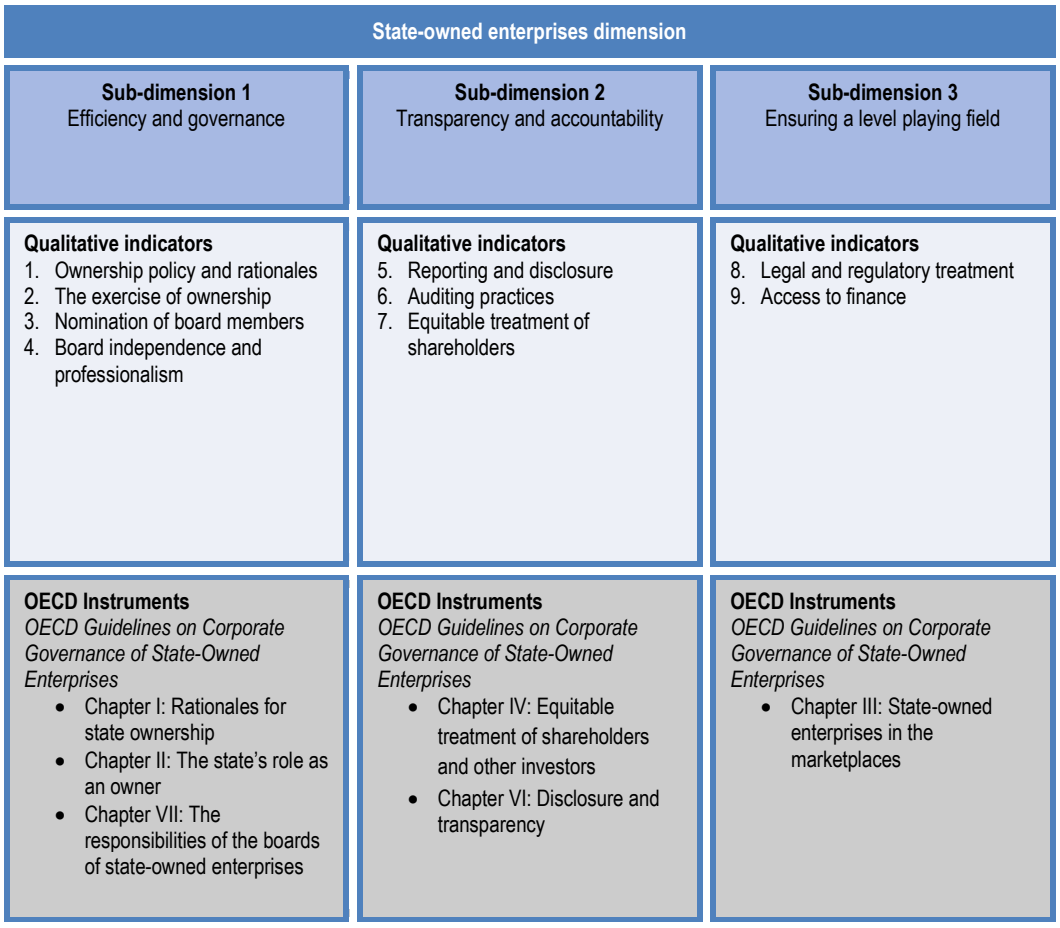
Figure 6.2 shows how the sub-dimensions and their constituent indicators make up the SOE assessment framework.

The six SEE economies' SOE frameworks were assessed by the public authorities as well as independent consultants in each of the economies. These actors were invited to score their performance on a scale from 0 (no implementation of the *SOE Guidelines*) to 5 (full implementation of the *SOE Guidelines*). The results were reconciled and processed by the OECD, and are summarised in Annex 6.A1. For more details on the methodology underpinning this assessment please refer to the methodology chapter.

State-owned enterprise performance in SEE economies

The SOE sectors of the six assessed South East European economies are broadly similar to those in some of the post-transition OECD member economies. While the quantitative information for these SEE economies is at best patchy, recent research suggests that the share of SOEs in total production and employment in most of these economies falls within the range of 3-7% (OECD, 2017). As in most comparable economies, most of the economically important SOEs are found in the infrastructure and network industries, and in some cases, the financial sector. An overview of the number of enterprises is provided in Table 6.1.

Figure 6.2. **State-owned enterprise assessment framework**



Source: OECD (2015a), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, http://dx.doi.org/10.1787/9789264244160-en.

The SOE landscape is, moreover, influenced by a history of recent and ongoing privatisation. Several economies in the region (e.g. Serbia and Montenegro) maintain privatisation portfolios under central ownership, which in some cases are the legacy of now-disbanded privatisation agencies. To some extent this may have resulted in governance practices that are not considered optimal from the perspective of this chapter: most policy makers apparently have not considered it worthwhile to develop formal state ownership policies for, and improve the governance of, companies that they wish to sell off. However, in the late phases of privatisation governments tend to be left with complicated cases of companies that have proven difficult to sell. This implies that in practice the duration of state ownership will in many cases be longer than planned, which suggests that improving the ownership and governance of these companies is fairly urgent.

Many SOEs in the region are loss making. For this reason, recent reform efforts have focused on – in addition to finding buyers for some of the companies – stemming the ongoing fiscal haemorrhaging. Furthermore, the process of aligning the assessed SEE economies with the EU Single Market has also had implications for the SOE sector. This is most visible in the infrastructure sectors, where unbundling the service provisioning

aimed at separating legal and natural monopolies into separate companies has had implications for the way electricity and railway companies and their ownership are organised.

Table 6.1. **Number of state-owned enterprises held by (central) governments**

	Number of SOEs	Government institutions exercising ownership	Comments
Albania	37 (partial portfolio)[1]	Ministry of Economy	
Bosnia and Herzegovina			
– The Federation of Bosnia and Herzegovina	53	Ministry of Energy; Ministry of Transportation; Ministry of Finance; various line ministries	
– The Republika Srpska	38	The Share Fund of the Republika Srpska; various line ministries	An additional 44 companies have minority government shareholdings
Kosovo	17 (partial portfolio)	Publicly Owned Enterprise Policy and Monitoring Unit (co-ordination agency)	An additional 43 companies are held by local and municipal public authorities
Former Yugoslav Republic of Macedonia	129	Central government; Ministry of Finance; various public agencies	The figure includes an estimated 12 municipal enterprises
Montenegro	34	Three state funds (Unemployment Fund, State Pension Fund and Investment Development Fund)[2]	There are 26 partly (minority) state-owned enterprises, several of which are either under liquidation or subject to ongoing (or stalled) privatisation
Serbia	201 (partial portfolio)	Ministry of Economy	The figure includes public enterprises as well as the privatisation portfolio overseen by the ministry

Note: 1. Information on Albania concerns only the portfolio of enterprises under the shared purview of the Ministry of Economy's Directorate General for State Property and the relevant line ministries, which comprises the majority – but not the totality – of SOEs in Albania. 2. In Montenegro, the Ministry of Finance also acts as an owner in some SOEs, but it is not the predominant state ownership entity.

Source: Submissions from authorities and independent consultants.

For the reasons mentioned above, relatively little attention has been given in recent years to restructuring the ownership and governance of SOEs in the region according to internationally accepted good practices. However, there are some encouraging exceptions. For example, the government of Serbia has established a category of SOEs ("public enterprises") that are slated for continued state ownership. They are subject to specific legislation which, when properly implemented, will strengthen their ownership and governance subject to the oversight of the Ministry of Economy.

Efficiency and governance

If SOEs are to operate efficiently and contribute to the competitiveness of their home economy then the state needs to act as "an active and informed owner" (as the *SOE Guidelines* put it).[2] Unless the government ownership is as competent and engaged as would be expected from the majority owner of a similar private company, the SOEs they oversee are likely to underperform. Weak ownership discourages SOE management and introduces a risk of abusive self-serving behaviour by corporate insiders.

On the other hand, the state also needs to abstain from ad hoc interventions in SOEs' operations and management. The prime means for active and informed state ownership are a clear and consistent ownership policy, the development of broad mandates and objectives for individual SOEs, a structured nomination process for boards of directors, and the effective exercise of established ownership rights. Moreover, one of the overarching principles in the consensus that underpins the *SOE Guidelines* is that the roles of overseeing and managing SOEs should be allocated to the most appropriate levels in a "chain of command" extending from the highest levels of government to the individual enterprises. The structure implied by the *SOE Guidelines* outlines the following four levels of decision making that should be involved:

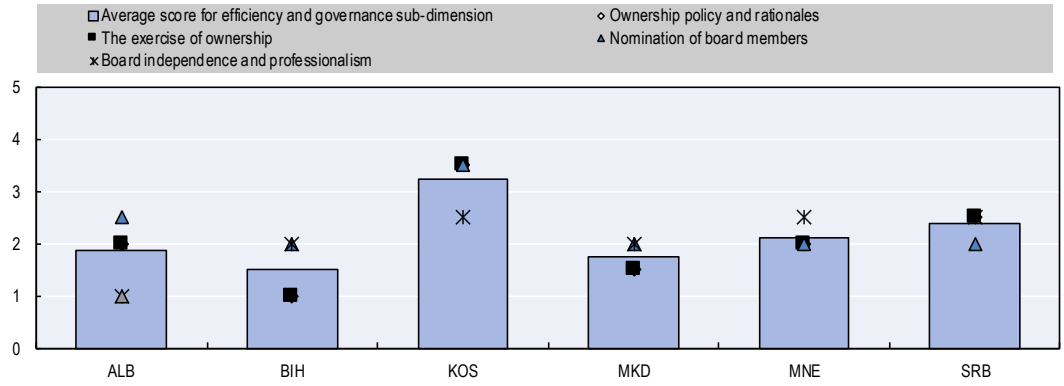
1. The government: to ensure a consistent approach (and to help avoid the "third agency problem" mentioned above), the government as a whole needs to develop an ownership policy. The ownership policy should normally communicate the rationales for enterprise ownership, how the government intends to exercise its rights as an owner, and any specific expectations (beyond commonly accepted commercial norms) that the state may have of its SOEs.
2. The ownership entity: the administrative role of exercising the ownership rights (further detailed below) is delegated to one or numerous state institutions charged with defining the operational and financial performance objectives of individual SOEs (or classes of SOEs) and with monitoring their implementation.
3. The board: the board of directors is the highest corporate authority within each SOE. It formulates (or approves) corporate strategies, monitors each SOE's executive management and generally holds overall responsibility for the company. SOE boards should be composed of qualified professionals who are able to exercise independent and objective judgement.
4. The management: the management may, according to corporate law and tradition, consist of an executive board of directors chaired by a chief executive officer (CEO), or of one CEO alone who is given freedom to compose his/her management group. The CEO is appointed, and can be dismissed, by the board of directors.

Every SOE operates within a specific legal, institutional and economic context, and any attempt to improve its governance needs to be tailored to those circumstances. SOEs are subject to varying degrees of enforcement and restrictions depending on their regulatory environments, as well as the sectors in which they operate. Nevertheless, there are key messages and lessons on SOE governance reform, both general and focused on information disclosure and accountability, which economies can garner from internationally agreed standards such as the *SOE Guidelines*.[3]

The efficiency and governance sub-dimension comprises four qualitative indicators (Figure 6.3): 1) ownership policy and rationale; 2) the exercise of ownership; 3) board independence and professionalism; and 4) the nomination of board members.

As the overall scores for the sub-dimension indicate, the ownership practices and corporate governance of SOEs in the six SEE economies can still be improved. In a number of economies, SOEs still tend to be, in the words of a recent review, "treated as political prizes to be divided up among political parties in the ruling coalition" (US Department of State, 2016).[4]

Figure 6.3. **Efficiency and governance: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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One exception is Kosovo, which has enacted important reforms in recent years including a corporate governance code for SOEs (EBRD, 2016a). In Serbia too there has been recent progress with the passage of a law on public enterprises. However, it is only applicable to a segment of the SOE sector.

Ownership policies and objectives have been developed to different degrees

According to the OECD *SOE Guidelines*, the **exercise of ownership** rights should be clearly identified within the state administration, centralised in a single ownership entity or, if this is not possible, co-ordinated by a centralised body, which should have the capacity and competencies to carry out its duties effectively.

In most of the assessed economies, state **ownership policies and rationales** have not been developed. Although in many cases a degree of "ownership policy" can be gleaned from laws, cabinet decisions and other secondary legislation, these are rarely consolidated into one concise document. Similarly, few governments have outlined a rationale for state ownership of enterprises, except for those economies (e.g. Serbia) which have created a special category of SOEs charged with operating in the public interest. In those cases, ownership rationales can be derived from the explanation of the nature of "public interest".

Table 6.2 gives an overview of the explicit or implicit ownership rationales in the six economies. Above-average practices are found in Kosovo, where a law on SOEs defines the state's overall ownership objectives, outlines (albeit not fully) the mandate of the ownership entity and clarifies its main functions, spelling out the main principles to be followed by the ownership entity in exercising ownership rights.

In general, the overall objectives for state enterprise ownership put forward by OECD and non-OECD governments fall into the following categories: 1) supporting national economic and strategic interests; 2) ensuring continued national ownership of enterprises; 3) supplying specific public goods or services (after deeming that the market cannot supply the same goods or services); 4) performing business operations in a "natural" monopoly situation; and 5) other operations such as creating or maintaining a state-owned monopoly (or oligopoly) where market regulation is deemed infeasible or inefficient (OECD, forthcoming).

Table 6.2. **Rationales for state ownership of enterprises**

	Supporting economic and strategic interests	Ensuring continued national ownership of enterprises	Supplying specific public goods or services (in the absence of private suppliers)	Performing business operations in a "natural" monopoly situation	Other
Albania	√		√		
Bosnia and Herzegovina	√ (FBiH & RS)	√ (RS)		√ (FBiH & RS)	
Kosovo	√	√	√		
Former Yugoslav Republic of Macedonia	√		√		
Montenegro	√				
Serbia	√		√		√

Note: FBiH – the Federation of Bosnia and Herzegovina; RS – the Republika Srpska.

Source: Submissions from authorities and independent consultants.

Likewise, the organisation of state ownership practices is generally not highly developed. As mentioned above, enterprise ownership should preferably be exercised on a whole-of-government basis rather than left to the discretion of individual ministries. This approach is considered good practice for a couple of reasons.[5] First, it helps avoid situations where a single line ministry is simultaneously tasked with the roles of ownership and sectoral regulation, which can be a source of considerable conflicts of interest. Second, as SOE portfolios shrink, governments often see a need to create a specialised administrative unit which brings together staff with a knowledge of commercial economics and law.

The SEE economies that have gone the furthest in this direction have put in place elements of a "dual ownership model",[6] where one central ministry or agency exercises ownership rights jointly with a line ministry. For instance, Kosovo has established a co-ordination agency, but it is not particularly large or well resourced. Serbia has allocated similar roles to its more influential Ministry of Economy, but only for a subset of its SOE portfolio.

In Albania, the ownership function for the majority of SOEs is exercised jointly by the Ministry of Economy's Directorate General for State Property and the relevant line ministries. In the Former Yugoslav Republic of Macedonia there is also an element of centralisation of the ownership function, in the sense that the ownership of most SOEs is exercised jointly by three state funds. A similar arrangement is in place in Montenegro, where three state funds share the ownership function. In a number of the assessed SEE economies, there are some exceptions to the prevailing ownership model, with a small subset of SOEs remaining outside of the remit of the main ownership entity/ies. This is by no means unique to the assessed economies, however: even in some OECD countries with predominantly centralised ownership arrangements, some large SOEs remain under the control of line ministries.

Politicised boards of directors continue to hamper the performance of many SOEs

To safeguard **board independence and professionalism**, and ensure that boards of directors are (in the words of the *SOE Guidelines*) "capable of objective and independent judgement", it is important that they include a sufficient number of independent members and that they do not include serving politicians (e.g. ministers, vice ministers, members of parliament). The board members of an SOE should ideally see themselves as agents of the

company rather than as representatives of the ministry that appointed them. This is, however, far from the reality in most of the assessed SEE economies.

In Albania, vice ministers serve on some SOE boards. Although this is not the case in the other five SEE economies, there are generally no rules to ensure the presence of independent directors, and in most cases boards are dominated either by civil servants or by people politically connected to the national executive. In Montenegro, most SOE board members are either current or former public officials with professional experience in those SOEs' sectors of operation. While there are no explicit nomination or qualification criteria in place for board members, a provision in Montenegro's Anti-Corruption Law does prohibit ministers and vice ministers from serving on SOE boards. Across the region, it is not uncommon for directors to act and vote subject to ministerial instructions and to report corporate information back to the government institutions that they represent. An encouraging recent development is Serbia's 2016 Law on Public Enterprises, which establishes criteria for board qualifications and the independence of certain board members. However, it applies to only a subset of SOEs that are designated to act in the "public interest".

One reason for the lack of autonomy of SOE boards of directors in the assessed economies is that the process for **nomination of board members** is strongly politicised. Good practices for nominating board members in other economies include formal qualification criteria for potential board members; inter-ministerial nomination committees; reliance on executive search companies and/or pre-screened "pools of directors"; and, crucially, rules ensuring that no serving politicians or persons directly related to them serve as directors in SOEs. Box 6.1 provides an example of board nomination practices in the United Kingdom. In the assessed SEE economies few such safeguards are found, and the *de facto* power over board nominations is commonly at the discretion of either line ministers or the head of government. Kosovo has established an inter-ministerial recommendation committee, which in terms of statutory rules is a good practice, but in reality this institution is broadly considered ineffective.

The way forward for improving efficiency and governance

State ownership practices among the assessed SEE economies are not particularly well developed, and reforming them would lead to significant efficiency gains for the economies. Sequencing reforms is, however, important. Experience from other economies suggests that the three priority areas for reform that should be addressed in the six SEE economies early in the process are the following:

The way forward for improving efficiency and governance

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Box 6.1. Good practice: Board appointment process in the United Kingdom

The general appointment process of the Office of Commissioner of Public Appointments (OCPA) is as follows (although this may vary slightly depending on the size of the SOE and the specific requirements of the post):

- The central ownership advisory unit, the UK Government Investments (UKGI), and the SOE Chair agree on the mix of skills and experience required on the board leading to agreement on a strategic plan of public appointments. A timetable for recruitment is then agreed between the SOE, the lead director in UKGI and an independent assessor (IA).
- A specification setting out the role and requirements for the board appointment is drafted and agreed with the government's human resource unit and the SOE. The role and person specification is then agreed with the body or minister making the final decision.
- A candidate search is undertaken with the vacant position being publicly announced (i.e. advertised) and often involving the use of recruitment agencies to ensure a more thorough search of potential candidates.
- On the basis of applications received a long list of potential candidates is produced. An initial sift involving UKGI, the IA and the SOE is conducted to produce a shortlist of candidates to interview.
- An interview panel is established comprising the lead UKGI policy official, the IA and the SOE Chair.
- The panel will then reach agreement on the preferred candidate and submit a panel report with recommendations to departmental ministers.
- Once ministers have agreed the recommendation the appointment can be made.
- An appointment is normally for a fixed period of three years, at which point the position is subject to re-election.
- The remuneration of the successful candidate, if over a certain threshold, needs to be agreed with the Chief Secretary to the Treasury.

Where the post is not OCPA regulated, the SOE runs the process but follows the OCPA guidelines in most instances. UKGI is closely involved in the process if the post is important (e.g. CEO or finance director), for example by joining the interview panel. In this way, UKGI is able to make suitable recommendations to give consent to appointments.

Source: OECD (2013), *Boards of Directors of State-Owned Enterprises: An Overview of National Practices*, http://dx.doi.org/10.1787/9789264200425-en.

The economies should strengthen the co-ordination of the ownership function. If centralising the ownership of SOEs into one single, specialised agency is not feasible, then governments should at least establish co-ordination functions to ensure that the enterprises they control are overseen on a whole-of-government basis. Co-ordination could notably involve harmonising the corporate governance and disclosure requirements placed on SOEs (e.g. concerning the criteria and nomination process for SOE board members).

All the assessed economies in the SEE region should undertake aggregate reporting and disclosure for the entire SOE sector. Governments should issue annual reports allowing parliaments, stakeholders, the public and press easy access to information about the size, composition and performance of the entire SOE portfolios. Some governments limit themselves to providing public access to individual SOE disclosure, for instance via an Internet portal. This can be a useful first step, but it should be complemented by the government communicating its activities as an enterprise owner. Through such transparency the public becomes aware of the state ownership issues and, in consequence, constituencies for reform are created and the reform process is itself facilitated.

SEE economies should set objectives for individual SOEs. In the absence of clear (financial and non-financial) objectives, SOE performance cannot be credibly monitored, leading to a situation of weak accountability and inefficiency. Governments need to specify what SOEs are expected to achieve in addition to earning money and how the costs of such "non-commercial objectives" are to be covered. Without this, managerial accountability in SOEs is very hard to establish.[7]

Once these reforms are progressing, the next issue to address would be **reorganising SOE boards of directors**. Nomination procedures should be established to ensure that all board members have the requisite skills and are capable of independent judgement. In practice this means shifting the balance away from civil servants and towards independent, outside directors, as well as establishing safeguards to ensure that individuals do not get nominated solely because of their association with government ministers or other politicians. In order to empower boards to fulfil their role as the highest decision-making body within each SOE they should have decisive influence over the employment and removal of the CEO.[8]

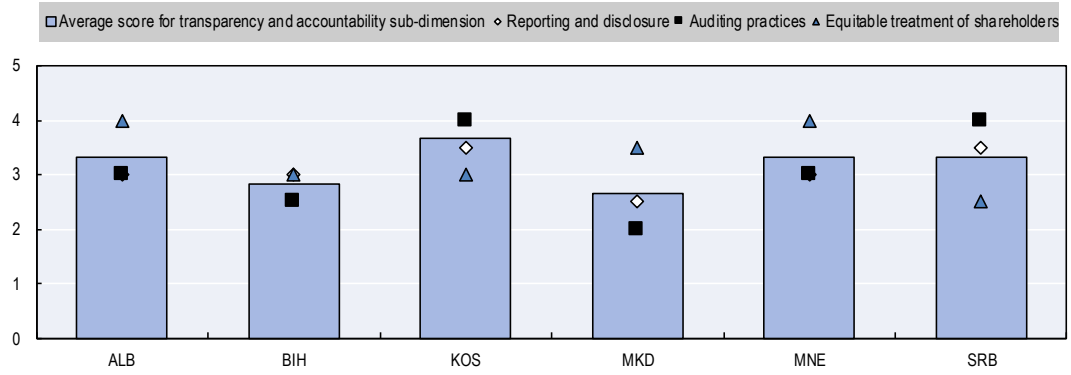
Transparency and accountability

Ensuring a high level of transparency and accountability is the very basis of any sound corporate governance regime. Information disclosure and higher standards of accountability in SOEs, when accompanied by other governance reforms – such as centralising state ownership, listing on stock exchanges, board improvements and financial restructuring – can help to improve their efficiency and performance. Information disclosure, including of both financial and non-financial data, is essential for the government to be an effective owner. It also helps parliament evaluate the performance of the state as an owner; the media to raise awareness of SOE efficiency; and taxpayers and the general public to have a comprehensive picture of SOE performance.

The transparency and accountability sub-dimension comprises three qualitative indicators (Figure 6.4): 1) reporting and disclosure, such as traditional measures of reporting and disclosure by the state individual SOEs; 2) auditing practices; and 3) the equitable treatment of shareholders, i.e. corporate accountability toward shareholders other than the state.

Most of the assessed SEE economies score around the average for the transparency and accountability sub-dimension (Figure 6.4). Overall scores for Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia are somewhat weaker than the others, largely explained by the relative weakness of their auditing practices.

Figure 6.4. **Transparency and accountability: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Reporting, disclosure and auditing practices are improving

Generally, transparency should be ensured both at the aggregate and the individual company level. The *SOE Guidelines* recommend that the state, or an ownership entity empowered to act on behalf of the state, engages in aggregate annual **reporting and disclosure** – providing an overview of the financial and other performance of its entire portfolio of SOEs, as well as more detailed information on individual enterprises.

Around half of the 52 countries[9] surveyed in the OECD *Compendium of State-Owned Enterprise Governance Practices* produce and make some form of aggregate reporting on SOEs available online (OECD, forthcoming). Most of them include all, or the majority of, their SOEs in the reports. In countries with well-developed aggregate disclosure practices, aggregate reports sometimes also include information on the state's ownership policy and its implementation, any recent changes in the state's overarching objectives for state ownership, and significant evolutions in the legal or corporate governance arrangements for SOEs (for example, introducing requirements for independence applicable to board members). To facilitate access by the general public, it is considered good practice to make such aggregate information available online.

Governments in the assessed SEE economies generally do not engage in aggregate reporting on SOE ownership and performance. This is partly due to the multitude of institutions (mostly ministries) involved in exercising the state's ownership rights. Countries in other regions have overcome this problem by establishing state co-ordination agencies to oversee the various line ministries' SOE portfolios. In some of the SEE economies, ministries overseeing one category of SOEs (e.g. the "public enterprises" found in several economies) issue reports for their own portfolio, for instance in the context of fiscal budgeting procedures. There are no publicly available overviews of the state's SOEs in a single published source in any of the six economies. This is problematic in the context of future SOE reform. A number of countries – and especially post-transition economies – have found that preparing aggregate reports is an essential first step in comprehensive SOE reform (in many cases these provided politicians with an overview of the state's financial engagements via SOEs for the first time).

Also in line with OECD good practice, the state should mandate detailed reporting by individual SOEs (OECD, 2015a). With due regard to enterprise size and capacity, this reporting should include: 1) a statement of enterprise objectives and their fulfilment;

2) financial and operating results; 3) corporate governance; 4) remuneration of board and executive management; 5) board composition; 6) foreseeable risk factors; 7) financial assistance received from the state; 8) material transactions with the state or related entities; and 9) stakeholder relationships. Moreover, the SOEs' financial statements should be subject to independent external audits based on high-quality auditing standards. The latter point is important because until relatively recently, a number of OECD and other governments relied largely on their state audit institutions for auditing SOEs. This kind of audit has, however, turned out to be insufficient when SOEs operate commercially.

The quality of reporting and disclosure varies across the assessed SEE economies, as well as according to how the SOEs are incorporated. As a general rule, SOEs that are subject to ordinary company law have higher standards of financial reporting than special-purpose entities. In some economies (e.g. Serbia) company law requires SOEs to report according to internationally recognised standards such as the International Financial Reporting Standards (IFRS). Kosovo and Serbia are considered to be performing better than the other economies, mostly because they subject parts of their SOE sectors to specific SOE laws that impose additional reporting requirements.

A challenge in a number of economies, however, is implementing these rules. SOEs (and other companies) do not necessarily respect their reporting requirements, preferring instead to incur penalties imposed by tax and other authorities. This is the case, for example, in Montenegro, where SOEs that are incorporated as joint stock companies have disclosure requirements that are of a reasonably high standard but do not consistently implement them. According to monitoring by the Securities Commission, only an estimated half of state-owned joint stock companies respect the applicable disclosure requirements.

Also, whereas financial reporting is in most instances reasonably good across the six economies, reporting about non-financial performance is in many cases rather incomplete. This is particularly problematic given that SOEs in the economies are regularly charged with undertaking public policy tasks. If there is no reporting on the fulfilment of these tasks, there is a serious risk that the fact that SOEs "are not only expected to earn money" becomes a smokescreen behind which managerial accountability suffers and corporate insiders are able to engage in self-serving behaviour. The Lithuanian authorities' approach for estimating – and reporting on – the costs and funding of SOEs' public policy objectives offers potential inspiration for these SEE economies. The related information is made public in the state's annual aggregate report on SOEs (Box 6.2).

The quality of **auditing practices** differs significantly among the six SEE economies. Some are largely reliant on state auditors (e.g. Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia) and, at most, subject only their large and commercially oriented SOEs to independent external audits. This is contrary to the *SOE Guidelines*, which note that "specific state control procedures do not substitute for an independent external audit". This applies equally to SOEs that are not commercial in nature, since the fact that they are expected to operate in the public interest demands higher rather than lower standards of disclosure. It should, however, be recognised that some SOEs are so small that more limited ambitions can be set for their reporting and auditing. The highest scores, ranging from 3-4 out of 5 (Figure 6.4), are achieved by Albania, Kosovo and Serbia as they apply auditing standards to their SOEs that compare favourably with the average OECD country.

Box 6.2. Good practice: Aggregate disclosure in Lithuania

Since 2010, the Lithuanian authorities have published an annual report on the characteristics, operations and performance of the state-owned enterprise portfolio. The report is produced by a central co-ordinating body, the Governance Co-ordination Centre, which is tasked with monitoring and reporting on SOEs' compliance with the state's policies and guidelines bearing on corporate governance and transparency. The report is available online and is notably produced in both Lithuanian and English (VKC, n.d.). Among the main elements included in the report are the following:

State ownership policy. The report gives an overview of the Lithuanian state's ownership policy and disclosure requirements for SOEs, enshrined in two policy documents, *Ownership Guidelines* and *Transparency Guidelines*. It also references the key legal acts bearing on SOEs' operations. It furthermore communicates the state's overarching objectives for SOEs, based on sorting enterprises into three categories according to whether they are primarily commercially oriented, primarily public service oriented or a mixture of both.

Corporate governance index. The corporate governance index rates all SOEs according to the quality of their corporate governance in three dimensions: transparency, boards of directors, and strategic planning and implementation. This section of the report is also used to highlight significant recent developments or issues of concern, such as major changes in the functioning or composition of SOE boards of directors.

SOE executive remuneration. This section reports on the average remuneration of high-level SOE executives by sector and by corporate form.

SOEs' non-commercial objectives. This section reports on the costs associated with SOEs' non-commercial objectives ("special obligations" in national nomenclature), as well as their related funding arrangements. It provides a breakdown by individual enterprise, including any losses incurred for funding non-commercial objectives. The related information is requested annually from line ministries by a central co-ordinating agency.

Value and performance of SOEs. This section provides an overview of the value of SOEs, their annual aggregate financial performance and their contributions to national employment, all broken down by sector. It also reports on SOEs' rates of return and highlights significant related evolutions since the preceding year.

Reporting on individual SOEs. This section provides detailed reporting on recent financial and corporate governance developments in Lithuania's largest SOEs. It also provides information on their board composition, identifying which board members represent ministries and which are considered independent.

Source: OECD (2015c), *Review of the Corporate Governance of State-Owned Enterprises: Lithuania*, www.oecd.org/daf/ca/Lithuania_SOE_Review.pdf; VKC (n.d.), "State-owned enterprises", http://vkc.turtas.lt/en.

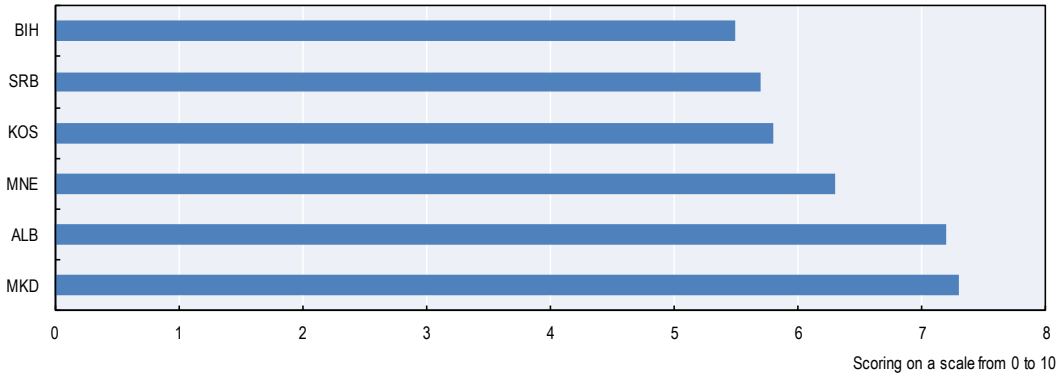
The protection of minority shareholders remains a concern in some economies

The concept of accountability in this *Competitiveness Outlook* has two dimensions: 1) "democratic accountability" towards the general public and the elected bodies that represent them; and 2) accountability towards individuals and firms that have invested in SOEs' activities. Democratic accountability is often achieved by preparing aggregate reports, which in many countries are prepared by the government and presented to parliament, then disseminated to the wider public. Accountability toward stakeholders, whether individuals or firms, relates to the *SOE Guidelines*' recommendations on

protecting minority shareholders and maintaining good stakeholder relationships. The point about minority protection is of particular importance when SOEs are tasked with carrying out public policy functions in addition to their commercial operations. This can result in considerable losses for the companies and their non-state investors, and it is important that all investors are aware of any such obligations at the time of undertaking their investments. Ad hoc interventions in SOEs to make them undertake politically expedient projects are a bad practice which significantly undermines these SOEs' (and the state's) accountability.

The equitable treatment of shareholders in SOEs is an area with scope for further improvement. Public authorities would in many cases argue that most of their SOEs have a corporate form which does not allow for outside investors, and the rest are joint stock or limited liability companies, which are subject to general company laws, including the protections for minority shareholders that they provide. However, this gives rise to two problems – first, that several of these laws do not provide a particularly high level of protection, even for private firms. Figure 6.5 shows an assessment drawn from the World Bank's *Doing Business* reviews, which indicates that investor protection is an area of general concern in economies like Bosnia and Herzegovina and Serbia, whereas a recent reform in the Former Yugoslav Republic of Macedonia has led to significant improvements.

Figure 6.5. **Protection of minority shareholders, general corporate sector**



Source: Doing Business (2017), *Doing Business 2017: Equal Opportunity for All*, www.doingbusiness.org/reports/global-reports/doing-business-2017.

StatLink http://dx.doi.org/10.1787/888933703941

Second, the question arises whether the state, given the powers it has, may either weaken implementation of the law or decide to disobey it. An example of the latter was found in Serbia, where the Belgrade Beer Industry (51% state owned) reportedly changed its articles of association despite court rulings, instigated by the minority shareholders, that the changes were unlawful.[10] However, more generally it is difficult to assess the implementation of minority shareholder protection in many of the assessed SEE economies, because they either do not have minority shareholdings in any SOEs or there have been no recent cases of minority shareholder complaints.

The way forward for transparency and accountability

While there has been progress in improving financial reporting and audit practices in several economies, further progress in this area would be useful.

The six economies **should apply good practices for financial reporting, such as IFRS, to all SOEs above a certain size threshold**, regardless of whether or not they are considered principally commercial operators.[11]

The quality of non-financial reporting should be improved significantly in all six SEE economies. SOEs that either receive public-sector support or operate at a loss due to public policy objectives that they have to fulfil should be expected to fully disclose these objectives and their fulfilment.

Governments in the assessed economies should **engage in aggregate reporting on a whole-of-government basis**. It is not sufficient to induce individual SOEs to disclose their operating results; the government itself should take responsibility for a consolidated evaluation and reporting on the state's enterprise portfolio. As mentioned earlier, this is seen as an essential element in deepening and broadening the reform of SOE sectors.

The protection of minority shareholders in SOEs should be strengthened in the six SEE economies. In the course of reforming their SOE sectors, governments often choose to list minority stakes in individual companies on stock markets. This strategy can lead to improvements in corporate governance, among other areas, because it subjects the SOEs in question to stock-market listing rules and securities regulation. However, the success of this approach depends on whether non-state investors can be certain that their rights will be respected and, in particular, the state does not vote its shares in the SOEs purely as a matter of public policy.

Ensuring a level playing field

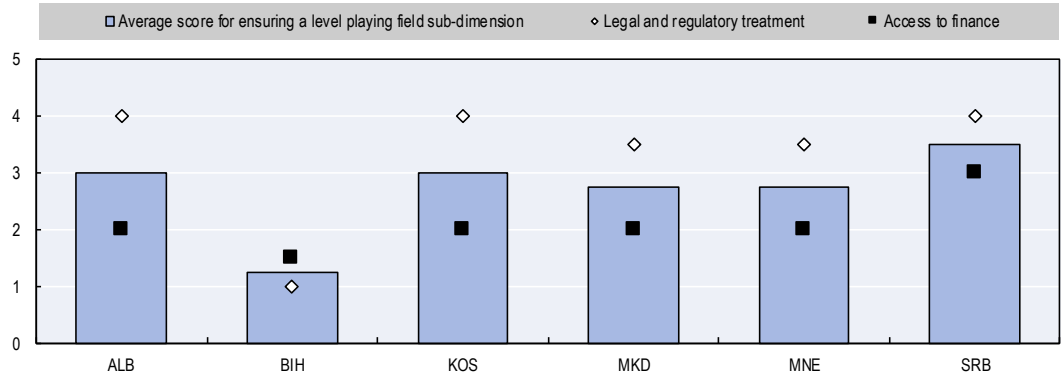
When SOEs engage in economic activities, it is commonly agreed among OECD countries that those activities must be carried out without any undue advantages (or disadvantages) relative to other SOEs or private enterprises. In addition to specific challenges, such as ensuring equal financial, regulatory and tax treatment, come some more overarching issues including identifying the cost of public-service activities and, where feasible, separating economic activities and public policy objectives. This topic is covered in the *SOE Guidelines*, and the OECD has developed further guidance, providing best practices intended as inspiration for regulators and policy makers (OECD, 2012).

The sub-dimension on ensuring a level playing field comprises two qualitative indicators (Figure 6.6): 1) legal and regulatory treatment; and 2) access to finance. To understand the evenness of the playing field between SOEs and private companies in the assessed economies, the starting point must be the corporate form of SOEs in each. State-owned enterprises, in the form of joint stock or limited liability companies and subject to ordinary company law, will (all other things being equal) be operating on a more equal footing. This applies to both elements of the scorecard: both the legal and regulatory treatment of SOEs and their access to finance will depend on their corporate profile. Where SOEs, or segments of SOE sectors, are incorporated pursuant to specific overall legislation (such as the Public Enterprise Law in Serbia) the competitive landscape depends on the specifics of this legislation and, in particular, its compatibility with ordinary corporate law. Weakly incorporated entities operating essentially as an extension of government ministries are – insofar as they operate in competitive markets at all – unlikely to compete on a level playing field.

With the exception of Bosnia and Herzegovina the assessed SEE economies score around the average for ensuring a level playing field (Figure 6.6). In other words, they have as a general rule obtained a level playing field for SOEs and other firms but with

some non-trivial exceptions. Bosnia and Herzegovina performs more weakly in this respect, with an average score of around 1.3, mostly because its SOE landscape contains numerous statutory corporations which are subject to treatment that may differ from ordinary corporate norms. Most other economies have incorporated their SOEs either under ordinary company law or under specific SOE legislation that expressly addresses issues such as competition rules, tax obligations and insolvency procedures.

Figure 6.6. **Ensuring a level playing field: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933703960

An interesting finding from the analysis is that (again with the exception of Bosnia and Herzegovina) the economies score markedly higher for establishing equal legal and regulatory treatment of SOEs, than for ensuring that they obtain their financing on market terms. This is discussed further below.

SOEs operate in similar legal and regulatory frameworks as other firms

A central tenet of competitive neutrality is the equal legal and regulatory treatment of SOEs and private companies. Among other things, this implies that the state ownership function should be carried out independently of, and separate from, state institutions that exercise regulatory functions in the sectors where SOEs operate. To maintain a level playing field, SOEs should be subject to equal or equivalent tax treatment to private competitors in similar circumstances. Moreover, both SOEs and the state as shareholders should not be protected from challenge via the courts if they are accused of infringing the law or disrespecting contractual obligations. Stakeholders should be able to challenge SOEs and the state as an owner in courts and/or tribunals and be treated fairly and equitably in such cases by the judicial system.

In comparison with a number of OECD countries, the assessed SEE economies have made good progress in ensuring that SOEs are subject to equal legal and regulatory treatment compared with private companies. This is in large measure due to the fact that they are incorporated in a similar form to their private competitors and subject to the same bodies of corporate law. This is not universally the case, as some economies have established a class of SOEs (generally called “public enterprises”) tasked with acting in the public interest and subject to a separate law. However, these public enterprise laws generally establish safeguards of their own that go some way toward maintaining a level playing field.

The treatment of SOEs and other enterprises also seems to be equal when it comes to standard corporate obligations such as compliance with tax rules or competition regulation. However, SOEs in all six economies – whether or not formally classified as operating in the public interest – are subject to significant non-commercial expectations from their government owners. In some cases the state compensates the SOEs by granting them a privileged market position and/or favourable price regulation. SOEs are in most cases (with the exception of statutory corporations) formally subject to the same insolvency and bankruptcy regimes as other companies, but it is unclear whether the threat of bankruptcy is credible in the case of systemically important SOEs.

Not all commercially operating SOEs obtain their funding on market terms

When SOEs raise financing (whether from the state budget or the commercial marketplace) the state should implement measures to ensure that the terms of both debt and equity financing are market consistent. Creditors sometimes seem to assume that there is an implicit state guarantee on SOEs' debts. This situation has in many instances led to artificially low funding costs disrupting the competitive landscape. Moreover, in those economies where state-owned financial institutions tend to be among the main creditors of SOEs involved in economic activities, there is great scope for conflicts of interest. In addition to the points raised above, there should also be no expectation that SOEs may benefit from their near-government status to run up tax arrears or be subject to lenient enforcement of tax rules. SOEs also should generally not benefit from "off market" funding arrangements from other SOEs, such as trade credits. Such arrangements, unless they are fully consistent with normal corporate practices, amount to preferential lending. The state should implement measures to ensure that inter-SOE transactions take place on purely commercial terms.

SOEs in the assessed economies generally do not obtain their financing on market-consistent terms. In some economies (e.g. Kosovo and Montenegro) many SOEs are loss making, so the fact that they obtain government finance and loans from international development banks would not in itself confer a privileged position in the marketplace. However, the continued "life support" for such companies could well hamper private-sector development in the longer term. In other economies in the region (e.g. Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia) government guarantees for borrowing by large and economically significant SOEs is either commonplace or occurs regularly. It is not uncommon to combine this with the direct provision of credit lines from the state to smaller SOEs.

Even in economies that normally expect SOEs to raise financing on market terms (e.g. Serbia), a couple of problems persist. First, the idea that SOEs, if operating on a commercial basis, should earn market-consistent rates of return has not gained hold among policy makers, and therefore many SOEs may effectively remain in the marketplace while earning lower returns on their capital than investors in private companies would require. Second, even in the absence of government guarantees for specific loans, the financial sectors in the economies widely perceive implicit government guarantees for the largest and most important SOEs. For this reason these SOEs are, even when raising finance from commercial lenders, effectively able to obtain better rates than private companies in like circumstances. It should, however, be mentioned that the latter departure from competitive neutrality is also found in the SOE sectors of numerous other economies, including in the OECD area. The European Union offers examples of measures for ensuring competitive neutrality (Box 6.3).

Box 6.3. Good practice: Measures for ensuring competitive neutrality in the European Union

Countries that are members of the European Union or use the EU model often have a provision like Article 106 EC, setting the rules for entities that perform services of general economic interest or are granted special or exclusive rights. Broadly, Article 106 EC provides that the services performed by government entities, or private entities on behalf of the government, should be subject to the competition provisions of the EC Treaty – unless applying these rules obstructs the performance of the particular tasks assigned to them under the law. Article 106 EC states:

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 18 and Articles 101 to 109.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

The first characteristic of the EU approach is that the principle of neutrality was recognised in the Treaty of the European Union for more than 50 years. Article 106 of the Treaty clearly establishes that public companies fall under the scope of competition law, and that EU Member States are not entitled to do anything contrary to this rule. Public companies are also subject to rules on monopolisation and state aids (subsidies). The second characteristic of the system is that the Treaty empowers the European Commission with the tools to tackle problems concerning the economic activities of public-sector companies. The Commission can require Member States to apply competition rules to public companies. And, if a public company infringes competition rules, the Commission itself can issue a decision against that company requiring it to stop the conduct, and can impose fines. If the public company infringes competition law with the assistance of the government, or due to governmental influence (for example the government requiring the company to charge abusive prices), the Commission can address a directive or a decision to the Member State, requiring it to stop these practices.

In addition to Article 106 EC, the European rules on state aid and subsidies apply to all subsidies and state aids that Member States or other public bodies provide to any company, public or private. They are particularly important in the context of public companies, given the specific relationship public bodies have with public companies. State aids cover not only capital injections or grants, but also tax reductions or tax holidays, reductions in the social security costs and warranties. State aids are generally forbidden, though there are exceptions. The Member States are obliged to notify the Commission if they plan to grant state aid to any company. The Commission then scrutinises the planned measure and decides whether to authorise it. Another tool used by the Commission to achieve competitive neutrality between public and private firms is the Transparency Directive, 13, which concerns the financial relationships between public bodies and public companies. The Transparency Directive requires separate accountability. Public companies that have both commercial and non-commercial activities need to separate their accounts to demonstrate how their budget is divided between commercial and non-commercial activities. These tools have been used in many sectors, including the postal, energy and transport sectors.

Source: Capobianco and Christiansen (2011), "Competitive neutrality and state-owned enterprises: Challenges and policy options", http://dx.doi.org/10.1787/5kg9xfgjdhg6-en.

The way forward for ensuring a level playing field

Most of the assessed SEE economies have made good progress in simplifying and standardising the corporate forms under which their SOEs operate. However, more can be done.

The six SEE economies should, in line with the consensus broadly shared among OECD governments, as well as recent reform efforts in numerous economies, **continue the conversion of statutory corporations into joint stock and limited liability companies**. The reliance on specific corporate forms such as "public enterprises" may be justified by the non-financial objectives with which these SOEs are tasked, but it should be kept to a minimum. A strong driver for a level playing field is having SOEs that operate according to the same corporate and commercial legislation as any private-sector enterprise.

Transparency is a priority area for reform in the six SEE economies. A large number of SOEs in the SEE region mix commercial and non-commercial objectives, and are active in both competitive markets and "niche activities" conducted in the public interest. OECD experience shows that competitive neutrality can be significantly enhanced when, first, governments clarify the non-commercial objectives that SOEs are expected to fulfil and, second, ensure a degree of separation of these activity areas within the SOEs.

Ideally the assessed SEE economies would **operate commercial operations in the marketplace in separate corporate vehicles from the public interest activities**, but such a separation is often not feasible in practice. At a minimum, separate accounts should be kept, which will allow policy makers to ascertain the exact nature and cost of the SOEs' departures from normal commercial practices.

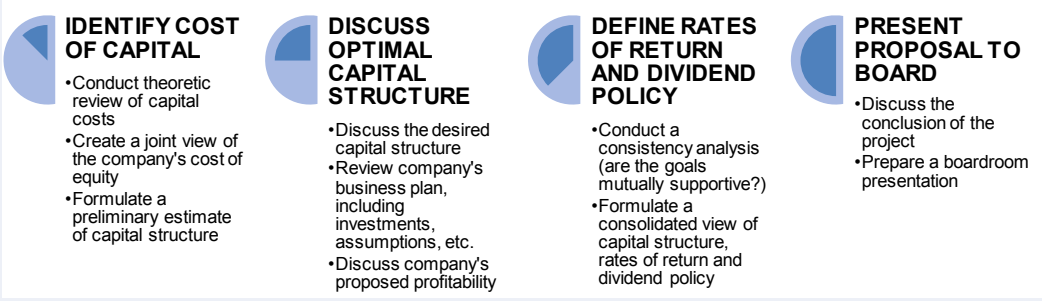
The funding and financing of SOEs among the assessed SEE economies need to be better aligned with commonly agreed good practices. SOEs that are commercially viable should be funded on market-consistent terms, should be expected to earn realistic returns on the state's invested capital and should pay regular dividends to the national treasury. A recent report by the OECD takes stock of national practices aimed at aligning SOE financing with private-sector practices (OECD, 2014b). Box 6.4 provides an overview of what is considered good practice for approaching SOE financing decisions.

Box 6.4. **Good practice approach to SOE financing decisions**

One of the fundamental policy tenets of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* is that SOEs should create value for their ultimate owners, the general public, through an efficient allocation of resources. For a good practice listed company, value creation implies that the returns on invested capital exceed the related costs of that capital (i.e. the returns required by shareholders and other providers of capital). Achieving such capital efficiency within SOEs can be challenging, in particular when there is insufficient clarity on the financial returns on SOEs' commercial activities and the non-financial – or "social*"* – returns on public policy activities. Good practice calls for structural separation between both types of activities and transparent compensation from the state budget for any public policy objectives that SOEs are expected to achieve (for example, universal service provision by the state-owned postal service operator).

Box 6.4. **Good practice approach to SOE financing decisions** (*continued*)

Other challenges occur when SOE financing decisions are no longer guided by the objectives of capital efficiency and value creation, but by state budgetary needs or ad hoc political objectives. Good practice calls for all decisions affecting SOEs' capital structure – ranging from rate-of-return requirements, to dividend pay-out levels, to the provision of state subsidies – to be taken with a view to achieving an optimal capital structure. The figure below illustrates what is considered a "good practice" process to guide decisions related to SOEs' capital structure. This approach notably takes into account the interdependence between capital efficiency, rate-of-return requirements and dividend pay-out levels.



Source: OECD (2014b), *Financing State-Owned Enterprises: An Overview of National Practices*, http://dx.doi.org/10.1787/9789264209091-en.

Conclusions

The assessed SEE economies have implemented some recent SOE reforms that have edged them towards internationally recommended good practices. Nevertheless, the efficiency and, hence, the contribution of SOEs to the competitiveness of these economies could clearly be enhanced. Many companies are loss making and few are currently expected to turn a profit comparable to private companies in similar circumstances. The options available to governments in this position are: reform the governance of SOEs to make them perform according to high corporate and commercial standards; privatise those SOEs that do not imperatively need to remain in state ownership; and, failing the above, liquidate certain companies. The current situation is complicated by the fact that several SOEs are still in the process of privatising, while some SOEs that remain in state ownership have been left over from from previous complicated privatisation programmes. The case for SOE reform is strong. First, privatisation often takes longer than envisaged, during which period the enterprises concern remain under public control and, as the case may be, a burden on public finances. Second, experiences from other post-transition economies indicate that the outcomes of privatisation processes are often better when governments establish specialised agencies – or empower specific ministerial departments – both to exercise ownership rights in SOEs and to spearhead privatisation processes. Third, restructured and well-functioning SOEs are often easier to privatise. With the possible exception of SOEs slated for trade-sale to a preferred buyer, enterprises that display good managerial, operational and transparency practices attract more bidders and higher revenues to the public purse.

Since the six SEE economies appear to be headed in the same direction as most OECD countries, namely towards SOE sectors that are strongly biased towards infrastructure and network industries, a priority area is to separate the state's ownership from other

functions. For instance, government ministries that are in charge of sectoral legislation and regulation bearing on the performance of SOEs should not also be responsible for the financial performance of these companies. If they are, onerous conflicts of interest may arise. A solution recommended by the OECD is to centralise government ownership into a specialised unit, or co-ordinating agency, which can exercise the ownership rights on behalf of the whole government rather than individual ministries.

Finally, SOEs' competitiveness is greatly enhanced by high levels of transparency. One aspect of transparency is the quality of financial reporting by individual SOEs – an area in which the assessed economies have made headway in recent years. Another important element is disclosure by the state as an owner, providing an overview of an economy's entire SOE portfolio and allowing third parties to assess its financial and non-financial performance as well as its governance arrangements. This aggregate reporting should include information about any requirements that SOEs are expected to fulfil in addition to commonly accepted corporate norms, as well as the cost and funding of such non-financial objectives. This is important both to ensure that SOE managers and their government owners can be held accountable for corporate performance, and to allow an informed assessment of whether or not SOEs compete with private enterprises on a level playing field.

Notes

1. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately. It should be noted that, here and in the following, the scores for Bosnia and Herzegovina have been developed by scoring the Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH) individually, and subsequently creating a combined score as an unweighted average of the two.

2. Ownership and control: the *SOE Guidelines* apply to enterprises that are under the control of the state, either by the state being the ultimate beneficiary owner of the majority of voting shares or otherwise exercising an equivalent degree of control. Examples of an equivalent degree of control would include cases where legal stipulations or corporate articles of association ensure continued state control over an enterprise or its board of directors in which it holds a minority stake. Some borderline cases need to be addressed on a case-by-case basis. For example whether a "golden share" amounts to control depends on the extent of the powers it confers on the state. Also, minority ownership by the state can be considered as covered by the Guidelines if corporate or shareholding structures confer effective controlling influence on the state (e.g. through shareholders' agreements). Conversely, state influence over corporate decisions exercised via bona fide regulation would normally not be considered as control. Entities in which the government holds equity stakes of less than 10% that do not confer control and do not necessarily imply a long-term interest

in the target company, held indirectly via independent asset managers such as pension funds, would also not be considered as SOEs. For the purpose of these Guidelines, entities which are owned or controlled by a government for a limited duration arising out of bankruptcy, liquidation, conservatorship or receivership, would normally not be considered as SOEs. Different modes of exercising state control will also give rise to different governance issues. Throughout the Guidelines, the term "ownership" is understood to imply control (OECD, 2015a).

3. Important additional insights can be gleaned from guidance publications such as OECD (2010).

4. The concrete citation relates to Montenegro, but it would apply equally to the other assessed SEE economies.

5. The *SOE Guidelines* go further in recommending the creation of an actual state ownership agency. However, this is often not politically feasible in practice and, at any rate, the recommendation depends on the economy in question having high standards of public-sector governance.

6. For a further description of alternative ownership models, see OECD (forthcoming).

7. For example, if non-commercial objectives are unclearly specified (and/or financed) the SOE management will be able to argue that almost any weak financial performance is due to the imposition of these objectives.

8. Provisions to this effect already exist in corporate or SOE laws in several SEE economies, but in actual practice politicians continue to have great powers over the hiring and firing of management in many SOEs.

9. Which did not include the six SEE economies.

10. This information was provided by a Serbian consultant working with the OECD Secretariat. It has not been independently verified.

11. EBRD (2015) made a similar point: SOEs and financial institutions, due to their role in the economy, should be expected to apply particularly high standards of transparency and disclosure.

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Annex 6.A1.
State-owned enterprises: Indicator scores

Table 6.A1.1. **State-owned enterprises: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Efficiency and governance						
Ownership policy and rationales	2.0	1.0	3.5	1.5	2.0	2.5
The exercise of ownership	2.0	1.0	3.5	1.5	2.0	2.5
Nomination of board members	2.0	2.0	3.5	2.0	2.0	2.0
Board independence and professionalism	1.0	2.0	2.5	2.0	2.5	2.5
Transparency and accountability						
Reporting and disclosure	3.0	3.0	4.0	2.5	3.0	3.5
Auditing practices	3.0	2.5	4.0	2.0	3.0	4.0
Equitable treatment of shareholders	4.0	3.0	3.0	3.5	4.0	2.5
Ensuring a level playing field						
Legal and regulatory treatment	4.0	1.0	4.0	3.5	3.5	4.0
Access to finance	2.0	1.5	2.0	2.0	2.0	3.0

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Chapter 7.

Education and competencies in South East Europe

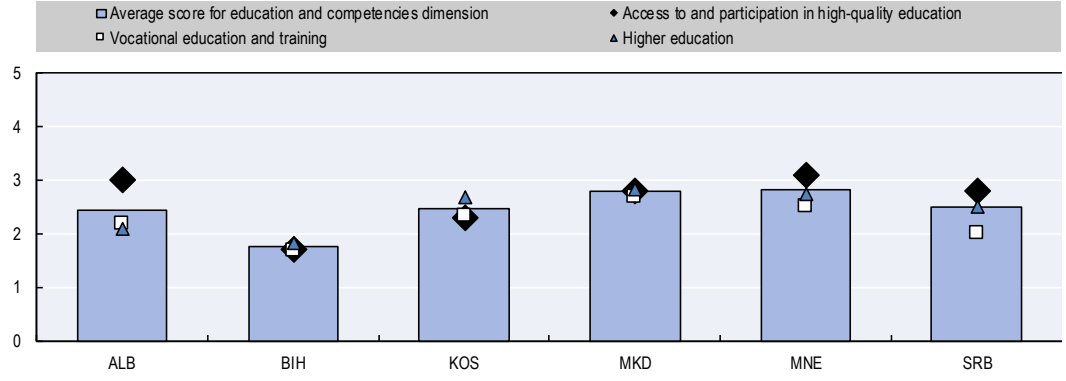
This chapter on education and competencies assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of education and competencies performance in South East Europe (SEE), including educational attainment, achievement in the Programme for International Student Assessment (PISA) and spending on education, the chapter then focuses on three essential sub-dimensions. The first sub-dimension, access to and participation in high-quality education, examines how early childhood education participation, teacher quality and equity in education shape education outcomes, and the extent to which SEE economies' policies improve equity, participation and the quality of education. The second, vocational education and training, analyses how the SEE economies are developing continuing education and training, fostering work-based learning and assuring the quality of vocational education and training. The third sub-dimension, higher education, assesses the implementation of national qualification frameworks, quality assurance, work-based learning (internship) and efforts to widen participation, as well as the development of career services and links with the private sector. The chapter includes suggestions for policy enhancements in each of these sub-dimensions in order to improve performance in education and competencies and to foster greater labour productivity, a long-term driver of competitiveness.

Main findings

A well-educated and competent workforce is central to competitiveness. In a global economy that is increasingly dependent on knowledge and skills, investment in education and competencies is critical to increase human capital and thus improve labour productivity, which is a long-term driver of economic competitiveness. Moreover, an educated and competent workforce is an important factor in attracting investment, integrating economies into global value chains and enabling the development of high-value added products and services.

On average, the six South East Europe (SEE) economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – achieve a score of 2.5 for the education and competencies dimension (Figure 7.1). This score signifies that they have adopted strategies to address the issues which are assessed through the 14 qualitative indicators of this dimension (see Figure 7.2 below). However, a score of below 3 indicates that policy implementation has not always followed suit and that policy monitoring and re-adjustment need to be further improved. Across all three sub-dimensions, the SEE economies are stronger in access to and participation in high-quality education, and higher education, than they are in vocational education and training.

Figure 7.1. **Education and competencies: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

No direct comparison with the 2016 *Competitiveness Outlook* assessment can be made, because the scope of the education and competencies dimension assessment framework has been changed from five to three sub-dimensions to provide a more in-depth assessment of education policies. The entrepreneurial learning sub-dimension of the *Competitiveness Outlook 2016* is also partially addressed in Chapter 8 (Employment). Nonetheless, the majority of the 2016 assessment's qualitative indicators were kept and redistributed across the three remaining sub-dimensions. Overall, the SEE economies

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

have made progress across the majority of these qualitative indicators. Quantitative findings have also confirmed this trend.

Achievements

All six reviewed SEE economies have recently adopted (or are about to adopt) updated national strategies to improve the quality of education and increase the competencies of the labour force. These new strategies are based on an assessment of the impact of previous strategies. These updated national strategies seek to improve the overall standard of education and/or address specific aspects of education, such as equity, vocational education and training (VET), and adult education.

All the economies have made progress in implementing their national qualifications frameworks and aligning them with the European Qualifications Framework (EQF). Over the period of this assessment, this has particularly been the case for the Former Yugoslav Republic of Macedonia and Kosovo.

The economies have made efforts to draw up policy frameworks that support equity in education. All six economies have recognised the importance of ensuring equitable access to, and participation in, education.

Remaining challenges and key recommendations

- **Increase expenditure on primary and secondary education;** the latter is considerably lower than in economies such as the Czech Republic, Poland and Slovenia, as well as OECD and EU-22[1] averages. The latest 2015 Programme for International Student Assessment (PISA) results for the participating SEE economies are well below those for peers from Central and Eastern Europe and the OECD average. One factor that explains this is the high percentage of secondary students who do not reach the baseline level of skills required for full socio-economic participation (PISA proficiency Level 2). Prioritising spending on primary and secondary education could help to ensure that all students reach this level.
- **Stimulate participation in early childhood education (ECE), for example by improving ECE provision and affordability.** Only 36.8% of children were enrolled in ECE on average in 2015, 58 percentage points below the EU average.
- **Invest more in increasing the attractiveness of the teaching profession and the participation of teachers in professional development programmes.** Teacher quality is one of the in-school factors that most determines students' learning outcomes. Yet the best candidates are not choosing the teaching profession and teachers in the SEE economies participate less often in professional development programmes than their peers in OECD countries.
- **Promote and strengthen work-based learning schemes like apprenticeships or internships.** PISA data show that vocational education is attracting disadvantaged students who have fallen behind at school. Increasing the share of students in work-based (in-company) learning remains a challenge. Co-operation between VET providers and higher education institutions, as well as businesses and social partners, needs to be reinforced.
- **Make efforts to reduce skills mismatches,** for example by fostering career guidance to direct students towards science, technology, engineering and mathematics (STEM) subjects, which have greater prospects for stimulating innovation. The

economies have an over-supply of graduates from the fields of business, administration and law, and an under-supply of STEM graduates.

Context

Education can be understood as a process that allows individuals to acquire the knowledge and skills required to perform specific tasks and to engage in a professional environment (UIC/OECD/EUROSTAT, 2002; UN, 2008). Competencies are broadly defined as "innate abilities …attitudes, skills and knowledge, applied to a certain context" (van der Klink and Boon, 2002: 4). As such, competencies can be considered as bridging the divide between education and employment. While competencies are normally acquired within educational institutions and programmes, they are also a result of an individual's work experience (e.g. tacit knowledge, and manual and technical skills).

To improve education and competencies is to build knowledge and skills for society as a whole. Theories of economic growth have pointed to education and human capital as key determinants of long-term growth, and several growth analyses models have suggested that relatively small improvements in the skills of an economy's labour force can have large impacts on future well-being (OECD, 2010a). For example, an OECD modelling exercise found that an increase in PISA scores in OECD countries by 25 points between 2010 and 2030 would increase the gross domestic product (GDP) of those countries by USD 115 trillion over the lifetime of the generation born in 2010 (OECD, 2010a).

This chapter looks at a broad range of strategies, action plans, laws, measures and institutions that influence educational attainment and the acquisition of competencies in SEE. Education and competencies are also closely related to other policy areas addressed in this publication, in particular:

- **Chapter 1. Investment policy and promotion** seeks to foster domestic and foreign direct investment (FDI), which depends on a skilled local workforce.
- **Chapter 2. Trade policy and facilitation** aims to better integrate economies with dynamic global value chains, which generates both opportunities and risks for education systems.
- **Chapter 8. Employment** policy is tailored to the quality of the labour force, which is largely determined by the education system and training programmes. Employment rates are very closely related to education levels and unemployment predominantly affects the poorly educated. Higher levels of educational attainment and skills, by contrast, bring substantial returns, such as higher employment rates and relative earnings (OECD, 2017a).
- **Chapter 9. Science, technology and innovation** are decisive factors for improving the allocation of scarce resources and for identifying new solutions to social and economic challenges. Science, technology and innovation rely on high-quality professionals to act as scientists, technicians and innovators.

Education and competencies assessment framework

This chapter analyses education and competencies in the SEE region by assessing three broad sub-dimensions:

1. Access to and participation in high-quality education: how do early childhood education participation, teacher attraction, professional development, and equity in education shape education outcomes? How, and to what extent, do SEE economies' policies improve equity, participation and the quality of education?
2. Vocational education and training: to what extent do SEE economies foster work-based learning schemes and quality assurance in VET and make it an attractive and demanding option? How advanced is the development and implementation of continuing education and training in SEE?
3. Higher education: to what extent have national qualification frameworks (NQFs) been implemented? How effectively do higher education (HE) quality assurance agencies work? To what extent have SEE economies implemented work-based learning (internship) schemes? How do SEE economies seek to widen participation in higher education? To what extent have SEE economies implemented policies to strengthen career orientation services and linkages between higher education institutions and businesses?

Figure 7.2 shows how the three sub-dimensions and their constituent indicators make up the education and competencies assessment framework. Each sub-dimension is assessed through quantitative and qualitative indicators, with quantitative data based on national and international statistics. Information on the qualitative indicators was collected by the OECD through a questionnaire addressed to government officials in the relevant ministries and agencies. The performance of SEE economies has been scored in ascending order on a scale of 0 to 5, summarised in Annex 7.A1.[2] For more details on the methodology underpinning this assessment, please refer to the methodology chapter.

Education and competencies performance in SEE economies

A high standard of education and competencies can have many benefits for an economy and society. The levels of higher education and skills in an economy's labour force are important for its ability to innovate, maximise productivity and move up the value chain.

The economic growth in a country or sector can be ascribed either to increased employment or to more efficient work, i.e. labour productivity. Labour productivity, in other words, is a key measure of economic performance and competitiveness. Figure 7.3 shows that labour productivity, as measured by GDP per person employed, was lower in the SEE economies than the EU or OECD average between 2012 and 2016. On average,[3] the SEE economies' GDP per person employed was only 43% of the OECD average in 2016. However, while labour productivity grew by 3.2% in OECD countries during 2012-16, it increased by an average of 6.9% in the SEE economies over the same period. Albania, Montenegro, and Bosnia and Herzegovina saw the strongest increases, of 14.5%, 12.2% and 8.4% respectively. Labour productivity growth in the Former Yugoslav Republic of Macedonia was similar to the OECD (3.2%) and EU (3.5%) averages, increasing by 4%, while labour productivity fell by 5.2% in Serbia. This drop is the result of an increase in Serbia's employment rate of 7 percentage points between 2012 and 2015 (see Chapter 8, Figure 8.3) which surpassed its GDP growth. However, Arsić and Anić (2017) point out that this fall in labour productivity was in reality smaller; when figures from the Central Registry of Compulsory Social Insurance are used instead of Serbia's Labour Force Survey data, then the increase in the employment rate seems to be less pronounced.

Figure 7.2. **Education and competencies assessment framework**

Education and competencies dimension

Outcome indicators
- GDP per person employed
- Highest educational attainment by gender
- Mean scores in science, reading and mathematics (PISA 2015)
- Share of low achievers in science, reading and mathematics (PISA 2015)
- Public expenditure on education (as share of GDP), by level of education

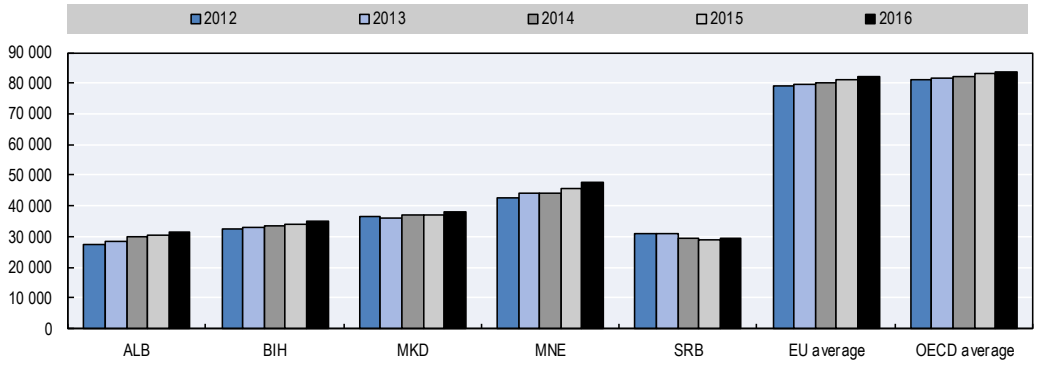
Sub-dimension 1 Access to and participation in high-quality education	**Sub-dimension 2** Vocational education and training	**Sub-dimension 3** Higher education
Qualitative indicators 1. Early childhood education 2. Teacher recruitment 3. Professional development of teachers 4. Equitable access to compulsory education 5. Strategies to prevent early school leaving	**Qualitative indicators** 6. Work-based learning (apprenticeships) 7. Quality assurance agency in VET 8. Continuing education and training	**Qualitative indicators** 9. Implementation of national qualifications framework 10. Quality assurance agency in higher education 11. Work-based learning (internships) 12. Career orientation services 13. Policy approach to improve equity in access to higher education 14. Higher education and entrepreneurship
Quantitative Indicators 1. Participation rate in early childhood education 2. Shortage of teaching staff (PISA 2015) 3. Minimum/maximum monthly teacher salary 4. Participation in professional development activities (PISA 2015) 5. Percentage of variance in student performance in science explained by PISA index of economic, social and cultural status (PISA 2015) 6. Percentage of resilient students among disadvantaged students (PISA 2015) 7. Early leavers from education and training, by gender	**Quantitative Indicators** 8. Enrolment in pre-vocational or vocational education (PISA 2015) 9. Enrolment in pre-vocational or vocational education by school socio-economic profile (PISA 2015) 10. Enrolment in a pre-vocational or vocational programme and science performance (PISA 2015) 11. Adult participation in learning	**Quantitative Indicators** 12. Employment rate of higher education graduates compared to the whole labour force

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 7.4 shows levels of educational attainment in the working-age population (aged 15 years and over) by gender. The share of tertiary-educated individuals in SEE is on average almost 10 percentage points below the EU average, while the share of the population educated only up to primary and lower secondary level is, on average, larger in the SEE economies (37.9%) than in the EU (29.7%). The proportion of women who are only educated up to this level is particularly high in the SEE economies, averaging 42.8% of the population, almost 10 percentage points above the share of men in this group. Kosovo has the largest gender gap between

women and men for this measure, with the share of women who did not attain upper secondary education 23.4 percentage points higher than that of men.

Figure 7.3. **GDP per person employed**

Constant 2011 PPP USD



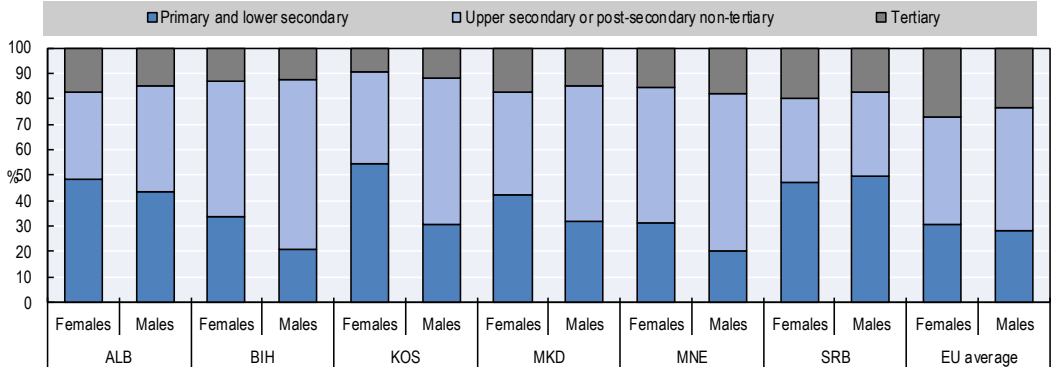
Note: Data for Kosovo are not available; PPP – purchasing power parity.

Source: ILO (2017), *ILOSTAT* (database), www.ilo.org/ilostat.

StatLink http://dx.doi.org/10.1787/888933704017

Figure 7.4. **Highest educational attainment by gender (2015)**

% of working-age population 15 years old and over



Note: 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. Data for Bosnia and Herzegovina are for 2014. Data for Montenegro are for 2012. EU-28 average calculated as a simple average by the author.

Source: Adapted from ILO (2017), *ILOSTAT* (database), www.ilo.org/ilostat.

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Higher levels of educational attainment are generally associated with positive social and economic outcomes for individuals, such as better health, higher employment rates, higher relative earnings and greater social engagement (OECD, 2017a). However, one should keep in mind that the link between educational attainment and actual proficiency is complex and that education systems differ in certain characteristics, such as their selectivity and content of curricula, particularly at higher levels of education (OECD,

2016a). Data from the OECD Programme for the International Assessment of Adult Competencies (PIAAC) show that adults educated up to upper secondary education in one country can have higher levels of proficiency than those who completed tertiary education in another (OECD, 2016a).

Four of the SEE economies (Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro) participated in the 2015 Programme for International Student Assessment (PISA). Serbia did not participate in the 2015 assessment, but did take part in 2012. The PISA results are helpful for assessing and comparing the outcomes of education policies (Box 7.1). For this reason, the expected participation of all six economies in the 2018 PISA assessment will be an important step forward for informing education policy making in the future.

The 2015 PISA results found that all the participating SEE economies have room to improve the quality of their science, reading and mathematics education. They scored well below the EU and OECD averages and those of selected OECD peers from Central and Eastern Europe (Figure 7.5)

Box 7.1. **Programme for International Student Assessment**

The Programme for International Student Assessment (PISA) is a triennial survey that assesses the extent to which 15-year-old students near the end of compulsory education have acquired key knowledge and skills that are essential for full participation in modern societies. The assessment does not just ascertain whether students can reproduce knowledge; it also examines how well they can extrapolate from what they have learned and apply that knowledge in unfamiliar settings, both inside and outside school.

Key features of PISA 2015:

- The PISA 2015 survey focused on science, with reading, mathematics and collaborative problem solving as minor areas of assessment. For the first time, PISA 2015 delivered the assessment of all subjects via computer. Paper-based assessments were provided for countries that chose not to test their students by computer, but the paper-based assessment was limited to science, reading and mathematics.

The students:

- Around 540 000 students completed the assessment in 2015, representing about 29 million 15-year-olds in 72 participating countries and economies.

The assessment:

- Computer-based tests were used, with assessments lasting a total of two hours for each student.
- Test items were a mixture of multiple-choice questions and questions requiring students to construct their own responses. The items were organised in groups, based on a passage setting out a real-life situation. About 810 minutes of test items were covered, with different students taking different combinations of test items.
- The PISA assessment has established a reporting scale of proficiency levels in the different domains, which are limited by score point thresholds. Proficiency Level 2 is constructed as the baseline level and indicates the proficiency all students should be expected to achieve by the time they leave compulsory education.

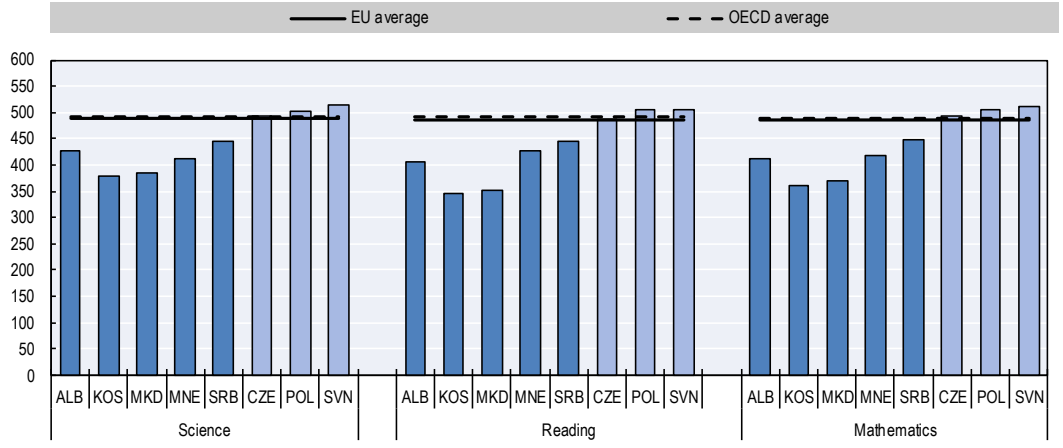
Box 7.1. **Programme for International Student Assessment** (*continued*)

- Students also answered a background questionnaire, which took 35 minutes to complete. The questionnaire sought information about the students themselves, their homes, and their school and learning experiences. School principals completed a questionnaire that covered the school system and the learning environment. For additional information, some countries/economies decided to distribute a questionnaire to teachers. It was the first time that this optional teacher questionnaire was offered to PISA-participating countries/economies. In some countries/economies, optional questionnaires were distributed to parents, who were asked to provide information on their perceptions of and involvement in their child's school, their support for learning in the home, and their child's career expectations, particularly in science. Countries could choose two other optional questionnaires for students: one asked students about their familiarity with and use of information and communications technology (ICT); and the second sought information about students' education to date, including any interruptions in their schooling, and whether and how they are preparing for a future career.

Source: OECD (2017b), "What is PISA?", http://dx.doi.org/10.1787/9789264281820-2-en.

Figure 7.5. **PISA 2015 performance in science, reading and mathematics**

Mean scores



Note: Results for Serbia are from 2012. Data for Bosnia and Herzegovina are not available. CZE – Czech Republic; POL – Poland; SVN – Slovenia.

Source: OECD (2016b), *PISA 2015 Results (Volume I): Excellence and Equity in Education*, http://dx.doi.org/10.1787/978926426649; OECD (2014a), *PISA 2012 Results: What Students Know and Can Do (Volume I, Revised edition, February 2014): Student Performance in Mathematics, Reading and Science*, http://dx.doi.org/10.1787/9789264208780-en.

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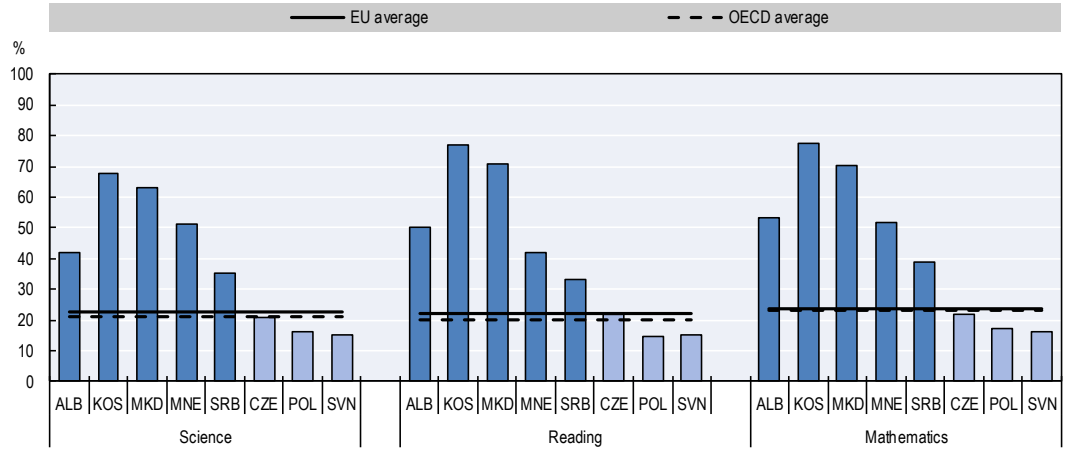
Albania and Montenegro have seen positive developments since previous PISA assessments. In science, Albania's mean performance improved by 37 score points between 2009 and 2015, the third largest improvement among the 59 education systems with comparable data. The improvement is even more remarkable given that the share of 15-year-olds in Albania who are covered by the PISA sample increased from 61% to 84%. Albania's and Montenegro's mean performance in reading has improved about

20 score points since 2009, among the largest improvements across the education systems with comparable data. In mathematics, Albania's mean performance has improved 36 score points since 2009, the largest improvement among the 57 education systems with comparable data, while Montenegro's average performance has improved by 19 score points since 2006.

The PISA assessment has established a scale of proficiency levels for the different domains. For example, in science, Level 2 – the baseline level – means students can draw on their knowledge of basic content and procedures to identify an appropriate explanation, interpret data, and identify the question being addressed in a simple experiment. All students should be expected to attain Level 2 by the time they leave compulsory education. Figure 7.6 shows the percentage of low achievers in the assessed economies, i.e. the percentage of students scoring below Level 2.

Figure 7.6. **PISA 2015 low achievers in science, reading and mathematics**

% of students scoring below Level 2



Note: Results for Serbia are from 2012. Data for Bosnia and Herzegovina are not available. CZE – Czech Republic; POL – Poland; SVN – Slovenia.

Source: OECD (2016b), *PISA 2015 Results (Volume I): Excellence and Equity in Education*, http://dx.doi.org/10.1787/978926426649; OECD (2014a), *PISA 2012 Results: What Students Know and Can Do (Volume I, Revised edition, February 2014): Student Performance in Mathematics, Reading and Science*, http://dx.doi.org/10.1787/9789264208780-en.

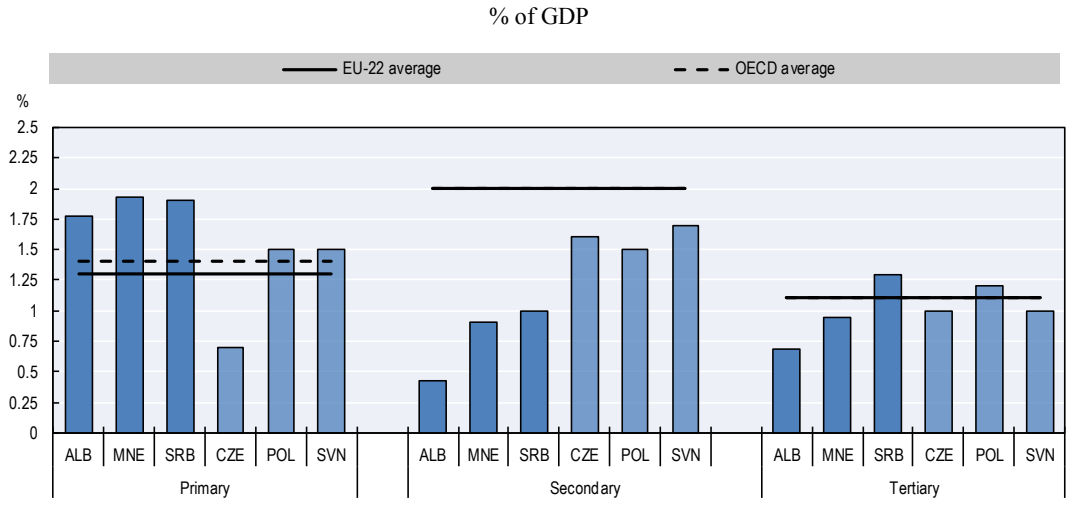
StatLink http://dx.doi.org/10.1787/888933704074

Among the participating SEE economies, in 2015 at least 40% of students were low achievers in science, ranging from 42% in Albania to 68% in Kosovo (Figure 7.6). Low achievers in reading range from 42% in Montenegro to 77% in Kosovo, and in mathematics from 52% in Montenegro to 78% in Kosovo. These figures are high, particularly in comparison to the OECD and EU averages of about 20%.

The resources that economies allocate to education explain some of the variation in education outcomes (OECD, 2017a). For example, in countries where educational expenditure is below a certain threshold – cumulative spending per student between 6 and 15 years of around USD 50 000 in purchasing power parity (PPP) terms – higher spending is associated with better student performance in reading (OECD, 2017a). No comparable data for spending per student are available for the SEE economies, but the

data on public expenditure on education as a share of GDP indicate that Albania, Montenegro and Serbia spend more on primary education than the OECD average – amounting to an average difference of 0.47 percentage points of GDP (Figure 7.7). Conversely, these three economies spend on average much less on secondary education than the OECD and EU-22 average, a difference of 1.22 percentage points of GDP (OECD, 2017a).

Figure 7.7. **Public expenditure on education by level of education (2014)**



Note: EU-22 average refers to the 22 Member States of the European Union which are also members of the OECD: Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxembourg, the Netherlands, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden and the United Kingdom. Data for Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo not available. National statistical offices and ministries of the SEE region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17. CZE – Czech Republic; POL – Poland; SVN – Slovenia.

Source: Albanian Ministry of Education, Sports and Youth, national statistical offices of Montenegro, and Serbia; OECD (2017a), *Education at a Glance 2017: OECD Indicators*, http://dx.doi.org/10.1787/eag-2017-en.

StatLink http://dx.doi.org/10.1787/888933704093

Findings from the 2015 PISA assessment confirm that these spending patterns have an impact, for example on the material resources of schools. Compared to principals in other school systems, more principals in Albania, Kosovo and Montenegro are concerned about the quality and the lack of material resources in their schools. Most strikingly, in Kosovo 43% of students attend schools where administrators agree that the capacity to provide instruction is hindered a lot by the lack of educational material (OECD, 2016c). In Albania and Montenegro these figures are 18% and 14% respectively, while the share for the Former Yugoslav Republic of Macedonia is close to the OECD average of 6%. In the Czech Republic, Poland and Slovenia, less than 3% of students attend such schools (OECD, 2016c). There are 0.77 computers for every student on average across OECD countries, a higher ratio than in Albania (0.15), the Former Yugoslav Republic of Macedonia (0.63), Kosovo (0.14) and Montenegro (0.20). The Former Yugoslav Republic of Macedonia has a higher ratio of computers per students than Slovenia (0.59) and Poland (0.46), however (OECD, 2016c). This higher ratio of computers per student indicates that dedicated government programmes are bearing fruit – such as the

"Computer for Every Child" initiative, supported by international donors and partners, including the United States Agency for International Development (USAID).

These outcome indicators reveal the need for policy efforts among the SEE economies to raise their populations' skill levels. It is encouraging that labour productivity rose faster than the OECD averages between 2012 and 2016, but the increase has not been equal across all economies, and labour productivity even declined in Serbia over this period. In Albania, Kosovo and Serbia, more than 40% of the working-age population is only educated up to primary or lower secondary level, with a relatively large gender gap in educational attainment in Kosovo. Although public spending on primary education is higher than the OECD average relative to GDP in the three SEE economies for which data were available, spending on secondary education is much lower. Despite improvement in Albania and Montenegro, PISA results are still well below the OECD and EU averages. The high share of students who did not reach the baseline proficiency level in science, reading and mathematics is particularly alarming and calls for policy action.

Access to and participation in high-quality education

This sub-dimension gauges the extent to which SEE economies are taking steps to ensure equitable access to, and participation in, high-quality education. To this end, it uses five qualitative indicators:

The **early childhood education indicator** measures SEE economies' ECE frameworks and strategies against five key ECE policy levers, identified by the OECD, and assesses how far they are implemented and monitored. These are: 1) setting out quality goals and regulations; 2) designing and implementing curricula and standards; 3) improving qualifications, training and working conditions; 4) engaging families and communities; and 5) advancing data collection, research and monitoring (OECD, 2011).

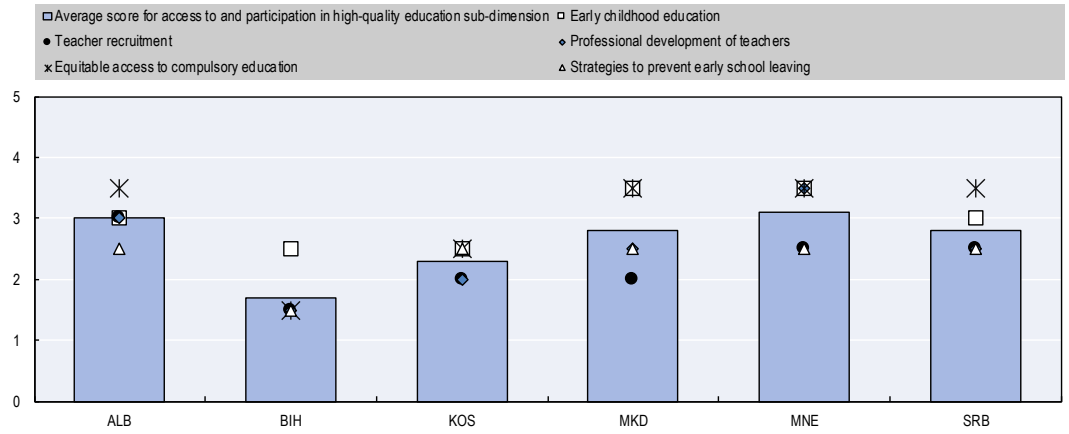
The **teacher recruitment** indicator gauges the development and implementation of policies that affect teacher recruitment and retention at all education levels, while the **professional development of teachers** indicator assesses whether teachers receive regular training and other opportunities to improve teaching quality.

The **equitable access to compulsory education** indicator measures the extent to which education policies foster equity through more and better support for disadvantaged students (e.g. children from socio-economically disadvantaged families or minorities). It assesses the extent to which policies have been designed and implemented to provide systematic support measures for those who fall behind at school, to strengthen links between schools and parents of disadvantaged pupils, and to provide resources direct to the students with the greatest needs.

The **strategies to prevent early school leaving** indicator assesses the extent to which the six SEE economies have adopted and implemented measures to reduce early school leaving. Ideally, these measures or existing legal frameworks should help eliminate the conditions that lead to early school leaving (prevention); address difficulties encountered by pupils as soon as they arise (intervention); and offer opportunities for education and training to pupils who have dropped out (compensation).

On average, the six SEE economies score 2.6 out of 5 for this sub-dimension (Figure 7.8). This means they have adopted strategies to improve these aspects of access to high-quality education and have started to implement them.

Figure 7.8. **Access to and participation in high-quality education: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933704112

Enrolments in and quality of early childhood education need to improve

Early childhood education (ECE) refers to "all forms of organised and sustained centre-based activities – such as pre-schools, kindergartens and day-care centres – designed to foster learning and emotional and social development in children [and] are generally offered to children from the age of three" (OECD, 2013: 1).

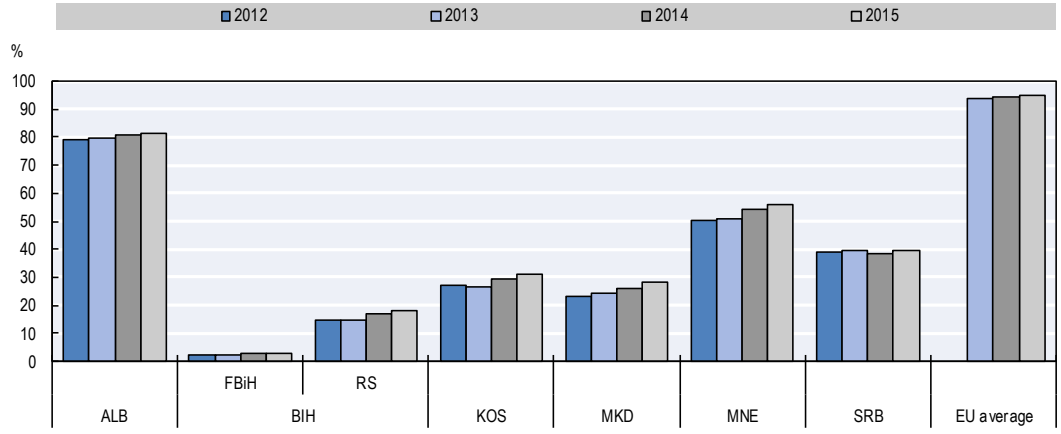
Participation in ECE promotes better student outcomes, mitigates social inequalities and can help children to get ready to enter and succeed in formal schooling (OECD, 2017a). A growing body of research has documented that children who have a strong start in their learning, development and well-being have better outcomes as they grow older (Duncan and Magnuson, 2013).

Although participation in ECE increased in SEE between 2012 and 2015, it is still well below the EU average (Figure 7.9). In 2015, only 36.8% of children were enrolled in ECE in SEE on average, 58 percentage points below the EU average.

As countries seek to further expand ECE, it is important to consider parents' expectations and needs in terms of accessibility, cost, programmes, staff quality and accountability (OECD, 2014b). The range of scores for the early childhood education indicator, from 2.5 to 3.5 (Figure 7.8), indicates that some SEE economies are more advanced than others when it comes to the development or application of the five ECE policy levers described above, as well as the implementation of actions to improve ECE quality, and the monitoring of those actions. Generally, all SEE economies have taken steps to increase enrolment in ECE and to ensure good-quality ECE services. This is reflected in an average score of 3 for this indicator. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Montenegro have adopted dedicated ECE or pre-school strategies. In Albania, Kosovo and Serbia, ECE objectives and corresponding actions are included in comprehensive education strategies. Kosovo and Bosnia and Herzegovina achieve a score of 2.5 for this indicator, reflecting that they have a framework to improve ECE quality which addresses most of the policy levers, but that there is room for stronger action when it comes to implementation. However, in 2017 both economies adopted strategies seeking to improve ECE quality.

Figure 7.9. **Participation rate in early childhood education**

% of children aged from 3 to age of compulsory primary education



Note: The EU average reflects the percentage of children aged 4 to the age of compulsory education as a share of the corresponding age group. Government statistical offices and ministries of the SEE region provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska, and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina, and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

Source: SEE statistical offices and EC (2017a), *Eurostat* (database), http://ec.europa.eu/eurostat/data/database.

StatLink http://dx.doi.org/10.1787/888933704131

The Former Yugoslav Republic of Macedonia and Montenegro scored 3.5 for this indicator; implementation of their respective ECE objectives is advancing according to their timelines and they have made efforts to further enhance ECE monitoring.

Montenegro's Strategy of Early and Preschool Education 2016-20 includes an action plan with an implementation timeline and budget allocation for each activity. It includes the development of programme quality standards with indicators for monitoring and evaluation, as well as targets to improve pre-service training, and professional development of staff. It also seeks to improve monitoring, supervision and counselling services for ECE staff and to set up teacher groups, networks of practitioners and models for exchanging good practice. The strategy also includes continuous activities which seek to raise awareness of ECE's importance and which aim to engage with parents and communities. Implementation of the action plan is monitored by the Ministry of Education and the Bureau for Education Services, which meet quarterly to assess progress; it is also monitored externally by the United Nations Children's Fund (UNICEF).

In the Former Yugoslav Republic of Macedonia, UNICEF is also supporting ECE, including activities to strengthen the capacities and effectiveness of ECE inspection services responsible for quality control, notably by introducing indicators for quality control. This initiative will help to ensure that in the future, norms and standards will be applied more consistently across public ECE institutions.

Serbia will benefit from the support of the World Bank in the framework of the Inclusive Early Education and Care project, which was approved in February 2017 and which will help the country to increase ECE provision, in particular in rural areas.

Teacher recruitment and professional development can increase their focus on teaching quality

The availability of high-quality teachers does not seem to be a particular concern for school principals in SEE, at least compared to OECD countries, and is much less of a concern than the lack of material resources in their schools. For instance, the percentage of students in schools whose principal reported that the capacity to provide instruction was not at all hindered by a lack of teaching staff was considerably higher than the OECD average of 39% in Albania (62%), Kosovo (49%), the Former Yugoslav Republic of Macedonia (88%) and Montenegro (72%) (OECD, 2016c).

However, "improving the efficiency and equity of schooling depends, in large measure, on ensuring that competent people want to work as teachers, that their teaching is of high quality, and that all students have access to high quality teaching" (OECD, 2005: 7). In this regard, the SEE economies should consider introducing more stringent admission criteria for initial teacher education (Skikos, 2013). Teachers' salaries also play an important role since they affect people's decisions as to whether to enrol in teacher education, whether to become a teacher after graduation and whether to remain in the profession (OECD, 2005; 2017a), thus ensuring that those with the greatest ability to teach choose that career path (OECD 2017c).

Figure 7.10 compares primary and secondary teachers' minimum/maximum monthly gross statutory salary to average monthly nominal wages[4] in 2015 for the four SEE economies for which data are available. Lack of data meant it was not possible to compare teachers' salaries with the average salary of the tertiary-educated workforce overall. Nonetheless, relating teachers' salaries to the average nominal salaries is still informative when comparing the ratios across SEE economies, the EU-6[5] and the ten Central and Eastern European countries (CEEC-10) who joined the EU.[6] Teachers' maximum monthly salaries in the four SEE economies are, on average, only 19.3% higher than the average nominal monthly wage. This gap is lower than in the EU-6, where teachers' maximum salary is on average 89 percentage points higher than the average nominal monthly wage (Figure 7.10). However, compared to the CEEC-10 average nominal wage, teachers in the four economies receive higher pay, both at the beginning and the end of their careers.

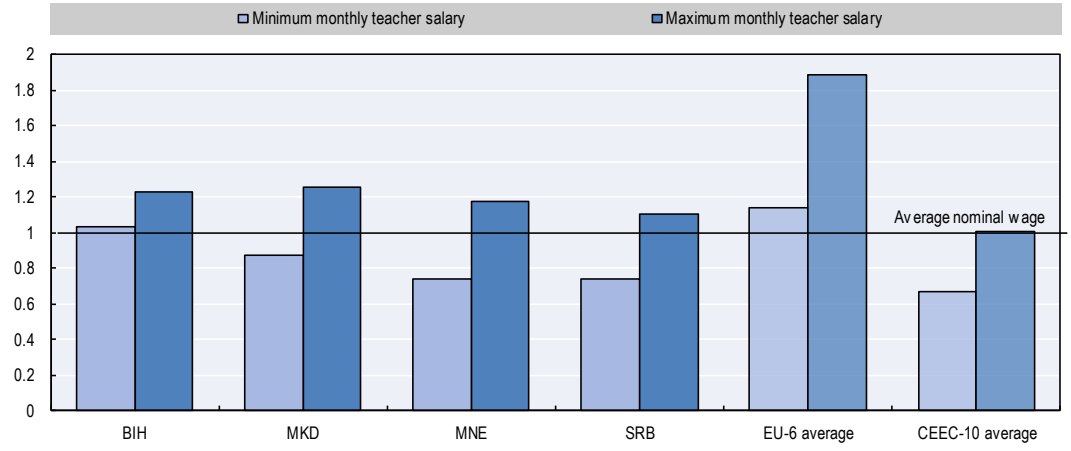
Since compensation and working conditions are important factors influencing whether schools can attract and retain skilled, high-quality teachers, policy makers should take teachers' pay into careful consideration as they seek to ensure quality teaching and sustainable education budgets (OECD, 2017a).

On average, the six SEE economies achieve a score of 2.2 for the **teacher recruitment** indicator (Figure 7.8). At over 2, this average score indicates that the economies have legislation in place that governs teacher recruitment at all education levels and that public education systems provide clear profiles of what teachers are expected to know and do. In addition, teacher education systematically combines subject knowledge, pedagogical knowledge and classroom experience. All the SEE economies have formal probationary periods and mentorships for new teachers.

All six SEE economies have included objectives and measures on teacher recruitment in their respective education strategies and accompanying action plans, although not all of the action plans have clear implementation timelines or budget allocations. In 2016, Montenegro adopted a dedicated strategy on teacher education, the Strategy of Teacher Education in Montenegro (2017-24).

Figure 7.10. **Minimum and maximum monthly teachers' salaries (2015)**

As ratios of average nominal wage



Note: Minimum/maximum monthly teacher salary refers to the minimum/maximum basic gross statutory salary for teachers in 2015. It has been calculated as the average of the minimum/maximum salary across primary (ISCED 2011 level 1) and secondary (ISCED 2011 levels 2 and 3) education. EU-6 – Belgium, France, Germany, Italy, Luxembourg and the Netherlands. CEEC-10 – Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The EU and CEEC averages have been calculated as simple averages using 2015 data or the most recent data available. Due to unavailability of more recent data, average nominal wages for Montenegro are for 2014. Teacher salaries have been converted from EUR to USD using the 2015 exchange rate available at UNCTADSTAT. Average nominal wages have been converted from local currencies to USD using the 2015 exchange rates available at UNCTADSTAT. Data for Albania and Kosovo are not available.

Source: Adapted from EC (2015a), *Teachers' and School Heads' Salaries and Allowances in Europe 2014/15*, http://eacea.ec.europa.eu/education/eurydice/documents/facts_and_figures/188EN.pdf; ILO (2016), *Global Wage Report 2016/2017: Wage Inequality in the Workplace*, www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_537846.pdf; UNCTAD (2017), *UNCTADSTAT* (database), http://unctadstat.unctad.org.

StatLink http://dx.doi.org/10.1787/888933704150

Although all economies have legislation in place regulating teacher recruitment, as well as objectives and measures in strategy documents, stakeholders reported that there were still major obstacles to recruiting the most talented individuals with the skills and motivation to teach. In the Former Yugoslav Republic of Macedonia, stakeholders reported that the teaching profession suffered from a poor image, in part caused by low salaries. For that reason, it was reported that the students entering teacher education had often performed below average in their high school exams. In Kosovo and the Former Yugoslav Republic of Macedonia, stakeholders argued that teacher recruitment processes were in some cases biased by political party affiliations, which implies that it is a desirable profession. In Serbia, stakeholders described that the ban on public-sector hiring, instituted in 2013, has led to a massive increase in part-time employment of teachers, affecting salaries. This situation will make it difficult to attract the most qualified secondary school graduates into the teaching profession.

Just like practitioners in any other profession, teachers need to keep up to date with advances in their fields, new ways of teaching and theories about how children learn, and curricular changes (OECD, 2016c). **Professional development of teachers** also helps

them to deepen and enhance existing practices in the classroom, for example adapting to students' diverse needs or mastering different ways to teach certain content.

Across OECD countries, school principals reported that, on average, about 51% of teachers had attended a professional development programme in the three months prior to the PISA assessment (OECD, 2016c). This is lower than in Albania (58%), but higher than in the Former Yugoslav Republic of Macedonia (16%), Kosovo (29%) and Montenegro (41%). The average score of 2.5 for the professional development of teachers indicator reflects the fact that all six SEE economies have legislation in place to govern the formal provision of teachers' participation in continuous professional development training (Figure 7.8). In almost all the economies, this legislation specifies the minimum time teachers need to participate in professional development per year. The average score also reflects the fact that in all of the economies the relevant strategy documents include objectives and measures to further improve the continuing professional development of teachers, although how implementation of those measures will advance still remains to be seen.

However, the SEE economies also need to focus on the relevance and applicability of professional development programmes, the capacity of training providers, and the systematic evaluation of teaching performance if they are to guarantee high teaching quality (Skikos, 2013).

Identifying teachers' development needs and providing the most relevant training are still challenges. Some of the economies have conducted noteworthy initiatives in this regard. Following a major reform in 2004, there are professional development teams in every Montenegrin school at every level of education. The co-ordinators of those teams work directly with the school's management and the Bureau of Education Services to create professional development plans for the school, which also feed in to the professional development plans at the state level. In Serbia, the Institute for Improvement of Education, together with other partner institutions undertook a large-scale assessment of teachers' professional development needs in 2016. Similarly, in Albania, 17 613 teachers and directors economy-wide were assessed in November 2015 and January 2016, by means of paper and computer-based tests, in order to identify their professional development needs.

Even so, all the SEE economies could do more to regularly address teachers' professional development needs, thus improving the overall quality of teaching. In Kosovo, for example, stakeholder interviews revealed that schools' capacities to identify teachers' training needs were limited in some municipalities, as were the corresponding budgets. Stakeholders in Serbia also highlighted that the lack of sufficient budget in some local governments was a major obstacle to a fully functioning system of teacher professional development.

Equity is improving in SEE education systems

Greater equity in education pays off – for society and individuals alike – with lower rates of school failure contributing to economic growth and social well-being (OECD, 2012). The highest-performing education systems combine quality with equity (OECD, 2012). Equity in education means that students' personal or social circumstances – such as gender, ethnic origin or family background – are not obstacles to realising their educational potential.

Results from the 2015 PISA assessment reveal that in the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro, between 5% and 7% of the variation in science performance is attributed to differences in students' socio-economic status, compared to 13% across OECD countries (OECD, 2016b). However, bearing in mind the high percentage of PISA low achievers in the participating SEE economies, discussed above, this finding should not be overvalued.

Student resiliency can be used as one proxy for how education systems succeed in promoting equity. In PISA, resilient students are "disadvantaged students within their countries and economies who beat the socio-economic odds against them and perform in the top quarter of students across all participating countries and economies after taking socio-economic status into account" (OECD, 2016b: 235). Fewer than one in ten disadvantaged students in the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro were top performers in PISA after taking socio-economic status into account (Table 7.1). Of all the countries and economies participating in the 2015 PISA assessment with comparable data, Kosovo ranked second lowest, the Former Yugoslav Republic of Macedonia fourth lowest and Montenegro twelfth lowest.

Table 7.1. **Percentage of resilient students among disadvantaged students (2015)**

KOS	MKD	MNE	CZE	OECD average	POL	SVN
2.5	4.1	9.4	24.9	29.2	34.6	34.6

Note: Students are classified as resilient if they are in the bottom quarter of the PISA index of economic, social and cultural status (ESCS) in the country/economy of assessment, and in the top performing quarter of students among all countries/economies, after accounting for socio-economic status. Data for Albania, Bosnia and Herzegovina, and Serbia are not available. CZE – Czech Republic; POL – Poland; SVN – Slovenia.

Source: OECD (2016b), *PISA 2015 Results (Volume I) Excellence and Equity in Education*, http://dx.doi.org/10.1787/9789264266490-en.

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In general, the six economies have placed great importance on providing equitable access to compulsory education, and have benefitted from many donor-funded projects in this area. The importance they attach to this is reflected in an average score of 3 for the equitable access to compulsory education indicator. All of them have adopted a strategic approach to guaranteeing equitable access to education (Figure 7.8).

The economies scoring above average for this indicator (Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia) have strategies in place to foster equitable access for disadvantaged students. They also provide support measures for those at risk of falling behind at school, provide some form of direct resources (in most cases in the form of free school transport and free textbooks), and seek to strengthen links between schools and parents of disadvantaged pupils. These economies also monitor the implementation of their strategies on equity in education. However, stakeholders noted that the monitoring is not always effective and that school coverage in rural areas does not always ensure equitable access to education.

In Kosovo, the Kosovo Education Strategic Plan 2017-21 provides an implementation timeline and budget allocation for the various activities seeking to increase inclusion of disadvantaged students in the education system. In 2016 Kosovo carried out numerous projects to increase inclusion in education in co-operation with international donors (though the large number may increase the challenge of co-ordinating all those projects effectively). It still remains to be seen how implementation of the measures in the

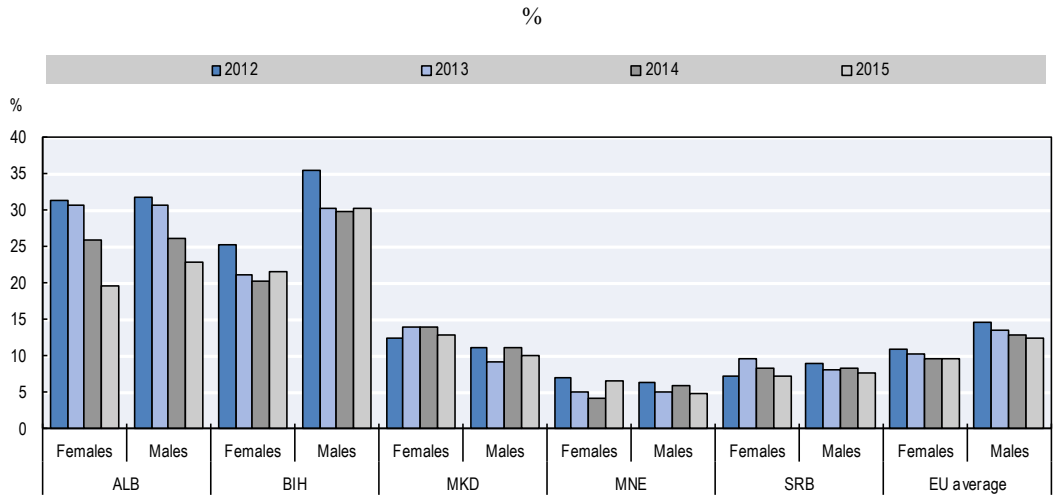
strategic plan will unfold. In Bosnia and Herzegovina, there are strategic documents at the state and entity levels which include objectives and some measures to improve equitable access to education for disadvantaged students.[7] However, measures in previous strategies have not consistently been given sufficient budgets for implementation. How far the measures identified in more recent strategy documents will be implemented, and whether the co-ordination of donor-funded projects can be strengthened, also remain to be seen.

Early school leaving is being tackled

The European Union defines early school leavers as 18-24 year olds who have only attained lower secondary education and who are no longer in education or training (EC, 2017a). Early school leavers can face serious difficulties in entering and remaining in the labour market, which makes early school leaving a problem for individuals and society alike (OECD, 2017a). Moreover, having students drop out without a qualification is an inefficient use of public funds. Governments therefore have a strong incentive to reduce the number of early school leavers and those dropping out.

Figure 7.11 shows great diversity among early school leaving rates, with two economies – Albania, and Bosnia and Herzegovina – having much higher rates than the EU average and the other SEE economies.

Figure 7.11. **Early leavers from education and training among 18-24 year-olds**



Note: Early leavers from education and training denotes the percentage of the population aged 18 to 24 having attained at most lower secondary education and not being involved in further education or training. The numerator of the indicator refers to people aged 18-24 who meet the following two conditions: 1) the highest level of education or training they have completed is ISCED 2011 level 0, 1 or 2 (ISCED 1997: 0, 1, 2 or 3C short); 2) they have not received any education or training (formal nor non-formal) in the four weeks preceding the survey. The denominator consists of the total population of that age group, excluding the respondents who have not answered the questions "highest level of education or training successfully completed" and "participation in education and training". Data for Kosovo are not available.

Source: EC (2017a), *Eurostat* (database), http://ec.europa.eu/eurostat/data/database.

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On average, the six SEE economies score 2.3 on the strategies to prevent early school leaving indicator (Figure 7.8), which means that early school leaving is being tackled in a strategy document which details policy measures, as well as corresponding budgets and

implementation timelines. Albania, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia achieve a score of 2.5 for this indicator. These economies target early school leaving in one or more strategies, which include action plans specifying budget allocations and implementation timelines. They have also implemented some of the measures to tackle early school leaving and their strategic documents include prevention, intervention and compensation elements.

For example, the Kosovo Education Strategic Plan 2017-21 defines objectives and policy actions to prevent early school leaving in compulsory education, and includes implementation timelines and budgets. Intervention elements exist in the form of Prevention and Response Teams towards Dropout and Non-Registration. Pilot training for these teams took place in 9 municipalities in 2016, followed by training sessions in 21 municipalities in 2017. Further policy measures in the plan are still to unfold. Kosovo's Law on Adult Education also offers opportunities for education and training to pupils who have dropped out.

Bosnia and Herzegovina is lagging behind on this indicator, with a score of 1.5. Although an analysis of the reasons for early school leaving has been conducted in the Federation of Bosnia and Herzegovina, an action plan with a clear implementation timeline would allow for a more strategic approach to reducing dropout rates. Similarly, the Republika Srpska Strategy for the Development of Education in 2016-2021 includes the objective of reducing early school leaving but lacks clear budget allocations and implementation timelines.

The way forward for access to and participation in high-quality education

A number of policy interventions would further improve the access to, and quality of, the education systems of the six SEE economies.

Given the low participation rates in ECE compared to the EU, **the economies would benefit from increasing the provision and affordability of ECE**, in particular Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Serbia. Economies should consider 1) setting out quality goals and regulations; 2) designing and implementing curricula and standards; 3) improving qualifications, training and working conditions; 4) engaging families and communities; and 5) advancing data collection, research and monitoring. As the entities (the Federation of Bosnia and Herzegovina and the Republika Srpska) in Bosnia and Herzegovina play an important role in ECE policy, it is important that their respective strategic documents take these elements into consideration in co-ordination with the state-level representatives.

The economies should increase the attractiveness of the teaching profession and seek to increase teachers' participation in professional development, for example by ensuring that there is sufficient budget for development activities throughout all municipalities. Raising the admission standards for initial teacher education, increasing teachers' starting salaries and making teaching a demanding career with real professional growth options would help to attract the most qualified candidates among tertiary graduates.

The economies should pursue the implementation of planned measures to increase the inclusion of socio-economically disadvantaged students and students from a minority background, and to prevent early school leaving. Policy options should encompass prevention, direct intervention – addressing difficulties encountered by students as soon as they arise – and compensation through schemes offering additional opportunities for education and training to those who have dropped out. In Bosnia and

Herzegovina – which has the highest share of early school leavers and scores the lowest on this indicator – the Federation of Bosnia and Herzegovina would benefit from a more comprehensive strategic framework, addressing prevention, intervention and compensation in a concerted effort. The Republika Srpska would benefit from translating its strategic objectives into concrete actions accompanied by an implementation timeline.

Vocational education and training

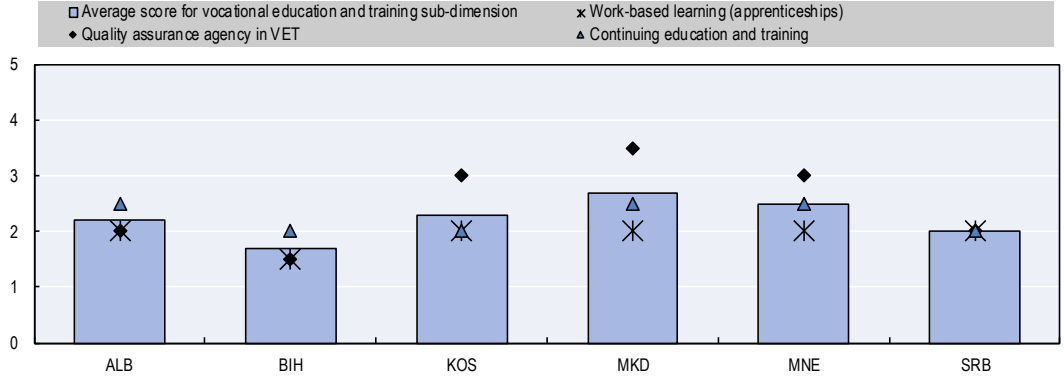
The vocational education and training (VET) sub-dimension includes three qualitative indicators (Figure 7.12).

The **work-based learning (apprenticeships)** indicator assesses the extent to which schemes include measures to: 1) enhance the co-operation between VET institutions and businesses; 2) increase the share of companies offering in-company work-based learning; 3) improve matching between VET students and businesses; and 4) provide for systematic monitoring and feedback.

The **quality assurance agency in VET** indicator measures the existence and effectiveness of agencies in charge of quality assurance and accreditation of VET programmes.

The **continuing education and training** indicator gauges the extent of development and implementation of continued education and training (CET).

Figure 7.12. **Vocational education and training: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Overall, the six SEE economies score an average of 2.2 out of a possible 5 in this sub-dimension, with individual average scores ranging between 1.7 for Bosnia and Herzegovina and 2.7 for the Former Yugoslav Republic of Macedonia. The overall average reflects the fact that the economies have largely adopted strategic documents with measures to improve work-based learning, quality assurance in VET, and continuing education and training, but that they need to make more effort to advance implementation. To ensure corrective measures are implemented, regular and independent evaluations would be an improvement for most of the economies.

In all of the economies for which data were available, except Albania, a higher share of students are enrolled in pre-vocational or vocational programmes than the average for OECD countries (Table 7.2).

Table 7.2. **Enrolment in pre-vocational or vocational education (2015)**

% of 15-year-old students enrolled in a programme with a pre-vocational or vocational curriculum

ALB	KOS	MKD	MNE	CZE	OECD average	POL	SVN
6.4	35.3	55.1	66.0	33.3	14.3	0.1	57.4

Note: Data for Bosnia and Herzegovina, and Serbia are not available. CZE – the Czech Republic; POL – Poland; SVN – Slovenia.

Source: OECD (2016c), *PISA 2015 Results (Volume II): Policies and Practices for Successful Schools*, http://dx.doi.org/10.1787/9789264267510-en.

StatLink http://dx.doi.org/10.1787/888933704283

In countries and economies with large enrolments in pre-vocational or vocational programmes, enrolments vary markedly according to schools' socio-economic profiles (OECD, 2016c). In the SEE economies for which data were available, enrolment in a vocational track is on average nearly 34 percentage points higher among students in disadvantaged schools (53%) than among students in advantaged schools (20%) (Table 7.3).

Table 7.3. **Enrolment in pre-vocational or vocational education by school socio-economic profile (2015)**

% of 15-year-old students

	ALB	KOS	MKD	MNE	CZE	OECD average	POL	SVN
Enrolled in an advantaged school (top quarter of the school-level PISA ESCS index)	4.3	17.8	24.0	33.4	14.8	2.7	0.2	0.0
Enrolled in a disadvantaged school (bottom quarter of the ESCS index)	6.5	44.9	72.8	89.2	33.7	23.9	0.1	90.6

Note: Data for Bosnia and Herzegovina, and Serbia are not available. ESCS – PISA index of economic, social and cultural status; CZE – Czech Republic; POL – Poland; SVN – Slovenia.

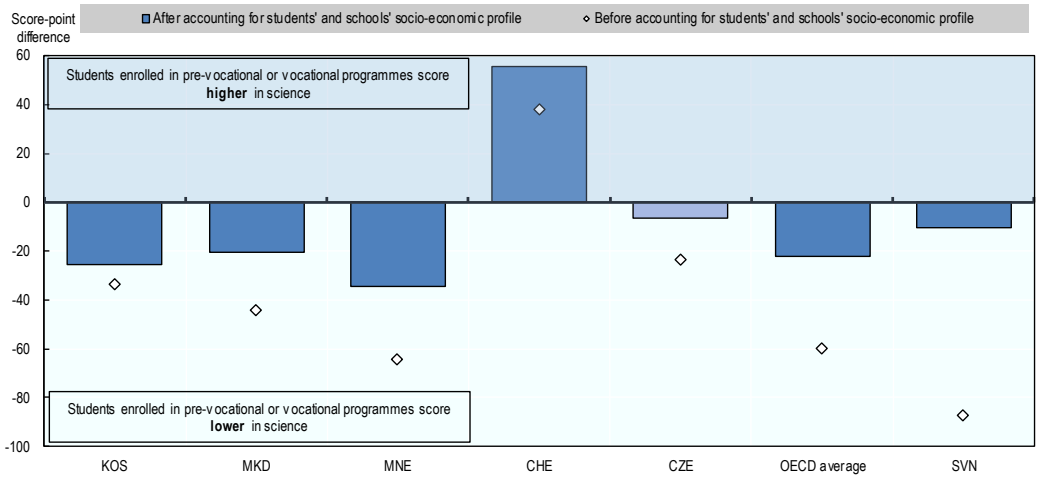
Source: OECD (2016c), *PISA 2015 Results (Volume II): Policies and Practices for Successful Schools*, http://dx.doi.org/10.1787/9789264267510-en.

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When considering the performance of students enrolled in general and vocational programmes, those in the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro scored at least 20 points lower in science than students in general programmes, after accounting for socio-economic status (Figure 7.13).

These data suggest that ensuring that VET schools provide better opportunities for students to consolidate essential cognitive skills is a priority, particularly given the large share of students enrolled in vocational tracks and the high number of low achievers.

Figure 7.13. **Enrolment in a pre-vocational or vocational programme and science performance (2015)**



Note: The socio-economic profile is measured by the PISA index of economic, social and cultural status. Statistically significant differences are marked in a darker tone. Data for Albania, Bosnia and Herzegovina, and Serbia are not available. CHE – Switzerland; CZE – the Czech Republic, SVN – Slovenia.

Source: OECD (2016c), *PISA 2015 Results (Volume II): Policies and Practices for Successful Schools*, http://dx.doi.org/10.1787/9789264267510-en.

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Work-based learning schemes and VET quality assurance agencies could be strengthened

A large body of research has shown that completing work-based learning in the form of an apprenticeship can have a positive impact on overall labour market outcomes for young people. These benefits include: 1) fewer repeated periods of unemployment than students graduating from a more school-based system (OECD/ILO, 2017); 2) 15-20% higher earnings than graduates from compulsory education (CEDEFOP, 2011); and 3) a greater probability of finding adequate employment than for those who completed full-time vocational education (Bertschy et al., 2009; Parey, 2012). Overall, apprenticeships can help to increase the general level of skills in the local economy and can enhance overall economic growth and productivity (Cappellari et al., 2012).

The six economies score an average of 1.9 for the **work-based learning (apprenticeships)** indicator, with five of them scoring 2, while Bosnia and Herzegovina scores 1.5 (Figure 7.12). All have a legal framework in place which regulates work-based learning schemes (although to different degrees), and almost all have relevant strategies which include measures to improve their schemes, whether they are dedicated VET strategies or overall education strategies.

Bosnia and Herzegovina scores slightly below the other SEE economies because, since the Strategy for the Development of Vocational Education and Training in BiH 2007-13 expired, it has adopted no new strategy documents to foster work-based learning at the state level. Bosnia and Herzegovina's Framework Law on Secondary Vocational Education and Training stipulates that tripartite advisory councils should be established, consisting of representatives of employers, trade unions and education authorities, whose

aim is to forge links between vocational education and the labour market. However, it has not been possible to establish these advisory councils at all levels of government. The Republika Srpska Strategy for the Development of Education in 2016-21 includes the objective of improving VET, but no clear budget allocations and implementation timeline for the measures it mentions could be identified.

The economies' scores are kept low by the fact that none of them provide incentives to increase the share of companies offering in-company work-based learning, although legislation provides for such incentives in Albania, the Former Yugoslav Republic of Macedonia and Kosovo. Comprehensive and systematic matching and feedback mechanisms are often still in the pilot stage or do not cover all occupations. Nonetheless, there have been notable activities to improve work-based learning schemes in VET, mostly with the support of international donors. Albania has piloted the Apprenticeship Schemes for Youth Employment, financed by the Erasmus+ Programme.[8] Albania is also working to improve the matching between VET students and companies. For example, the Skills for Jobs project seeks to develop regional apprenticeship/traineeship matching platforms in Vlora, Lezha and Berat. Montenegro has established a web portal for the exchange of information between employers and VET schools in order to improve matching. All VET schools focusing on tourism and hospitality are part of the platform, which is used by more than 100 employers. Montenegro is seeking to extend this matching practice to additional occupations. Kosovo has established six competence centres which are piloting an information management system to centralise available work-based learning opportunities for VET students.

Quality assurance is a critical element – for improving the performance and attractiveness of VET, as well as for responding to changing labour market needs. Although quality assurance and accreditation of VET can take different forms in different education systems they always "consist of external assessments in relation to predefined requirements (objectives, criteria, standards of quality) for VET programmes or the provider organisation, they lead to reasonable judgements, and finally to a decision with implications for the VET provider and/or the quality of the training programme, dependent on what has been assessed" (CEDEFOP, 2009, p. 8). On average, the SEE economies achieve a score of 2.5 for the **quality assurance agency in VET** indicator (Figure 7.12). All of the economies benefit from international co-operation on VET quality assurance through the European Training Foundation. The highest scoring economies (Kosovo, the Former Yugoslav Republic of Macedonia and Montenegro) have aligned their methodologies with the European Quality Assurance in Vocational Education and Training framework (EQAVET), while the Former Yugoslav Republic of Macedonia is the only member of the EQAVET network among the six economies.

However, a lack of human and financial resources remains a challenge in this area. In particular, quality assurance agencies in Albania, Kosovo and Serbia would be more effective if they had more financial resources.

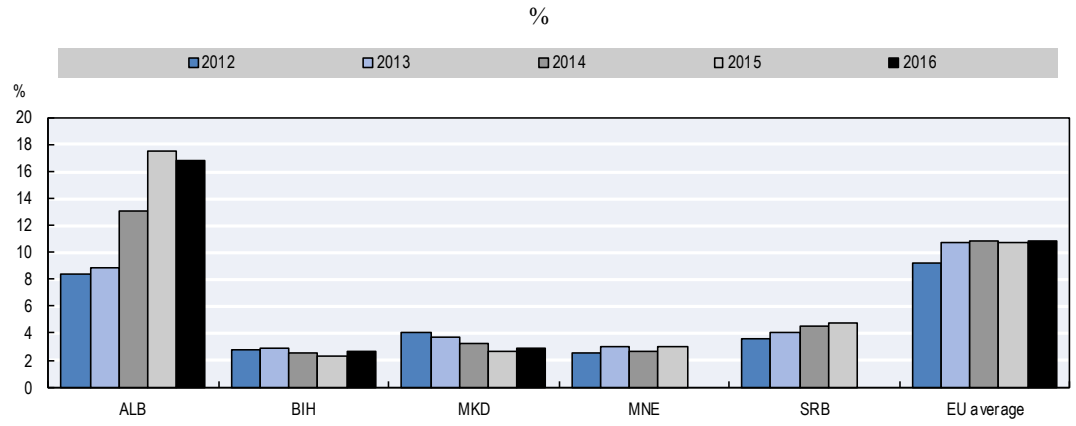
Take up of continuing education and training is low

Skills depreciate if they are not actively maintained. For this reason, and because of new and increasingly complex work tasks (and possibly greater job mobility), workers should seek to maintain and upgrade their skills through continued education and training (CET) to stay abreast of the constant changes on the labour market. Continuing education and training, or lifelong learning, helps workers preserve their employability and helps companies adjust and stay competitive (ILO, 2008). Skills obtained through CET can also

increase labour productivity by reducing skills mismatches (OECD, 2015). CET is clearly of great relevance to economies such as those in South East Europe which have relatively high levels of unemployment (see Chapter 8), and are undergoing a process of industrial restructuring. Meeting these challenges requires the upgrading of work skills, especially among middle-aged cohorts suffering from a lack of educational and training opportunities.

Adult participation in learning remains low in the SEE economies. In 2015 on average only 6% of 25-64 year-olds had received education or training in the four weeks preceding the survey (Figure 7.14), while in the EU, the figure was 10.7%. Albania had the highest share of adults participating in education and training.

Figure 7.14. **Participation in learning among 25-64 year-olds**



Note: Adult participation in learning (previously named "lifelong learning") refers to 25-64 year-olds who stated that they received education or training in the four weeks preceding the survey (numerator). The denominator consists of the total population of the same age group, excluding those who did not answer the question. Both the numerator and the denominator come from the EU Labour Force Survey. The information collected relates to all formal or non-formal education or training whether or not relevant to the respondent's current or possible future job. Data for Kosovo were not available. 2016 data for Montenegro and Serbia were not available. Government statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: Albanian Ministry of Social Welfare and Youth; statistical offices of Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia; EC (2017a), *Eurostat* (database), http://ec.europa.eu/eurostat/data/database.

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On average, the six SEE economies scored 2.3 on the continuing education and training indicator (Figure 7.12). This implies either that they all include CET or lifelong learning, along with defined objectives and policy measures, in their overarching education strategies (Albania, Kosovo and Serbia); or that they have dedicated CET or lifelong learning strategies (Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Montenegro).

Albania, the Former Yugoslav Republic of Macedonia and Montenegro score above the average for this indicator. Montenegro has adopted the Plan for Adult Education 2015-19, which defines priorities for the implementation of the Strategy for Adult Education 2015-25. To implement this plan, annual adult education plans are developed for each unit of local government, along with the activities, stakeholders and resources needed to achieve them. Although the Strategy for Adult Education 2015-25 is being

implemented, there is little reliable information on investment by employers and other partners in various forms of professional training and employee development.

In 2013 the Former Yugoslav Republic of Macedonia adopted the Strategy for Vocational Education and Training in a Lifelong Learning Context 2013-20. It has also finalised a draft version of the Strategy for Adult Education 2016-20. The validation of special curricula for adult education is under way; so far about 23 separate curricula have already been approved by the Centre for Adult Education. The organisation of education in secondary VET schools for adults is under way in many municipalities throughout the Former Yugoslav Republic of Macedonia, which is co-operating with the European Training Foundation to implement a validation system for non-formal education.

Albania has made progress in including adults in CET. Although it has not adopted a dedicated strategy for CET, its National Strategy for Employment and Skills 2014-20 includes clearly defined measures and objectives for CET. The Ministry of Labour, Social Affairs and Equal Opportunities, in collaboration with the National Employment Services, provides vocational training through nine public vocational training centres which operate in the biggest cities – Tirana (two operational centres), Shkodër, Durrës, Elbasan, Korçë, Fier and Gjirokastër – as well as a mobile centre which mainly covers the north-eastern part of the economy.

The way forward for vocational education and training

The high percentage of students enrolled in the vocational track and the high number of low achievers in PISA highlight how crucial it is to **ensure that VET schools provide better opportunities for students to consolidate basic skills**. Programmes could assess essential skills at the outset and address any weaknesses, as well as integrate basic skills development into professional programmes (OECD, 2014c).

Box 7.2 provides good-practice examples which SEE economies could adapt in order to increase the number of employers participating in work-based learning schemes, particularly in small and medium-sized enterprises (SMEs). It also provides examples of how both **matching between apprentices and employers and external quality assurance of VET schools could be further improved**.

Box 7.2. **Good practice: Examples of fostering work-based learning in VET in OECD countries**

Support measures to encourage companies to offer apprenticeships

The Apprenticeship Grant for Employers (AGE) in the United Kingdom is an example of a financial support measure that targets employers that have never provided apprenticeships before, or not in the last 12 months. Created as an initiative to help lower youth unemployment, it provides apprenticeship grants (worth GBP 1 500) to employers recruiting 16-24 year-olds. AGE helps support SMEs that would otherwise not be in a position to hire apprentices; 80% of the members of the London Chamber of Commerce and Industry are SMEs. A long-term aim of the AGE programme is to provide half of small businesses (defined as having 50 or fewer employees) with new apprenticeships – of which at least half are for people aged 16-18.

Box 7.2. Good practice: Examples of fostering work-based learning in VET in OECD countries (*continued*)

Austria shows how intermediate bodies can provide support measures for companies. The apprenticeship programme in Austria is modelled on a system of co-ownership. In the system, government authorities only marginally engage with companies. Instead, intermediate bodies – such as economic chambers of commerce, training providers and social partners – act as the interface. These intermediate bodies offer support to companies through the various stages of the training process (e.g. accrediting companies as a training company before the apprenticeship; and providing training guidelines and quality assurance checklists for companies to refer to throughout the training). This model helps to engage companies as they consider these intermediate bodies to be their own organisations.

Matching apprentices and employers

France offers an example of how apprenticeships can be made more accessible to SMEs through matching services. It has created a matching service to support SMEs in finding skilled workers. The Confederation of SMEs (CPME), works with the intermediary agency the Association de Gestion de Formations en Alternance pour les Petites et Moyennes Entreprise (AGEFA-PME) to offer small enterprises support in filling apprenticeships. A web portal makes it easier for businesses to find information on apprenticeship tax credits and regional aids. Web services also include a national database to showcase potential apprentices and a competence-based search-engine on qualifications and training centres. One of the more useful approaches is a methodological toolbox to guide aspiring apprentices on how to successfully apply for positions (e.g. via interview and soft-skills training) and to help young people to develop strong basic skills, in order to facilitate their integration into SMEs. Thus, young people can more easily connect with the small businesses most aligned with their skills.

The United Kingdom government has established the Apprenticeship Vacancies service – a digital platform that enables companies and potential apprentices to connect. Prospective employers can display apprenticeship vacancies in an open format online. The service is managed by the National Apprenticeship Service, and is the official apprenticeship database for England. The system permits vacancies to be viewed by thousands of potential apprentices registered on the system, and gives useful information about apprenticeships and training providers.

Quality assurance procedures supporting inclusiveness and ensuring equity

The Swedish Schools Inspectorate is an example of how quality assurance of VET schools can be organised at the national level and operated by a public authority. The Swedish Schools Inspectorate undertakes regular inspections of compulsory and upper secondary schools. The regular inspections are supplemented by quality audits that concentrate on specific areas of interest, targeting samples of 30-40 schools within each project. In recent years, it has reported on three quality audit projects. The 2011 report *Workplace-Based Education: In Practice* showed that vocational programmes had to intensify efforts to inform and prepare tutors in their duties, while also preparing students in understanding work-based learning and their education goals.

Austria's *Qualitätsmanagement Lehre* (QML) also monitors the quality management of apprenticeship programmes at the national level. It does so by drawing on national exam results and data sourced by apprenticeship offices. It gathers statistics on dropout rates, completion of apprenticeships and final exam non-attendance, as well as the results of the apprenticeship leaving exam. The apprenticeship advisory board then reviews the results at the national and regional level involving sectoral organisations and takes steps accordingly, which could include reforming occupational standards, enhancing support measures for apprentices, or improving the apprenticeship leaving exam.

Source: EC (2015b), *High-Performance Apprenticeships & Work-Based Learning: 20 Guiding Principles*, http://ec.europa.eu/social/BlobServlet?docId=14881&langId=en.

Higher education

Higher education (HE) drives research and fuels the formation of human capital by equipping graduates with technical, professional and discipline-specific knowledge and skills; cognitive and information processing skills; and social and emotional skills (OECD, 2017d).

The higher education sub-dimension assesses policies to provide high-quality HE and to prepare students to become skilled contributors to society and to lead innovation in a knowledge-based economy. To this end, this sub-dimension includes six qualitative indicators (Figure 7.15):

The **implementation of national qualifications frameworks** (NQFs) indicator assesses the current state of implementation of national qualifications frameworks against the ten steps of NQF implementation defined by the European Higher Education Area qualifications frameworks' working group (EC/EACEA/Eurydice, 2015).

The **quality assurance agency in higher education** indicator measures the existence and effectiveness of government agencies in charge of quality assurance and accreditation of higher education programmes.

The **work-based learning (internships)** indicator aims to assess existing internship schemes in the economies, as well as policy measures to increase the use of internships in higher education.

The **policy approach to improve equity in access to higher education** indicator is a qualitative indicator looking at approaches to equity, but does not measure actual equity in higher education. Such approaches can take different forms: a general policy approach targeting all categories of students, measures focusing on various under-represented groups, or – in most cases – a combination of both.

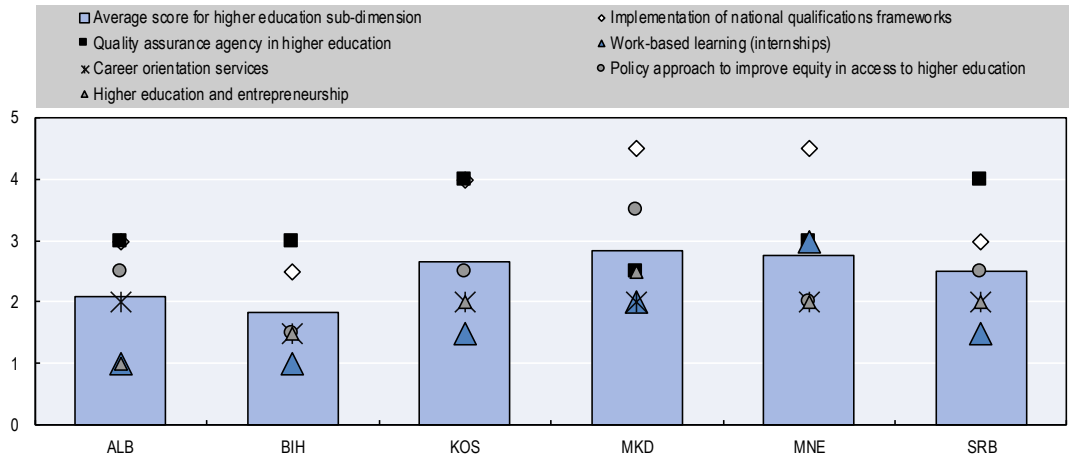
Two qualitative indicators analyse how the SEE economies provide students with the necessary information and skills to improve their employability and skills matches. The **career orientation services** indicator aims to gauge the extent of provision of such services. The **higher education and entrepreneurship** indicator assesses if there are policy frameworks or at least initiatives to better support links between higher education, the labour market and entrepreneurs.

On average, the SEE region scores 2.4 out of 5 on this sub-dimension (Figure 7.15). In other words, the SEE economies have adopted strategies to improve HE and have started to implement them, but have not always done so rigorously.

The implementation of national qualification frameworks and quality assurance is progressing

> A qualifications framework is an instrument for the development, classification and recognition of knowledge and skills along a continuum of agreed levels. It is a way of structuring existing and new qualifications, which are defined by learning outcomes, i.e. clear statements of what the learner must know or be able to do whether learned in a classroom, on-the-job, or less formally. The qualification framework indicates the comparability of different qualifications and how one can progress from one level to another, within and across occupations or industrial sectors (and even across vocational and academic fields if the NQF is designed to include both vocational and academic qualifications in a single framework). (Tuck, 2007: v)

Figure 7.15. **Higher education: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933704245

On average, the six SEE economies achieve a score of 3.6 for the **implementation of national qualifications frameworks** indicator (Figure 7.15), ranging from 2.5 for Bosnia and Herzegovina to 4.5 for the Former Yugoslav Republic of Macedonia and Montenegro.

Montenegro adopted its national qualifications framework law in 2010 which was complemented by secondary legislation and the establishment of sectoral commissions in 2011-12. Montenegro's national qualifications framework has a level structure with three categories of descriptors (knowledge, skills and competences). Each level includes qualifications with dedicated learning outcomes which are described through the descriptors and study programmes have re-designed. HE institutions in Montenegro are required to apply the European credit transfer and accumulation system since 2004 (ETF, 2017a). In addition, the Montenegrin Credit Transfer System enables for learning outcomes achieved in one context to be taken into account in another context since it is aligned with the European Credit Transfer and Accumulation System and with vocational education and training (ECVET) (ETF, 2017a). In 2014, Montenegro's national qualifications framework was self-certified against the qualifications framework of the European Higher Education Area and referenced to the European Qualifications Framework. Going forward, a particular focus should be placed on non-formal and informal learning, as well as on promoting the framework and qualifications register to target groups and stakeholders (CEDEFOP, 2017a).

The Macedonian Qualifications Framework (MQF) includes the European Credit Transfer and Accumulation System and European Credit System for Vocational Education and Training credit ranges, a level structure and level descriptors, as well as learning outcomes according to those levels. Sectoral Qualifications Councils have been established and study programmes have been redesigned on the basis of the learning outcomes included in the MQF. With the support of the European Training Foundation, the MQF was complemented by an inventory of qualifications in 2015 which covers all existing formal qualifications, as well as the verified non-formal adult education programmes (ETF, 2017b). The MQF was self-certified and referenced to the European Qualifications Framework in February 2016. A roadmap for further implementation of the MQF has been drafted, which includes concrete steps to guide its implementation by 2019. The implementation of the MQF is advancing and has benefitted from several

donor-funded projects. These include the Instrument for Pre-Accession Assistance (IPA) Twinning project (2015-17) on Further Improvement of the System for Development and Implementation of the National Qualifications Framework, which has been particularly helpful for adopting and aligning relevant legislation. Nonetheless, challenges in the implementation of the MQF remain, such as capacity-building, funding and stakeholder involvement and cooperation (CEDEFOP, 2017b).

In 2015, Kosovo, which scores 4 on this indicator, was invited to participate in the European Qualifications Framework advisory group. The European Qualifications Framework Referencing Report of the Kosovo Qualifications Framework was endorsed in February 2016, although an updated version of the report was expected to clarify certain types of qualifications in 2017 (CEDEFOP, 2017c). Implementation of the national qualifications framework is in progress, but needs to resolve a number of challenges, including implementing a system for validation of non-formal and informal learning, accrediting VET schools and other providers, developing occupational standards, and developing new qualifications and including them in the framework (CEDEFOP, 2017c).

Albania, Serbia and Bosnia and Herzegovina still have some way to go before fully implementing their national qualifications frameworks and self-certifying and referencing them to the European Qualifications Framework. Doing so will enable qualifications obtained in these economies to be better understood by employers in other European countries, thus enhancing mobility and employability.

Quality assurance is an important bridge between learning outcomes, the accreditation system, the certificate supplement and the multidimensional role of the national qualifications framework. On average, the six SEE economies score 3.3 out of 5 for the **quality assurance agency in higher education** indicator (Figure 7.15). Albania, Bosnia and Herzegovina, and Montenegro each score 3, indicating that they have set up a fully operational agency with a formal mandate for HE quality assurance and accreditation of study programmes. The agencies in these economies also have sufficient financial and human resources to carry out their tasks effectively. Their staff receive regular training (with the latest training attended no more than two years ago) and benefit from an internal planning mechanism to help them work effectively.

The Kosovo Accreditation Agency is fully operational and became a full member of the European Association for Quality Assurance in Higher Education (ENQA) in 2014. The Commission for Accreditation and Quality Assessment in Serbia is also full member of ENQA and at the time of writing was in the process of renewing its membership.

The Higher Education Accreditation and Evaluation Board in the Former Yugoslav Republic of Macedonia benefits from internal planning mechanisms. However, its staff have not received training in the last two years, which could be an important obstacle to its effectiveness.

Work-based learning schemes (internships) could become more widespread in higher education

The OECD's *Jobs for Youth* study advises that the use of internships and other forms of on-the-job learning could help students acquire some labour-market experience before graduation to facilitate smooth transitions from school to work (OECD, 2010b). The six SEE economies score an average of 1.7 for the work-based learning (internships)

indicator (Figure 7.15), reflecting the fact that not all of them have adopted policy measures to promote the use of internships in HE.

Montenegro receives the highest score (3) out of the six economies. Its Law on Higher Education specifies that European Credit Transfer and Accumulation System credits can be awarded for internships. During the accreditation procedure of a new higher education institution or programme, the institution must submit documentation to the Council for Higher Education (the government body responsible for quality assurance) on conditions for practical training. Since 2012, Montenegro has conducted the Professional Training of Persons with Acquired Higher Education programme, which enables higher education graduates without work experience to acquire knowledge and skills over a period of nine months. This scheme also provides incentives for employers to take on interns, as their salary is entirely paid by the government. The scheme matches participants with employers based on graduates' preferences and their grades. Monitoring and feedback are included through periodic surveys of graduates and employers participating in the programme.

Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo have not included in any strategy document policy measures to promote the use of work-based learning in HE. Bosnia and Herzegovina has not adopted any coherent legal framework to regulate internships and none of its strategy documents include any concrete actions to promote internships. Although the Former Yugoslav Republic of Macedonia has not formulated any concrete policy measures to foster the use of internships in HE, its Law on Higher Education prescribes that all students in the second, third and fourth year of their studies should participate in at least one internship during the academic year. The law also prescribes that internships should not be shorter than 20 working days. Stakeholder interviews revealed, however, that internships are not adequately monitored and merely produced "results on paper" rather than actually developing the necessary skills. Legislation in Albania specifies that credits can be awarded for internships as part of study programmes, and prescribes the credit ranges.

Equity in access to higher education is largely enshrined in policy

Equity is an important determinant of high-quality education systems. The six SEE economies score 2.4 on average for the policy approach to improve equity in access to higher education indicator (Figure 7.15), meaning that almost all of them have developed some national policy approach to widening participation in HE, but have not managed to advance implementation to a satisfactory level.

In the Former Yugoslav Republic of Macedonia, Kosovo and Serbia, strategic documents include measures to widen the access to HE for under-represented groups. The Former Yugoslav Republic of Macedonia is the most advanced of the economies in using policy interventions to facilitate access for these groups. For example, each academic year, it provides six types of scholarship programmes for specific under-represented groups.

Albania and Montenegro have not included measures to widen participation in HE in any strategic document, but they have included such measures in their respective laws on HE. Montenegro has targeted support schemes which apply to students with special needs. Since the academic year 2015/16 students with special needs have been exempted by law from tuition fees; as of the academic year 2017/18, all first-year university students will be exempted from tuition fees. Albania provides targeted support to students whose families are included in social assistance programmes. Albania's law on HE

(adopted in 2015) foresees the creation of a national agency for financing higher education, which should further improve the process of identifying and supporting under-represented groups.

The Priorities for Development of Higher Education in Bosnia and Herzegovina 2016-26 foresees increased participation in higher education, but it remains to be seen how this objective will be implemented in practice. The Federation of Bosnia and Herzegovina has developed the Strategic Directions of Development of Higher Education in FbiH for 2012-22 – Synergy and Partnership, which does not explicitly mention an objective for widening participation in higher education but says that the state must take care of the underprivileged. The Republika Srpska Strategy for the Development of Education in 2016-21 does not specifically include objectives for widening participation in higher education, targets or an implementation timeline. However, it does list the "enhancement of student standards" as one of its five strategic objectives, including measures such as increasing the number of students in student accommodation centres, and granting scholarships for socially vulnerable students and students with disabilities.

Career orientation services and links between HE institutions and businesses should be strengthened

If young people choose the wrong career, the costs of later changes might be high, both for the individual and for the education system, although these costs may be reduced by flexible pathways to other occupations or educational tracks (OECD, 2010c).

In the six SEE economies, the unemployment rate of all HE graduates aged 15 and over averaged 16.2% in 2015, 7.7 percentage points below the average unemployment rate (Skikos, 2016). However, the average unemployment rate of recent HE graduates (those who graduated between 2010 and 2015) reached 37.1% in 2015, which underscores the difficulty HE graduates face during the transition from HE to the labour market. A recent study conducted by the European Commission (Skikos, 2016) found a large oversupply of graduates from some broad fields of study, such as business, administration and law. For example, in the academic year 2013/14, 28% of graduates completed their studies in the fields of business, administration and law, while 22% completed their studies in science, technology, engineering and mathematics (STEM) subjects (Skikos, 2016).

Skills mismatches amount to an inefficient allocation of resources, making it harder for productive firms to obtain skilled labour, reducing labour productivity at the economy level (Adalet McGowan and Andrews, 2015). Recent research conducted by the OECD South East Europe Regional Programme and summarised in the policy handbook *Bridging Skills Gaps in South East Europe,* suggests that considerable skills gaps are hampering labour productivity in the SEE economies (OECD, 2016d).

On average, the six SEE economies score 1.9 on the **career orientation services** indicator. Many have established career orientation services and have included the issue in recently adopted strategies. Nevertheless, career orientation services lack the human resources, capacity and information to provide adequate guidance. The largest public HEIs often have an operational career guidance centre in place. For example, in 2011 the University of Montenegro, in co-operation with the employment bureau, created the university's Career Development Centre, which helps students to identify the right career path. More strategic approaches to improving career guidance, such as in the Former Yugoslav Republic of Macedonia and in Montenegro, have only recently been adopted and implementation has only recently begun. Finally, institutional collaboration is rather

weak. While most of the economies score 2, Bosnia and Herzegovina scores 1.5 due to weak and relatively underdeveloped career guidance.

"Entrepreneurship creates new companies, opens up new markets, and nurtures new skills" (EC, 2017b). Entrepreneurship can be encouraged by appropriate teaching (OECD, 2010d). Businesses need targeted support for start-ups and early growth, such as finance and training, to supplement entrepreneurship education. Universities are key players in these areas, while local government and public policy has a clear role in supporting them in these tasks (OECD, 2010d).

On average, the six SEE economies achieve a score of 1.8 for the **higher education and entrepreneurship** indicator. All of them, except Albania, have adopted strategic documents that make explicit reference to the importance of linking higher education, the labour market and entrepreneurship. In all six economies, one or more universities have entrepreneurship centres and/or incubators that organise entrepreneurship promotion events, provide support for business model and business plan development, and which actively recruit students from non-business and non-technical fields.

However, all of the economies still have room for improvement when it comes to stimulating linkages between higher education and entrepreneurship. Most economies have included objectives and policy measures in this regard in a (higher) education strategy document, but it remains to be seen to what extent those measures will be implemented.

The way forward for higher education

The six SEE economies should consider a number of actions for their HE systems in order to reduce skills mismatches, create a highly educated labour force which will be able to spur innovation, increase productivity and thus strengthen competitiveness.

The economies should seek to design and implement comprehensive measures to encourage stronger co-operation between HEIs and businesses when designing study programmes, and in providing work-based learning opportunities such as internships.

All of the economies should carry out external evaluation of HEIs in accordance with the *Standards and Guidelines for Quality Assurance in the European Higher Education Area* (ESG),[9] and should provide their HE quality assurance agencies with sufficient human and financial resources to guarantee the highest quality of study programmes.

The economies should continue tackling the under-representation of socio-economically disadvantaged groups at HEIs. They could consider using scholarship schemes to direct students away from over-supplied subjects towards those with better prospects of employment and fostering innovation, such as STEM subjects. They should also seek to implement policies that provide more informed and more systematic career guidance and orientation to students.

The SEE economies should take more decisive action to increase the linkages between HE and entrepreneurship, following the OECD good-practice criteria outlined in Box 7.3.

Box 7.3. Good-practice criteria for linking HE and entrepreneurship

Strategy for supporting university entrepreneurship:

1. A broad understanding of entrepreneurship is a strategic objective of the university, and there is top-down support for it.
2. The objectives of entrepreneurship education and start-up support include generating entrepreneurial attitudes, behaviour and skills, as well as enhancing growth in entrepreneurship (both high-tech and low-tech).
3. There are clear incentives and rewards for entrepreneurship educators, professors and researchers who actively support graduate entrepreneurship (mentoring, sharing of research results, etc.).
4. The recruitment and career development of academic staff take into account entrepreneurial attitudes, behaviour and experience as well as entrepreneurship support activities.

Financing and human resources development:

A minimum long-term financing of staff costs and overheads for graduate entrepreneurship is agreed as part of the university's budget.

1. There is a goal for internal university entrepreneurship to become self-sufficient.
2. Entrepreneurship educators and staff involved in entrepreneurship start-up support are given human resource development.

Start-up support infrastructure:

The university has a dedicated entrepreneurship structure (chair, department, support centre), which closely collaborates, co-ordinates and integrates faculty-internal entrepreneurship support and ensures viable cross-faculty collaboration.

1. There are either facilities for business incubation on the campus or assistance is offered to gain access to external facilities.
2. There is close co-operation and referral between university-internal and external business start-ups and entrepreneurship support organisations; roles are clearly defined.

Entrepreneurship education:

Entrepreneurship education is progressively integrated into curricula and the use of entrepreneurial pedagogies is advocated across faculties.

1. The entrepreneurship education offer is widely communicated, and measures are undertaken to increase the rate and capacity of take-up.
2. There is a suite of courses, using creative teaching methods and tailored to the needs of undergraduate, graduate and post-graduate students.
3. The suite of courses contains a differentiated offer that covers the pre-start-up, start-up and growth phases. Active recruitment is practised for some courses.
4. Outreach to alumni, business support organisations and firms is a key component of entrepreneurship education.
5. The results of entrepreneurship research are integrated into entrepreneurship education messages.

Box 7.3. **Good-practice criteria for linking HE and entrepreneurship** (*continued*)

Business start-up support provided by universities:

Entrepreneurship education activities and start-up support are closely integrated.

1. Team building is actively facilitated by university staff.
2. Access to private financing is facilitated through networking and dedicated events. Mentoring by professors and entrepreneurs is offered.
3. Entrepreneurship support in universities is closely integrated into external business support partnerships and networks, and maintains close relationships with firms and alumni.

Evaluation of university entrepreneurship support:

1. There is regular stock-taking and performance checking of technology transfer and entrepreneurship support practice.
2. Evaluation of entrepreneurship education and start-up support activities is formalised and includes immediate (e.g., post-course), mid-term (e.g., graduation), and long-term (e.g., alumni and post-start-up) monitoring of its impact.

Source: OECD (2010d), *University Entrepreneurship Support: Policy Issues, Good Practices and Recommendations*, www.oecd.org/edu/imhe/46588578.pdf.

Conclusions

Overall, the six SEE economies have taken positive and important steps to improve the quality of education and the competencies of the labour force. All SEE economies have recently adopted (or are about to adopt) national strategies to improve education broadly and/or to address specific aspects. Outcome indicators show that SEE economies have made some progress in improving the knowledge and skills level of their populations, and in converging towards OECD and EU levels.

Despite these positive trends, the economies still have some way to go to catch up with the performance of education systems in OECD and EU countries. They need to overcome important challenges to assure the further improvement of education and competencies. ECE could be made more widely available and affordable, particularly in rural areas. Teaching as a profession still suffers from a poor image and teachers' low levels of participation in professional development are an obstacle to better performance. Increasing the share of in-company work-based learning and providing VET and HE students with relevant practical skills remains a persistent challenge. In light of youth unemployment rates and the unemployment rate of recent HE graduates, economies should prioritise aligning their study programmes more closely with the needs of the labour market and involving businesses and social partners more closely in the design of study programmes and work-based learning schemes.

Addressing those challenges with thorough policy implementation will strongly contribute to building firm foundations for boosting competitiveness and social well-being in South East Europe.

Notes

1. EU-22 average refers to the 22 Member States of the European Union which are also members of the OECD: Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxembourg, the Netherlands, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden and the United Kingdom.

2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

3. Calculated as a simple average of Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia. In general, SEE averages in this chapter are calculated as simple averages.

4. The "nominal" or money value of wages is expressed at current prices and is not adjusted for the effects of inflation. In comparison, "real" wages are adjusted for inflation.

5. The EU-6 comprises Belgium, France, Germany, Italy, Luxembourg and the Netherlands.

6. The CEEC-10 refers to the Central and Eastern European countries which joined the EU: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

7. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

8. Erasmus+ is the EU's programme to support education, training, youth and sport in Europe. Its budget of EUR 14.7 billion will provide opportunities for over 4 million Europeans to study, train, gain experience, and volunteer abroad (EC, n.d.).

9. The first *Standards and Guidelines for Quality Assurance in the European Higher Education Area* (ESG) were adopted by the Ministers responsible for higher education in 2005 based on a proposal prepared by the European Association for Quality Assurance in Higher Education in co-operation with the European Students' Union, the European Association of Institutions in Higher Education and the European University Association. *The Standards and Guidelines for Quality Assurance in the European Higher Education Area (ESG) 2015* were adopted by the Ministers responsible for higher education in the European Higher Education Area in May 2015. For more information on the ESG, see EHEA (2016).

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Annex 7.A1.
Education and competencies: Indicator scores

Table 7.A1.1. **Education and competencies: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Access to and participation in high-quality education						
Early childhood education	3.0	2.5	2.5	3.5	3.5	3.0
Teacher recruitment	3.0	1.5	2.0	2.0	2.5	2.5
Professional development of teachers	3.0	1.5	2.0	2.5	3.5	2.5
Equitable access to compulsory education	3.5	1.5	2.5	3.5	3.5	3.5
Strategies to prevent early school leaving	2.5	1.5	2.5	2.5	2.5	2.5
Vocational education and training						
Work-based learning (apprenticeships)	2.0	1.5	2.0	2.0	2.0	2.0
Quality assurance agency in VET	2.0	1.5	3.0	3.5	3.0	2.0
Continuing education and training	2.5	2.0	2.0	2.5	2.5	2.0
Higher education						
Implementation of national qualifications framework	3.0	2.5	4.0	4.5.0	4.5	3.0
Quality assurance agency in higher education	3.0	3.0	4.0	2.5	3.0	4.0
Work-based learning (internships)	1.0	1.0	1.5	2.0	3.0	1.5
Career orientation services	2.0	1.5	2.0	2.0	2.0	2.0
Policy approaches to improve equity in access to higher education	2.5	1.5	2.5	3.5	2.0	2.5
Higher education and entrepreneurship	1.0	1.5	2.0	2.5	2.0	2.0

StatLink http://dx.doi.org/10.1787/888933704321

Chapter 8.

Employment policy in South East Europe

This chapter on employment assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of employment trends and performance in South East Europe, the chapter then focuses on four essential sub-dimensions. The first sub-dimension, labour market governance, analyses the capacity of key labour market institutions and strategies to ensure high-quality jobs and develop flexible, inclusive and proactive labour markets. The second, activation policy, assesses activation measures and institutions and their ability to bring jobseekers and disadvantaged groups into the labour force and into jobs. The third, job quality, analyses policy measures that contribute to the well-being of workers by looking at earnings quality, labour market security and quality of the working environment. The final sub-dimension, social economy, explores government efforts to promote the social economy and an environment conducive to social enterprises. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions in order to improve employment policy, which in turn would foster the competitiveness of these economies.

Main findings

Long-term competitiveness will be achieved by fostering more inclusive and cohesive societies in which widespread employment opportunities with high-quality jobs and sufficient social protection raise living standards. Creating more and better quality jobs is a major challenge for governments in the South East Europe (SEE) economies assessed in this *Competitiveness Outlook*.

The six assessed SEE economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – share a number of common labour market conditions and trends. Their employment performance is considerably lower than in the European Union (EU): only 38.4% of the working-age population was employed in 2015, compared to 65.4% on average in the EU and 67.6% in the OECD. The average share of the economically active population (all employed and unemployed persons who supply labour to produce economic goods and services) in the working-age population was 23% lower in the SEE economies than in the EU – 49.5% versus 72.5%.[1] The economies are also characterised by youth and long-term unemployment rates that are among the highest in Europe. High rates of informal employment are a further challenge, with harmful consequences for economic performance due to the inefficiency of the informal sector, loss of tax revenues, limited access to social protection, comparatively low wages, and workers' vulnerability when they lose their job or retire.

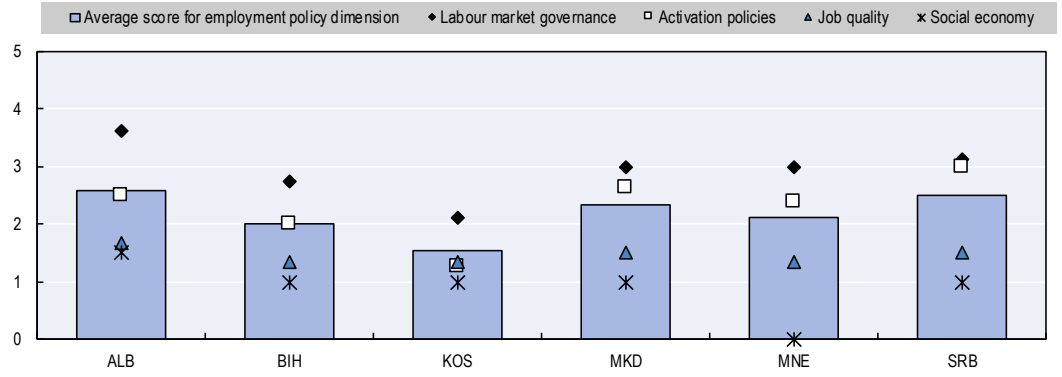
While growth-enhancing policies play an important role in increasing employment, they are not sufficient as they do not address the structural nature of the employment challenges in the assessed economies, characterised by high rates of youth unemployment, long-term unemployment, difficulties in integrating vulnerable groups – including female workers – into the labour market and high rates of informal employment. These will only be resolved by labour market policies that improve employment opportunities and yield better, more equitable outcomes for the working-age population. Employment policy can provide a framework of strategies, action plans, laws, measures and institutions that improve the functioning of labour markets, make them more inclusive, and enhance their ability to address the post-crisis and demographic challenges (World Bank/WIIW, 2017a).

In this *Competitiveness Outlook* assessment, the six economies score an average of 2.2 out of 5 for the employment policy dimension (Figure 8.1). This means that although strategies, action plans, laws, measures and institutions are mostly in place, further efforts are needed to implement them. Two economies – Albania and Serbia – score approximately 2.5, thanks to their relatively advanced overall employment policy implementation. Bosnia and Herzegovina,[2] the Former Yugoslav Republic of Macedonia and Montenegro score between 2 and 2.5, indicating that further progress is needed in implementation. Kosovo scores approximately 1.5, as it is in the final stages of adopting many of its strategies.

The six SEE economies generally do well when it comes to labour market governance, with an average score of 2.9, but they could do more to improve their performance in employment activation (average score 2.3) and job quality (average score 1.4). As for policies to promote the social economy, efforts are still nascent, with an average score of 0.9.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Figure 8.1. **Employment policy: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

In comparison with the 2016 assessment, several points deserve some attention. While overall employment rates have risen and unemployment rates fallen, the SEE economies are still facing structural challenges. Several changes have been made to the assessment framework since the last *Competitiveness Outlook*. There are two new sub-dimensions, activation policies and job quality, while the labour mobility sub-dimension has been removed. Several changes have also been made to the indicators.[3]

The main changes that have taken place since the 2016 assessment are likely to be due to the selected economies adopting and implementing new employment strategies (implementation began in 2016 and 2017). All six economies have adopted new legislation in several areas targeted at increasing the flexibility of labour markets. The 2016 assessment showed that on average, workers on permanent contracts in the SEE economies enjoy greater protection from individual and collective dismissals than in many OECD countries. Likewise, employment protection legislation is on average more restrictive for fixed term and temporary contracts in the SEE economies compared to the OECD average. While this aspect has not been assessed in this present report, this is unlikely to have changed much since 2016.

Achievements

Most of the assessed SEE economies have made efforts to design comprehensive employment frameworks through a consultative processes.

Most of the economies have relevant institutions in place, aiming to address their specific labour market challenges.

All the SEE economies are attempting to address structural unemployment through activation policies.

The SEE economies have started to consider developing social enterprises as a way of strengthening the development of the social economy so as to stimulate innovation and encourage the inclusion of vulnerable groups in labour markets.

Remaining challenges and key recommendations

- **Implement fully the measures set out in strategies and action plans.** Effective implementation is often hampered by a lack of funding and human resources, as well as weak co-ordination with other policies (e.g. education policies, tax policies).
- **Strengthen the capacities of social partners, in particular worker organisations,** which often lack the capacity to undertake analysis and to engage actively and constructively in a social dialogue with government.
- **Continue to tackle informal employment.** Although estimates put informal employment as high as 30% in some of the economies, measures to gradually coax informal workers into formal work are often lacking. Labour inspectorates do not have enough capacity, which further hampers detection and enforcement.
- **Improve activation policies** to increase the motivation and employability of the unemployed and to facilitate additional employment opportunities; and **create an effective institutional setup** able to co-ordinate delivery of a complex array of services. Activation policies are still insufficiently developed in most of the six economies and have limited impact. This is often due to poor targeting, disincentives for unemployed people to participate in activation measures, and ineffective policy design.
- **Strengthen the capacity and infrastructure of public employment services (PES), the key institutions implementing activation policies, to provide quality support.** Staff workloads are high (on average about 400 jobseekers for a single PES officer), which can seriously limit the implementation of active labour market policies.
- **Improve skills matching, and ensure that training measures are effective.** Current skills gaps analyses are limited in their coverage and data provided, and are seldom institutionalised or integrated into educational and employment systems.
- **Improve job quality by targeting the factors that affect earning, job security and the quality of the working environment.** Overall job quality is lower compared to the EU and OECD averages, reflected in low earnings, high labour market insecurity and poor working environments.
- **Further support social enterprise development.** Most of the assessed economies are currently either drafting legislation on social enterprises or have recently adopted it. Nevertheless, social enterprises generally do not play a role in their strategic frameworks, and in the implementation of support measures.

Context

Reducing unemployment and creating jobs are top priorities for all the economies covered by this publication. Employment policy relates to government activities, including strategies, action plans, laws, measures and institutions intended to promote full, productive and inclusive employment.

The SEE economies' weak labour markets are a serious source of social concern, as they undermine competitiveness in the medium and long term. Low rates of employment mean diminished production, while the long-term unemployed are at risk of losing occupational skills and struggling to find future work. High rates of unemployment are a

burden on public finances, as they lead to greater social spending on benefits for the jobless and can undermine social cohesion. Furthermore, very low youth employment rates impede the building of human capital and increase young people's dependency on support systems, thus diminishing the economies' long-term growth potential. Finally, high rates of informal unemployment are prompting concerns about worker protection, making it difficult for governments to deliver high-quality public services and are hindering productivity and growth (OECD, 2008).

Employment policy has significant links to other policy areas in the assessed economies. This chapter particularly relates to the following chapters of this *Competitiveness Outlook*:

- **Chapter 1. Investment policy and promotion** addresses the key factors facilitating investment, including employment policy. Research finds that more stringent employment protection legislation may deter foreign direct investment (FDI) (Dewit, Görg and Montagna, 2009) and that relaxing labour regulations may increase it. Moreover, FDI, which brings capital and technology, often leads to demand for skilled labour. Studies find that this can result in higher wages for skilled labour, which is a key job quality component (Hale and Xu, 2016).
- **Chapter 2. Trade policy and facilitation** can lead to diversification and global value chain integration, but it requires a flexible, motivated and well-qualified labour force. Activation policies can increase the labour force's motivation and incentives to actively seek employment opportunities, help job seekers to find suitable employment and increase employability through additional education and training. However, insufficiently developed activation policies can act as a constraint on integration into global value chains and on economic diversification. A flexible, motivated and well-qualified labour force is thus relevant for creating a favourable environment in which both domestic and foreign enterprises can better respond to changing trade circumstances.
- **Chapter 4. Tax policy** has an influence on the level of employment in an economy, as well as on other choices made by participants in the labour market. For example, labour taxation determines the difference between the total labour costs faced by employers and the real consumption wages received by employees, thus affecting labour demand and labour supply decisions. This may contribute to a reduction of the labour force by diminishing incentives to either work, or to work in the formal sector. Furthermore, tax policy can affect retirement decisions, the number of hours worked, decisions relating to employee training and career choice (including whether to be an employee or self-employed) (OECD, 2011).
- **Chapter 7. Education and competencies** largely determine the quality of a labour force. In a global economy that is becoming increasingly dependent on skills, countries with lower skill levels need to develop their human capital and be more competitive. However, attempts to boost workforce skills through vocational training without considering how they interact with labour market developments and policies are likely to be ineffective (OECD, 2015a). Moreover, it is important that economies avoid the "low skill equilibrium" trap which can develop in some areas where a concentration of employers in a region are pursuing price-based competition strategies, and rely on low-skilled and standardised production. This can often occur in more peripheral rural regions, drawing them into a vicious circle – it does not pay for people to invest in skills when skills are not valued by employers. At the same time, those who do acquire skills may move away to seek more appropriate jobs elsewhere (OECD, 2014a).

Employment policy assessment framework

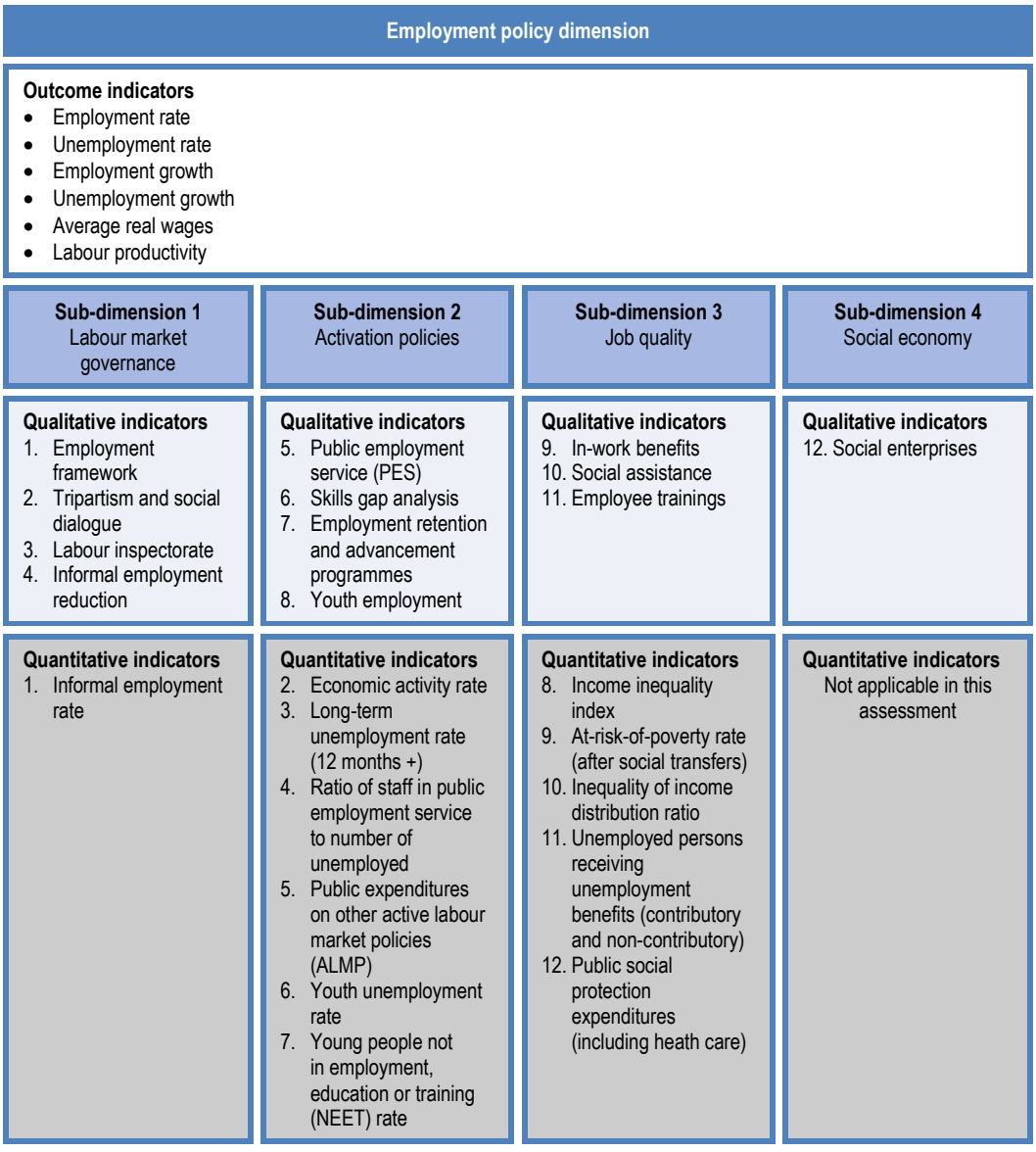
The employment policy dimension in the 2018 *Competitiveness Outlook* examines the extent to which the assessed SEE governments have established competitive employment policies. Without seeking to be exhaustive, it considers four broad sub-dimensions that are critical to a healthy labour market and favour economic growth and well-being across the population:

1. Labour market governance: are there comprehensive strategies with corresponding action plans in place and do they sufficiently address key labour market issues? How effective are tripartism and social dialogue in addressing the concerns of all the relevant stakeholders in the labour market? Do policies seek to improve the labour inspectorate's capacity to address informal employment and other violations of labour law? Do policies address informal employment, and how far advanced are they?
2. Activation policies: are the existing activation policies designed efficiently and do jobseekers, particularly vulnerable groups, have sufficient motivation, employability and opportunities to integrate into the labour market? Do policies seek to improve the capacity of public employment services as the key institutions implementing active labour market policies? What measures are in place to assess the skills gap in the workforce, and are the results used in policy making? Are measures in place that would help individuals who have entered work – including low-paid workers – to remain and progress in work? What policies are in place to reduce youth unemployment?
3. Job quality: are there financial incentives in place that would improve the quality of earnings for needy families or individuals? Do policies sufficiently seek to ensure labour market security, measured in terms of unemployment risk and unemployment insurance? Are there measures in place to sufficiently encourage employee training, to improve the quality of employees' working environment, and to increase their productivity?
4. Social economy: do the SEE economies seek to encourage the social economy? What measures, if any, have they taken to create an enabling environment for social enterprises?

Figure 8.2 shows how the sub-dimensions and their constituent indicators make up the employment policy dimension assessment framework. The design of the framework is in line with the principal objective of the OECD Jobs Strategy: to promote policies and institutions that can foster sustained improvements in individual and social well-being through stronger labour market performance. The OECD Jobs Strategy takes a broad perspective by defining labour market performance in terms of three complementary pillars that are key for inclusive growth and well-being: 1) more and better jobs; 2) inclusive labour markets; and 3) adaptability and resilience.[4]

Each sub-dimension is assessed through quantitative and qualitative indicators. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Quantitative indicators are based on national or international statistics. Qualitative indicators have been collected and scored in ascending order on a scale of 0 to 5, and are summarised in Annex 8.A1.[5] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 8.2. **Employment policy assessment framework**

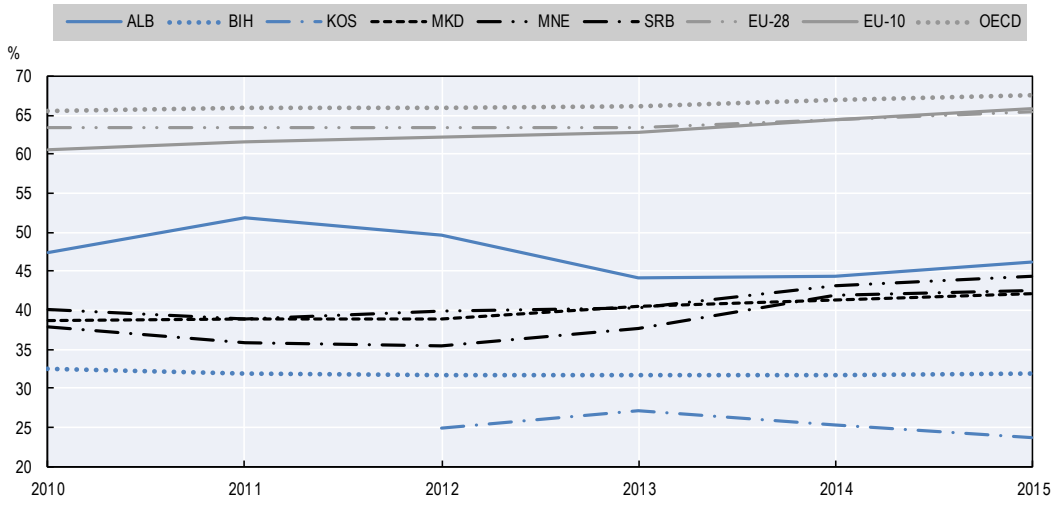


Labour market performance in the SEE economies

Between 2012 and 2015, the number of jobs in the six economies increased by about 370 000, indicating an employment recovery. This is also reflected in changes to employment rates (Figure 8.3) – the share of employed persons in the total population above 15 years of age. Despite the recovery, employment rates are still lower on average in these economies than the EU and OECD averages.

Figure 8.3. **Employment rate at age 15 and above**

% of total working-age population



Note: Data not available for Kosovo for 2010 and 2011. EU-28 – all 28 EU Member States; EU-10 – Cyprus,* the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

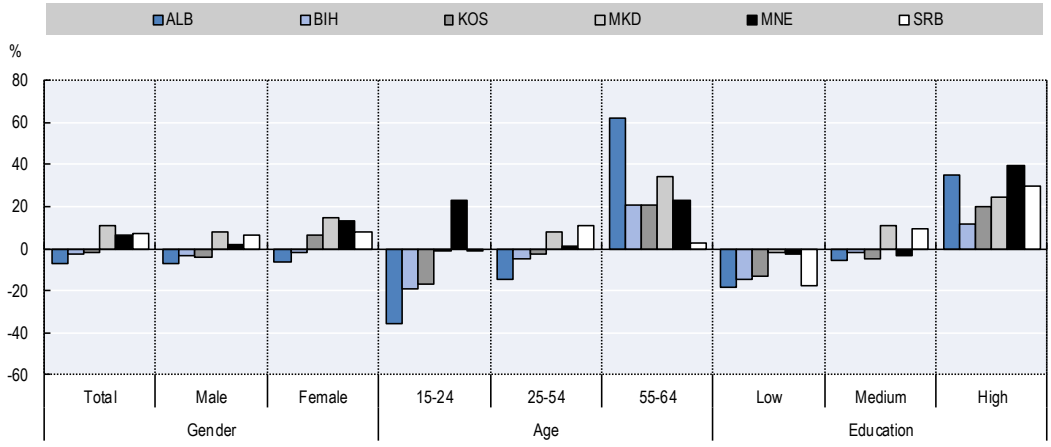
* Footnote by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus. Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus" issue. 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.

Source: EC (2017b), *Employment and Unemployment (Labour Force Survey)* (Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts; OECD (2017), *OECD Data* (database), https://data.oecd.org.

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Breaking down employment growth by gender, age and education reveals important differences among the six SEE economies (Figure 8.4). While the employment growth among the female labour force between 2010 and 2015 is encouraging, the share of women in employment in the SEE economies, at 38.6% in 2015, remains lower than in EU economies such as Austria, where it is 47.2% (Table 8.1). The 15-24 age group exhibited negative employment growth rates for most of the SEE economies and constituted 7.4% of employment in 2015 on average among the six. This is significantly lower than in Austria, where the same age group constituted about 12.3% of the employment in 2015. For the 55-64 age cohort, high employment growth can also be explained by pension reforms in some of the economies. For example, regulations on early retirement in Serbia have become more restrictive since 2011 (Government of the Republic of Serbia, 2016). While the labour force with higher education increased between 2010 and 2015, the average share of labour force with higher education in employment is still only 23.2% in the SEE economies, compared to 33% in Austria. Particularly alarming are the negative employment rates in all six economies among less educated workers, given they make up a significant share of the labour force in employment: 21.1% in 2015.

Figure 8.4. **Employment growth (2010-15)**



Note: Data for Kosovo for 2010 refer to 2012. Level of education refers to the highest level completed, classified according to the 2011 International Standard Classification of Education (ISCED). Low refers to ISCED levels 1-2 (primary and lower secondary education); medium to ISCED levels 3-4 (upper secondary or post-secondary non-tertiary); and high to ISCED levels 5-8 (tertiary education).

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts.

StatLink http://dx.doi.org/10.1787/888933704378

Table 8.1. **Distribution of employment (2015)**

% in employment by gender, age and education

	Gender		Age			Education		
	Male	Female	15-24	25-54	55-64	Low (levels 0-2)	Medium (levels 3-4)	High (levels 5-8)
ALB	57.1	42.9	8.7	71.6	19.7	46.1	35.7	18.2
BIH	62.7	37.3	6.0	78.0	16.0	17.8	64.6	17.6
KOS	77.4	22.6	9.9	76.7	13.5	15.0	61.0	24.0
MKD	60.0	40.0	7.0	78.1	14.9	22.1	53.7	24.2
MNE	54.5	45.5	7.5	78.6	13.9	8.0	61.4	30.5
SRB	57.0	43.0	5.2	78.3	16.5	17.6	57.5	24.9
AUT	52.8	47.2	12.3	75.7	12.1	13.2	53.8	33.0

Note: AUT – Austria. Level of education refers to the highest level completed, classified according to the 2011 International Standard Classification of Education (ISCED). ISCED levels 1-2 refers to primary and lower secondary education; ISCED levels 3-4 refers to upper secondary or post-secondary non-tertiary; and ISCED levels 5-8 refers to tertiary education.

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts.

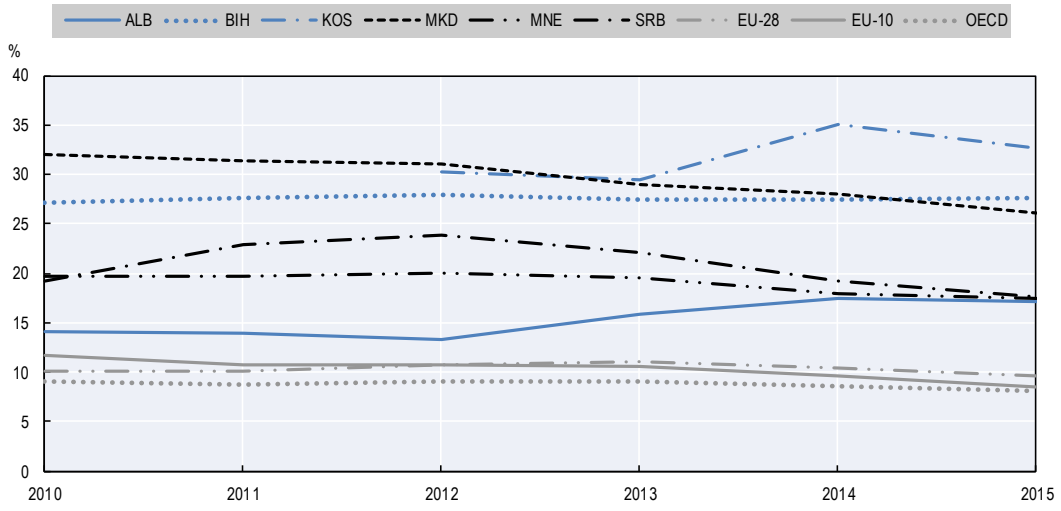
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Unemployment rates in the six SEE economies, measured as the proportion of people in the labour force who do not have a job and are actively looking for work, are relatively high compared to the EU and OECD averages (Figure 8.5).

Looking at unemployment growth (Figure 8.6), the people most affected by rising unemployment rates in Albania, Bosnia and Herzegovina, and Kosovo are those aged between 55 and 64, and the more highly educated. On the other hand, these were also the two groups whose employment growth was the highest (Figure 8.4), compensating somewhat for the effects of rising unemployment.

Figure 8.5. **Unemployment rates at age 15 and above**

% of labour force

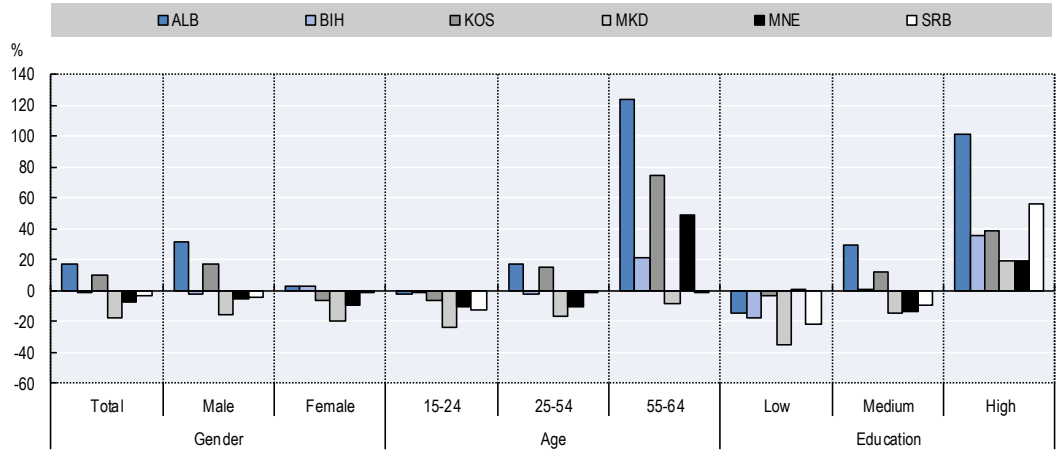


Note: Data not available for Kosovo for 2010 and 2011. EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

Source: EC (2017b), *Employment and Unemployment (Labour Force Survey)* (Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts; OECD (2017), *OECD Data* (database), https://data.oecd.org.

StatLink http://dx.doi.org/10.1787/888933704397

Figure 8.6. **Unemployment growth (2010-15)**



Note: Data for Kosovo for 2010 refer to 2012. Level of education refers to the highest level completed, classified according to the 2011 International Standard Classification of Education (ISCED). Low refers to ISCED levels 1-2 (primary and lower secondary education); medium to ISCED levels 3-4 (upper secondary or post-secondary non-tertiary); and high to ISCED levels 5-8 (tertiary education).

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts.

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The evidence suggests that labour market challenges are structural and that growth alone will not be enough to create the number and types of jobs needed in labour markets. Growth following recovery from the financial crisis has not been observed to significantly affect employment in the SEE economies, and the impact of growth on unemployment is small. In the EU, on the other hand, there has been a significant positive relationship between growth and employment (Kovtun et al., 2014; World Bank/WIIW, 2017a). This suggests that the SEE economies are not yet in a situation in which economic growth will guarantee a return to job growth.

Labour market governance

Labour market governance covers strategies, action plans, laws, measures and institutions that influence the demand and supply of labour (ILO, 2016a). Labour market governance is paramount in ensuring high-quality jobs, as well as developing flexible, socially inclusive and proactive labour markets. Having strong governance, clear directions, independent labour market regulation and enforcement can increase the responsiveness of labour markets and also give strong signals to investors.

The labour market governance sub-dimension is in this section using four qualitative indicators (Figure 8.7):

The **employment framework** indicator assesses whether there is a co-ordinated, strategic government approach to employment, and to what extent it has been implemented. While employment policy is a cross-cutting policy area, this indicator provides an overarching view of relevant employment strategies, action plans, laws, measures and institutions.

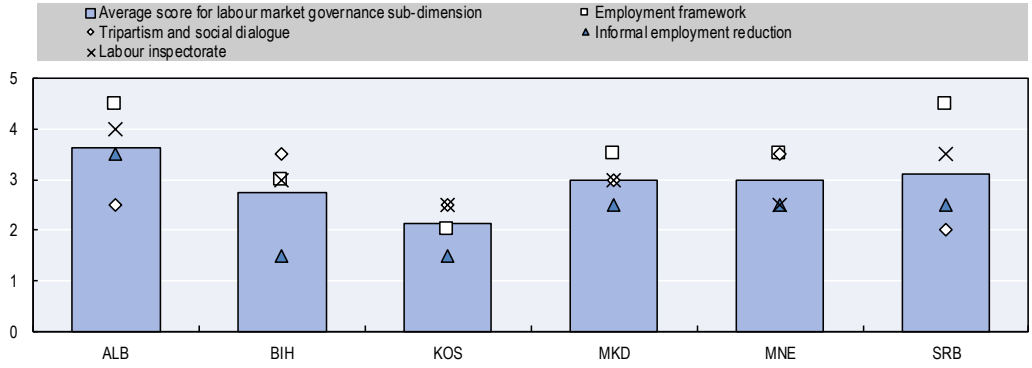
The **tripartism and social dialogue** indicator assesses the status quo of policy, legal and institutional frameworks with reference to industrial relations and effective social dialogue, as well as its level of implementation. In order to ensure that employment frameworks reflect and address the various concerns of all the relevant stakeholders, engagement by social partners – employers, workers and governments – is key (known as tripartism). This indicator aims to determine whether social partners are adequately included in social dialogue, whether there is a constructive dialogue taking place and whether tripartism has resulted in improving employment policies.

The **informal employment reduction** indicator examines the effectiveness and scope of programmes specifically targeted at reducing informal employment. This is a broad indicator, looking at all the relevant institutional, legal and policy frameworks in place, their degree of implementation, and monitoring.

The **labour inspectorate** indicator assesses the existence and effectiveness of labour inspectorates, and specifically their role in detecting and enforcing laws against informal work.

The six SEE economies' average score overall for the labour market governance sub-dimension is approximately 3, indicating that the economies have relevant policy, legal and institutional frameworks in place and have been implementing a range of measures. However, there are differences among the economies, with some being more advanced in their implementation than others. The more advanced economies regularly monitor implementation, including through external evaluations in some cases, and follow them up with corrective measures. This partially explains why Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia score 3 or above, while Bosnia and Herzegovina scores 2.8 and Kosovo 2.1.

Figure 8.7. **Labour market governance: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933704435

Employment frameworks and tripartite dialogue exist and are being implemented to varying degrees

As seen in Figure 8.7 all the economies score 2 or above for the **employment framework** indicator, indicating that they have adopted a strategic approach to employment – either a specific employment strategy or one that combines it with related policy areas such as skills development. And, with the exception of Kosovo, they are all implementing measures as part of their strategies. The next step would be to improve their monitoring of progress against their implementation plans to identify if any corrective action is necessary.

While Kosovo has relevant legislation in place to regulate the functioning of the labour market, the draft Sectoral Strategy 2015-2020 on employment has not yet been adopted, which partially explains its low score for the employment framework indicator. Albania and Serbia both score 4.5 for this indicator. Albania has adopted the National Employment and Skills Strategy (NESS) 2014-2020, which has clear and measurable objectives, as well as defined actions and measures with timelines and budgets. Implementation is well underway and, while there is progress in many areas, more is required. Similarly, Serbia has made significant efforts to improve labour market functioning through its comprehensive National Strategy for Employment 2011-2020 and its yearly action plans, which are being implemented within their time frames and are regularly monitored. In both economies, there is good overall co-ordination with other institutions, social partners and other stakeholders.

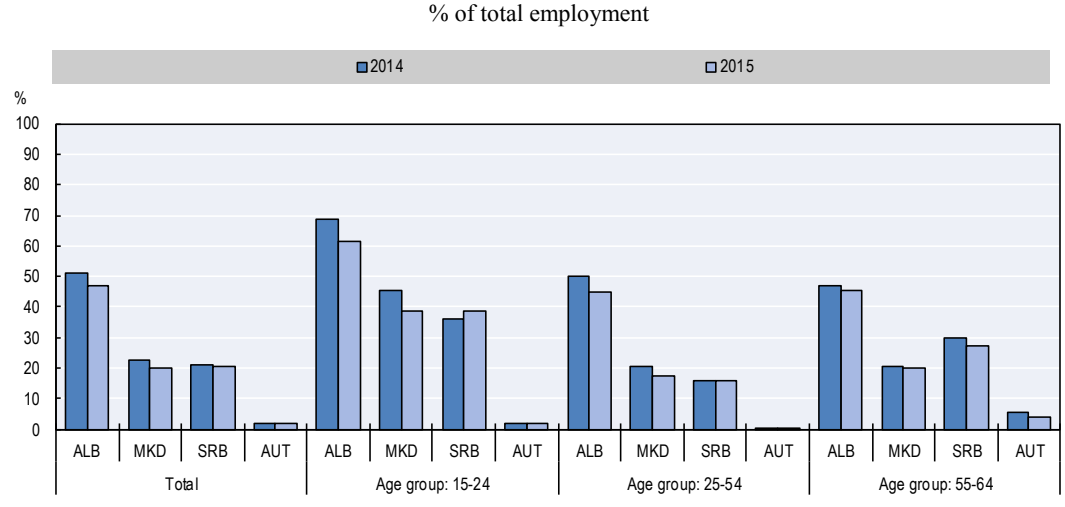
Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Montenegro score 3, 3.5 and 3.5, respectively. Overall, they are on the right track, with most of their respective strategies in place, implementation on the way, and internal monitoring regularly undertaken. In Bosnia and Herzegovina, the entities of the Republika Srpska and the Federation of Bosnia and Herzegovina govern the employment framework, while co-ordination and international co-operation takes place at state level. In the process of developing employment policies and strategies, the entity governments act autonomously, with no horizontal co-ordination between them. While the score reflects Bosnia and Herzegovina as a whole, there are differences between the entities. The Republika Srpska has adopted the new Employment Strategy 2016-2020, but the Federation of Bosnia and Herzegovina's Strategy for Employment 2009-2013 is now out of date. It has started drafting a new employment strategy, which is expected to be adopted in 2018.

Employers and workers should be able to express their views on employment-related issues. Having effective **tripartism and social dialogue** can facilitate participatory policy-making processes and link the government's agenda with those of the economic actors on the ground (employers and workers). The average score for the tripartism and social dialogue indicator is 2.8. All six SEE economies have tripartite councils in place to engage in dialogue with social partners. While social dialogue does take place in all the economies, more effort is needed to build social partners' capacity, in particular among worker organisations. Moreover, the impact of tripartism and social dialogue is not regularly evaluated by independent evaluators.

High informal employment continues to have a severe impact on labour markets

Informal employment can be broadly described as employment engaged in producing legal goods and services where one or more employment-related legal requirement is not complied with, including registering for social security, paying taxes or complying with labour regulations (OECD, 2008). Data on informal employment are hard to come by in the SEE economies, and it is only covered by labour force surveys in Albania, the Former Yugoslav Republic of Macedonia and Serbia. Among these three economies, in 2015 the share of informal employment in total employment was highest in Albania (46.7%), followed by Serbia (20.4%) and the Former Yugoslav Republic of Macedonia (19.9%). This is very high – for example in Austria the rate was 1.6%. Young people aged between 15 and 24 are particularly affected by informal employment (Figure 8.8.). Where informal jobs constitute a stepping stone towards formal careers for youth, a high incidence for this age group may not be a source of major concern. On the other hand, an informal career start can have a negative effect, often leading to inactivity. The OECD estimates for selected emerging economies show that informal jobs rarely lead to better employment opportunities, for example (OECD, 2015b).[6]

Figure 8.8. **Informal employment (2014 and 2015)**



Note: AUT – Austria.

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts.

StatLink http://dx.doi.org/10.1787/888933704454

Informal employment can have several negative consequences for the economy. First, workers employed in the informal sector have limited access to social protection, inadequate contracts and lower wages, and they are highly vulnerable when they lose their jobs or retire. High levels of informality may also reduce workers' access to training, exacerbating skills shortages. This ultimately generates greater inequalities, which is of particular concern in the SEE economies, where inequality is already high (Figure 8.17). Second, production in the informal sector is often inefficient, either because firms limit their size to avoid being detected or because they use outdated production technologies (Andrews et al., 2011). Firms operating in the informal sector also have limited access to finance and qualified labour. Third, high levels of informality reduce tax revenues. Many informal workers may also be receiving social benefits, adding to the fiscal burden on the state. Reducing informality might therefore result in bringing more taxpayers into the tax base. Finally, in addition to reducing tax revenues, complete or partial non-compliance with tax or security regulations can increase contribution rates for formal workers (e.g. higher labour taxes), or reduce the quality, targeting or coverage of public services and thus reduce further any incentives to formalise (OECD, 2015b).

One of the main causes of informality is high labour taxation. The assessed SEE economies impose relatively low corporate and personal income taxes; instead the tax mix is tilted toward indirect taxes and social security contributions (SSCs), which are levied at relatively high tax rates. High SSCs create a significant tax burden on labour income; they reduce employees' work incentives by reducing their after-tax earnings and make it expensive to hire workers, especially low-income and low-skilled workers. The larger the difference between total labour costs in the formal sector and after-tax disposable income for workers (the "tax wedge"), the greater the incentive for employers and employees to avoid taxes by remaining or joining the informal economy. Moreover, the average tax wedge is highly regressive in Albania, the Former Yugoslav Republic of Macedonia and Serbia at the bottom of the income distribution, meaning that the average contribution rate is higher for low-income workers (see Chapter 4, Tax policy).

Likewise, stricter employment protection legislation increases the incentives for informal employment in countries with limited enforcement capacity (OECD, 2008). While the general consensus is that stricter employment protection legislation is associated with higher rates of informality (Marshall, 2007), research also shows that this relationship is moderated by strong enforcement of labour regulation and good governance (Loayza and Rigolini, 2006). Nevertheless, the association between informal employment and stricter employment protection legislation can be most clearly seen in the business cycle (e.g. fluctuations in business demand or seasonal production schedules). Where regulations on temporary forms of employment are strict, allowing businesses to only hire fixed-term and temporary workers in exceptional circumstances, then informal employment is used to increase their flexibility in a business cycle upswing. By the same token, informal employees have less job security during economic downturns (OECD, 2008). The *Competitiveness Outlook* 2016 assessment showed that on average, for fixed term and temporary contracts, legislation in the SEE economies – with the exception of Kosovo and Montenegro – remains more restrictive than in OECD member states (OECD, 2016e). Also, workers on permanent contracts enjoy greater protection from individual and collective dismissals in Albania, Bosnia and Herzegovina and Montenegro than in OECD countries.

While the average score of approximately 2.3 for the informal employment reduction indicator (Figure 8.7) suggests that the relevant institutional, legal or policy frameworks for reducing informal employment are in place, the SEE economies need to invest more effort in implementing them. Albania has the highest score (3.5) and shows the most concerted efforts in tackling informal employment. It recently adopted the Occupational Safety and Health Policy Document 2016-2020, which addresses informal employment to a significant degree. This document is complemented by the National Employment and Skills Strategy 2014-2020. In addition, the Albanian government launched a large campaign in 2015 to fight informality. The campaign involved a significant number of stakeholders and resulted in an increase in more than 70 000 new registrations as employees or self-employed. Bosnia and Herzegovina and Kosovo have the lowest scores, at 1.5 each. While legal provision and functioning institutions (e.g. labour inspectorates) that address informal employment are in place in both of Bosnia and Herzegovina's entities, their efforts are rather fragmented and do not address the issues systematically. Similarly, there is no coherent approach for tackling informal employment in Kosovo.

Labour inspectorates exist in all six economies, but face several limitations

The effective enforcement of labour regulations, combined with enforcing tax and social security regulations, and providing greater incentives for formalisation, are essential to combat informal employment. Labour inspectorates play an important enforcement role. Labour inspection is a complex activity, as labour standards are broad and often incorporated in numerous legal instruments, their application is spread throughout the state's territory and concern numerous issues. Inspection is also labour intensive and, though not expensive, does need resources, as it requires well-trained inspectors in order to function optimally. Labour inspectorates in transition economies in general are often plagued by internal problems, including limited numbers of inspectors, poorly paid staff, lack of training and capacity, lack of resources, and vulnerability to corruption (ILO, 2013a).

All six SEE economies have labour inspectorates. Their tasks include providing education and information on legislation requirements, preventing violations of labour standards by offering advice, and penalising offences. Labour legislation, offences and penalties are clearly defined and have been made easily accessible to employers. As indicated by the average score of approximately 3.1 for this indicator (Figure 8.7), labour inspectorates have been actively implementing their duties, including enforcing laws against informal work. The highest-scoring economies are Albania (4) and Serbia (3.5). Bosnia and Herzegovina scores 3, with well-functioning labour inspectorates in place in both entities – given the weak overall performance in tackling informal employment, this indicates that there is a good institutional base in place that needs to be complemented by other measures.

While labour inspectorates in the SEE economies overall have adequate structures, powers and facilities to monitor the enforcement of labour legislation, they still face challenges. These tend to be limited human resource capacities, a lack of modern equipment, a lack of preventative measures (e.g. awareness-raising activities), poorly organised visits due to a lack of registers, limited standard operating procedures and poor interaction with social partners (EC, 2014; ILO, 2013b, 2017a, 2017b, 2017c, 2017d). Bosnia and Herzegovina, for example, lacks adequate communication between the entities' inspectorates – their databases do not allow them to share data and information. This creates an opportunity for non-compliant employers to reproduce bad practices in different areas of the economy (ILO, 2013b).

The way forward for labour market governance

The assessed SEE economies should continue implementing employment strategies while addressing stakeholders' concerns, at both national and local levels. Specifically, in view of the low employment rates for women, the *OECD Recommendation on Gender Equality in Public Life* (OECD, 2016a) recommends that all economies should adopt a dual approach to gender equality: 1) make gender a mainstream part of the design, development, implementation and evaluation of all public policies and budget; and 2) level the playing field between men and women through actions that target specific forms of gender discrimination. Moreover, co-ordinating implementation better with other areas affecting employment would be welcome (e.g. tax policy, education policy and social policy). Finally, more efforts are needed to ensure regular and independent evaluations that lead to corrective measures. Kosovo would benefit from adopting an employment strategy that provides clear directions for implementing various measures. Likewise, Bosnia and Herzegovina would benefit from co-ordination between both entities on employment measures. To ensure this, the Federation of Bosnia and Herzegovina should adopt a new strategy, to be co-ordinated in turn with the Republika Srpska's Employment Strategy 2016-2020 at state level, in order to achieve a better impact for both entities and Bosnia and Herzegovina as a whole.

The economies should consider improving social partners' capacities, in particular workers' organisations, to ensure their active participation in social dialogue. This would strengthen the participatory process and could lead to better employment outcomes.

The six SEE governments need to make more effort to reduce informal employment. Bosnia and Herzegovina especially could benefit from a more coherent approach to addressing informal employment. While there are legal provisions in place, as well as functioning institutions (e.g. labour inspectorates) that address informal employment in both entities of Bosnia and Herzegovina, their efforts are rather fragmented and would benefit from better co-ordination of measures. In six SEE economies specific measures to reduce informal employment could include reducing the tax burden where possible, especially for wages, to create financial incentives for a transition to formal employment. Box 8.1 gives an example from Austria of a scheme that aims to bring selected professions from informal employment into a legal framework by providing them with a minimum level of social protection. The economies could also run awareness-raising campaigns on the benefits of social protection and public services.

The SEE economies should build the capacity of their labour inspectorates and use their existing resources more efficiently. This could be done by implementing or increasing the use of risk-assessment processes to better target inspections, and increasing co-ordination and information sharing among enforcement agencies (e.g. tax, social security and labour inspection agencies) (OECD, 2008). Overall, the six SEE governments should ensure that labour inspectors are independently monitored and that inspectorates adjust their practices according to their findings.

Activation policies

Activation is defined as a combination of mutually supporting policies for unemployed people (registered unemployed) or welfare benefit recipients who are able to work (ETF, 2011). For activation policies to be successful they need to give people the motivation and incentives to seek employment, to increase people's employability and to help them to find suitable employment, and to expand employment opportunities. The implementation

of activation policies can be managed through efficient labour market institutions, such as public employment services (OECD, 2016b).

Box 8.1. Good practice: Fighting informal unemployment with service employment cheques in Austria

In Austria, VAEB is a public insurance institute for railway and mining company employees. It is under the auspices of the Federal Ministry for Employment, Social Affairs and Consumer Protection, which deals with public health, annuity, and casual insurance. In 2005, VAEB introduced the "service employment cheque", with the aim of bringing people from selected service professions from informal employment into a legal framework by providing them with a minimum level of social protection, such as casualty insurance, which would not be costly or administratively complex.

Since 1 January 2006, the Service Employment Cheque has served to formalise the employment relationships between people providing simple household services in private homes (employees) and people requiring such services (employers), provided the payment from the individual employer does not exceed the monthly minor employment threshold (in 2016 this was EUR 569.48). Selected services that qualify for the service employment cheque include cleaning work, childcare, grocery shopping and simple garden maintenance (such as sweeping leaves, cutting grass).

Employers can buy the service employment cheques at newsagents, VAEB, post offices or online, paying EUR 10.2 for a cheque worth EUR 10. The extra 2% pays for casualty insurance (1.3%) and administrative costs (0.7%). Service employment cheques are also available in other values, up to EUR 100 per cheque. On top of the statutory casualty insurance, employees can opt in to voluntary health and annuity insurance, at a monthly rate of EUR 58.68. Service employment cheques have been a great success, with rapid growth in the amounts both sold and redeemed between 2006 and 2015. The total value of cheques sold grew from EUR 997 432 in 2006 to EUR 7.8 million in 2015, and those redeemed grew from EUR 872 427 in 2006 to EUR 7.6 million in 2015.

Source: World Bank/WIIW (2017c), "Lessons learned from fighting informal employment in Austria and Sweden: Social security vouchers for the service sector and addressing under-reporting of hours worked", www.seejobsgateway.net/document/lessons-learned-fighting-informal-employment-austria-and-sweden-social-security-vouchers.

Building on the approach taken by Brown and Koettl (2012), activation policies can be broadly classified as interventions 1) targeting the demand side of the labour market, i.e. incentives for retaining and creating employment; 2) targeting the supply side of the labour market, i.e. incentives for seeking and keeping jobs and for human capital enhancement; and 3) improving labour market matching between the demand and supply sides. The first group includes financial incentives for employers to either keep the employment relationship with workers in order to prevent and/or reduce employment outflow, or to create new jobs in order to increase employment inflow, such as wage subsidies, self-employment incentives and other measures. The second group includes various financial transfers, or subsidies designed as income supplement, public works, training or other measures to improve labour skills and competencies. The third group is about labour market matching, which is a form of job brokerage between employers and job seekers. The main policy instruments within this group are job search assistance, counselling, monitoring and employer intermediation services. In addition, youth-oriented programmes and programmes intended for people with disabilities are recognised as a separate measure in some classifications (Lehmann and Kluve, 2008). Public employment

services (PESs) are the leading institutions that implement activation policies, in co-ordination with the other relevant institutions and stakeholders.

This sub-dimension assesses the policy, legal and institutional arrangements for activation policies, as well as relevant programmes and measures. Four qualitative indicators are used for this sub-dimension:

The **public employment services** indicator assesses the capacity of the PES to operate active labour market policies (ALMPs).

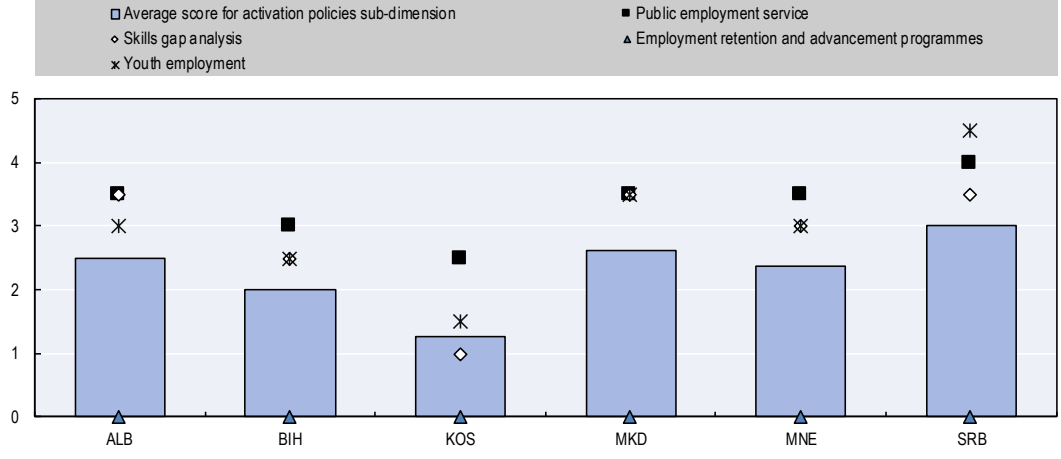
The **skills gap analysis** indicator measures the extent to which an economy conducts skills gaps analysis, as well as the extent to which the analysis informs policy making.

The **employment retention and advancement programmes** indicator measures the extent to which the SEE economies apply a combination of services to help unemployed individuals who have entered work as well as low-paid workers to remain and progress in work. These services combine job coaching and advisory services with financial incentives rewarding sustained full-time work, as well as completing training or education whilst employed (Sianesi, 2011).

The **youth employment** indicator examines the effectiveness and scope of policy, legal and institutional frameworks specifically targeting youth unemployment.

Overall, legal, institutional and policy frameworks for active labour market policies are in place throughout the six SEE economies (Figure 8.9), reflected in the average score across the economies of 2.3. This indicates that relevant measures are being implemented, but that more efforts are needed to increase PES capacities, improve targeting and co-ordinate better with other areas (e.g. social and education policy). All economies score 0 for the employment retention and advancement programmes indicator because the OECD assessment found that none of them have these programmes.

Figure 8.9. **Activation policies: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

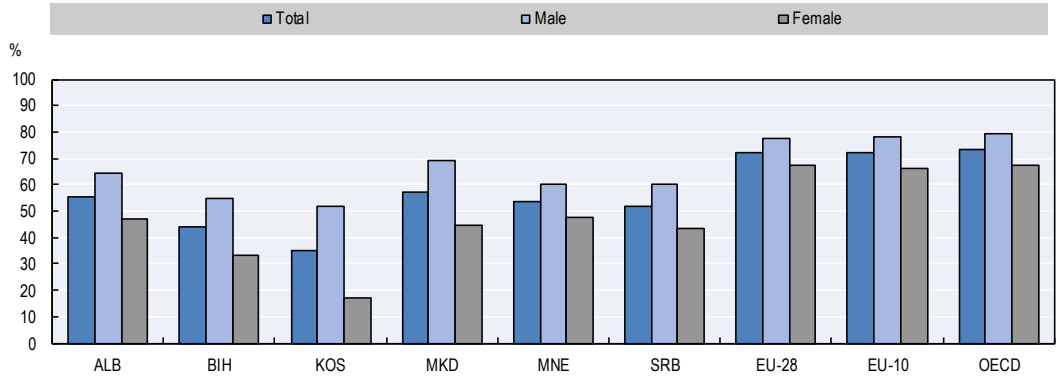
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SEE economies are facing significant challenges in activating their labour force

Figure 8.10 shows that the share of economically active people in the total working-age population is larger in the EU and the OECD than in the assessed SEE economies.

Figure 8.10. **Economic activity rate for the 15-64 age group (2015)**

% of total working-age population



Note: EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

Source: EC (2017b), *Employment and Unemployment (Labour Force Survey)* (Eurostat database), http://ec.europa.eu/eurostat/web/lfs/data/database; World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts; OECD (2017), *OECD Data* (database), https://data.oecd.org.

StatLink http://dx.doi.org/10.1787/888933704492

The economic activity rate for the EU-28, EU-10 and the OECD for people aged 15-64 was above 70% in 2015. For the six SEE economies, the average rate was 49.5%, and in Kosovo only 35.1%. Economic activity rates in these economies are mainly suppressed due to gender inequality. In 2015, economic activity rates for men were about 60%, while for women they were about 40%. This is in sharp contrast to the EU and the OECD average economic activity rates, where gender differences were less pronounced.

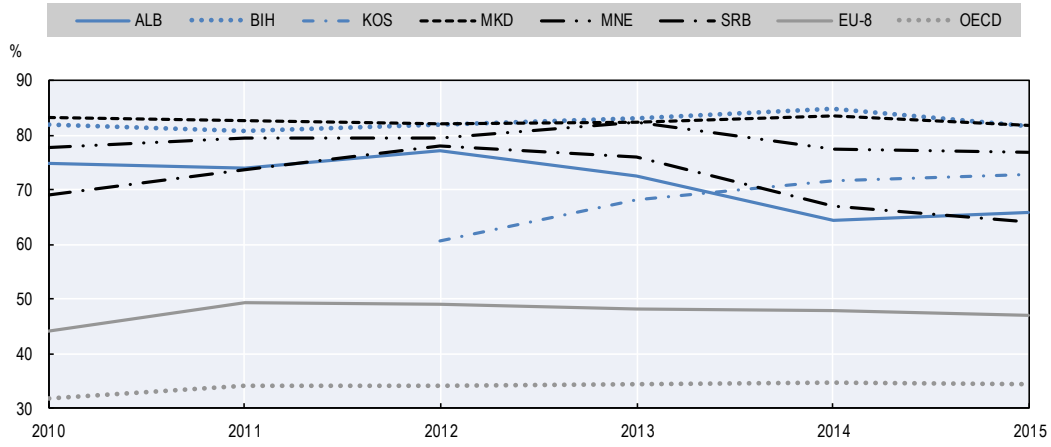
Long-term unemployment is another serious issue in these SEE economies (Figure 8.11). Unemployment tends to have more severe effects the longer it lasts (OECD, 2013). Long-term unemployment can lead to loss of skills, self-confidence and motivation, and translate into acute social and health problems that sap the ability to work and look for a job (OECD, 2014b). Without well-targeted support through activation policies there is a substantial risk that the long-term unemployed will exit the labour market altogether.

The incidence of long-term unemployment, measured as a share of the labour force, is highest among the youngest cohort (Figure 8.12).

While all six SEE economies have been implementing various active labour market policies (ALMPs), public expenditure for these measures as a share of gross domestic product (GDP) is low compared to EU economies. In 2013 the six SEE economies, excluding Kosovo, spent on average 0.1% of their GDP on ALMPs. This is significantly lower than average expenditure in the EU (0.46% of GDP) and OECD (0.6% of GDP) in 2011 (the last year for which aggregate data are available) (Numanović, 2016).

Figure 8.11. **Share of long-term unemployment (12 months +)**

% of unemployed



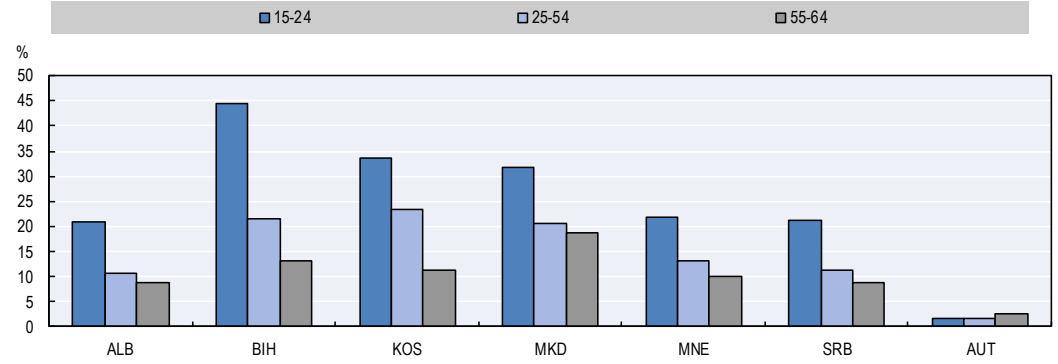
Note: Data not available for Kosovo for the years 2010 and 2011. EU-8 – the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The OECD average excludes Chile. The EU and OECD averages have been calculated as simple averages.

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts; OECD (2017), *OECD Data* (database), https://data.oecd.org.

StatLink http://dx.doi.org/10.1787/888933704511

Figure 8.12. **Long-term unemployment rate (12 months +) in 2015**

% of labour force by age



Note: AUT – Austria.

Source: World Bank/WIIW (2017b), *SEE Jobs Gateway* (database), www.seejobsgateway.net/charts.

StatLink http://dx.doi.org/10.1787/888933704530

The portfolio of ALMPs in the SEE economies is also rather limited. By dividing ALMPs into employment subsidies, self-employment/start-up support, training and provision of public works/public sector jobs, the analysis shows that in Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia, ALMP spending is predominantly on employment subsidies (Table 8.2). While these mainly affect cyclical unemployment, they are less effective at addressing structural unemployment. Given the structural challenges labour markets are facing in these economies, spending on employment

subsidy measures may not be justified. Moreover, such measures can encourage employers to lower labour costs without having an impact on labour market performance (Numanović, 2016). Table 8.3 shows a similar picture to that in Table 8.2: the greatest share of participants benefit from employment subsidies, except in the Former Yugoslav Republic of Macedonia, where the largest share are in training programmes.

Table 8.2. **Active labour market policies (expenditure) in 2015**

% of total expenditure

	Employment subsidies	Self-employment/start-up support	Training	Public work/public sector jobs
ALB	68	n/a	32	n/a
BIH	71	15	10	4
MKD	38	32	28	2

Note: Data unavailable for KOS, MNE and SRB. N/a – not applicable.

Source: Numanović (2016), "Weak labour markets, weak policy responses: Active labour market policies in Albania, Bosnia and Herzegovina and Macedonia", www.analitika.ba/en/publications/weak-labour-markets-weak-policy-responses-active-labour-market-policies-albania-bosnia.

StatLink http://dx.doi.org/10.1787/888933704701

Table 8.3. **Active labour market policies (participants) in 2015**

% of all participants

	Employment subsidies	Self-employment and start-up support	Training	Public work/public sector jobs
ALB	79	n/a	21	n/a
BIH	62	12	18	9
MKD	35	6	57	2
OECD	50	3	36	11

Note: Data unavailable for KOS, MNE and SRB. N/a – not applicable.

Source: Numanović (2016), "Weak labour markets, weak policy responses: Active labour market policies in Albania, Bosnia and Herzegovina and Macedonia", www.analitika.ba/en/publications/weak-labour-markets-weak-policy-responses-active-labour-market-policies-albania-bosnia.

StatLink http://dx.doi.org/10.1787/888933704720

Overall, ALMP coverage is low in these three economies compared to the EU and OECD average, both as a share of the unemployed and as a share of the labour force (Table 8.4). Participation in ALMPs is mainly optional – people can apply following an open announcement. The economies lack a well-established institutional mechanism to guide unemployed individuals through the employment process, steering their participation according to their needs (Numanović, 2016).

Table 8.4. **Active labour market policies (coverage)**

	Coverage rate of unemployed people (%)	Coverage rate of total labour force (%)
ALB (2015)	13.5	1.5
BIH (2014)	2.4	1.0
MKD (2015)	6.5	1.7
EU (2014)	41.7	4.4
OECD (2014)	46.3	3.7

Source: Numanović (2016), "Weak labour markets, weak policy responses: Active labour market policies in Albania, Bosnia and Herzegovina and Macedonia", www.analitika.ba/en/publications/weak-labour-markets-weak-policy-responses-active-labour-market-policies-albania-bosnia.

StatLink http://dx.doi.org/10.1787/888933704739

Public employment services need greater capacity to improve the impact of activation policies

The public employment services in the SEE economies still have many limitations which hamper the effective implementation of their activation policies.

In terms of performance against the public employment services indicator, all the economies have PESs in place, institutional co-ordination between national and sub-national government bodies is good and all are implementing ALMPs. This results in an average score of 3.3 (Figure 8.9). Overall, however, they lack the capacity and infrastructure to implement active labour market policies fully, as explained above. Not all the economies have independent impact assessments in place to inform policy framework design and implementation updates. Kosovo scores the lowest, 2.5, mainly because it currently has no functioning central employment agency. While the agency should start functioning soon, its role is currently carried out by the Ministry of Labour and Social Welfare and local employment offices, which operate within their own legally defined mandates. Although PESs drive activation policies in all the economies, for those policies to succeed it is crucial that other actors are also involved. These should include responsible ministries, social partners, social welfare centres, educational establishments, local authorities and employers.

The eligibility criteria for registering with public employment services are usually defined in the country's legislation on employment and unemployment-related benefits. It is important that the criteria filter out those who may be working in the informal economy or have no intention of accepting work – otherwise there is too much pressure on the employment service to make sure that those who register adhere to the active job search rules and are available for work. Overall, in the assessed SEE economies the eligibility criteria tend to be rather liberal, however, and there is often no clear distinction in status between the employed, the unemployed or the inactive. While in principle it is desirable that PESs are accessible to anyone looking for a job, regardless of their previous position on the labour market, it is also important to exclude people who are actually working, or to give them jobseeker rather than unemployment status (ETF, 2011).

There also tends to be an overlap in the SEE economies between unemployment status and social benefits, including unemployment benefits, health insurance, various social welfare benefits, child benefits, maternity/paternity benefits, war veterans' allowance and other potential benefits. This is one of the reasons people often seek unemployment status. For example, when health insurance or benefits for a particular population group, such as war veterans, are also linked to unemployment status, they cannot be easily revoked by non-compliance measures, hence activation measures have a limited impact. Also, this places an additional administrative burden on PES staff.

Compliance with the PES requirements (by reducing benefits in the case of non-compliance) seems to be rather weakly enforced across the economies. Serbia, which has the highest overall score for this indicator, has explicit penalties for someone who refuses to participate in a training programme or turns down a job offer but enforcement appears to be weak. This is due to the lack of communication between the PES, the centre for social welfare and the service provider (e.g. training programmes, public works) (World Bank, 2013).

Some studies have shown that employment agency staff in the SEE economies spend most of their time registering clients and providing basic information (Tomev and Meinardus, 2012). Their heavy workload seriously inhibits the effectiveness of activation

policies. The client-to-staff ratio in Albania, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia is about 400:1 (i.e. 400 jobseekers for every staff member), which significantly deviates from the 100:1 ratio recommended by the International Labour Organization (ILO) (Kuddo, 2012). Moreover, there are many fewer counsellors responsible for developing client relationships than other staff (e.g. administrative staff). When managers at various levels are included, then the number of counsellors may be less than 40% of the total, yet they carry about 80% of the responsibility for the successful delivery of typical PES objectives. As a consequence, the case load is extremely high, preventing the PES staff from providing efficient job brokering, job search assistance through intensive counselling interviews or job search monitoring and verification (ETF, 2011). Recent evidence from a German experiment suggests that reducing client-to-staff ratios enables a more personalised service, which in turn has a positive impact on employment. In the experiment, 14 local PES offices hired additional caseworkers to lower the client-to-staff ratio to an average of 70:1 (from the usual 80:1 to 250:1) to improve the quality of placement services, resulting in shorter unemployment benefit durations in the participating PES offices. The costs of hiring additional caseworkers were offset by decreased benefit expenditure after a period of about ten months (OECD, 2016d).

Gaining employers' trust is a precondition for a PES to function as a competent job broker. This is not easy, because employers often have negative perceptions of the PES. Employers may perceive jobseekers referred by the PES as less motivated and trustworthy than other jobseekers and suspect that the PES is concealing important information in attempting to reintegrate an individual into the labour market (Larsen and Vesan, 2012). The lack of quality service provision to enterprises affects the PES's reputation with employers in the assessed economies. The lack of coherent strategies for attracting employers to the service also contributes to the poor quality of vacancies offered by the PES. Most registered vacancies, in fact, are for unskilled and low-paid jobs, or for work in dangerous conditions; these make them unattractive to unemployed clients and especially to young people.

Skills gap analyses are used to design training schemes, but require better integration into overall employment and education policies

Skills gap analysis is a method of identifying and assessing gaps and mismatches between the skills people have and those needed in the workplace. It can also include sectoral-specific assessments of skill needs, qualitative and quantitative forecasts and foresight exercises (ETF, 2016). Skills-matching ensures that training measures are effective and can result in increased job placement rates. On a broader level, it can also contribute to more effective investment in human capital by individuals, governments and businesses (Box 8.2). Public employment services are the main institutions to provide this type of labour market information for human resource purposes. The ultimate beneficiary should be the central government administration responsible for developing human resources.

Most of the assessed SEE economies conduct some form of skills gap analysis, although in Kosovo these mainly are done through donor-financed projects without any policy framework systemically addressing the issue. In most of them, the PES researches employers' needs (mainly through business surveys) to assess occupation levels and types, specialist knowledge and experience. All six SEE economies indicate that they use the findings from skills analysis to design short-term training schemes to help workers acquire the skills needed on the labour market, as confirmed by the average score of 2.8 (Figure 8.9).

Done correctly, skills assessments and anticipation exercises can inform how occupational standards are updated or on-the-job and retraining courses developed. Occupational standards, for example, identify the skills, qualifications and experience required to perform an occupation. They are then used to develop curricula and qualifications for quality assurance or to guide firms' human development strategies, among other uses. In the United Kingdom, identified skill needs feed into the National Occupation Standards to fast track the development of standards in new occupations or occupations with changing skill requirements. In Australia, Austria, Belgium (Flanders and Wallonia) the Czech Republic, Denmark, France, Japan and Portugal, skills assessments and anticipation exercises are used to inform re-training, on-the-job training programmes and/or apprenticeship schemes. The results can also feed into education policy. In Norway, for example, an expected lack of engineers, teachers and health professionals was an important factor in deciding the offer of post-secondary education vacancies (OECD, 2016c).

Box 8.2. **Good practice: The Expert Group on Future Skills Needs in Ireland**

The Expert Group on Future Skills Needs (EGFSN) in Ireland advises the Irish government on the economy's current and future skills needs. Composed of experts from industry, education and training, and unions, it has a central role in ensuring that labour market needs for skilled workers are anticipated and met.

Established in 1997, the EGFSN reports to the Minister for Jobs, Enterprise and Innovation and the Minister for Education and Skills. Forfás, Ireland's policy advisory board for enterprise, trade, science, technology and innovation, in conjunction with FÁS, the National Training Authority, provides the EGFSN with research and analysis support. The FÁS Skills and Labour Market Research Unit provides the group with data, analysis and research and manages the National Skills Database.

The Expert Group on Future Skills Needs provides advice to the government on skills issues that affect enterprises through skills foresight and benchmarking, strategic advice on building skills through education and training, and data collection and analysis on the demand and supply of skilled labour.

Some of the outcomes include the Action Plan for Jobs 2012-2015, ICT Skills Action Plan 2014, Strategy for the Manufacturing Sector to 2020, Trade Tourism and Investment Strategy, Further Education and Training and Higher Education Strategies, and Migration Policy: Eligible Occupations.

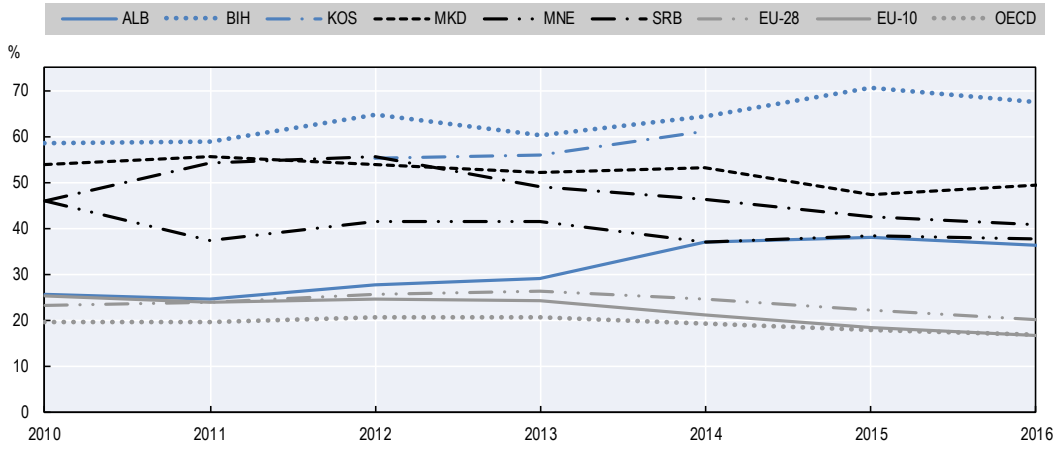
Source: EGFSN (2017), "About us", www.skillsireland.ie/About-Us.

Youth unemployment needs to be further addressed

A person's first experience of employment has a profound influence on their later working life. Getting off to a good start helps young people take their place in the labour market and lays the foundations for a good career. By contrast, it can be hard to make up for first-time failure (OECD, 2014b). Reducing youth unemployment is thus crucial in the SEE economies (Figure 8.13). Weak job creation in the region leads to difficult school-to-work transitions and most young people enter the labour market only after an initial spell of unemployment.

Figure 8.13. **Youth unemployment rate for 15-24 age group (2010-15)**

% of labour force aged 15-24



Note: Data for Kosovo not available for the years 2010, 2011, 2015 and 2016. EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

Source: World Bank (2017a), "Unemployment, youth total (% of total labor force ages 15-24) (modelled ILO estimate)", *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=2&series=SL.UEM.1524.ZS&country=#; ASK (2017), *Labour Market* (database), http://askdata.rks-gov.net/PXWeb/pxweb/en/askdata.

StatLink http://dx.doi.org/10.1787/888933704549

Furthermore, young people need to participate in employment, education or training if they are to take their place in the labour market and be self-sufficient. Most economies focus on youth unemployment alone, but this underestimates how vulnerable young people can be. Broadening the perspective to those not in education or training affords a better insight into the challenges they face. With the exception of Montenegro, the share of young people not in employment, education or training (NEET) in the SEE economies is almost double the EU and OECD averages (Figure 8.14). Young NEETs are considered "at risk": being jobless, inactive and with no access to learning.

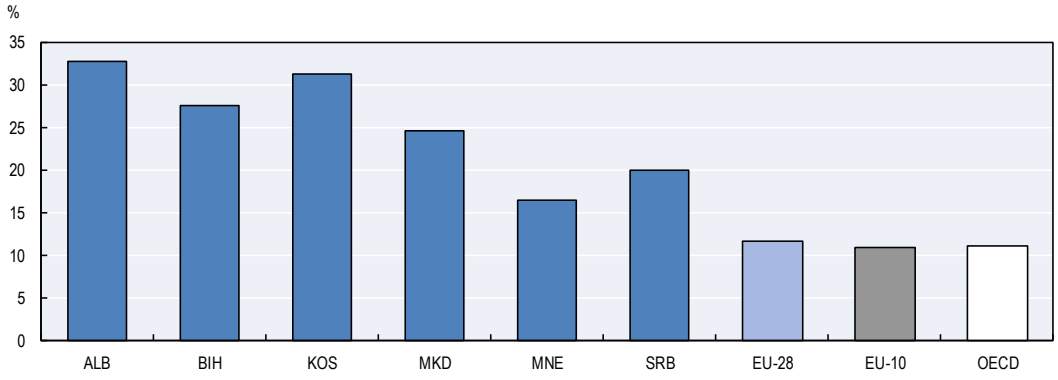
Measures to reduce youth unemployment include targeted training and various job creation schemes (Box 8.3). Most of the assessed SEE economies have various legal, institutional and policy frameworks to address the issue of rising youth unemployment. While overall, implementation of measures to reduce youth unemployment is well under way, not all the areas set out in strategies and action plans are being implemented in full. This leads to an average score of 3 for the six economies (Figure 8.9). Kosovo scores only 1.5. Its youth unemployment programmes are mainly implemented by donors in an uncoordinated manner – a worrying situation as Kosovo's youth unemployment rate is the highest in the region. The new Sectoral Strategy 2015-2020 has not yet been adopted and there is no strategic framework to guide the implementation of various measures. It is expected that the strategy will have an action plan dedicated specifically to youth.

Serbia has the highest score, at 4.5. As part of its National Strategy for Employment 2011-2020, it has been improving youth unemployment targeting efforts based on impact evaluation. For example, the National Action Plan 2017 places a greater focus on specific groups of young people, such as people under 30 years of age with no or few qualifications,

or young people who have been looking for a job for more than 12 months (long-term unemployed), as well as orphans. Most of the SEE economies are monitoring their own strategies and actions plans; nevertheless, more needs to be done to revise their programmes on the basis of a regular independent impact assessment.

Figure 8.14. **Not in employment, education or training at age 15-24 (2015)**

% of total population aged 15-24



Note: EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The OECD average does not include Korea. The EU and OECD averages have been calculated as simple averages.

Source: ILO (2017e), *Key Indicators of the Labour Market* (database), www.ilo.org/global/statistics-and-databases/research-and-databases/kilm/lang--en/index.htm.

StatLink http://dx.doi.org/10.1787/888933704568

Box 8.3. **Good practice: Support for youth in Brandenburg, Germany**

Since 1999, ENTERPRISE has been supporting young people in starting their own business. ENTERPRISE is an initiative of *iq consult*, a social enterprise working on the development of concepts in business start-up support, regional development and cultural industries. The aim of ENTERPRISE is to respond to high unemployment rates in the federal state of Brandenburg, eastern Germany, and to growing numbers of young people leaving the region to find work elsewhere in Germany.

The project provides youth with optimal conditions for planning, starting and running their own business. It offers young entrepreneurs a mixture of individual face-to-face support from a business advisor, group learning in workshops and their first working experience in the enterprise business incubator, to help shape their ideas. As many participants in the project also need additional financial means in order to realise their concept, ENTERPRISE offers micro-loans from a special fund or facilitates contact with local financial institutions. To this end, ENTERPRISE organises networking events where young business starters get together with regional firms. ENTERPRISE has offices in different locations in Brandenburg and in Berlin.

The initiative has an operational annual budget of EUR 25 000 and six business advisors and trainers. Partners involved in the project include the Ministry of Labour of the Federal State of Brandenburg, local municipalities, the Department for Business Development, financial institutions, Chambers of Commerce, Chamber of Crafts, regional business networks and local youth organisations. The project has supported over 300 start-ups.

Source: OECD (2009), "Shooting for the moon: Good practices in local youth entrepreneurship support", www.oecd.org/cfe/leed/45204509.pdf.

The way forward for activation policies

Activation policies in the six SEE economies need to address the three pillars of motivation, employability and opportunities, and be backed up by an institutional setup able to co-ordinate the delivery of a complex array of services. A number of tools need to be mobilised to achieve this (ETF, 2011; Numanović, 2016; OECD, 2015b, 2016a):

- **Eligibility criteria should ensure that recipients of unemployment benefits are available for work**, in other words that they are contactable and ready to accept suitable jobs. Benefits may reduce motivation, unless they are conditional on active job searching and being available for suitable jobs.
- **Economies should improve the targeting of their activation measures** in order to reach the most vulnerable and hard-to-employ people in the labour market, and to tackle important challenges such as youth unemployment, low rates of labour market participation among women and long-term unemployment. Given women's low employment rates, it is important to develop and implement a gender mainstreaming approach, and combine this with targeted approaches for disadvantaged women (low-skilled women, women with family duties) to increase their employability.
- **Participation in ALMP programmes should be more personalised** and adapted to individual needs.
- **The six SEE economies should expand and diversify their ALMP portfolios**. The employment subsidies and related measures that currently dominate financing should be complemented with other measures, such as training. This support should be combined with stricter measures to tackle informal employment and to ensure that jobseekers are actively searching and available for work.

The SEE economies could consider increasing the capacity of their public employment services and the ratio of staff to jobseekers. This would reduce their workload and ensure more effective implementation of activation policies. Bosnia and Herzegovina, for example, would also benefit from improved co-ordination efforts between the PESs in the Republika Srpska and the Federation of Bosnia and Herzegovina, providing a platform for mutual learning and exchanging practices. In Kosovo, on the other hand, it is imperative to get the central PES functioning to take the pressure off the Ministry of Labour and Social Welfare. More specifically, PES in all the economies could consider (Duell et al., 2016; OECD, 2015b):

- **Improving their job brokerage services**. Job-search assistance through intensive counselling interviews needs to be high quality and personalised, a take work-first approach but with a preference for stable jobs where possible. Selective referrals to full-time activation programmes are also required. Job-search monitoring and verification can have a considerable impact on re-employment rates. At the same time, matching and referring jobseekers with vacancies often proves effective in increasing the rate of re-employment, especially for jobseekers who are hard to place or still unemployed after a period of independent job searching.
- **Further strengthening and developing services to employers** in order to advertise more vacancies and improve the reputation of PES as a reliable service provider for employers.

- **Introducing e-services like e-coaching,** which can be used to reach out and serve certain target groups and help make the work of the PES more efficient. In the Netherlands in 2010, the PES redesigned its service to interact with jobseekers only via digital services during their first three months of unemployment. The PES then offers personal face-to-face or telephone interviews in the fourth month, and the 10% most disadvantaged jobseekers are entitled to receive more intensive support through individual or group coaching from the fourth month onwards. Other jobseekers have access to e-coaching and other general e-services. Customers who cannot use online services (even with help) get services in local offices.
- **Establishing specialised units or case managers for specific groups** (e.g. young people, people with disabilities) and should co-operate more with institutions (such as social enterprises and NGOs) that specialise in working with disadvantaged and vulnerable groups in order to take advantage of their expertise.
- **Regularly undertaking performance evaluations** to determine the cost-effectiveness of implementing activation policies.

The assessed SEE economies would also benefit from developing a wider range of instruments to measure and anticipate skills needs, while at the same time ensuring that representative data are collected regularly. In the long run, it would be useful to use the findings of skills gap analyses to improve employment policies, as well as to inform the education system so that students are better equipped to enter the workplace.

The economies could consider further measures to reduce youth unemployment, such as reforming labour regulations and labour taxation, reducing skills mismatches, promoting youth entrepreneurship and improving access to various productive inputs.

The SEE economies could consider introducing employment retention schemes, which have the potential to help unemployed individuals who have recently entered work, as well as low-paid workers, to remain and progress in work. These services combine job coaching and advisory services with financial incentives rewarding sustained full-time work, as well as completing training or education while employed.

Job quality

This section looks at the job quality sub-dimension (Figure 8.15). Job quality refers to multiple aspects of employment that contribute to workers' well-being. There are three key dimensions of job quality that have been shown to be particularly relevant for workers' well-being in the literature on economics, sociology and occupational health (OECD, 2014b):

- Earnings quality: the level and distribution of earnings.
- Labour market security: unemployment risk and unemployment insurance.
- Quality of the working environment: the nature and intensity of the work, how it is organised and the working atmosphere.

Poor job quality affects productivity through poor working practices and job strain, which reduce work performance. Analysis in Chapter 7 on Education and competencies (Figure 7.3) shows that labour productivity is significantly lower in the six SEE economies than in the EU or OECD, although it is growing more quickly on average.

This sub-dimension focuses on the policies that can have a direct or indirect impact on job quality. While job quality plays an important role in labour market policies, it is also significantly affected by other relevant policies (e.g. education policy, social policy, investment policy). The sub-dimension has three qualitative indicators:

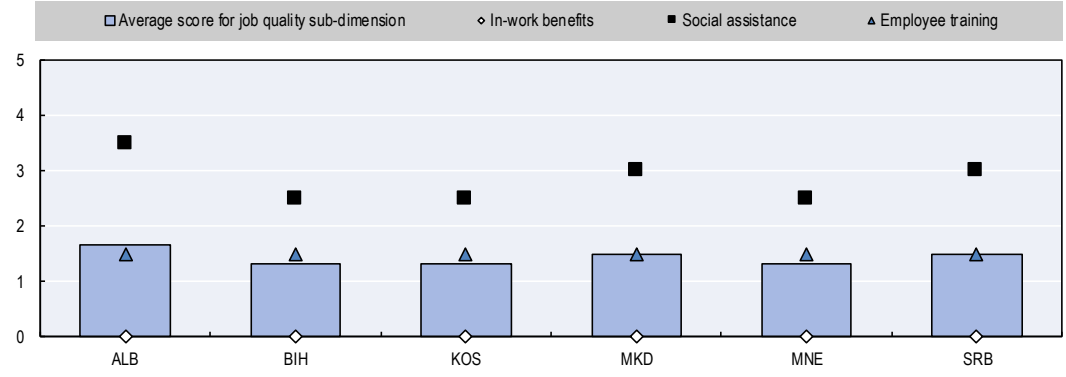
The **in-work benefits** indicator asks whether an economy has welfare schemes designed to provide an income supplement to needy families or individuals on the condition that they work. In-work benefits are a specific type of make-work-pay policies – the other one being a reduction in social security contributions (OECD, 2005).

The **social assistance** indicator looks at the policy, legal and institutional arrangements for the social assistance framework, as well as relevant programmes and measures adopted recently.

The **employee training** indicator measures the policy, legal and institutional arrangements for employee training, as well as relevant programmes and measures.

The assessed SEE economies have a relatively low average score for the job quality sub-dimension, at approximately 1.4 (Figure 8.15).

Figure 8.15. **Job quality: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

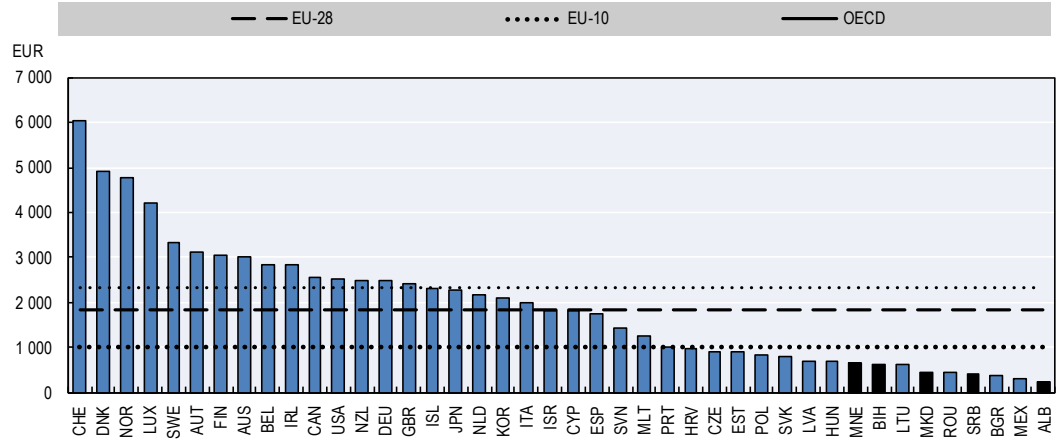
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Job quality needs to improve to reduce inequality in the SEE economies

In terms of gross average real monthly wages, the economies trail behind most of the EU and OECD economies (Figure 8.16). While wages are an essential part of the story, it is also important to look at income distribution to fully understand earning inequality. Income inequality can be linked to crime, poverty and social exclusion. A well-known measure of earning inequality is the Gini coefficient, whereby the coefficient ranges from 0 (or 0%) to 1 (or 100%), with 0 representing perfect equality and 1 representing perfect inequality. The evidence shows that the Gini coefficient is relatively high, meaning that inequality is high, in the assessed economies, especially compared to the EU and OECD averages (Figure 8.17). Moreover, in the Former Yugoslav Republic of Macedonia and Serbia, the risk-of-poverty indicator (measured after social transfers) looks at the share of people with an equalised disposable income who are below the at-risk-of-poverty threshold.[7] The data show that in 2015 their shares were 21.5% for the Former Yugoslav Republic of Macedonia and 25.4% for Serbia. This is relatively high compared to the EU average of 17.3%. While there are also considerable differences within the European

Union, some economies report much lower shares, such as the Czech Republic with 9.7% and the Netherlands with 11.6% (EC, 2017a).

Figure 8.16. **Gross average real monthly wages (2014)**

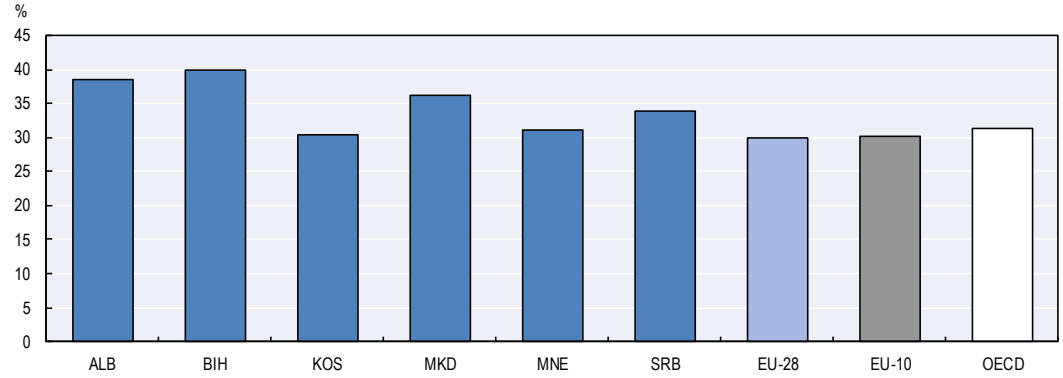


Note: Gross average nominal monthly wages in local currency units were taken from the ILO *Global Wage Report 2016/17*. To obtain gross average real wages, the World Bank "Consumer price index (2010 = 100)" was used to deflate values. To convert values in local currency to EUR, UNCTAD currency exchange rates were used. The OECD average does not include France, Chile, Greece or Turkey as there were no gross average nominal monthly wages in local currency units available in the *Global Wage Report 2016/17*. Data for Kosovo are missing. The EU and OECD averages have been calculated as simple averages.

Source: ILO (2016b), *Global Wage Report 2016/17: Wage Inequality in the Workplace*, www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_537846.pdf; UNCTADstat (2017), *Currency Exchange Rates* (database), http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=117; World Bank (2017b), "Consumer price index (2010 = 100)", *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=2&series=FP.CPI.TOTL&country.

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Figure 8.17. **Income inequality (2014)**



Note: Most recent data for Albania are 2012 and for Kosovo 2013. EU-28 – all 28 EU Member States; EU-10 – Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. The EU and OECD averages have been calculated as simple averages.

Source: Solt (2016), *The Standardized World Income Inequality Database* (database), https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/11992.

StatLink http://dx.doi.org/10.1787/888933704625

In-work benefits frameworks are absent from all the economies

In-work benefits are designed to increase the net income from work and the difference between in-work income and out-of-work benefits, thereby increasing employment incentives, which in turn is expected to increase labour supply (Wu, 2000). Hence, in-work benefits can improve earnings quality and equality. None of the SEE economies has legal, institutional and policy frameworks for in-work benefits or their implementation – hence they all score zero for this indicator (Figure 8.15). Lack of financial resources, combined with insufficient understanding of the benefits of this approach, are potential reasons why such policies have not been introduced.

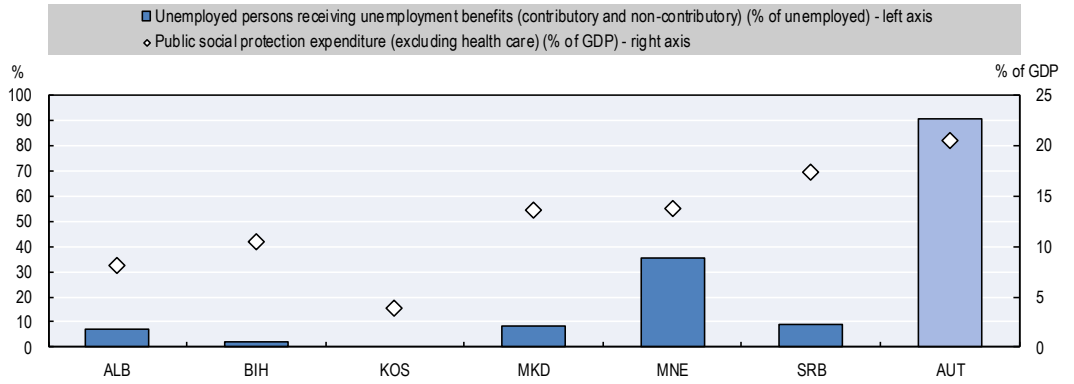
Social assistance is failing to prevent extreme hardship

Social protection, particularly unemployment benefits, can play a key role in providing income security to workers and their families in the event of temporary unemployment. It is thus an important indicator of job quality. The most recent data available for the SEE economies (excluding Kosovo) show that on average about 12.3% of unemployed people receive some form of unemployment benefits (contributory or non-contributory) (Figure 8.18). While this share varies from 2% in Bosnia and Herzegovina to 35.6% in Montenegro, the overall share is lower than in Austria (90.5%) and Slovenia (30.8%). What is more, data on social public expenditures (excluding health care) as a share of GDP show weaker performance among the SEE economies (on average 11.7%) than in Austria and Slovenia (20.4% and 17.4%, respectively). Among the SEE economies, Serbia has the highest share of public social expenditure (excluding health care) as a share of GDP (Figure 8.18).

Benefit duration follows the standard 12-month limit in most economies (Kovtun et al., 2014). Taking into consideration the high shares of long-term unemployment (Figures 8.11 and 8.12), benefit coverage is therefore likely to have expired for a large portion of the unemployed. While some of this evidence does not bode well for labour market security, it can also mean that unemployment benefits are not encouraging people to stay out of the labour market. It has been argued that unemployment benefits in some of the SEE economies are not typically accompanied by active labour market policies, even though they have been shown as important in helping workers return to work (Blanchard et al., 2013). Moreover, the unemployment benefits system's low coverage does not provide enough security for most unemployed people, which in turn creates incentives to enter informal employment (ETF, 2011).

The overall implementation of social assistance measures is well under way in the assessed economies (Figure 8.15). On average, the economies score approximately 2.8, with Albania having the highest score of 3.5. Albania is currently progressing well in the implementation of its Strategy for Social Protection 2015-2020 – the implementation is also being supported by the World Bank through the Social Assistance Modernization Project, which aims to improve the main social assistance programmes and to increase the government's capacities. However, in the assessed SEE economies, the social assistance provided by social work centres and public employment offices is often not integrated, resulting in limited targeting to increase the employability of able-bodied beneficiaries of social assistance.

Figure 8.18. **Social benefits indicators**



Note: For the quantitative indicator on unemployed people receiving unemployment benefits (contributory and non-contributory), data are available for 2012 for Albania, Montenegro and Serbia; 2011 for Austria and Bosnia and Herzegovina; and 2009 for the Former Yugoslav Republic of Macedonia; but are not available for Kosovo. For the public social protection expenditures (excluding health care) quantitative indicator, data are available for 2011 for Albania, Austria (AUT), Bosnia and Herzegovina, Montenegro, and Serbia; for 2010 for the Former Yugoslav Republic of Macedonia; and for 2009 for Kosovo.

Source: ILO (2014), *World Social Protection Report 2014/15: Building Economic Recovery, Inclusive Development and Social Justice*, www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_245201.pdf.

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Employee training could be boosted through strategic frameworks and employer incentives

Employee training can be an important element in educating workers about the effective use of technology, ensuring a competitive edge in the market, promoting health and safety among employees, creating opportunities for career development and personal growth, helping employers comply with laws and regulations, and improving productivity and profitability (ETF, 2014). As seen from their average score of 1.5 (Figure 8.15), the SEE economies need to improve their legal, institutional and policy frameworks for employee training. Doing so would encourage enterprises to offer regular training to their employees. While there are legal provisions in their respective labour laws which either oblige an employer to provide training under specific circumstances, or not to discriminate against an employee who would like to take on training, there are no other measures in place that offer incentives to enterprises.

The way forward for job quality

The six SEE economies should continue implementing reforms to improve social assistance systems by strengthening and standardising eligibility criteria, improving coverage, reducing work disincentives, and strengthening the links between the social assistance programmes and other institutions (e.g. public employment services).

The economies should develop incentives for and facilitate companies' provision of employee training. These could include tax incentives and other relevant measures.

The economies could further improve job quality by assisting workers to find quality jobs early in their careers, and by curbing informality.

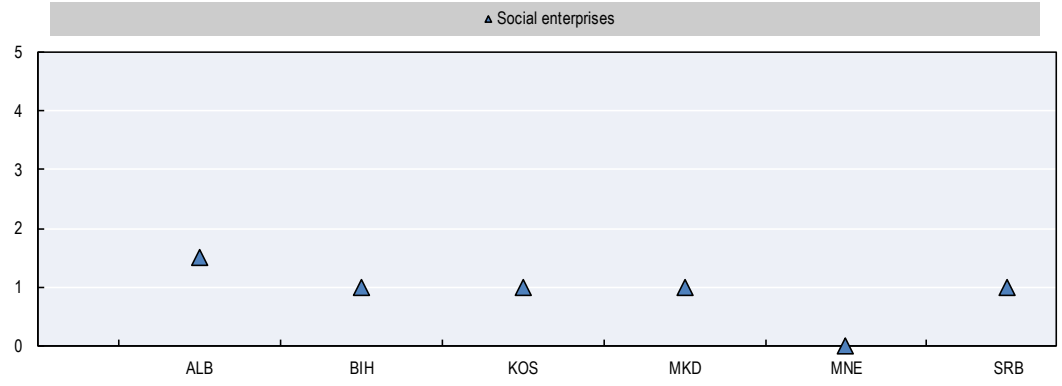
SEE economies could consider developing in-work benefit schemes. In-work benefits can translate into potentially significant increases in employment rates, provided they have a sufficiently large impact on financial incentives. When in-work benefits are very low, they are unlikely to have much of an impact on employment. On the other hand, generosity has to be accompanied by narrow targeting in order to channel help to the neediest families and keep programme costs within reasonable limits. Well-designed targeting, conditions on the number of hours worked to become eligible and phasing-out rates (i.e. the speed at which benefits are withdrawn as incomes rise), can help them to be effective.

Social economy

The social economy is a broad term and can include co-operatives, mutual societies, non-profit associations, foundations and social enterprises, but this chapter focuses on social enterprises. In the EU, a social enterprise is an enterprise whose main objective is to have a social impact rather than make a profit for its owners or shareholders (EC, 2016). In terms of the impact on competitiveness, some research points to the role of social enterprises, and a vibrant social economy as a whole, in encouraging innovation. The social entrepreneur seeks to achieve social goals by developing new combinations of goods, services and methods (Borza et al., 2009). There is no single legal form for social enterprises. Many operate in the form of social co-operatives, some are registered as private companies limited by guarantee, some are mutual, and many are not-for-profit organisations such as provident societies, associations, voluntary organisations, charities or foundations (EC, 2016).

This section assesses the social economy sub-dimension. It has only one indicator: social enterprises. For the time being, the social economy in the six SEE economies is in the earliest stages of development, as reflected by the low scores for this indicator (Figure 8.19).

Figure 8.19. **Social economy: Sub-dimension indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933704663

Among these economies, social enterprise development is seen as part of the social inclusion strategy or policies benefiting people with a disability. All six assessed SEE economies need to develop the legal, regulatory and financial framework required to foster the growth of social businesses and entrepreneurship. Most economies have taken important steps towards developing strategic frameworks to regulate social enterprises.

Albania, with a score of 1.5, has already adopted the relevant legislation and has addressed social enterprises in its National Strategy for Employment and Skills. While implementation is at an early stage, the strategy envisages support mechanisms for social enterprises via two measures: 1) designing and implementing measures to support social entrepreneurship; and 2) creating conditions for fostering female and male employment in the third sector (the non-profit sector with a social enterprise focus). Serbia has not yet adopted relevant legislation but has a draft law, and various non-government stakeholders have created the Coalition for the Development of Social Entrepreneurship, which has started to offer policy advice, advocacy and research on the social enterprise sector (NESsT, 2017).

The support infrastructure for social enterprise development is still taking off, with only a few support organisations actively working in the region. They provide a wide range of capacity building and training courses on business planning, product development, sales and marketing. These organisations tend to be local initiatives backed by one-off project funds. One of the few visible success stories in social enterprise support and education is the Youth Bank of the Mozaik Foundation in Bosnia and Herzegovina. It has already supported 16 800 young people through 1 800 community projects that offer education and training in self-employment and social entrepreneurship, and has funded 21 businesses since 2009. Social enterprises' financing strategies rely mostly on grant funding, given that most social enterprises are start-ups or early-stage businesses. A large number of start-up social enterprises have benefitted from private-sector support, e.g. from banks or companies (NESsT, 2017).

The way forward for the social economy

- **The six SEE economies could introduce special legal structures that govern social enterprises** or draft laws on social economy initiatives. Such measures would significantly strengthen the sector by raising its profile and lending it greater legitimacy. They could also develop national social strategies with the involvement of key stakeholders.
- **The economies could build public awareness** of the potential embodied in social enterprises through events, award schemes and campaigns.

The economies should consider supporting social enterprises through capacity-building activities such as documenting and learning from best-practice models, organising capacity-building and knowledge-sharing events to develop the skills of entrepreneurs and supporting organisations, as well as encouraging and supporting intermediaries who channel resources and skills to social enterprises (NESsT, 2017).

Social enterprises' financing needs could be addressed by further developing micro-finance and small business support networks, encouraging and rewarding community participation and investment in social enterprises (NESsT, 2017).

Conclusions

The six SEE economies are generally aware of their labour market challenges and have taken steps to improve their employment policies. Most of them have designed comprehensive employment strategies to resolve structural unemployment, particularly youth unemployment. In order to make their labour markets more flexible and inclusive, however, the SEE economies should increase their efforts to implement and co-ordinate their activities with other areas affecting employment (e.g. tax policy, education policy

and social policy). Regular and independent evaluations would ensure that regular policy adjustments are made. Informal employment is widespread across the region, yet there are few measures in place to shift informal firms and workers into the formal sector. Informal employment should be tackled as a long-term commitment, including through reducing the tax burden where possible, especially on wages, in order to create financial incentives for the transition to formal employment. Likewise, labour inspectorates need greater capacity to ensure effective enforcement of the labour law.

The structural unemployment challenges facing the six economies – especially low activity rates, high youth and long-term unemployment and significant gender gaps – mean that activation policies deserve very close attention. They should be efficiently targeted and designed and ensure that the unemployed have the incentives to take them up. Yet the economies' public employment services are struggling with insufficient capacity and infrastructure, which inhibit the effective implementation of high-quality policies.

Overall, job quality is relatively low in the six SEE economies, resulting in high inequalities and, consequently, poor labour productivity. Improving earning quality, labour market security and the quality of the working environment are therefore highly relevant.

Social enterprises offer new avenues for job creation, especially for vulnerable groups. More efforts are required to draft strategic frameworks and legislation that would regulate how social enterprises function and provide them with the support they need.

Notes

1. The EU and OECD averages have been calculated as simple averages.
2. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the state, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
3. The following indicators have been added to the assessment: employment retention and advancement programmes (under the activation policies sub-dimension); in-work benefits, social assistance, employee training (under the job quality sub-dimension); and social enterprises (under the social economy sub-dimension). The following indicators have been excluded from the assessment: migration strategy, foreign qualification recognition, migrants in labour market data (previously under the labour mobility dimension); employment protection legislation for regular contracts, employment protection legislation for fixed-term contracts (previously under the labour market governance sub-dimension); and social economy initiative strategy and social economy statistics (previously under the social economy sub-dimension).
4. For more information visit www.oecd.org/employment/jobs-strategy/about.

5. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

6. Argentina, Brazil, Chile, China, Colombia, Costa Rica, India, Indonesia, Mexico, South Africa, Turkey and the Russian Federation.

7. Set at 60% of the national median equivalised disposable income after social transfers.

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Annex 8.A1.
Employment policy: Indicator scores

Table 8.A1.1. **Employment policy: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Labour market governance						
Employment framework	4.5	3.0	2.0	3.5	3.5	4.5
Tripartism and social dialogue	2.5	3.5	2.5	3.0	3.5	2.0
Informal employment reduction	3.5	1.5	1.5	2.5	2.5	2.5
Labour inspectorate	4.0	3.0	2.5	3.0	2.5	3.5
Activation policies						
Public employment services	3.5	3.0	2.5	3.5	3.5	4.0
Skills gap analysis	3.5	2.5	1.0	3.5	3.0	3.5
Employment retention and advancement programmes	0.0	0.0	0.0	0.0	0.0	0.0
Youth employment	3.0	2.5	1.5	3.5	3.0	4.5
Job quality						
In-work benefits	0.0	0.0	0.0	0.0	0.0	0.0
Social assistance	3.5	2.5	2.5	3.0	2.5	3.0
Employee training	1.5	1.5	1.5	1.5	1.5	1.5
Social economy						
Social enterprises	1.5	1.0	1.0	1.0	0.0	1.0

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Chapter 9.

Science, technology and innovation in South East Europe

This chapter on science, technology and innovation (STI) assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of innovation trends and performance in South East Europe, the chapter then focuses on five essential sub-dimensions. The first sub-dimension, governance of STI policies, assesses whether governments take an overarching strategic view and co-ordinate policies across all relevant ministries. The second, public research system, looks at how they are funded and managed in order to foster research excellence. The third, innovation in firms, measures the degree to which business innovation is promoted and supported financially and institutionally. The fourth, public-private knowledge transfers and linkages, examines policies to facilitate science-industry collaboration and technology transfer to overcome barriers between academia and business. The final sub-dimension, human resources for innovation, focuses on specific measures aimed at creating appropriate incentives and mobility for researchers to foster research excellence and co-operation with industry. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions in order to spread the diffusion of innovation and new technology more widely, which in turn would foster the competitiveness of these economies.

Main findings

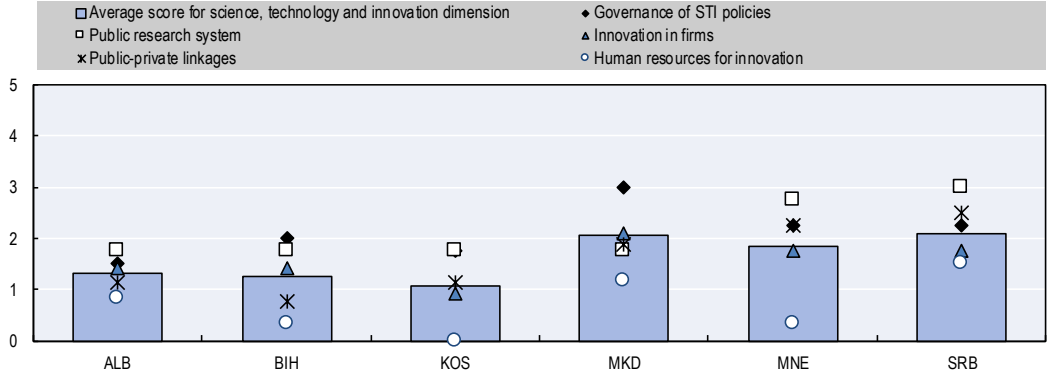
Overall science, technology and innovation (STI) outcomes remain modest in the six South East Europe (SEE) economies assessed here: Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia. Investment in research and development (R&D) is very low, particularly in the business sector. Scientific outputs and production of high-technology goods and services lag as a consequence. Foreign direct investment (FDI) rarely targets knowledge-intensive sectors, due to skills gaps, fragmented labour markets and low levels of integration into global knowledge flows and value chains. The situation is aggravated by endemic brain drain.

Nevertheless, as the World Bank Enterprise Surveys have found, small and medium-sized enterprises (SMEs) in the six SEE economies do have a strong propensity to innovate, albeit in non-technological ways (World Bank, 2013). This assessment found a dynamic information and communications technology (ICT) service sector, and medium-high technology automotive and machine tool industries.

Future challenges will include finding resources to increase investment in R&D, and improving the overall governance of innovation at the policy and institutional level, finding ways to foster technology diffusion and absorption, and developing business-academia linkages and incentives to individuals to unleash their creative potential.

In recent years, some of the SEE governments have adopted increasingly holistic STI strategy frameworks. However, this development is still in its infancy, as evidenced by average scores of between 1 and 2 on this dimension (Figure 9.1). These signify that on average the SEE economies are still in the process of adopting relevant frameworks, rather than advancing their implementation.

Figure 9.1. **Science, technology and innovation: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Governance of STI policies is relatively advanced, with three of the economies having adopted an STI strategy (the Former Yugoslav Republic of Macedonia, Montenegro and Serbia). Implementation in the Former Yugoslav Republic of Macedonia

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

is well co-ordinated, but the two other economies are less advanced. Public research system policies are also relatively advanced, while support for business investments is less so. The promotion of public-private linkages is mostly at the pilot stage. The area of human resources for innovation is the least advanced, with very few policies to facilitate and encourage individual researchers to innovate and transfer their innovation to the private sector.

Comparison with 2016 assessment

STI policy has gained prominence in the six SEE economies in the last two years. Serbia and Montenegro have established holistic STI strategies, with Serbia establishing a ministerial-level council to co-ordinate STI policy in Serbia, while the innovation fund of the Former Yugoslav Republic of Macedonia has started operation. Kosovo has taken steps towards drafting an innovation law. The first venture capital fund in the region – South Central Ventures, established under the Enterprise Innovation Fund (ENIF)[1] – has realised its first eight portfolio investments in SEE (South Central Ventures, n.d.). Incubator infrastructure has expanded to all six economies. Serbia and Montenegro have set up science and technology parks (STPs), but they have yet to develop activities to facilitate knowledge transfer and linkages between business and academia.

Achievements

The six assessed SEE economies have taken positive steps towards establishing strategic approaches to STI policy. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have adopted holistic innovation strategies, while Albania, Bosnia and Herzegovina,[2] and Kosovo have prepared drafts for adoption.

The Former Yugoslav Republic of Macedonia and Serbia have strengthened horizontal co-ordination with ministerial-level councils to co-ordinate STI policy in both economies.

Independent and professional innovation funds have been established in Serbia and the Former Yugoslav Republic of Macedonia to implement competitive innovation grant instruments.

Start-ups benefit from an infrastructure of incubators and accelerators, and the first venture capital funding. All six economies have established incubator infrastructure offering events such as hackathons, start-up weekends, mentoring and training. South Central Ventures, a venture fund financed by the European Investment Fund, the European Commission and the SEE governments, has started operations in all six economies.

The first science and technology parks have been established in Bosnia and Herzegovina, Montenegro and Serbia. However, these parks have yet to develop strong ties to academia.

Serbia has established rules governing the intellectual property split between individuals and institutions; at least 50% of profits from an invention goes to the researcher, which should encourage researchers to patent their discoveries.

Remaining challenges and key recommendations

- **Increase and consolidate financial support for research and development.** Overall financial support is a small fraction of that offered in comparable transition countries, particularly for business innovation. Introducing performance-

based contracts for institutions would increase the efficiency of government spending in this area. Financial support for business innovation (and in some cases, public-sector research) largely depends on donor financing or loans, threatening sustainable development of the innovation ecosystem over time. Funding instruments are fragmented across ministries for education, science and economy, and various agencies.

- **Place more emphasis on technology diffusion and absorption policies.** In the absence of government support for technology extension services, the European Bank for Reconstruction and Development's (EBRD) Advice for Small Businesses programme is active across the six economies and has effectively enhanced SMEs' technological development. However, the SEE governments have not implemented such instruments, which are crucial for technology absorption in middle-income economies, enabling the SEE economies to catch up with more advanced ones. Cross-border technology transfer to SMEs is yet to be developed, for example, through collaboration with international networks such as Fraunhofer.
- **Use procurement to encourage innovation.** While government demand for innovative products and services may be limited, existing procurement can be adapted to encourage innovative solutions by using functional requirements rather than technical specifications, as they can spur innovative solutions while enhancing competition and preventing bid rigging.
- **Develop a structured approach to creating links between business and academia.** Strong barriers remain between the business and academic communities. In particular, they could consider: 1) introducing the "third mission" of co-operation with industry in higher education institutions (HEIs); 2) introduce private-sector representation on the governance boards of HEIs and public research organisations (PROs); 3) develop "triple helix"[3] type events to create opportunities for business and academia to meet; 4) use innovation vouchers to initiate small-scale collaboration; and 5) develop collaborative grants for more mature projects.
- **Provide incentives for individuals to unleash their creative potential.** Except in Serbia, there are no clear rules on splitting intellectual property rights between an individual researcher and their institution. Researchers are not evaluated on their co-operation with business, and there are no schemes to promote mobility between the public and private sectors, such as industrial master's or PhDs, entrepreneurial leave of absence, or subsidies for employment transfer.
- **Make better use of the SEE economies' highly educated diaspora and tackle the brain drain.** More than 30% of highly educated people have left the region. While bringing them back might seem difficult in the short term, steps could be taken to improve connections and knowledge flows through programmes like the Unity for Knowledge scheme in Croatia.
- **Improve the creation of STI-related statistics to enable the development of evidence-based policies.** The economies collect very few statistical indicators relevant to science, technology and innovation, and only Serbia and the Former Yugoslav Republic of Macedonia are covered by the European Innovation Scoreboard (EIS).

Context

The knowledge created through R&D performed by businesses, the public sector and foreign firms is a determinant of long-term productivity growth (Guellec and Van Pottelsberghe de la Potterie, 2004). Because wider society reaps a greater return on business R&D than the business does itself, some degree of public intervention is justified (Hall, Mairess and Mohnen, 2010). Innovation can also come from sources other than R&D – notably non-technological innovation.

Science, technology and innovation (STI) policy spans the entire innovation value chain: from the creation of fundamental knowledge in basic research to applied research and technology. This enables the transfer of knowledge to the economic sphere, and finally to innovation, fostering the creation of new products, processes, marketing and organisational models. The effect of public R&D on productivity depends in large part on the intensity of the business R&D effort, which facilitates the commercialisation of innovation. Therefore, governments need to support both public and private research, development and innovation (RDI) activities, and facilitate flows of knowledge between the two sectors.

A strong justification for government spending on R&D can be found in its high social rate of return. A recent meta-analysis found a mean social return of 170% to the entire society (Appelt, forthcoming). In Croatia, it was estimated at 73%, more than double the rate of return on infrastructure, and seven times as high as that for education. This result is explained by R&D knowledge capital starting from a low base, compared to capital invested in infrastructure and education (Aprahamian and Correa, 2015).

Analysis of STI policy in the SEE economies reveals significant links with other policy areas related to competitiveness treated elsewhere in this publication, in particular:

- **Chapter 1. Investment policy and promotion** aims to bring in foreign direct investment (FDI). FDI can allow new technology to be adopted, especially by small and medium-sized enterprises (SMEs) and particularly if investment promotion is focused on knowledge-intensive sectors. A proactive STI policy can also be a powerful driver of FDI by knowledge-intensive firms wishing to benefit from local knowledge. Indeed, a strong local STI system can provide specific knowledge inputs to knowledge-intensive firms.
- **Chapter 2. Trade policy and facilitation** and STI reinforce each other, since a strong innovation context will give an economy a competitive advantage in its exports. Effective trade policies which open up domestic markets to foreign technology, as well as opening foreign markets to domestic companies, will be strong enablers of the scaling up needed to return investment in R&D.
- **Chapter 3. Access to finance** is a primary issue for innovative companies in the SEE economies which have very weak venture capital and business angel investment systems.
- **Chapter 4. Tax policy** such as tax credits can be used to encourage business R&D spending, while environmental taxes (such as emissions levies) encourage firms to innovate to reduce their tax burden.
- **Chapter 5. Competition policy** strives to increase competition in markets where it is not working well, and thus contributes to improving conditions for innovation. Empirical evidence shows that competitive markets are most conducive to

innovation, even though, in theory, extreme competition may have the opposite effect (Friesenbichler and Peneder, 2016; Aghion et al., 2005).

- **Chapter 7. Education and competencies** are vital for increasing the number and quality of researchers who can carry out STI activities. A strong innovation ecosystem can also encourage talented people to remain in their home country instead of emigrating.
- **Chapter 10. Digital society** is the enabling tool for a major change in scientific practices that can be aggregated under the umbrella of "open science" (OECD, 2015a). Likewise, e-business and e-commerce are major enablers of innovation in the business domain.

Science, technology and innovation assessment framework

The science, technology and innovation dimension in the *2018 Competitiveness Outlook* examines the policy framework for STI. It presents an analytical framework built on the approach developed in the OECD Reviews of Innovation Policy,[4] a comprehensive approach to reviewing national innovation systems which has been used for in-depth reviews of both OECD member and non-member countries. The future joint OECD-EU STI Policy Survey will use a similar framework.

Without seeking to be exhaustive, it considers five broad sub-dimensions which are critical for the development and dissemination of new knowledge to the wider economy:

1. Governance of STI policies: what is the overarching strategic framework for STI? How is policy co-ordinated among concerned government bodies? What is the institutional set-up for implementation?
2. Public research system: how are higher education institutions (HEIs) and public research organisations (PROs) funded? What institutional arrangements ensure research excellence?
3. Innovation in firms: what financial instruments and institutional arrangements are used to support business investment in innovation? How are innovative start-ups nurtured? How is technology diffusion encouraged?
4. Public-private knowledge transfers and linkages: how is science-industry collaboration supported through appropriate instruments and institutional arrangements? How is technology transfer supported?
5. Human resources for innovation: what specific policies are in place to ensure the proper incentives for researchers to contribute to the knowledge economy? Which schemes facilitate mobility of professionals between academia and the private sector?

Figure 9.2 shows how the sub-dimensions and their constituent indicators make up the science, technology and innovation dimension assessment framework. Each sub-dimension is assessed through quantitative and qualitative indicators. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices.

Quantitative indicators are based on national or international statistics. Qualitative indicators have been collected and scored in ascending order on a scale of 0 to 5, and are summarised in Annex 9.A1.[5] For more details on the methodology underpinning this assessment, please refer to the methodology chapter.

Figure 9.2. **Science, technology and innovation assessment framework**

Science, technology and innovation dimension

Outcome indicators
- gross domestic product (GDP) per person employed
- high-tech manufacturing exports and medium high-tech exports (% of manufacturing exports)
- knowledge intensive services exports (% of total services exports)
- patent applications to the European Patent Office (EPO) and United States Patent Office (USPTO)
- charges for the use of intellectual property, payments (% of GDP)
- charges for the use of intellectual property, receipts (% of GDP)

Sub-dimension 1 Governance of STI policies	**Sub-dimension 2** Public research system	**Sub-dimension 3** Innovation in firms	**Sub-dimension 4** Public-private knowledge transfers and linkages	**Sub-dimension 5** Human resources for innovation
Qualitative indicators 1. National STI plan or strategy 2. Horizontal policy co-ordination 3. Implementation of STI policies 4. International STI policy strategy and framework	**Qualitative indicators** 5. Funding of public research institutions and universities 6. Public research institutional arrangements	**Qualitative indicators** 7. Innovation promotion 8. Financial support: competitive grants for research and innovation in businesses 9. Fiscal incentives for RDI 10. Institutional support: incubators and accelerators 11. Institutional support: technology extension services 12. Public procurement for innovation	**Qualitative indicators** 13. Innovation voucher schemes 14. Competitive co-operative grants 15. Innovative clusters 16. Technology institutes, competence centres, and science and technology parks (STPs)	**Qualitative indicators** 17. Mobility between academia and industry 18. Researcher evaluation in favour of business-academia co-operation 19. Intellectual property rights for business-academia co-operation
Quantitative indicators 1. Gross expenditure on R&D (GERD) (% of GDP) 2. International co-publications (Scimago)	**Quantitative indicators** 3. Citeable documents (per million population) 4. Average number of citations per document 5. Number of researchers per million population (full-time equivalent) 6. Volume of international competitive research grants (Horizon 2020)	**Quantitative indicators** 7. Business expenditure on R&D (% of GDP) 8. Score SMEs introducing innovations (EIS) 9. Motivational index (Global Entrepreneurship Monitor) 10. Non R&D innovation expenditures (EIS) 11. Number of firms introducing a new product/service (EIS) 12. Number of firms introducing a process innovation (EIS)	**Quantitative indicators** 13. Charges for the use of intellectual property, receipts (World Bank World Development Indicators) 14. Joint publications between academia and industry (Web of Science)	**Quantitative indicators** 16. Number of highly educated emigrants 17. Number of science, technology, engineering and mathematics (STEM) graduates

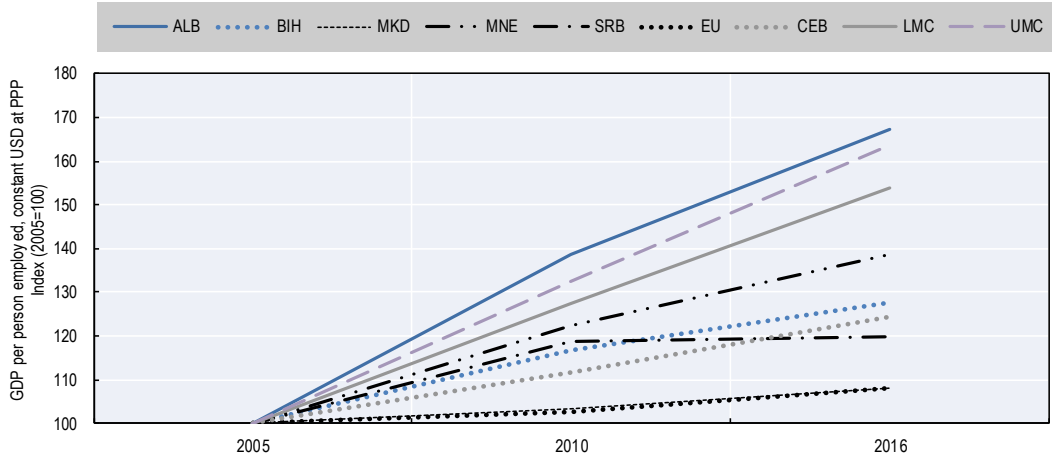
Science, technology and innovation performance in SEE economies

While natural resource endowments and fixed capital investment are major drivers of productivity in the factor-driven and efficiency-driven stages of development, STI plays an important role as a driver of productivity in innovation-driven economies close to the efficiency frontier.

Labour productivity has grown at different rates in the six SEE economies in the past decade (Figure 9.3). Overall it has grown faster than the European Union (EU) average, which is to be expected from economies which are far from the efficiency frontier. In Albania, Bosnia and Herzegovina, and Montenegro, it has also grown faster than in the benchmark group of Central Europe and the Baltics (CEB)[6] economies. However, when compared with economies with a similar degree of development (lower-middle income for Kosovo, and upper-middle income for the others), only Albania outperforms this benchmark.

Figure 9.3. **Labour productivity evolution (2005-16)**

Index of GDP per person employed, constant USD at purchasing power parity (2005=100)



Note: Data for Kosovo are not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); LMC – lower middle-income countries; UMC – upper middle-income countries. In SEE, Kosovo is considered to be lower middle income, while the other five economies are upper middle income under the World Bank classification.

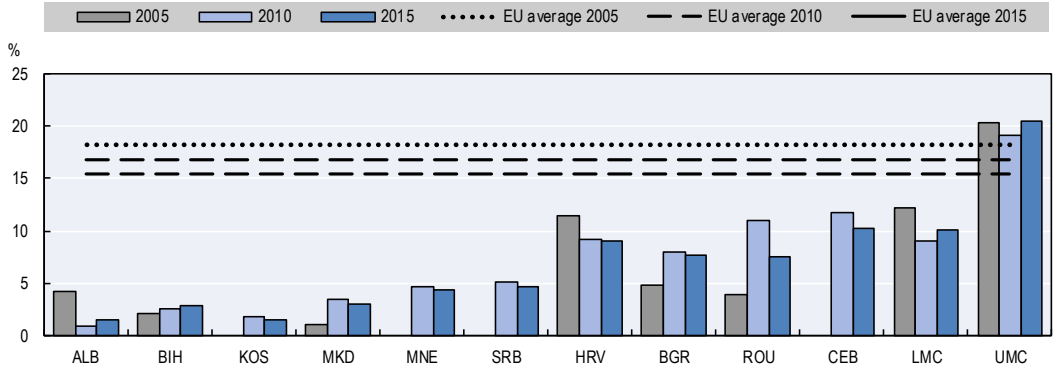
Source: World Bank (2017), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

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In a well-performing innovation ecosystem, high-tech products make up a significant fraction of total manufacturing exports. High-tech exports are at a very low level in the SEE economies, not only compared to the EU Member States, but also to upper- and lower-middle income countries (Figure 9.4). However, the data should be interpreted with caution, since high-tech exports from middle-income countries often rely on assembly operations, which create relatively little value added in the country itself. In order to improve the analysis, the SEE economies would need to meet the conditions[7] that would enable them to be included in the OECD's trade in value added (TiVA) statistics (OECD, 2016a) to be in a better position to evaluate their integration into global value chains.

When medium-technology products are included, the SEE economies perform significantly better. This is in large part due to the development of the automotive industry value chain, notably in the Former Yugoslav Republic of Macedonia where high- and medium-technology products accounted for 56% of manufactured exports; and in Serbia, where they accounted for 39%, in 2015. This is comparable with, or even higher than the EU average of 54% and the CEB average of 48%. Unfortunately, such favourable statistics do not signify a strong knowledge-intensive input from the local economies, since they largely depend on large foreign investments in the automotive industry and imported technology and design. Indeed, FDI has created very limited spillover effects in the SEE economies (Estrin and Uvalic, 2016; OECD, 2017a).

Figure 9.4. **High-tech exports as a share of manufactured exports (2005-15)**



Note: HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); LMC – lower middle-income countries; UMC – upper middle-income countries. In SEE, Kosovo is considered to be lower middle income, while the other five economies are upper middle income under the World Bank classification.

Source: Government statistical offices (for Kosovo and Montenegro); other data from World Bank (2017), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

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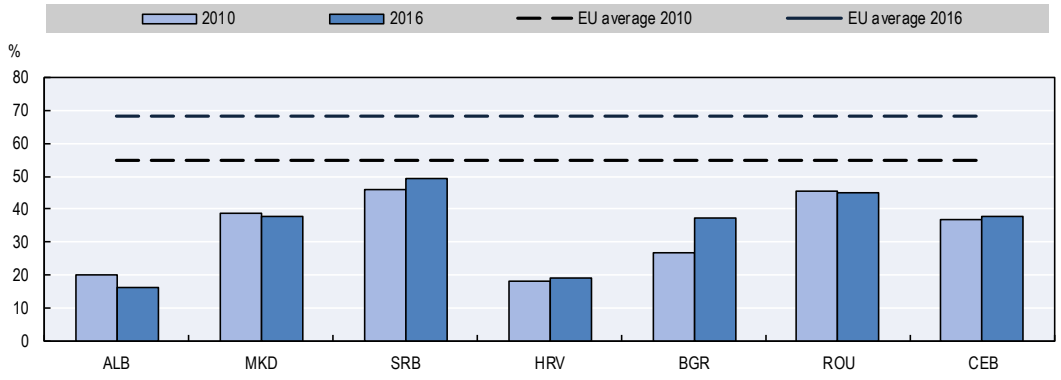
The six SEE economies are essentially service economies, and therefore exports of knowledge-intensive services also need to be considered (Figure 9.5). Serbia's performance here exceeds the CEB average, while the Former Yugoslav Republic of Macedonia's is comparable. One particular area of strength lies in the very dynamic ICT services sector – which represented 37% of Serbia's services exports in 2015 (World Bank, 2017). Naturally, this indicator also depends on the size of the denominator, and thus coastal areas such as Albania have lower values on this indicator due to the dominance of tourism in their services exports.

When it comes to filing patents the SEE economies lag significantly behind, not only the EU average, but also the CEB average. Only a tiny fraction of patents filed in either the European Patent Office (EPO) and the United States Patent and Trademark Office (USPTO) originated in the SEE economies (Figure 9.6).

Figure 9.7 displays two important outcomes for intellectual property (IP) exchanges: receipts from and payments for the use of IP. Figure 9.7.A shows receipts for domestic inventions sold to foreign clients, and Figure 9.7.B shows payments for the use of foreign

inventions. Payments for IP use are an indicator of technology diffusion into the SEE economies, as a foreign licence is paid for and used domestically.

Figure 9.5. **Knowledge-intensive services exports as a share of all services exports (2010 and 2016)**

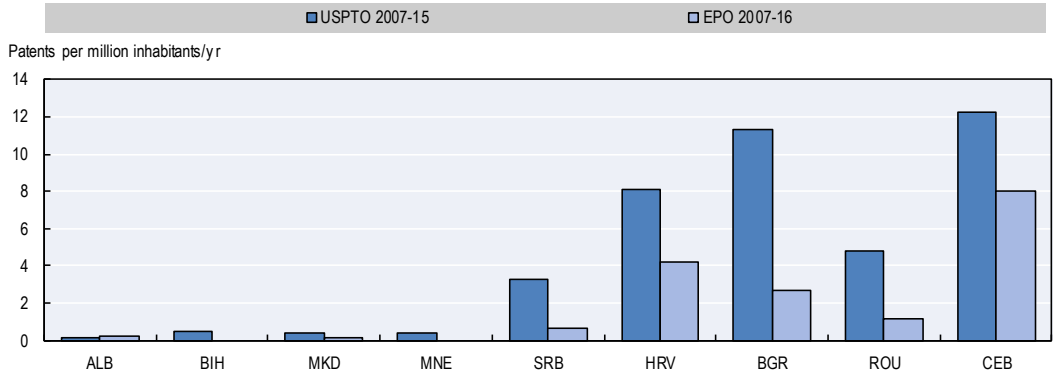


Note: Data for Bosnia and Herzegovina, Kosovo and Montenegro are not available. HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: National statistical offices (Albania and Serbia); EC (2017a), *European Innovation Scoreboard 2017*, http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_fr.

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Figure 9.6. **Patenting trends in South East Europe**



Note: Data for Kosovo unavailable. HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); USPTO – United States Patent and Trademark Office; EPO – European Patent Office.

Source: USPTO (2017), *Statistics* (dataset), www.uspto.gov/learning-and-resources/statistics; EPO (2017), *Statistics* (dataset), www.epo.org/about-us/annual-reports-statistics/statistics.html.

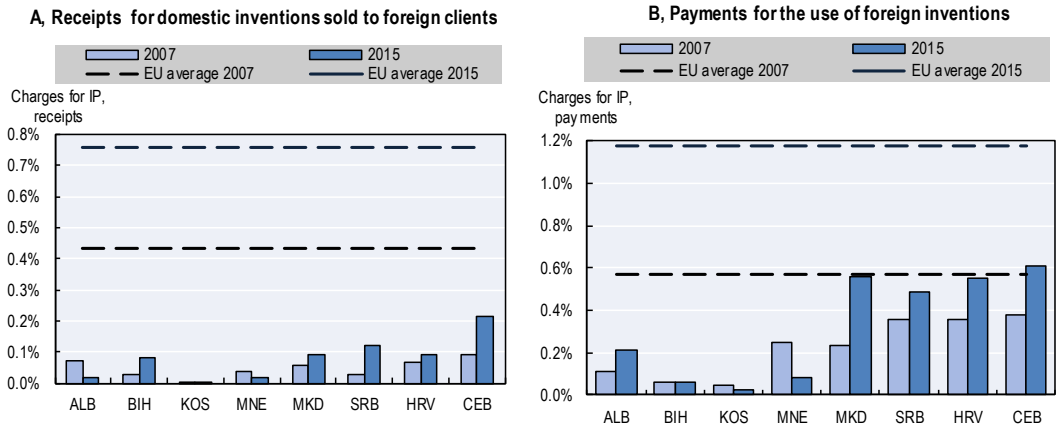
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Figure 9.7.A shows that the six SEE economies receive less than one-sixth of the EU average, and less than half the CEB average for their IP. Figure 9.7.B also shows a large gap compared to the EU average for IP payments. However, it is interesting to note that the Former Yugoslav Republic of Macedonia and Serbia attain levels comparable to the

CEB average, indicating comparable levels of technology absorption to Central Europe countries.

Figure 9.7. **Charges for the use of intellectual property, receipts and payments**

% of GDP



Note: HRV – Croatia; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: World Bank (2017), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

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The following sections examine in further detail the levers which are at the disposal of the six SEE economies to realise the full potential of STI, using the five sub-dimensions of the assessment framework.

Governance of science, technology and innovation policies

The eminently interdisciplinary nature of innovation makes the governance of research and innovation a challenge. Research and research-based policies are usually the domain of ministries of education and science, while business innovation is usually covered by economy ministries. Innovation drives progress throughout society, and touches upon a wide range of issues, including tax policy, competition law and regulations (OECD, 2010a). Line ministries from finance, telecommunications, defence and energy, to transport, health, agriculture and tourism also have a strong interest in innovation.

The governance of STI policies sub-dimension assesses these aspects through four qualitative indicators (Figure 9.8):

The **national STI plan or strategy** indicator assesses the adoption of a national innovation strategy and action plan with responsibilities, timelines, objectives, budgets and monitoring systems.

The **horizontal policy co-ordination** indicator assesses formal and informal mechanisms to ensure synergies and avoid conflicts across the ministries concerned. In the case of a formal body such as an innovation council, the indicator assesses its mandate, as well as its analytical capacity for evidence-based policy decisions.

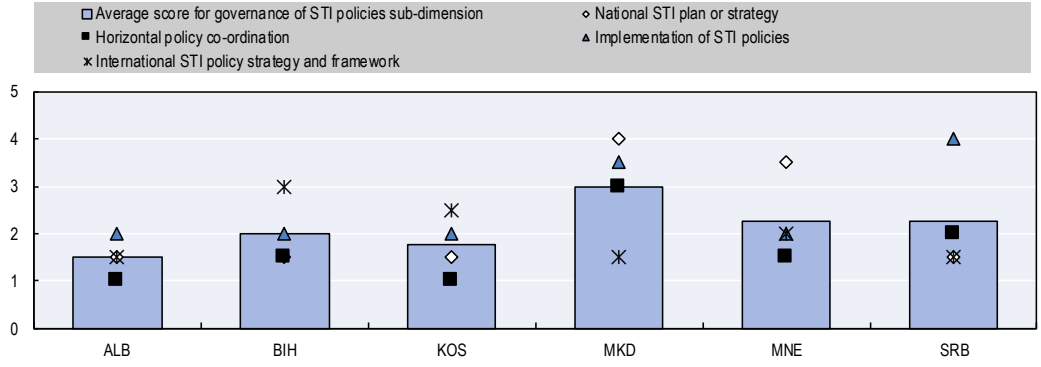
The **implementation of STI policies** indicator assesses the implementation body, be it an agency, a fund or part of a ministry, in particular its professionalism and autonomy from policy makers.

The **international STI policy strategy and framework** indicator assesses policies that support scientific co-operation on a bilateral or multilateral basis, as well as cross-border technology transfer.

Governments need to take an overarching strategic view and co-ordinate policies across the whole of government. Failure to do so can create sets of overlapping and even contradictory measures, while leaving gaps in crucial areas where government support is needed. In particular, they need co-ordinated and consensual policies aiming to bridge the gap between academia and business.

The Former Yugoslav Republic of Macedonia has gone furthest in governance of STI policies, achieving an average score of 3 (Figure 9.8). With OECD support, it adopted an integrated innovation strategy in 2012, covering the whole innovation value chain from basic research to business innovation. It was also the first economy to set up a ministerial-level co-ordination body chaired by the prime minister – although this body has not met between mid-2015 and mid-2017 due to an ongoing governmental crisis – as well as a working-level inter-ministerial working group. It also has a functioning Innovation Fund. Montenegro and Serbia have an average level of 2, with recently adopted innovation strategies. Serbia has an advanced Innovation Fund and also set up a ministerial-level co-ordination body in 2017. The other three economies score below 2, since they lack overall strategies and co-ordination mechanisms, haven't set up any innovation agencies, and mostly focus on international co-operation aspects.

Figure 9.8. **Governance of STI policies: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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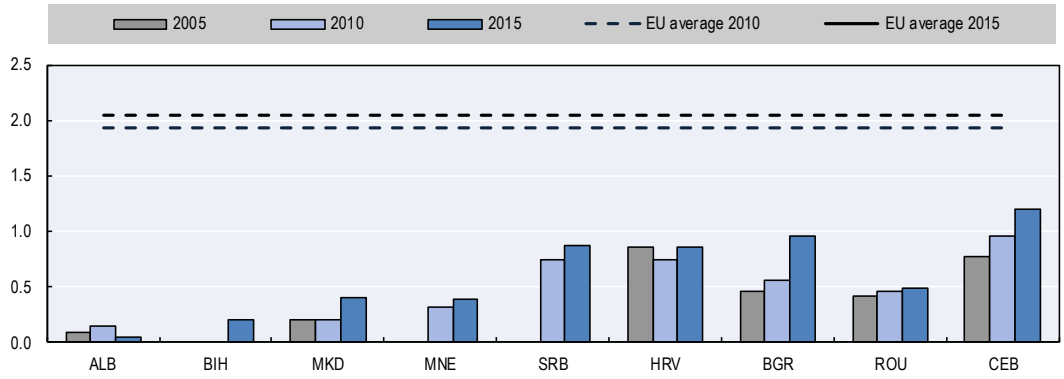
Low research and development expenditure suggests weak commitment to supporting STI

Overall spending on R&D is a key statistical indicator of government commitment to supporting STI policies. Figure 9.9 gives an overview of gross expenditure on R&D (GERD). Overall, GERD remains below 0.5% of GDP in most SEE economies except Serbia, where it reaches 0.9%. This is a small fraction of the EU average level of 2%, and also lags significantly behind the CEB. However, most of the SEE economies have now started to measure GERD, and there has been some increase in spending as the STI agenda has become more prominent.

However, large financial support instruments still mostly depend on donor grants or loans, such as European Instrument for Pre-accession (IPA) grants and World Bank STI policy loans, which are often weighed against other government priorities, and may or may not be renewed. For example, Montenegro implemented grant schemes under the World Bank-financed Higher Education and Research for Innovation and Competitiveness (HERIC) project in 2012-15, but follow-on financing is not foreseen in the short term as priorities have changed. Such fluctuations disrupt attempts to nurture an emerging innovation ecosystem, which is a long-term process best served by long-term and sustainable measures. Indeed, for a grant scheme to have an impact it needs to be sustained so that applicants learn and improve over time. Discontinuing funding discourages them from applying if the process restarts later, introducing further delays in the catch-up process.

Figure 9.9. **Gross domestic expenditure on R&D (GERD)**

% of GDP



Note: Data for Kosovo are not available. HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: Government statistical offices and ministries as part of the *Competitiveness Outlook* assessment 2016-17; Eurostat (2017), *Gross Domestic Expenditure on R&D (GERD)* (dataset), http://ec.europa.eu/eurostat/web/products-datasets/-/t2020_20&lang=en.

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Approaches to strategies, policy implementation and horizontal co-ordination vary

Policy focus on science, technology and innovation varies from economy to economy. While the Former Yugoslav Republic of Macedonia has developed and implemented an innovation strategy, Serbia and Montenegro implemented policies before any holistic innovation strategies were adopted,[8] although they have since adopted some (Serbia's Action Plan is still pending at the time of writing in October 2017), and the other three economies are yet to adopt them. Serbia also set up a ministerial-level co-ordination body in 2017. Albania, Bosnia and Herzegovina, and Kosovo all have draft strategies. Horizontal policy co-ordination remains an area for improvement in most economies.

Table 9.1 summarises the progress made and remaining challenges in the first three qualitative indicators for this sub-dimension, **national STI plan or strategy**, **horizontal policy co-ordination** and the **implementation of STI policies**.

Table 9.1. **Innovation strategy frameworks in the SEE economies**

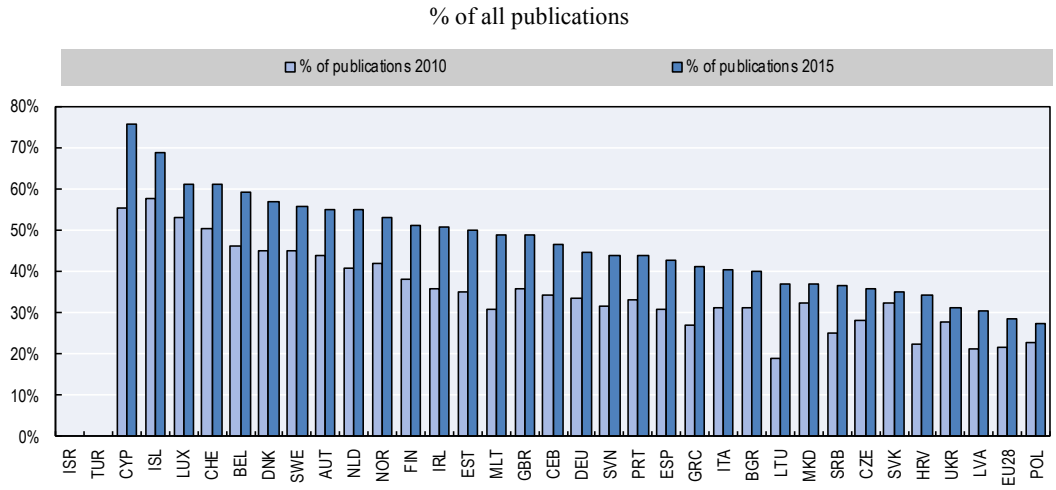
Achievements and progress	Remaining challenges
Albania	
– Currently drafting an Innovation Strategy and holding stakeholder consultations. – Triple Helix Action Plan (THAP) adopted by Prime Minister's office with many actions particularly relevant to creating academia-business linkages. – Implementation of policies allocated to professional agencies: National Agency for Scientific Research and Innovation (NASRI) for research and research-based innovation, and the Albanian Investment Development Agency (AIDA) for business innovation.	– Innovation Strategy is yet to be adopted. – Implementation and financing of THAP to be confirmed. – THAP foresees the creation of an Innovation Council, currently pending. – Co-ordination between AIDA and NASRI to be enhanced.
Bosnia and Herzegovina[1]	
– Drafted the state-level Strategy for the Development of Science. – The Republika Srpska has adopted an entity-level Strategy for Scientific and Technological Development. – The Federation of Bosnia and Herzegovina has published a draft strategy from 2012. – Some policy instruments have been implemented at state and entity levels.	– Implementation of instruments is fragmented between the state, entity and cantonal levels, and across the ministries in charge of education and science and those in charge of the economy, industry, entrepreneurship. No dedicated agency exists. – The draft strategies at the state level and of the Republika Srpska are still mostly focused on science, with limited reference to R&D in the business sector; approval is pending. – The Federation of Bosnia and Herzegovina's draft strategy was never adopted due to an over-ambitious objective for GERD (1.5% of GDP).
The Former Yugoslav Republic of Macedonia	
– Adopted its Innovation Strategy (supported by the OECD SEE programme) and Innovation Law in 2012. – The ministerial-level Committee for Entrepreneurship and Innovation met regularly to arbitrate issues during the implementation. – Inter-ministerial working group on innovation meets regularly and co-ordinates implementation. – Established an Innovation Fund financed through a World Bank loan. Evaluation of the Fund is initiated by the European Network of Innovation Agencies (TAFTIE).	– The Committee for Entrepreneurship and Innovation has not met during 2015-17. – The balance between the instruments implemented by the Fund, the Ministry of Education and Science, the Ministry of Economy and the Agency for Promotion of Entrepreneurship (APPRM) could be improved.
Kosovo	
– Drafted its innovation strategy in 2012 (with support from the OECD SEE programme), recent updates have merely covered some data. – Established a working group to draft an Innovation Law which has been sent to the Cabinet of the Minister as of September 2017. – IT strategy adopted with a significant pillar concerning innovation (Pillar 8).	– Innovation strategy is yet to be adopted. – Fragmented policy implementation between Ministry of Education, Science and Technology (for scientific research), Ministry of Economic Development (IT-related innovation policy) and KIESA, the SME agency (SME vouchers and equipment grants).
Montenegro	
– Adopted its Strategy of Innovation Activities (SIA) in 2016, and is actively implementing it. – Established a Scientific Council with members from the Ministry of Science, academia and one member from the private sector, with a mandate mostly related to science. – Implemented specific grant schemes before the existence of its strategy, notably under the World Bank HERIC project since 2012 (USD 16 million).	– The Ministry of Economy is not included in the Scientific Council and has a relatively minor role in the implementation of the SIA. – The successful HERIC project has not secured financing to follow up its financial support instruments.
Serbia	
– Adopted the Research for Innovation strategy in 2016. – Established the ministerial-level Committee for Innovative Entrepreneurship in May 2017, and will have a dedicated Secretariat to provide an evidence base for decision making. – Its Innovation Fund has been operational since 2011 and is a member of TAFTIE. Its grant programmes have been independently evaluated by Applied Economics Ltd. (Israel)	– The strategy's action plan is yet to be adopted and implemented. – The co-ordination of implementation between the Fund, and the economy and education and science ministries could be improved.

1. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska, and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina, and the Republika Srpska are taken into account in the *Competitiveness Outlook* 2018 assessment, when relevant. The Brčko District is not assessed separately.

International co-operation is progressing, but could be further enhanced

The governance of science, technology and innovation policy increasingly has an international dimension (OECD, 2010b). In the SEE economies for which data are available, scientific co-publications between domestic and foreign researchers are growing faster than the overall volume of publications.[9] However, with just 37% of publications being co-publications, researchers in Serbia and the Former Yugoslav Republic of Macedonia are still engaging internationally less than average (Figure 9.10).

Figure 9.10. **International co-publications**



Note: Data for Albania, Bosnia and Herzegovina, Kosovo, and Montenegro are unavailable.

1. Note 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 (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

2. Note 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.

3. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: EC (2017a), *European Innovation Scoreboard 2017*, http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_fr.

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All six of the SEE economies are associated with Horizon 2020.[10] Serbia has been the most successful economy, with 158 projects which had attracted EUR 55 million as of September 2017, including 2 European Research Council grants, and a large grant under the Spreading Excellence and Widening Participation scheme.[11] These results exceed Serbia's budget contribution to Horizon 2020 of EUR 34 million as of January 2017. The other five economies combined have attracted only 95 projects, worth EUR 11 million, which is considerably less than their contribution to the scheme.

Participation in Maria Skłodowska-Curie actions (grants for scholarly exchanges under Horizon 2020) has again been most extensive in Serbia, with 41 exchanges, followed by 9 for Bosnia and Herzegovina, and 1-3 exchanges each for the remaining 4 economies. Bosnia and Herzegovina, Kosovo and Montenegro actively support scientists by subsidising consulting to help them write Horizon 2020 proposals. Serbia and Montenegro are in the process of restructuring their network of national contact points to make them more efficient at transmitting key information from Brussels to the research institutions.

Bosnia and Herzegovina has one of the most advanced frameworks for international co-operation in the region. This is because it is the main area of focus of its state-level Ministry of Civil Affairs within its STI policy, the other areas being mostly devolved to the entities and cantons. Its previous Strategy for the Development of Science outlined a structured approach, as does the draft new one. It has given consistent support for participation in international calls (Horizon 2020, EUREKA and others), and runs a recurrent grant scheme[12] which finances participation in international conferences, fairs and collaborative R&D projects with foreign partners. Kosovo also has a relatively developed internationalisation policy, with instruments supporting participation in conferences, academic exchange and small collaborative projects. Kosovo's IT strategy also foresees international cluster linkages.

All of the economies have bilateral co-operation agreements and scholarships to facilitate international mobility. However, since Horizon 2020 mobilises significant contributions from national budgets, there is very little space to finance other types of international co-operation. Therefore, this co-operation mostly relies on initiatives by partner countries, such as recent joint calls by Serbia and the People's Republic of China, and Albania and Austria.

A regional co-operation initiative in science and technology is being established under the name of the Western Balkans Research and Innovation Centre (WISE), an international organisation with a mission to strengthen regional research innovation and technology systems and improve the research and innovation climate in South East Europe.[13] Initially, it envisages having seven members: the six economies covered in this report, and Croatia. The initiative was initiated at a ministerial conference in Split in September 2015, and has now been ratified by four economies: Albania, Bosnia and Herzegovina, Croatia and Montenegro. Ratification by four members makes it possible to establish the organisation, which will have its headquarters in Split, Croatia.

In addition, the Multi-Annual Action Plan for a Regional Economic Area in the Western Balkans (MAP) foresees important regional initiatives, such as the development of a regional centre of excellence to promote collaboration among science, technology and industry, as well as engagement of those communities with Europe-wide smart growth approaches (MAP, 2017).

It is interesting to note that none of the six economies has a structured programme for co-operation with their diasporas. As will be discussed below, brain drain is a significant issue, and several attempts were made in the past to attract emigrants back to their home economies through "brain gain" programmes, with limited success. However, there are other ways to engage with the diaspora to facilitate the circulation of knowledge. Croatia's Unity through Knowledge fund offers an interesting example, linking diaspora members with domestic institutions (Box 9.1).

Box 9.1. Good practice: Unity through Knowledge Fund in Croatia

The Unity through Knowledge Fund (UKF) was established in Croatia in 2007 as an instrument to connect Croatian scientists and professionals to centres of excellence abroad, using the diaspora connection as an effective tool to enhance the partnerships. Co operation between a Croatian institution and a foreign one provides the opportunity to transfer knowledge and enhance the competitiveness of domestic knowledge production.

The programme includes a cross-border grant which supports medium-scale collaborative research projects in Croatia with the involvement of the Croatian scientific and research diaspora, as well as a grant designed to increase the mobility of young researchers and professionals between academia and Croatian industry. In order to help establish partnerships, the Ministry of Science, Education and Sports has created a database of contacts within the Croatian scientific diaspora. The programme provides incentives to domestic researchers and members of the diaspora to connect and collaborate with each other. This collaboration enables the domestic institution to gain knowledge from the international partner.

A total of 91 projects received support during the first cycle (2007-12), including 560 scientists (380 from Croatia and 180 from the diaspora, who were at institutions including Yale University, ETH Zürich, and the Royal Institute of Technology in Sweden). It also allowed projects to attract additional funding from the European Seventh Framework Programme (FP7) (34% of funding for Croatian projects from FP7 in the period 2007-10 originated from UKF-related projects).

UKF was selected as "best practice" by the European Regional Economic Forum in the area of developing human capital and managing migration for more competitive European regions. It was also selected as "good practice" by the International Labour Organization for promoting linkages between migration and development.

Source: Adapted from Hornstein Tomić and Pleše (2014), "Skilled mobility as a challenge for Croatian diaspora and migration policies".

The way forward for the governance of STI policies

The positive trends observed in the governance of STI systems should be continued and reinforced.

Among the more advanced economies which have adopted holistic strategies – the Former Yugoslav Republic of Macedonia, Montenegro and Serbia – **the focus should be on enhanced implementation and sustainable financing of instruments, as well as independent assessment of the impact of those instruments**, and of the strategy as a whole.

The other economies (Albania, Bosnia and Herzegovina, and Kosovo), **should prioritise the adoption of draft strategic frameworks after a substantial stakeholder consultation process** to ensure widespread buy-in and mobilisation in their implementation. In the meantime, Kosovo could implement Pillar 8 of its IT strategy which would boost innovation in the IT sector, while Albania could implement its officially adopted Triple Helix Action Plan, to help prepare the ground for its future innovation strategy. In Bosnia and Herzegovina, the state-level strategy uses a bottom-up approach of consolidating entity-level strategies and policies.

Overall, most economies need to improve their inter-ministerial co-ordination. The Former Yugoslav Republic of Macedonia could resume meetings of its Committee for Entrepreneurship and Innovation, while Serbia needs to ensure the successful

functioning of its newly established Council for Innovative Entrepreneurship. Bosnia and Herzegovina, and Montenegro could consider expanding the membership of their scientific councils to include members from economic ministries. They could also broaden their mandate to include the full scope of business innovation (including non-technological innovation). Albania and Kosovo could consider establishing the innovation councils foreseen in their draft strategies. Box 9.2 offers a good-practice example from Norway of horizontal co-ordination of STI governance.

All six SEE economies could improve the implementation of their innovation policies, particularly co-ordination at the working level. They need closer co-operation between bodies in charge of supporting science, for example between ministries of education and science and their agencies, and between the economic ministries and their SME agencies. They also need to conduct independent evaluation of the performance of these agencies. Bosnia and Herzegovina's situation continues to be the most complicated, with responsibilities split not only between sectors, but also across the state, entity and cantonal levels of government. It might be useful to establish a state-wide working group with participants from both government sectors at different levels in order to share experiences and policy concepts, while respecting the constitutional mandate of each actor.

International co-operation could be organised more strategically, in order to prioritise the many different modes of co-operation, including bilateral agreements and participation in European instruments. The different economies have had different levels of success with participation in Horizon 2020, and some economies are planning to improve the efficiency of their National Contact Point networks, as well as supporting scientists in proposal writing. Regional sharing of good practices could prove useful in this domain, and this could take place in the framework of WISE, as soon as it is established.

The SEE economies could make greater use of their very widespread diasporas through programmes of collaborative grants, such as the Croatian UKF scheme (Box 9.1). Internationalisation policies should also consider opportunities for SMEs and cross-border technology transfer, in collaboration with international networks such as Fraunhofer, which is transferring Industry 4.0 practices to companies and academic institutions in Transylvania (Fraunhofer, 2014).

Governments need to create an overarching strategic view and co-ordinate policies across the whole of government. Failure to do so can create sets of overlapping and even contradictory measures, while leaving gaps in crucial areas where government support is needed. In particular, they need co-ordinated and consensual policies aiming to bridge the gap between academia and business need to be co-ordinated and consensual. See Box 9.2 for an example from Norway.

Public research system

A strong research base provides for knowledge creation in the transition to knowledge-based economies. Research occurs in both the public and private sectors: innovation in the business sector is covered in the next sub-dimension, while this section focuses on research in higher education institutions (HEIs) and public research organisations (PROs). HEIs and PROs represent an overwhelming majority of the R&D capacity of economies in the SEE region, which is why their management, modes of financing, and opportunities for human capital development are key for creating research excellence in the region.

Box 9.2. Good practice: Horizontal science, technology and innovation co-ordination in Norway

Norway's Long-Term Plan for Research and Higher Education 2015-2024 (LTP) is built around three overarching government objectives for STI policy: 1) developing research communities of outstanding quality; 2) enhancing competitiveness and innovation; and 3) tackling major social challenges.

The LTP aims to adopt a long-term perspective, to serve as a plan and not only a strategy, and to cover a broad policy spectrum, not confined to the policy fields in the remit of the Ministry of Education and Research. It has enhanced horizontal strategic orientation and co-ordination, setting a whole-of-government framework for high-level meetings chaired by the prime minister and cabinet discussions on STI issues, and helped improve the consistency of the various activities of the Norwegian research agency. Regular revisions of the LTP every four years provide an opportunity for stakeholders to meet and add more concrete structural and programme-style policy activities to the LTP from 2018 onwards, without changing the plan's general orientation.

Source: OECD (2017b), *Public Procurement for Innovation: Good Practices and Strategies*, http://dx.doi.org/10.1787/9789264265820-en.

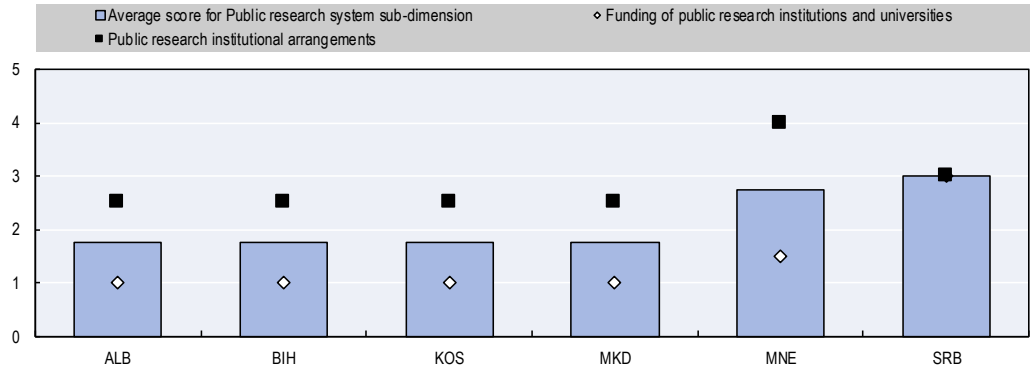
The public research system sub-dimension assesses these aspects through two qualitative indicators (Figure 9.11):

The **funding of public research institutions and universities** indicator assesses the financing framework, which usually consists of a combination of institutional funds (block funds) and project funds. Some economies have introduced performance-based research funding, based on the rationale of rewarding output, rather than input (Box 9.3).

The **public research institutional arrangements** indicator measures the legal and institutional frameworks for governing public research institutes and universities. A major aspect of governance is the balance between the principle of academic autonomy (which ensures long-term stability of research priorities), and the influence which a ministry can exert to ensure coherence with overall government social priorities.

Serbia and Montenegro are in the lead on this sub-dimension, with an average score close to 3, signifying that they have adopted and largely implemented the relevant frameworks. The situation in these two economies differs, however. Serbia has established and run an entirely project-based funding system for its PROs for several years now with nominally[14] competitive research grants, and has a well-developed institutional framework. At the same time, Montenegro has gone ahead with an advanced evaluation of its national university and has implemented restructuring on the basis of this assessment, while on the funding side is still relies mainly on legacy block grants without any performance requirement and has only a few competitive research grants. In the remaining economies, basic governance frameworks are in place but funding is still largely based on legacy systems, and performance contracting is still seen as only a remote possibility for the future (Figure 9.11).

Figure 9.11. **Public research system: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Research outcomes are improving

The volume and quality of scientific production offers a measure of basic research outcomes. The number of scientific articles per million population is used as a measure of volume; quality measures use citations per article, normalised relative to the average for the 28 EU Member States (EU-28). The performance of the SEE economies is very low, both in volume and quality, but the trend between 2010 and 2015 is clearly positive for the Former Yugoslav Republic of Macedonia, Montenegro and Serbia (Figure 9.12).

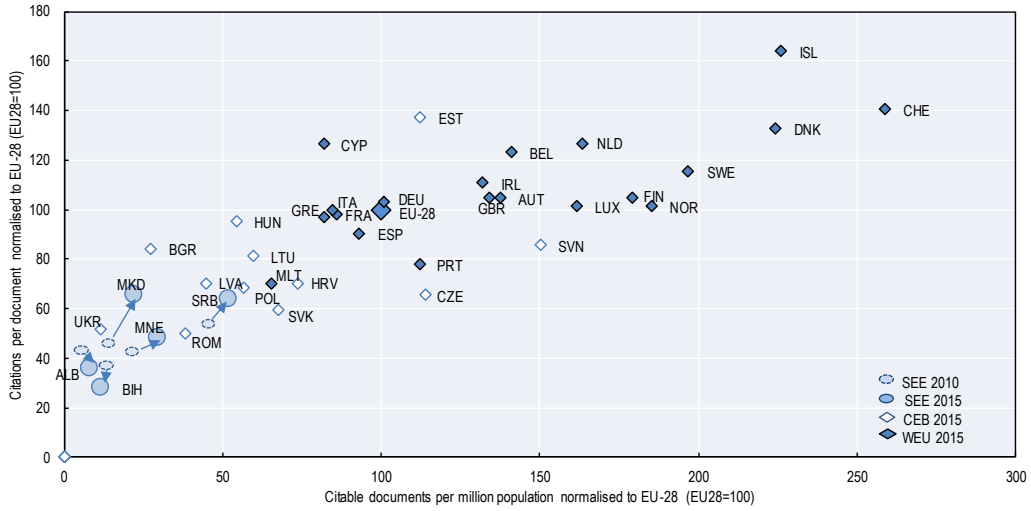
Another measure of quality is the share of scientific publications which are among the top 10% most cited. According to the European Innovation Scoreboard, 4.1% of publications in the Former Yugoslav Republic of Macedonia reached this benchmark in 2016 (up from 3.6% in 2010), while 5.3% of Serbian publications achieved this, up from 4.6% (EC, 2016). This performance is nearly in line with the average for Central Europe (5.7%), but still significantly behind the EU-28 average (10.6%).

The SEE economies' modest performance overall in the scientific area can be linked to the shortage of funding discussed under the previous sub-dimension, which translates into a modest number of researchers overall. However, the productivity of those researchers – measured as the number of publications per researcher – is higher than in most developed European countries (Figure 9.13).

Legacy block funding dominates, but performance-based schemes are envisaged for the future

Of the six economies, Serbia has adopted the most radical approach to funding public research, allocating 100% of funds on a competitive basis, based on domestic and international peer reviews of projects (Box 9.3). However, in practice, the success rate of applications is over 80%, so the process cannot be considered very competitive. Serbia plans to reform this approach in 2019 under its new strategy. This reform will combine project and institutional funding, and introduce performance criteria. The other SEE economies mostly rely on legacy block institutional funding calculated through formulas based on the number of researchers and students (for HEI). The Former Yugoslav Republic of Macedonia and Montenegro are carrying out feasibility studies to identify potential future models for performance-based financing. The studies are focused on identifying relevant models of performance contracting as well as key performance indicators which could be used for such contracting.

Figure 9.12. **Scientific production in SEE and comparator countries**



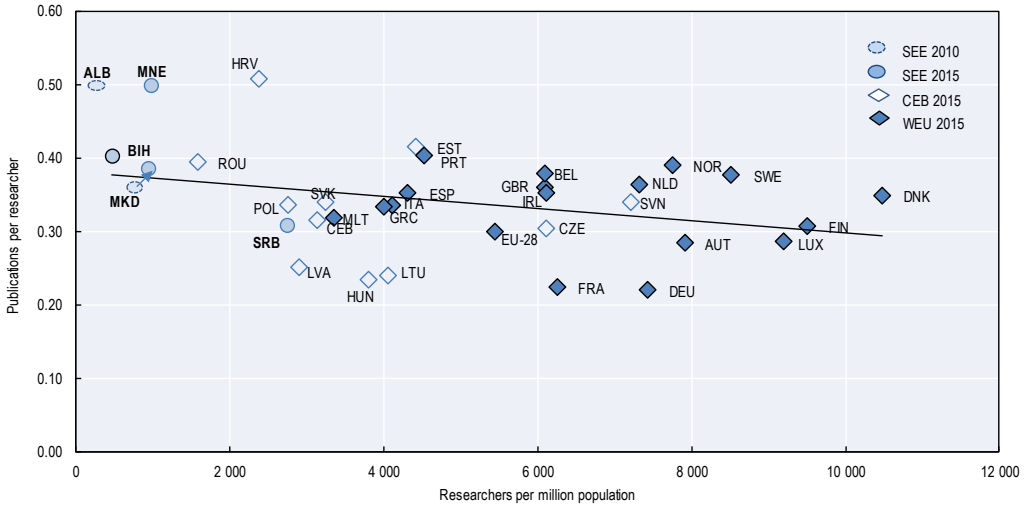
Note: WEU – Western Europe; EU-28 – the 28 EU Member States.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: Scimago (2017), *Country Rankings* (dataset), www.scimagojr.com/countryrank.php; World Bank (2017), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

StatLink http://dx.doi.org/10.1787/888933704967

Figure 9.13. **Productivity of scientists in SEE and comparator countries**



Note: WEU – Western Europe; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); EU-28 – the 28 EU Member States.

Source: Scimago (2017), *Country Rankings* (dataset), www.scimagojr.com/countryrank.php; World Bank (2017), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&preview=on#.

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Box 9.3. **Performance-based funding**

Funding of research in HEIs and PROs usually relies on a combination of institutional "block" funding, and competitive research grants. Institutional funding provides long-term stability which enables institutions to engage in long-term research cycles, while competitive grants enable excellent researchers to get extra funding for high-impact projects which are often mission oriented. Governments can use them to steer research towards priority fields or issues.

While competitive grants are clearly focused on outcomes, and ensure that funds are allocated to the research teams with the best chance of achieving excellent outcomes, block funding is traditionally based on simple formulas often related to faculty size and infrastructure costs, with specific investment plans for new equipment. In recent years, countries have started including performance-based indicators to encourage excellence in this institutional component.

The OECD STI Outlook has found two broad groups of practices in performance-based research funding systems:

1. **Indicator-based** performance-based research funding at university level relies on quantitative formulas using bibliometric measures, citations and a broad range of indicators including external research funding, completion rates, employment of graduates, faculty size, student population, prizes and awards, university league tables, and summary indexes. Systems like this are used in Austria, Denmark, Finland, Germany, Greece, Norway, the Russian Federation and Turkey.
2. **Peer reviews** at the level of the university, fields within universities or departments may be informed by metrics, or summary indices. Such systems are in force in Australia, Denmark, Italy, Poland, the Slovak Republic and the United Kingdom.

Source: OECD (2016b), "Financing public research", http://dx.doi.org/10.1787/sti_in_outlook-2016-36-en.

Additional funding is also available for projects through competitive grants, but this financing is not always predictable. For example, the Law on the Scientific and Research Activities in the Former Yugoslav Republic of Macedonia foresees an annual call for research projects but in practice, after a large call in 2012 for laboratory equipment (which equipped 83 laboratories), it issued no further calls until 2017. Montenegro issued significant calls for funding between 2014 and 2016 for research grants and the establishment of the science and technology park. This received finance under HERIC (through a World Bank loan), but has not since secured follow-up financing. In Kosovo, the Ministry of Education and Science regularly issues calls for small projects of up to EUR 10 000 each, awarding five grants in the first nine months of 2017, while larger research grants were provided in a single call financed from an EU Instrument for Pre-Accession Assistance (IPA) project. In Albania, the National Agency for Scientific Research and Innovation (NASRI) has the responsibility for issuing calls, but has not done so since 2013 due to a restructuring process.

The governance of academic institutions is regulated, although approaches to academic autonomy vary

All of the SEE economies have functional governance systems for HEIs and PROs in place. HEIs and PROs have governing boards with clear rules and mandates. Most of the governing boards have elected members representing the faculty, the government and students. Most universities have mission statements, but they do not include the so-called

"third mission" of co-operation with the private sector. There is no formal requirement for private-sector participation in governing boards.

A variety of approaches is used to balance academic autonomy and the influence of the ministry. In Kosovo, Montenegro and Serbia, the government has minority representation on university boards, while the canton government has majority representation in Sarajevo University.[15] Albania has a hybrid solution, whereby the government is represented on the administrative boards of universities, which are complementary to their senates. Albania's 2015 Law on Higher Education also stipulates that the Ministry of Education will have a majority of seats (four out of seven) on administrative boards unless the university can justify covering at least 50% of its budget from tuition fees, in which case the faculty is entitled to four seats (Government of Albania, 2015). The Former Yugoslav Republic of Macedonia does not prescribe the composition of university by law – instead it is determined by the statute of each university. It does not foresee any formal representation of the government, and exerts influence informally.

While most of the SEE economies have some form of monitoring of their HEIs, Montenegro has had the European University Association carry out a comprehensive evaluation of its HEIs. It implemented the recommendations from this evaluation to restructure the University of Montenegro into a single legal entity.

The way forward for public research systems

Beyond the overall issue of low levels of public expenditure on R&D, **the six SEE economies could enhance the conditions for excellence through more sophisticated funding and governance mechanisms**.

The SEE economies should continue to develop feasibility studies for performance contracting for financing research, while taking local constraints into account.

The SEE economies could commission external evaluations of PROs and HEIs, using Montenegro as an example, to recommend measures for enhancing the performance of basic research in their institutions.

In order to facilitate co-operation with the private sector, HEI mission statements could introduce a "third mission" of co-operation with business. The economies could also consider private-sector participation in the governing boards of universities.

Innovation in firms

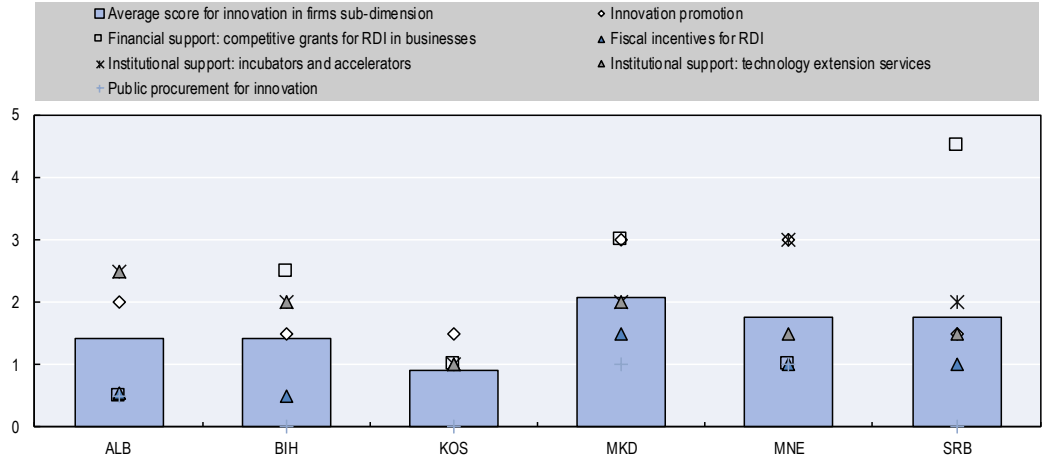
Market mechanisms alone cannot ensure optimal levels of business investment in innovation. This is because innovation suffers from three market failures: 1) uncertainty (both technological and commercial), which is much higher than the risk taken in usual business situations; 2) indivisible upfront fixed costs (such as the cost of developing a prescription drug); and 3) the public good nature of innovation outputs which makes it difficult for a firm to accrue the full benefit for itself.

Such market failures are exacerbated in the SEE economies due to the small size of firms as well as small markets which are insufficiently integrated into global value chains. These features make it less attractive for foreign capital to invest in innovative projects in the region. Skills gaps combined with brain drain also limit the creative forces which could drive innovation. In such an environment it is crucial to achieve the right policy mix to raise awareness and create incentives for businesses to invest more in research, development and innovation.

The innovation in firms sub-dimension assesses these aspects through six qualitative indicators: 1) innovation promotion; 2) financial support (competitive grants for research and innovation in businesses); 3) fiscal incentives for RDI (tax credits and VAT exemptions); 4) institutional support (incubators and accelerators); 5) institutional support (technology extension services); and 6) public procurement for innovation (Figure 9.14).

Frameworks to support innovation in firms are still at an emerging stage in the six SEE economies, as can be seen from their average scores which range between 1 and 2 (Figure 9.14). Innovation promotion is quite widespread; innovation funds in the Former Yugoslav Republic of Macedonia and Serbia have implemented competitive grants for R&D in firms; and incubator infrastructure is emerging all over the region. However, technology extension services, procurement for innovation and fiscal incentives for RDI are largely absent from government policies.

Figure 9.14. **Innovation in firms: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Businesses need government support for R&D

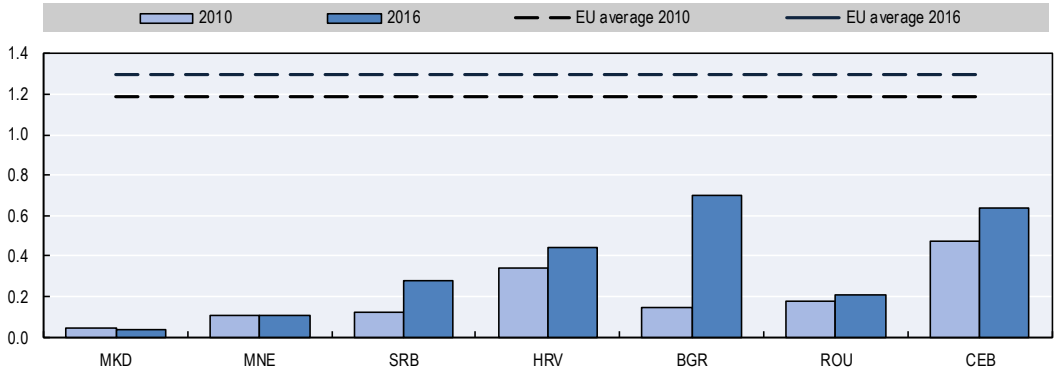
Business expenditure on R&D is a fraction of that in Central European countries, and lower still in comparison with the EU Member States (Figure 9.15). As mentioned in the introduction, Croatia experienced social rates of return on R&D of 73% in 2011, much more than the returns on infrastructure or education, notably due to a low stock of knowledge capital in the country (Aprahamian and Correa, 2015). As Croatia is a good comparator for the SEE economies, given their shared history, this suggests that business expenditure on R&D is clearly below socially desirable levels in the six economies, and thus government action is needed to remedy this situation.

Entrepreneurship itself is still largely necessity driven, rather than opportunity driven, as shown in the motivational index measured by the Global Entrepreneurship Monitor (Figure 9.16).

Venture capital is in its infancy in the SEE economies. The pioneering South Central Ventures/Enterprise Innovation Fund (ENIF) is a EUR 40 million fund sponsored by the European Investment Fund and the European Commission. The fund has invested in five ventures in Serbia and the Former Yugoslav Republic of Macedonia, as well as ventures in Croatia (South Central Ventures, n.d.).

Figure 9.15. **Business expenditure on research and development in SEE**

% of GDP

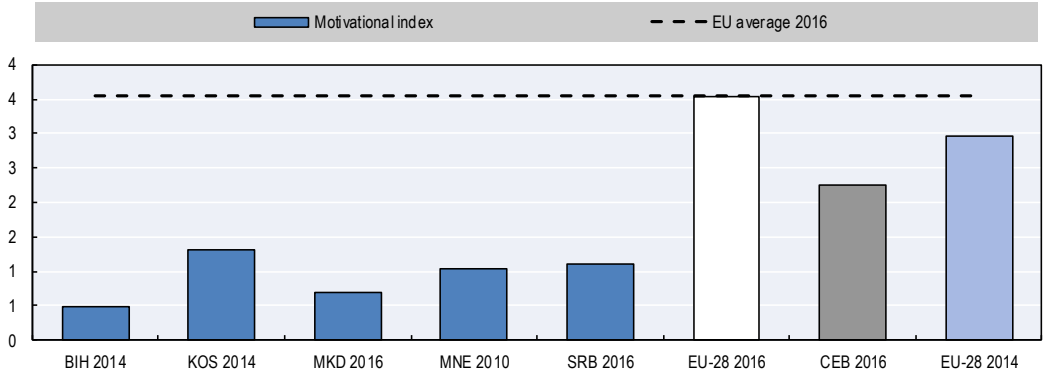


Note: Data for Albania and Kosovo are unavailable. HRV – Croatia; BGR – Bulgaria; ROU – Romania; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: Government statistical offices and ministries as part of the *Competitiveness Outlook* assessment 2016-17; EC (2017a), *European Innovation Scoreboard 2017*, http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_fr.

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Figure 9.16. **Motivational index in SEE**



Note: The motivational index is the ratio of opportunity-driven total entrepreneurial activity to necessity-driven entrepreneurial activity. Data for Albania unavailable. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

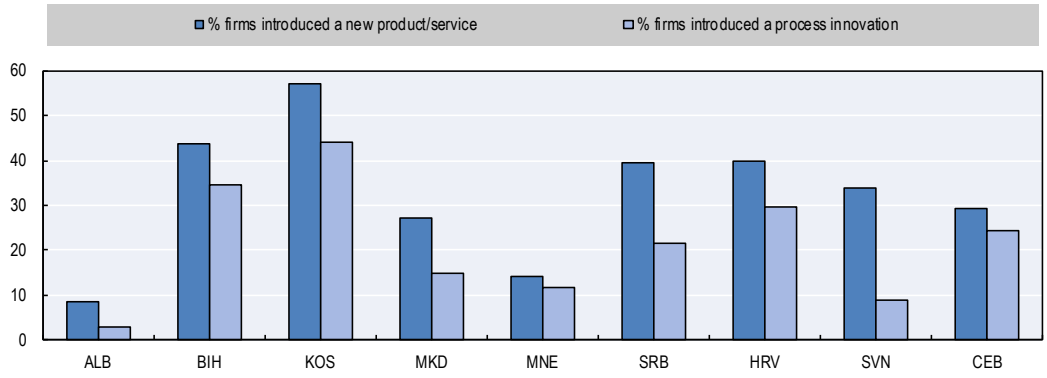
Source: GEM (2011), *2010 Global Report,* www.gemconsortium.org/report; GEM (2015), *2014 Global Report,* www.gemconsortium.org/report; GEM (2016), *2015/16 Global Report,* www.gemconsortium.org/report; GEM (2017), *2016/17 Global Report,* www.gemconsortium.org/report; EC (2017a), *European Innovation Scoreboard 2017*, http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_fr.

StatLink http://dx.doi.org/10.1787/888933705043

In contrast, self-reported innovation in firms is higher in Bosnia and Herzegovina, Kosovo, and Serbia than the CEB average (Figure 9.17). Firms in the Former Yugoslav Republic of Macedonia report that 12% of their sales originate from innovative products

and services, and firms in Serbia report 10%; slightly more than the CEB average of 9.6% and close to the EU-28 average of 13% (EC, 2017a). As existing firms invest very little in R&D, we can infer that these innovations are mostly non-technological innovations, often "me too" imitations of foreign products and services. This hypothesis is also supported by the high levels of investment in non-R&D innovation expenditure, with companies in the Former Yugoslav Republic of Macedonia and Serbia reporting greater expenditure than the EU average (EC, 2017a).

Figure 9.17. **Firms introducing innovations in SEE (2016)**



Note: HRV Croatia; SVN Slovenia; CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: EC (2017a), *European Innovation Scoreboard 2017*, http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards_fr.

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Innovation promotion activities are being developed

The Former Yugoslav Republic of Macedonia and Montenegro have developed a strategic approach to innovation promotion, which is included in their strategies and action plans. They have run promotional activities including events such as start-up fairs, hackathons, Open Science days and competitions. The other economies have also organised various events, but not as part of a strategic approach. For example, both Serbia and the Republika Srpska run very successful competitions for the best technological innovation. Over the period 2005-15, 2 359 teams participated in these competitions, attended 366 training sessions, and created 80 start-up companies. Non-government organisations (NGOs) and other private initiatives organise additional events such as start-up weekends, hackathons and training, often sponsored by donors. Examples of these include events run by Innovation Centre Kosovo, and hackathons in Mostar (Bosnia and Herzegovina) and Tirana (Albania). The OECD organised pioneering "triple helix" competitions in Bosnia and Herzegovina in 2012, and in Kosovo and Albania in 2015, which demonstrated the potential of bringing together academia, business and government to innovate.

Another key component of innovation promotion is the establishment of effective communication through websites and social media. Initiatives in this area remain relatively fragmented, with no one-stop-shop for innovators to provide holistic information in a single portal. Instead, information is fragmented across the websites of different

ministries, agencies and innovation funds, and websites dedicated to certain events (e.g. the Best Technological Innovation competition in Serbia).

Financial support for research and development is emerging, but below potential

The average score for the **financial support for research and innovation in businesses** indicator is 2.1, but varies from 0.5 in Albania to 4.5 in Serbia (Figure 9.14). The Serbian Innovation Fund is the leading initiative offering competitive grants for R&D in business, and is seen as a good practice example in the region. The fund has been implementing "mini" grants of up to EUR 80 000 and "matching" grants of up to EUR 300 000, according to international best practice, including international peer reviews of project proposals. It has also used impact assessments to revise its programme manuals. It must be noted, however, that only 48 firms benefitted from the fund's support over 2011-15 – it would need to be scaled up to make a real impact on the Serbian economy. Its total disbursement of EUR 6 million has created 276 jobs in the companies it has funded – about EUR 22 000 per job.

The Former Yugoslav Republic of Macedonia has also established a Fund for Innovation and Technology Development (FITD), which provides four forms of financing to SMEs: 1) co-financed grants for start-ups and spin-offs; 2) co-financed grants and conditional loans for the commercialisation of innovations; 3) co-financed grants for technology transfer; and 4) technical assistance through business technology accelerators. In its first two years of operation (2015-16), the FITD distributed 30 grants to start-ups, and 7 grants for the commercialisation of innovations. It issued a technology transfer funding call, but this was unsuccessful notably because of a collateral requirement, which it will remove in the future. It has issued no calls under the fourth instrument for business accelerators.

The Federation of Bosnia and Herzegovina provides small-scale grants to support individual innovators, as well as larger grants for equipment, as part of an SME package. This grant has been implemented for several years, and has been evaluated. The Republika Srpska has no operational instruments to support R&D in firms. There is a state-level grant to support a technical culture and innovations, offering individual innovators up to EUR 3 000.

Albania, Kosovo and Montenegro have no dedicated instruments for R&D in firms, but firms are able to apply for R&D grants offered by their science ministries. In practice, most SMEs are not aware of these grants, and there have been only one or two exceptional cases of an SME applying. In addition, applications are hampered by additional administrative steps – for example in Montenegro, an SME would need to register as a scientific institution to be eligible.

The SEE economies have not implemented any **fiscal incentives for R&D** in firms in the form of tax breaks or credits, and the average score is thus below 1 (Figure 9.14). Some strategic documents mention the possibility of conducting feasibility studies for such incentives. Some economies have VAT exemptions for certain categories of scientific equipment.

Institutional support for R&D exists, but home-grown technology extension services are needed

Incubators and accelerators are designed to support the emergence of start-up companies, and accelerate their development through appropriate mentoring and connections to sources of finance. The average score on this indicator is 2.1 (Figure 9.14). All six of the economies have established incubators, initially with the support of foreign donors. Norway supported the Innovation Centre in Banja Luka (Bosnia and Herzegovina), INTERA in Mostar and the Innovation Centre Kosovo in Pristina, while Italy supported the Innovation Hub in Tirana. These incubators offer co-working space, training and events such as hackathons and start-up weekends. Governments are also starting to support the incubators. In the Former Yugoslav Republic of Macedonia, the FITD was planning to issue a call for tenders to support incubators in 2017. In Bosnia and Herzegovina, the Ministry of Science of the Republika Srpska gives financial support to the Banja Luka Innovation Centre, while INTERA in Mostar only partly relies on grants from the Federal Ministry of Development, Entrepreneurship and Crafts. Montenegro's incubator in Podgorica has closed, though two others remain in Bar and Berane, and government support is focusing on the science and technology park, which will be discussed under the next sub-dimension. Albania is establishing a third incubator in Tirana under its Triple Helix Action Plan. In Serbia, incubators are mostly supported by municipalities and NGOs.

While incubators serve start-ups, mostly in technology-driven sectors (predominantly ICT firms in the SEE economies), **technology extension services** (Box 9.4) are an important policy tool to support the diffusion of relevant technologies to a wider group of SMEs, including mature ones in traditional industries. They can help firms to upgrade their operations and realise incremental innovation which does not require extensive R&D investment. These services place audit and consulting at the disposal of SMEs.

None of the six SEE governments applies a systematic approach to technology extension services – this is reflected in the average score of 1.7 (Figure 9.14). Albania comes closest in the agricultural sector, where its five Centres of Agricultural Technology Transfer across the country provide agricultural technologies to farmers, offering technical expertise and demonstrations of new technology in agriculture. Albania also offers manufacturing firms a programme of innovation audits which identify gaps, but there is no follow-up to help remedy the deficiencies identified.

The Former Yugoslav Republic of Macedonia's Innovation Strategy includes offering technical assistance to SMEs, and its Competitiveness Strategy includes strengthening capacities for SMEs to help them understand IP rights and implement in-house R&D. Kosovo's SME agency provides a scheme for consultancy and training for SMEs, but with no focus on technology. Kosovo and the Federation of Bosnia and Herzegovina also provide matching grants for firms to buy equipment for modernisation. While this can be an effective tool to support modernisation, it requires relatively large individual grants, which implies that only a very small number of companies can benefit.

In the absence of government support, the EBRD's Advice for Small Businesses programme is active across the six economies. In 2014-16, the programme assisted over 1 200 SMEs in the region, with 70% of beneficiaries reporting an increase in turnover within 12 months of completing the project. Their median growth was 25%. At the same time, 58% of companies increased their number of employees, by a median of 25%, and 21% of SMEs reported accessing finance within one year of project completion (EBRD,

2015). With costs amounting to about EUR 5 000 per job created, these figures show the breadth of impact which relatively moderate investment in technology extension services can have.

Box 9.4. **Technology extension services**

Technology extension services concentrate on offering direct support to local firms, bringing about pragmatic improvements in their operations and practices, usually with commercially proven technologies. Technology extension services fall between basic business development services such as business planning and basic marketing, and high-end R&D (such as technology transfer offices and centres of scientific excellence).

Their role starts with public mission background work, which includes providing information, awareness raising, and training. These activities eventually identify specific examples of companies needing help to upgrade their skills, and product or service delivery processes. This preparatory stage should be funded by governments as a public mission.

Once they have identified a project, extension services perform an audit to assess the state of operation of the company's production processes and their results. Based on the results of the audit, they prepare an improvement plan, and offer assistance to implement it. Such projects are usually co financed between the firm and government. Firms are often unable to support the full cost of such services, but should participate in and finance at least part of it.

Examples of technology extension services include the Manufacturing Extension Partnership in the United States, which has support centres in every state; the Canadian Industrial Research Assistance Program, which makes field engineers available in every province; and the French *Réseaux de développement technologique* (structuring industries, strengthening SME performance and attracting foreign investors), which operates in every region.

An example from a medium-income country is the Turkish Small and Medium Industry Development Organization (KOSGEB), an agency of the Ministry of Industry and Technology. KOSGEB runs several instruments aimed at developing capacity among SMEs. It provides subsidies for firms to buy consulting services and also subsidises laboratory services. The programme was originally intended to help manufacturing firms, but has gradually expanded to include service firms as well.

Source: Innovation Policy Platform (n.d.), "Technology extension services", www.innovationpolicyplatform.org/content/technology-extension-services.

Public procurement is not used to promote innovation in the six SEE economies

Public procurement can be used to fulfil the demand for a new product or service, or to improve existing products or services. Public procurement accounted for about 14% of GDP in the European Union in 2016 (EC, 2018), a considerable budget, part of which could be leveraged as an incentive to innovation. Examples from neighbouring countries include the introduction of hybrid (solar and wind-powered LED) lighting in the Jaroslaw commune in Poland and smart personal protection systems for fire fighters in Hungary (OECD, 2017b). The Croatian government tendered out de-mining following the 1990-95 war. This gave a start-up firm, Dok-Ing, the opportunity to start producing de-mining robots, which are now successfully exported to over 25 markets worldwide. Other, more proactive procurement for innovation policies have the specific objective of stimulating innovation (Box 9.5).

Box 9.5. **Procurement for innovation in OECD countries**

A recent OECD study (OECD, 2017b) found that 80% of responding countries supported procurement for innovation, and 50% have an action plan specifically for procurement for innovation. Examples include the Austrian Action Plan on Public Procurement Promoting Innovation (2012), whose implementation is progressing well thanks to co-ordinated governance and the empowerment and mobilisation of procurers, and the Danish Strategy for Intelligent Public Procurement.

Implementing procurement for innovation can be challenging, and governments need to overcome a range of hurdles in the process, including risk aversion, lack of skills among procurement officials, management issues and political support. An earlier study showed that more than 60% of governments used performance-based tender specifications, 50% provided guidance to procurement personnel to avoid focusing on lowest price, 47% involved suppliers early in the process to foster innovation through dialogue, 46% allowed tenderers to propose new products and services for small lots, 42% practised pre-commercial procurement, and 39% communicated the government's long-term needs to allow companies enough lead time to respond (OECD, 2013a). However, only 10% had a specific budget for public procurement of innovation.

Source: OECD (2017b), *Public Procurement for Innovation: Good Practices and Strategies*, http://dx.doi.org/10.1787/9789264265820-en; OECD (2013a*), Implementing the OECD Principles for Integrity in Public Procurement: Progress since 2008*, http://dx.doi.org/10.1787/9789264201385-en.

There are virtually no policy initiatives in the six SEE economies to exploit the potential of government procurement for encouraging innovation, and the average score for this indicator is 0.4 (Figure 9.14). Only the Former Yugoslav Republic of Macedonia's Innovation Strategy mentions procurement for innovation, and it has only one pilot scheme run jointly by the Skopje bus company and the FITD. This involves a call for ideas for smart bus stops and a hackathon to develop an innovative software solution for optimising bus routes. In the other SEE economies, the only recent evolution in public procurement has been a gradual shift towards favouring the economically more advantageous solution rather than the lowest price.

Risk aversion, particularly concerning corruption, is a strong barrier to the development of procurement for innovation. It should be noted that specifying functional requirements in calls for tenders, rather than technical specifications, has the effect of broadening the number of potential suppliers, and is encouraged under the Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement (OECD, 2012b). For example, a tender for public schools in Finland asked for a "solution for locking schools", whereas a more traditional approach would have been to request "mechanical locks for schools". Such a broad functional requirement meant they got more creative solutions, including both hardware and software to enhance school security (OECD, 2017c).

The way forward for innovation in firms

The SEE economies have made a number of positive developments in government support to innovation in firms. Innovation funds are being used in two of the economies, and incubators/accelerators are operating in all six. Innovation events help to raise overall awareness about the benefits of business innovation. However, these policies largely focus on a small subset of firms, namely high-tech start-ups. The beneficiaries represent a

few dozen firms in each economy, and the cost of job creation is relatively high (for example EUR 22 000 per job in the case of the Serbian Innovation Fund).

The SEE economies could consider implementing policies to **spread new technology to a broader range of SMEs** through systematic support for technology extension services. They could build on the experience of the EBRD's scheme, which has helped several hundred beneficiaries in each economy, and created jobs at the cost of only about EUR 5 000 per job.

Procurement for innovation represents another untapped resource for supporting innovation. While governments' need for radically innovative products and services may be limited, the SEE economies could consider **adapting their existing procurement processes to use functional requirements rather than technical specifications** to allow innovative solutions to emerge.

Information promoting innovation is dispersed across the websites of ministries, agencies, NGOs and innovation centres and so on. Therefore the SEE economies could consider creating **integrated innovation websites to provide a single location** to spread information to firms more efficiently.

Public-private knowledge transfers and linkages

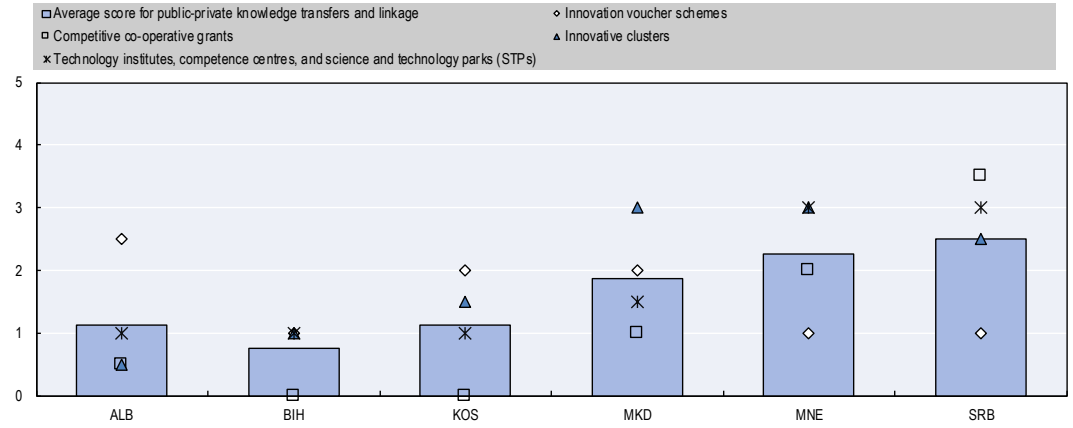
Partnerships for innovation among industry, academia and government can accelerate value creation in innovation when the actions of these three stakeholders are co-ordinated. This acceleration of value creation comes from synergies arising between the three stakeholders: businesses have first-hand access to new technologies; scientists receive feedback from entrepreneurs about the commercial viability of their research; and governments obtain insights into the types of policy interventions that spur industry-research co-operation. The main challenge in implementing such partnerships is to ensure effective communication among the three stakeholders, in light of their different priorities, environment and mindsets. Other practical barriers include differences in values, time horizons, working practices and communication methods, which are all very different between academia and business. Therefore, research-industry partnerships have to be carefully structured and implemented to overcome these barriers, initiating a virtuous cycle of communication and co-operation, combining the market knowledge of entrepreneurs with technology from academia and policy frameworks from government.

An indication of barriers to collaboration is a low number of public-private co-publications. In 2017, for example, only 4.4 of these were published per million population in Serbia and less than 1 in the Former Yugoslav Republic of Macedonia, compared to an average of 9 in comparable Central European economies, and 28 in the EU (EC, 2017b).

Policy intervention can help to support these processes. The public-private knowledge transfers and linkages sub-dimension assesses the degree of government support to these partnership initiatives. It comprises four qualitative indicators: 1) innovation voucher schemes; 2) competitive co-operative grants; 3) innovative clusters; and 4) technology institutes, competence centres, and science and technology parks.

The six SEE economies have made unequal progress in this sub-dimension, with scores ranging from 0.75 to 2.5 (Figure 9.18). Cluster policies are the most developed, with some economies creating their first science and technology parks. However, only Serbia and Montenegro have implemented competitive co-operative grants, and innovation voucher schemes have had mixed outcomes.

Figure 9.18. **Public-private knowledge transfers and linkages: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Cluster policies have had mixed results, but remain present in the region

Clusters are defined as geographical concentrations of interconnected companies: specialised providers, service providers, firms in related industries and associated institutions in particular fields that compete but also co-operate (Porter, 1998). Innovative clusters are clusters where the activities focus on co-innovation.

Clusters can be initiated by businesses which understand the potential of co-operation. Where market failures lead to a sub-optimal level of clustering, governments can intervene to foster interactions and co-operation instead. In situations where governments are not sufficiently proactive, international donors often step in to initiate cluster initiatives; however it is difficult to ensure the long-term efficiency and sustainability of such donor-initiated clusters (Ketels, Lindqvist and Sölvell, 2006).

Policy instruments used to develop clusters include 1) engaging actors (events and networking), to create trust; 2) capacity building among cluster managers, as well as offering individual companies collective services (counselling, training or joint marketing); and 3) facilitating large scale-collaborative R&D. However, cluster policies are prone to problems such as "institutional capture", or the allocation of public resources to sectors that are not likely to become competitive (Potter, 2009).

In the SEE economies, general initiatives such as joint and collaborative R&D which could become innovative clusters have been implemented by donors. In some cases governments have also extended support, but often activity has declined when the donor funding expired. A recent analysis failed to find any impact of clusters on company competitiveness in Bulgaria, the Former Yugoslav Republic of Macedonia or Serbia (Karaev, 2014). Since companies do not perceive that they have received any benefit, they also do not wish to contribute significant membership fees towards cluster operations. Government support persists, but at too low a level for higher value-added activities such as joint R&D that could bring them closer to innovative clusters.

In Serbia, the Ministry of Economy supports clusters, albeit with declining financial support. Only a few of its 22 existing clusters are considered successful, for example the automotive, ICT and apparel clusters (SECEP, 2010), and even those have not developed

an "innovative" aspect. Their main weaknesses stem from mistrust among enterprises; unskilled cluster management; and a lack of common infrastructure for R&D, design and training.

The Former Yugoslav Republic of Macedonia also has a cluster support programme, but these clusters "lack potential for innovation […] and they have achieved very little in sharing and creating economies of scale" (Karaev, 2014). Montenegro's cluster policy has been evaluated by the United Nations Development Programme (UNDP), but this evaluation was not made available. In Bosnia and Herzegovina, clusters have previously been exclusively donor-funded initiatives, and many have disappeared. However, a feasibility study is in progress for a new IT cluster for Herzegovina, which should also include a competence centre within INTERA. Kosovo's IT strategy foresees establishing a cluster of excellence for IT, with an international board, and a joint competence centre. Albania has included a cluster feasibility study in its Triple Helix Action Plan.

Overall, the SEE economies would need to reassess their cluster policies in light of their potential impact, and either reform them based on businesses' true needs (e.g. around competence centres, such as envisaged in Herzegovina and Kosovo), or discontinue them if the benefits do not justify the costs.

Voucher schemes and grants for technology transfer and linkages are rare in the SEE economies

As pointed out above, co-operation between academia and business needs to overcome substantial barriers. Two types of instruments can be used to offer the right incentives for collaboration: innovation vouchers and co-operative grants. Innovation vouchers have a low unit value (usually EUR 2-8 000), and support SMEs to do initial exploratory projects with a research institution in order to test the ground for co-operation, with limited risk. Innovation vouchers need to be simple to implement, with fast turnaround (less than 3 weeks from application to award in most cases), and usually do not have a selection process. They mostly operate on a "first come, first served" basis, or deal with excess demand through a lottery. In Flanders, the application form is one page, and a response is received the very same day (OECD, 2013b). Box 9.6 gives an example of an innovation voucher scheme in Poland.

Collaborative grants are more substantial, and need a rigorous selection process based not only on technological merit, but also on market opportunity. The Flemish collaborative grant requires applicants to prove that each EUR 1 of subsidy will translate into a EUR 25 increase in turnover.[16] In sum, innovation vouchers provided by governments offer limited purchasing power to SMEs to purchase knowledge, whereas collaborative grants incentivise multi-institutional R&D activities.

The Former Yugoslav Republic of Macedonia has an **innovation voucher scheme**, but it is underfunded, offering only 26 vouchers worth EUR 500 each per year. Across the six assessed economies, the average score for this indicator is 1.6 (Figure 9.18). Albania and Kosovo did launch innovation vouchers, but both programmes failed due to insufficient take-up by companies. The ministries in charge have not yet investigated the cause of this failure, but promotion of the schemes was not sufficient. Montenegro plans to run an innovation voucher scheme under its industrial policy, but has not yet implemented it. Serbia's Innovation Fund envisages introducing an innovation voucher as part of the technology transfer facility, while Bosnia and Herzegovina has no plans for any voucher schemes.

Box 9.6. Good practice: An innovation voucher scheme in Poland

The Polish Agency for Enterprise Development (PARP) started implementing a voucher scheme in 2008, with the objective of initiating collaboration between entrepreneurs and academia. The voucher targets micro, small and medium-sized enterprises, and can only be used for product or process development by a research institution (Jasinski, 2014).

The face value of the voucher is EUR 4 000, covering up to 80% of the project cost. In the first six years of implementation (2008-14) vouchers were distributed to 2 053 entrepreneurs. An evaluation prepared by Uniconsult showed that 41% of companies continued to co operate with academia after the voucher project was over (PARP, 2010).

The voucher is still available as of 2017; the subject of the development now needs to be linked to a Smart Specialisation topic.

Serbia has allocated funding for **competitive co-operative grants** to its Collaborative Grant Scheme which it is planning to run during 2017, and this indicator has an average score of 1.2 (Figure 9.18). The grants are expected to cover up to 70% of the total eligible cost, with a maximum of EUR 300 000 per project. The lead applicant must be an SME operating in Serbia, and the consortium must include at least one public scientific research organisation. Montenegro also had a Collaborative R&D Subprojects (CRDS) grant under the HERIC project in 2015. This instrument is expected to be moved to the Ministry of Science. However, funding for a future collaborative grant has not yet been secured. The Former Yugoslav Republic of Macedonia has no operational instrument at the moment, but plans to design one in 2017 and pilot it in 2018. Other economies have no competitive co-operative grant schemes.

Technology institutes, competence centres, and science and technology parks are just emerging

Institutions to support knowledge transfers from academia include competence centres, technology institutes and science and technology parks (STPs). Competence centres bring together academia and businesses for joint work on research projects. These centres run multi-year research programmes in a specific field. Typically, they are co-funded by the public and private sector. They often provide doctoral-level education, and organise events such as seminars or workshops. Competence centres are often virtual rather than physical.

Technology institutes facilitate knowledge transfers between academia and businesses, provide knowledge through research services with a consultancy-like approach and provide access to equipment. Technology institutes are physical centres. They target technologically competent SMEs – who need to have a minimum level of capability – and help them take their innovation capacity a step further.

STPs are business support schemes offering infrastructure and a range of support services to high-tech SMEs. They tend to have formal and operational links with centres of research excellence, such as research universities or PROs, which enable technology transfer, and are viewed as a means of creating dynamic regional clusters of innovation. Technology parks offer technical training, financial services, advanced equipment and networking activities.

Among the six SEE economies, the average score for the indicator on technology institutes is 1.8 (Figure 9.18). Serbia has the most significant applied technology institutes, including the Mihajlo Pupin Institute, which focuses on IT; the Nikola Tesla

Institute, which covers electrical engineering; and the Institute for Biological Research Siniša Stanković. Serbia also has five science and technology parks but even the most significant of these, Belgrade STP, currently operates more as an incubator than as a genuine STP. Even though the University of Belgrade is one of its founders, its links to academia are not well established, and collaboration between companies and academia occurs on an ad hoc rather than a systematic basis. In 2012 Serbia drafted a feasibility study for two competence centres, for agro-food and biomedicine, with the support of the OECD (2012a) – but no such centres have yet been established.

Montenegro is in the process of establishing a national STP, headquartered in Podgorica, with operational units called "impulse centres" in Nikšić, Bar and Pljevlja, at an estimated cost of EUR 16 million. The centre in Nikšić is up and running with 14 tenant companies, and has organised a variety of training and events, but the laboratory is not yet operational.

In Bosnia and Herzegovina, INTERA – a private foundation initiated with donor support – is currently operating mostly as an incubator or accelerator, providing workspaces, training and events such as hackathons. Future plans include the establishment of an excellence centre to serve the future IT cluster. Kosovo also envisages a competence centre in its IT Strategy, while Albania's Triple Helix Action Plan mentions a feasibility study for the establishment of competence centres.

The way forward for public-private knowledge transfer and linkages

The six SEE economies have made some efforts to bridge the gap between academia and business, including some notable high-profile investments in STPs in Bosnia and Herzegovina, Montenegro, and Serbia. However, they will need to make additional effort before these actions bear fruit. There are also less costly policy actions that could bring about change.

The economies need to change the structure of the incentives on offer to encourage academia and business to seek co-operation with each other. As discussed in the public research system sub-dimension, introducing a "third mission" for universities and PROs – to co-operate with industry – could be helpful, as could including co-operation with businesses in academics' evaluation criteria (see next section).

The SEE economies need to organise more events to bring the different communities together and encourage them to co-operate to resolve problems. The OECD has organised triple helix competitions bringing together academia, business and local government in Albania, Bosnia and Herzegovina, and Kosovo. Competitions like these have shown concrete results in the form of partnerships, consulting agreements and launches of new products based on business-academia collaboration (OECD, 2013c). Such events are not costly, since they can offer modest in-kind prizes of consulting for the best projects. Newly established STPs would be natural venues for such events.

The economies could make better use of innovation vouchers, which are currently underused in the region. A relatively low-value voucher can provide an incentive for businesses and academic institutions to start co-operating. However, in order for schemes to have an impact, they need to issue a large number of vouchers, and these vouchers need to be used. In order to ensure uptake, the instrument should be widely promoted.

The SEE economies could consider introducing collaborative grants as a follow-on to vouchers, with progressively higher unit values, the amounts correlating to the market potential of the innovation. For example, the Flemish innovation agency requires

consortia to provide market studies which demonstrate the market potential of the proposed innovation, offering evidence that the future increase in turnover will be at least 25 times the subsidy amount.

Support for clusters should become more selective, supporting clusters with excellent management practices, and encouraging them to integrate in innovation as a key collaborative activity.

To rationalise investment in brick and mortar, the SEE economies should estimate the costs and benefits of large STP projects carefully. If such projects are to go ahead, they need to create relevant links between science and academia, rather than simply operate as incubators or training centres. Smaller-scale competence centres with a sectoral focus might prove more likely to achieve the goal of knowledge transfer. In this respect the Multi-Annual Action Plan for a Regional Economic Area in the Western Balkans (MAP) provides important initiatives, such as the development of a regional centre of excellence to promote collaboration between science, technology and industry, as well as engaging those communities with Europe-wide smart growth approaches (MAP, 2017).

Human resources for innovation

People and their skills are the main drivers of innovation. While Chapter 7 (Education and competencies) covers skills more generally, the sub-dimension on human resources for innovation focuses on specific measures aimed at steering scientific careers towards research excellence and co-operation with industry. It has three qualitative indicators (Figure 9.19):

The **mobility between academia and industry** indicator considers the use of policy measures to improve the mobility of professionals between public research institutions and the private sector, which can help to circulate knowledge and enhance conditions for co-operation.

The **researcher evaluation in favour of business-academia co-operation** indicator considers how far such mobility is encouraged by explicitly including it in scientists' evaluations, and as part of the criteria for advancement into higher positions such as professorships.

The **intellectual property rights for business-academia co-operation** indicator assesses whether there is an equitable distribution of rights between institution and researchers, something which can create an incentive for the researcher to produce patents, which will enable licensing and commercialisation.

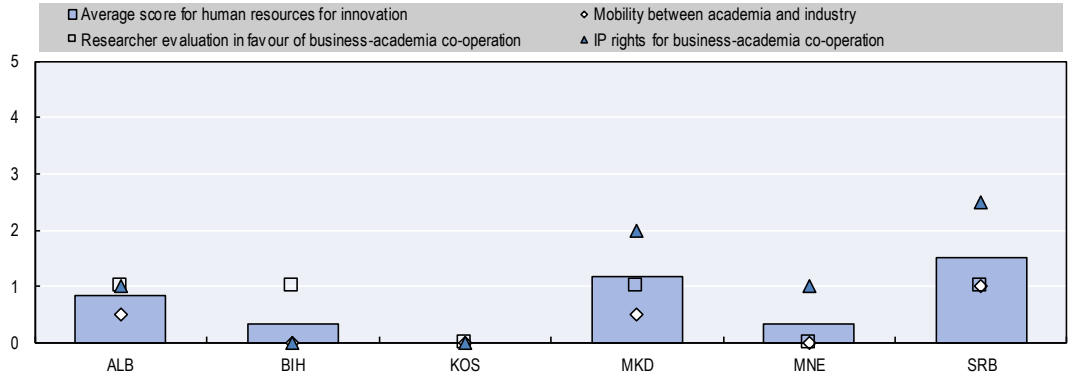
The SEE economies have implemented very few of these measures, and this is reflected in their average scores of between 0 and 1.5 (Figure 9.19). Some economies have made dispositions concerning the split of IP between researchers and institutions, but there are virtually no measures to encourage mobility between the public and private sectors, nor evaluation rules to encourage scientists to collaborate with the private sector.

Scientific careers are not steered towards research excellence or business co-operation

The analysis of policies for **mobility between academia and industry**[17] considers whether the economies offer some of the practices present in OECD countries, such as 1) industrial PhD schemes, providing fellowships for candidates to work on a project jointly defined by a company and a university; 2) provisions for entrepreneurial leave of

absence, which allow researchers in PROs to take unpaid leave and have a guaranteed return to employment, should their ventures fail; and 3) subsidies for scientists who wish to switch to working in the private sector.

Figure 9.19. **Human resources for innovation: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705100

None of the SEE economies have any such policies in place, and the average score for this indicator is 0.3 (Figure 9.19). In Albania, the Triple Helix Action Plan does mention mobility, but provides no funding for the tasks envisioned, which consist mainly of communication and stakeholder consultations on potential future action. In the Former Yugoslav Republic of Macedonia, the Innovation Strategy foresees the introduction of an entrepreneurial leave of absence, but this has never been acted upon.

In order to foster knowledge transfer to the private sector, many countries use metrics on patents and co-operation with industry when evaluating academic researchers. Among the SEE economies, however, there is no evidence of any formal policies to evaluate **researchers for business-academia co-operation** and the indicator has an average score of 0.7 (Figure 9.19). In the Former Yugoslav Republic of Macedonia, the Cyril and Methodius University of Skopje has introduced items such as patenting and consulting for the private sector among the criteria for promotion to professorship. However, such activities provide few points overall, and offer only a symbolic incentive to collaborate with industry.

When assessing **intellectual property rights for business-academia co-operation,** this chapter does not consider the general IP regime, which is covered in Chapter 1 (Investment policy and promotion). Rather, it considers how IP rights are split between institutions and individual researchers. In order to achieve the correct incentives for all stakeholders to engage in the development of commercially viable IP, a delicate balance must be struck. The 1980 Bayh-Dole Act in the United States clearly defined a split of IP rights between the university, the researcher and the federal government, achieving the appropriate incentives for each stakeholder. The researcher has an incentive to draft the patent, while the part reserved to the university justifies the support it provides to patenting and commercialisation of inventions through its technology transfer office. Since the act was passed, patenting at US universities has increased sharply and they have generated large amounts of licensing revenue (OECD, 2003). Consequently, many other countries have adopted similar legislation to encourage technology transfer (OECD,

2003). However, countries should ensure their legislation is adapted to their own specific issues such as the organisation of the higher education and research sector, R&D financing mechanisms, and the existence of support services for technology transfer.

In the assessed SEE economies, the average score for this indicator is 1.1 (Figure 9.19). The split is well defined in Serbia, where the Innovation Law clearly states that researchers are entitled to at least half of the profits from any IP which they authored. In Montenegro, the issue was been addressed through the HERIC project, but there are no specific rules on the split of IP. None of the other SEE economies have defined precise criteria for splitting IP rights.

Human capital is high, but affected by brain drain

As discussed in Chapter 7, although tertiary educational attainment is below the EU average in the six SEE economies, overall it is comparable with the CEB average. Tertiary attainment is significantly higher in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia. Assessment of one of the quantitative indicators for this sub-dimension reveals a similar pattern for the proportion of STEM graduates among the tertiary-educated population.

Local companies, including the most successful high-growth companies, do not see a lack of human capital as a significant barrier to innovation. Only 5% of high-growth SMEs[18] in the SEE economies considered human capital as a major impediment to innovation – far behind corruption, informality, access to finance, regulation, competition policy, public procurement, labour market policies and SME support services (OECD, 2013c).

As discussed in sub-dimension 2, limited investment in R&D means there are a low number of researchers in the SEE economies. However, they are more productive than in most EU countries, and are as likely to publish in the best quality journals as the CEB average. Another positive point is the relatively widespread provision of ICT training in enterprises. In Serbia, 22% of enterprises offer ICT training, similar to the EU average on that indicator, while the figure is 12% in the Former Yugoslav Republic of Macedonia (EC, 2017a).

Brain drain remains a very acute issue in the SEE economies. The emigration rates of highly educated individuals continue to rise, and exceeded 30% of tertiary graduates in the six SEE economies in 2010. This compared to about 10% of tertiary graduates in the 15 countries that were EU members prior to 2004 (EU-15), and 19% in the CEB. Emigration rates range from 15% of tertiary graduates in Serbia and Montenegro to 43% in Bosnia and Herzegovina (Landesmann and Mara, 2016). Data on immigration by highly skilled workers (brain gain) are not available, but remain anecdotal.

In conclusion, there is a significant gap between the relatively good performance of scientists from the region in scientific publications, and the very poor performance on patenting and commercialisation of knowledge.

The way forward for human resources for innovation

Serbia's introduction of the IP split in the Serbian Innovation Law in 2010 is a positive achievement. **Serbia's next step should be to make academics aware of the law in order to encourage them to patent their discoveries**. The other economies could also consider a similar reform.

All six SEE economies should consider measures to encourage greater mobility of researchers between the public and private sectors. One such measure is the entrepreneurial leave of absence. The guarantee of a return to a safe job could lower the perceived risk of entrepreneurship and encourage researchers to try to start up their own companies. Such a measure does not require additional spending, even though the institution has to invest some effort in replacing the person during their absence. Industrial master's and PhD degrees could be implemented with relatively limited subsidies.

Finally, **introducing collaboration with industry into academics' evaluation criteria** could send a strong message to the academic community that knowledge transfer is desirable and helps create a positive dynamic of co-operation. This message is absent today.

Conclusions

The six SEE economies have demonstrated that they have taken initial steps towards an STI policy framework that is conducive to scientific excellence and a thriving innovation ecosystem. Governments are adopting holistic innovation strategies which span the whole spectrum of science, technology and business innovation. They have put in place governance frameworks for HEIs and PROs, and are increasing their efforts to create an environment favourable to the emergence of start-up companies, centred on incubators and accelerators.

A number of challenges remain. These include the efficient implementation of adopted strategies, notably through better horizontal co-ordination between ministries and agencies, both at the decision-making and implementation levels. The economies could consider new modes of financing for public research, based on performance contracts. They could further improve the governance of HEIs and PROs, notably by introducing private-sector representation on governing bodies. In order to encourage business investment in R&D, governments could develop technology extension services to help diffuse new technology and consider leveraging public procurement to stimulate innovation.

A number of measures would encourage knowledge transfer and linkages between the public and private sectors, starting with events to bring together the business and academic communities, innovation vouchers to initiate collaboration, and cluster policies focusing on common R&D activities, including the establishment of dedicated competence centres to create the conditions for joint activities.

To help develop human resources for innovation, the economies could provide clearer incentives through rules on the division of intellectual property rights, ensure that collaboration activities are taken into account when evaluating academics, and specific measures to support the inter-sectoral mobility of professionals.

Addressing those challenges would enable the region to build an innovation ecosystem which would facilitate the transition towards a knowledge-based economy.

Notes

1. A public-sector fund, established by the European Investment Fund, and the European Commission, managed by South Central Ventures.
2. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the state, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
3. "Triple helix" is a term which designates business-academia-government partnerships for innovation.
4. See the OECD Reviews of Innovation Policy webpage for more information and a list of published reviews, www.oecd.org/sti/inno/oecdreviewsofinnovationpolicy.htm.
5. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
6. Central Europe and the Baltics consist of 11 transition countries: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
7. In particular, input-output tables are a pre-condition for this.
8. These economies did have science and technology strategies, but they did not cover business innovation.
9. The overall volume of publications is also very low, as will be discussed later in this chapter (Figure 9.12).
10. The biggest EU research and innovation programme ever, with nearly EUR 80 billion of funding available over 2014-20.
11. Personal communication from B. Fabianek, July 2017.
12. Support to Innovation and Technical Culture in Bosnia and Herzegovina.
13. Personal communication from Danica Ramljak, interim director of WISE, 12 October 2017
14. Very high success rates – in excess of 80% – show that the grants are in reality not very competitive.
15. In Bosnia and Herzegovina, the rules vary according to entity and canton.
16. Private communication from IWT, the Flemish innovation agency.
17. The international mobility of researchers, such as Maria Skłodowska Curie actions, is discussed under international co-operation in the first sub-dimension.
18. "High growth" is defined as a growth in turnover of over 20% per annum over three consecutive years.

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Annex 9.A1.
Science, technology and innovation: Indicator scores

Table 9.A1.1. **Science, technology and innovation: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Governance of STI policies						
National STI plan or strategy	1.5	1.5	1.5	4.0	3.5	1.5
Horizontal policy co-ordination	1.0	1.5	1.0	3.0	1.5	2.0
Implementation of STI policies	2.0	2.0	2.0	3.5	2.0	4.0
International STI policy strategy and framework	1.5	3.0	2.5	1.5	2.0	1.5
Public research system						
Funding of public research institutions and universities	1.0	1.0	1.0	1.0	1.5	3.0
Public research institutional arrangements	2.5	2.5	2.5	2.5	4.0	3.0
Innovation in firms						
Innovation promotion	2.0	1.5	1.5	3.0	3.0	1.5
Financial support: competitive grants for RDI in business	0.5	2.5	1.0	3.0	1.0	4.5
Fiscal incentives for RDI	0.5	0.5	1.0	1.5	1.0	1.0
Institutional support: incubators and accelerators	2.5	2.0	1.0	2.0	3.0	2.0
Institutional support: technology extension services	2.5	2.0	1.0	2.0	1.5	1.5
Public procurement for innovation	0.5	0.0	0.0	1.0	1.0	0.0
Public-private knowledge transfers and linkages						
Innovation voucher schemes	2.5	1.0	2.0	2.0	1.0	1.0
Competitive co-operative grants	0.5	0.0	0.0	1.0	2.0	3.5
Innovative clusters	0.5	1.0	1.5	3.0	3.0	2.5
Technology institutes, competence centres, and science and technology parks	1.0	1.0	1.0	1.5	3.0	3.0
Human resources for innovation						
Mobility between academia and industry	0.5	0.0	0.0	0.5	0.0	1.0
Researcher evaluation in favour of business-academia co-operation	1.0	1.0	0.0	1.0	0.0	1.0
IP rights for business-academia co-operation	1.0	0.0	0.0	2.0	1.0	2.5

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Chapter 10.

Digital society in South East Europe

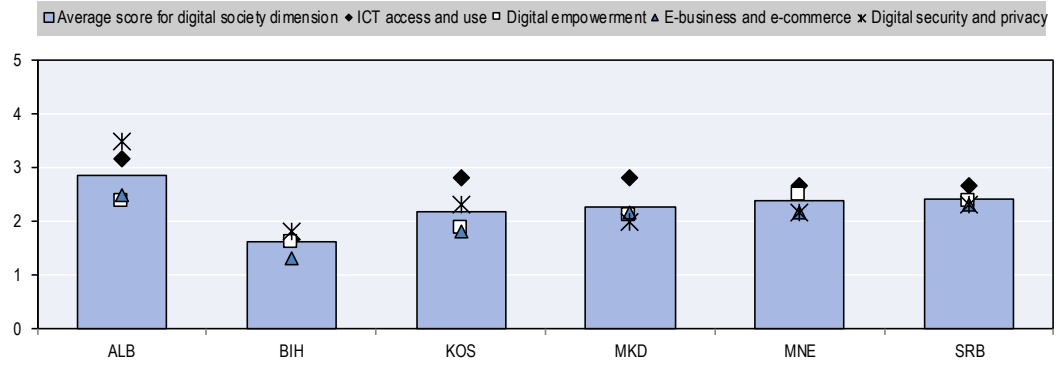
This chapter on the digital society assesses the policy settings, strategies, processes and institutions in six South East European economies. It begins with a brief overview of trends and performance in developing the inclusive use of information and communications technology (ICT), including the importance of digital ICT imports and exports of goods and services, Internet access, broadband penetration and the use of e-commerce. It then focuses on four key sub-dimensions. The first sub-dimension, ICT access and use, examines the legislative and institutional framework to foster ICT access. The second, digital empowerment, gauges the establishment of policy and institutional frameworks to maximise the benefits of digitalisation for the economy and society. The third, e-business and e-commerce, assesses the promotion of ICT adoption by small and medium-sized enterprises, e-commerce legislation, and the safeguarding of e-commerce consumers. Finally, the digital security and privacy sub-dimension examines the legal framework for and implementation of personal data protection, digital risk management and e-authentication. The chapter includes suggestions for enhancing policies in each of these sub-dimensions in order to improve access to and use of digital technology and participation in Europe's envisaged Digital Single Market, which in turn would foster the competitiveness of these economies.

Main findings

Digitalisation[1] can bring great benefits to society and the economy. However, it tends to progress unevenly; while new technology can create opportunities for businesses and citizens, it can also be disruptive, displacing workers, creating new digital divides and worsening inequality (OECD, 2017a). Thus, cross-sectoral national digital strategies are focused on enabling the positive economic and social conditions necessary for boosting countries' competitiveness, economic growth and social well-being (OECD, 2015a). The six SEE economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – have adopted a Multi-annual Action Plan (MAP) which includes digital integration as its fourth component. It stresses the importance of implementing far-reaching interventions and actions such as future-proof digitalisation strategies, an updated regulatory environment, improved broadband infrastructure, and strategies for access and digital literacy in order to open up the digital economy more widely and to integrate the economies into the pan-European digital market (MAP, 2017).

The digital society dimension assesses policies for an inclusive and competitive digital society in the six SEE economies. Together they score on average 2.5 out of 5 (Figure 10.1). This score implies that SEE governments have adopted policies and legal frameworks to develop the digital society and are in the initial stages of policy implementation. While each economy's performance is partly related to its stage of development, it is clear that progress is directly linked to the importance governments place on information and communications technology (ICT) in their vision for future growth, and to their commitment to implementing their digital society policies. Albania and Kosovo have made the most progress since the previous assessment cycle (OECD, 2016b). Both of these governments have enhanced intragovernmental co-operation, emphasised the cross-cutting character of ICT in their development strategies, and allocated resources to implement their digital strategies.

Figure 10.1. **Digital society: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Serbia and Montenegro have continued the smooth implementation of their digital strategies, strengthening aspects of their support for the ICT industry and e-business development. The Former Yugoslav Republic of Macedonia, on the other hand, has slowed down the implementation of activities in some domains since 2015. In a positive development, Bosnia and Herzegovina adopted both electronic communications and information society policies in the first half of 2017, laying the foundations for better performance in the future.

On average, the SEE economies perform better in the area of ICT access and use, facilitating broadband development effectively. They also perform well in digital security and privacy, propelled by digital public administration reform policies and e-government development. They are weaker in e-business and e-commerce, mainly due to challenges in consumer protection and promotion of digital business, while the weakest domain is digital empowerment, particularly e-inclusion. Overall, they need to enhance their monitoring, evaluation and readjustment of policies in almost all areas.

Comparison with the 2016 assessment

The digital society assessment framework was profoundly revised for this edition due to the rapid evolution of the field which forced an update of the way policies are assessed. Direct comparison with the 2016 assessment is thus not possible or may be misleading. The 2016 framework for this dimension included three sub-dimensions – ICT readiness and intensity, ICT in education, and e-business and e-commerce – and only three qualitative indicators are directly comparable between the two editions. Nonetheless, a qualitative comparison can be made based on achievements and challenges identified in the previous edition.

Since 2016, the six SEE economies have taken positive steps to adopt and implement cybersecurity policies, while the development of e-business and e-commerce has remained at the same level. Their regulatory reforms and broadband development have also progressed smoothly, with Kosovo making impressive improvements since 2016. Both Albania and Kosovo have made significant progress in implementing their digital strategies. Montenegro and Serbia have maintained a similar score on average over the two assessment cycles, while Bosnia and Herzegovina's recent adoption of new digital society policies is reflected in a slight performance improvement, although the legal framework is not yet in place and no significant changes have yet been delivered. On the other hand, while the Former Yugoslav Republic of Macedonia received a very positive assessment for ICT in education and e-accessibility in 2016, it has not performed so well in the current broader assessment, which covers e-skills development and e-inclusion. Although the economies have made progress since 2016 in adopting e-accessibility regulations, they have not been fully implemented in public websites and portals, and wider e-inclusion remains a challenging policy area.

Achievements

The six SEE economies have taken positive steps to facilitate broadband development and to align their regulatory frameworks with the European Union (EU) *acquis*. Most of the SEE economies have adopted European broadband policies and regulatory frameworks that allow for palpable improvements in the coverage and speed across communications infrastructures. Most have also set targets such as providing basic broadband to all citizens, using satellite broadband to extend coverage to 100% of the

population and enabling investments in next generation networks to deliver 30 Mbps (megabits per second) by 2020.

Most of the SEE economies have adopted cross-cutting digital strategies to support the development of ICT across all sectors. Most of the SEE economies have also recognised the important role of the ICT sector and have adopted strategies to support its development in co-operation with the information technology (IT) industry.

The six economies have taken steps to strengthen their e-business and e-commerce legal frameworks. They have aligned their sectoral legislation and regulations with the European E-Commerce Directive (2000/31/EC) and have made efforts to address non-legal bottlenecks to e-business take-up, such as building awareness and capacity among small and medium-sized enterprises (SMEs).

Most of the SEE economies have established national Computer Emergency Response Teams (CERTs) and made progress in adopting cybercrime strategies and legislation. Most of them have defined critical information infrastructure (CII), and CERTs or similar teams are in place in a variety of government institutions. The SEE economies, apart from Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia, have already adopted policies and legislation relating to digital security matters.

Most of the SEE economies have adopted e-authentication frameworks and improved their e-authentication schemes. Most have adopted updated e-signature legislation, and in some cases they have revised their technology selection to promote the wider use of e-authentication. They are gradually aligning their e-government services with their national interoperability frameworks.

Remaining challenges and key recommendations

- **Enhance the use of ICT for teaching and learning, as well as for developing e-skills for students and professionals**. All six economies have included relevant strategic objectives in their ICT or education sector policies, but none have managed to really transform education by using ICT to take learning to the student and worker, adapt teaching to the learner's needs or adopt multi-device and 24/7 learning approaches. Their competency frameworks are largely outdated, the ICT industry suffers from skills gaps, and schools often lack IT equipment, connectivity and e-curricula. The SEE economies should therefore co-ordinate their education and digital strategies and inject more resources to fund equipment purchases and connection upgrading.
- **Prioritise the inclusion of underprivileged groups in digital strategies.** Policies for e-inclusion are scarce and incomplete. While progress has been made in adopting e-accessibility regulations, there is little enforcement of them for public-sector websites and e-services, and in some cases they are optional. The SEE economies could make the implementation of e-accessibility mandatory and strengthen the relevant capacities in the public sector.
- **Take steps to systematically respect privacy and data protection, especially in social media.** While all six SEE economies have legal frameworks and authorities for personal data protection, online privacy and data abuse issues are still not clearly understood by data controllers in the public and private sector. The SEE economies should increase their public awareness campaigns and enforce

mandatory training for professionals in the private and public sector, following OECD recommendations on privacy and personal data (OECD, 2013c).

- **Promote the adoption of digital technology by SMEs.** Although all of the SEE economies have included some relevant measures in their digital strategies, their activities and programmes have not had any substantial impact on SMEs and should be revised and allocated specific resources. The SEE economies could consider wider campaigns to promote the adoption of e-business and e-commerce and look at the legal and non-legal barriers to increased take-up.

Context

The continuous migration of all kinds of social and economic activities to the Internet has increased the potential for information and communications technology to foster a knowledge society and to strengthen competitiveness. Furthermore, the use of ICT spurs innovation, which in turn can boost productivity and competitiveness (OECD, 2016a). ICT can reduce trading inefficiencies and transaction costs and affect competitive positioning, thereby contributing to rising productivity and economic growth. ICT also has great potential to promote social inclusiveness and to increase citizens' overall well-being. Well-designed digital policies can help the economies of South East Europe (SEE) to seize the huge potential offered by the digital economy within the European Digital Single Market for boosting economic growth and inclusion.

Analysis of the digital society in SEE reveals significant links with other policy areas. ICT plays an increasingly important cross-cutting role, enabling growth and innovation in all sectors. Digitalisation affects all policy domains to some extent, including tourism and culture, transport, access to finance, tax, anti-corruption, agriculture, energy and the environment. However, this chapter has particularly close links to the following chapters in this publication:

- **Chapter 7. Education and competencies** are intertwined with the development of a digital society, while digital technologies can transform teaching and learning inside or outside school. The competitiveness of the SEE ICT industry is reduced by a shortage of skills. In order to seize the opportunities created by digital technologies, individuals have to develop the right set of skills to use the new technologies and to perform new tasks associated with them. This challenges existing skills-development systems, including formal and non-formal education, and training (OECD, 2016e).
- **Chapter 8. Employment policy** includes skills gap analysis, adoption of digital tools for recruitment and matching, and measures for developing a skilled workforce which is in high demand in the ICT industry. The development of the digital economy is expected to boost innovation and start-ups, creating thousands of new jobs. In the near future, 90% of jobs will require some level of digital skills (EC, 2016a).
- **Chapter 9. Science, technology and innovation** in all sectors of the economy are driven by ICT. Digitalisation is the enabling tool for the major changes in scientific practices that can be aggregated under the umbrella of open science (OECD, 2015a). In most OECD countries, ICT accounts for the largest share of business expenditure on research and development (R&D), between 20% and 25%, representing between 0.2% and 0.3% of gross domestic product (GDP) (OECD, 2014).

- **Chapter 16. Public services** that are efficient include e-government services which foster the development of a digital society. Effective e-services require appropriate infrastructure and legislation to enable data exchange and the interoperability of information systems, while ensuring a good balance between access to public information on the one hand and privacy and data protection on the other.

Digital society assessment framework

This chapter analyses digital society development in the six reviewed SEE economies (Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia) in four broad sub-dimensions:

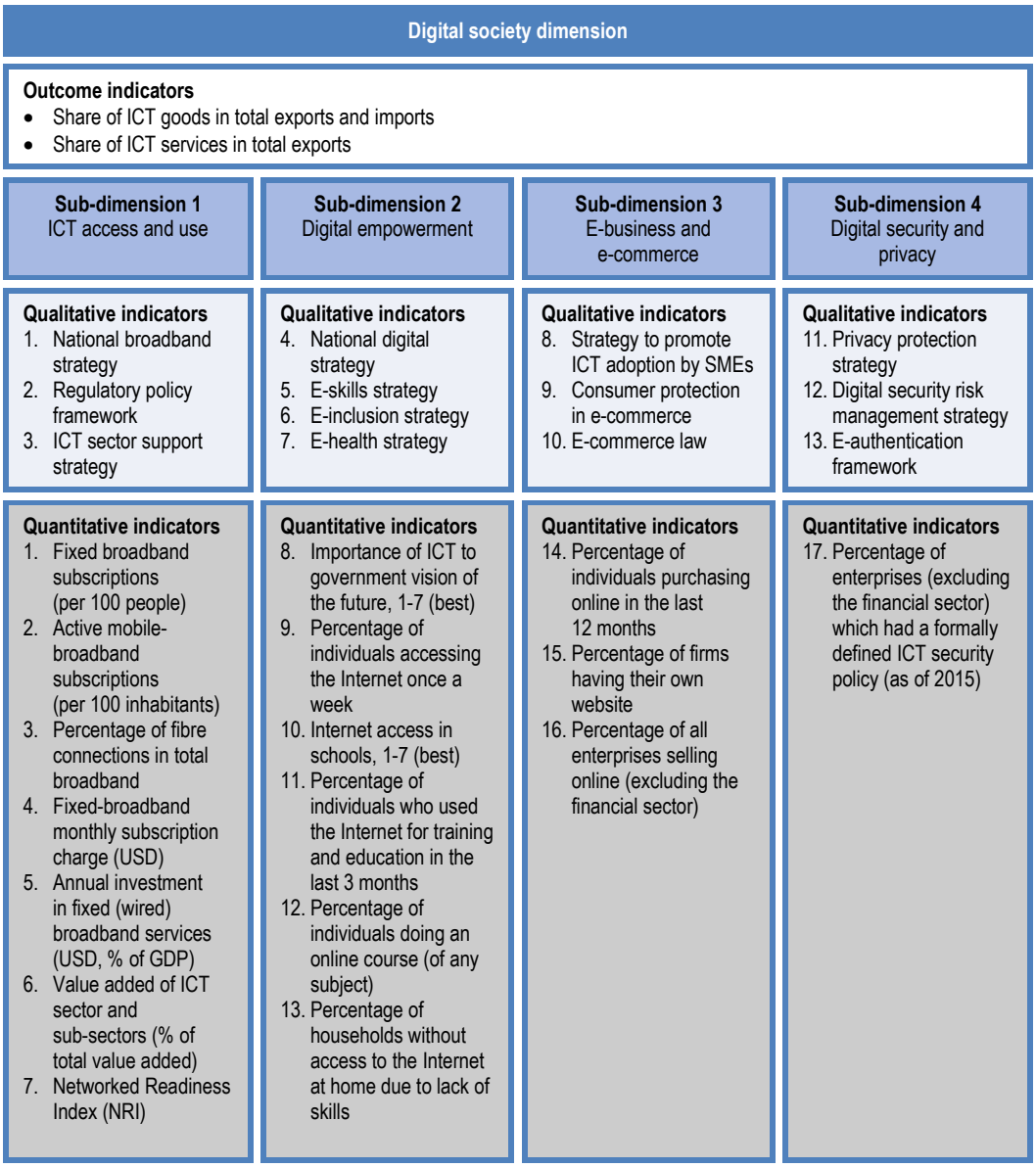
1. ICT access and use: is a strategy in place to develop broadband infrastructure further and has it been implemented? Is the regulatory framework appropriate to foster competition in the ICT sector? Is there a strategy under implementation to support the growth of the ICT sector?
2. Digital empowerment: is a national digital strategy adopted, effectively implemented and monitored? Is there a framework for e-skills development for professionals and students? Is there a policy in place for promoting the e-inclusion of the entire population? Is e-health development part of the digital society agenda?
3. E-business and e-commerce: how actively is the adoption of ICTs by SMEs promoted across all sectors? What measures are taken to promote e-business? Does the framework for consumer protection effectively cover e-commerce transactions? Is the legal framework for e-commerce complete and fully implemented?
4. Digital security and privacy: is a privacy protection strategy being implemented? Has a digital risk management framework been adopted and are institutional capacities in place to implement it? Is e-authentication promoted and are e-services developed on a functional interoperability framework?

Figure 10.2 shows how the sub-dimensions and their constituent indicators make up the digital society assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Quantitative indicators are based on national or international statistics. Qualitative indicators have been scored in ascending order on a scale of 0 to 5, and are summarised in Annex 10.A1.[2] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Digital society performance in SEE economies

The proportion of imports of ICT goods as a share of all imports is a gauge of how well ICT has been absorbed into society and the sophistication of its use. Imports of ICT goods have remained stable over time and are uniform across the six SEE economies at 3-4% (World Bank, 2017b). This is about half the European Union (EU) average (7.9%) and significantly lower than the 9% average for Central Europe and the Baltics (CEB)[3] (World Bank, 2017b). This shows that while CEB countries are catching up with Western Europe through increased imports, for the SEE economies the overall gap seems to be widening.

Figure 10.2. **Digital society assessment framework**

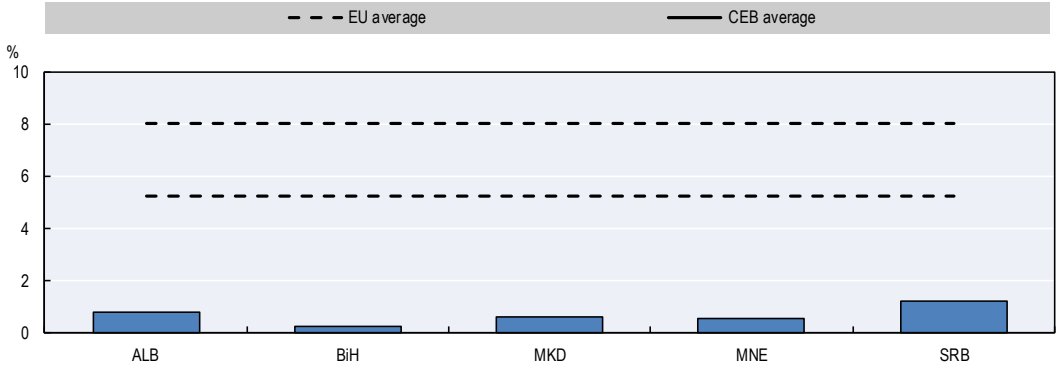


On the other hand, a closer look at exports of ICT goods and services in 2015 (Figures 10.3 and 10.4) reveals that the competitive strength of the ICT sector varies across the SEE economies. Serbia has the greatest proportion of ICT goods exports, but at 1% of overall goods exports this is still significantly below both the EU and CEB averages. Serbia also has the greatest proportion of ICT services exports, reaching the EU average of 35% of all services exports, followed by the Former Yugoslav Republic of Macedonia at 22%, which is very close to the CEB average of 25%. The share among the other four SEE economies ranges between 8% and 12%, significantly below the CEB average. The available data thus suggest that SEE economies are stronger at exporting ICT services than goods, but in most cases their performance is weak. Note that these service exports include computer and communications services (telecommunications and postal and courier services) and information services (computer data and news-related service transactions), which also encompass lower value-added services, such as call

centres. The right digital society policies and a commitment to developing an environment conducive to innovation and the digital economy could help the SEE economies realise the potential for growth in the ICT sector.

Figure 10.3. **ICT goods exports (2015)**

% of goods exported, BoP



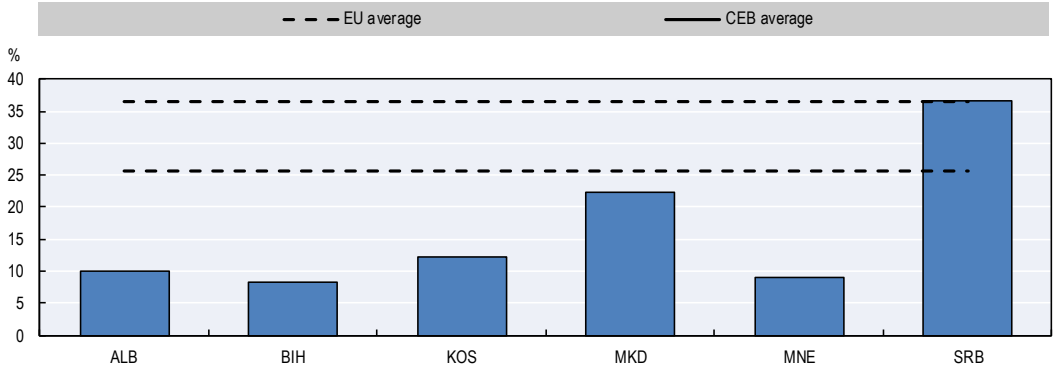
Note: Data for Kosovo are missing. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); BoP – balance of payments.

Source: World Bank (2017b), *TCdata360* (database), https://tcdata360.worldbank.org.

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Figure 10.4. **ICT services exports (2015)**

% of services exported, BoP



Note: CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia); BoP – balance of payments.

Source: World Bank (2017b), *TCdata360* (database), https://tcdata360.worldbank.org.

StatLink http://dx.doi.org/10.1787/888933705176

ICT access and use

The European Digital Single Market (DSM) strategy demonstrates the importance of the digital economy for the European Union, making it one of the ten top political priorities of the European Commission (EC). The DSM has three objectives: 1) making it

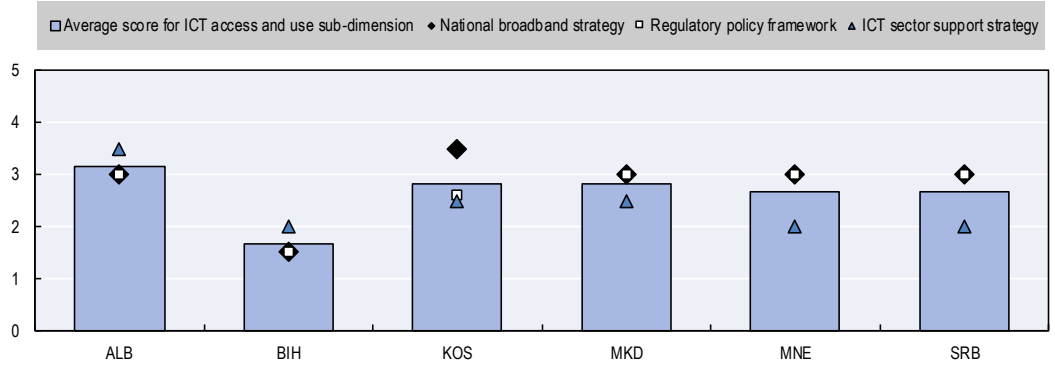
easier for consumers and businesses to access online products and services across Europe; 2) improving conditions for digital networks and services to grow and thrive; and 3) boosting the growth of the European digital economy (EC, 2015a). Achieving these ambitious objectives requires boosting investments in next generation broadband infrastructure to ensure fast, reliable and affordable connectivity for all citizens. It also means implementing regulatory safeguards to facilitate competition, technology neutrality[4] and ICT industry growth (EC, 2015a).

The ICT access and use sub-dimension includes three qualitative indicators:

- The **national broadband strategy** indicator assesses whether the SEE economies have adopted policy documents that define measurable objectives for broadband development, accompanied by concrete action plans with budgets and accountable actors, and which include adequate co-ordination tools, as well as processes to monitor and evaluate implementation (OECD, 2004a).
- The **regulatory policy framework** indicator measures whether the SEE economies have adopted and implemented an ICT regulatory policy framework, and whether they are monitoring its impact on society and the economy. This indicator also assesses whether the ICT regulatory framework follows the key elements of the OECD Recommendations on Regulatory Policy and Governance (Box 10.1; OECD, 2012a).
- The **ICT sector support strategy** indicator measures whether the SEE economies have a coherent strategy to support the sector and ICT industry, and to what extent it has been implemented. The assessment analyses whether the strategy promotes research and development programmes on emerging ICTs, access to capital mechanisms, ICT standards, ICT exports and foreign direct investment in ICT.

The six SEE economies have largely made significant progress in transposing the EU 2009 regulatory framework for telecoms and increasing broadband penetration through the implementation of relevant policies, although some challenges remain. On average, the SEE region scores over 2.5 out of 5 on this sub-dimension, and a closer look reveals that only Bosnia and Herzegovina falls below this average (Figure 10.5). The other five economies are implementing broadband policies and regulatory frameworks and have support strategies for the ICT industry in place.

Figure 10.5. **ICT access and use: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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All of the SEE governments have recognised the growth potential of the ICT sector and its industry, which is reflected in the proliferation of ICT sector support policies adopted in the last couple of years. Although resources to support the IT industry are still scarce, governments are demonstrating a renewed interest in promoting it as a cross-sectoral driver of entrepreneurship and innovation.

Broadband strategies are helping to improve availability and demand

Broadband development policies drive the development of action plans and legal or regulatory reforms. These in turn influence the selection of technologies, ensure universal access to broadband and help to create demand for broadband services and applications. In recent years, the SEE economies have made significant progress in setting up appropriate broadband policies.

Five of the six SEE economies score 3 or more out of 5 on the national broadband strategy indicator (Figure 10.5). The exception – Bosnia and Herzegovina – only adopted its long-term draft policy on Electronic Communications for 2017-2021 in March 2017, though without full consensus being achieved at all levels of government. Recently, the Ministry of Communications and Transport of Bosnia and Herzegovina set up a working group to prepare the national broadband strategy, which is expected to be submitted to the Council of Ministers for adoption by the end of 2017. Albania and Serbia are implementing dedicated broadband strategies that align with their digital strategies. In fact, Serbia completed its broadband strategy in 2016 and is preparing a new strategy for adoption in 2017. Kosovo and Montenegro have incorporated their broadband development policies into their digital strategies. In Kosovo the policy has been more than halfway implemented and funds have been secured for the next period, including a World Bank loan for EUR 37 million for rural broadband infrastructure development. Montenegro has transitioned from the successfully implemented Information Society Strategy 2012-2016 to the new Strategy for the Development of the Information Society by 2020, which was launched in 2017. This continuity in broadband policy implementation is reflected in its indicator score.

The Former Yugoslav Republic of Macedonia currently lacks a dedicated national broadband strategy. One was initially planned for 2016 according to the adopted short-term ICT Strategy 2016-2017. Nevertheless, the short-term ICT Strategy along with the Regulatory Strategy 2012-2016 of its telecoms regulator, the Agency for Electonic Communications (AEK), have consistently driven broadband development. The Regulatory Strategy had achieved nearly 100% of its objectives by the end of 2016.

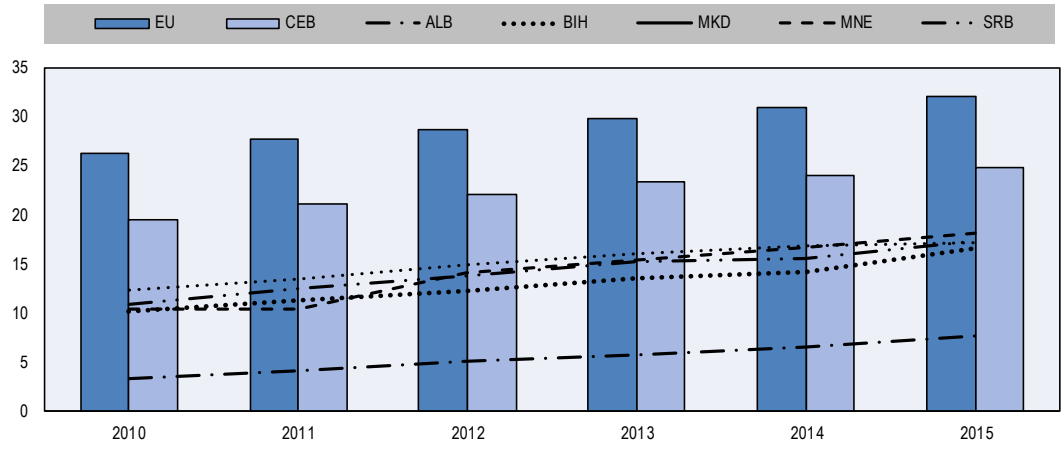
Two quantitative indicators demonstrate the progress achieved in broadband development in the SEE region: fixed broadband subscriptions per 100 inhabitants (Figure 10.6) and active mobile-broadband subscriptions per 100 inhabitants (Figure 10.7).

Fixed (wired) broadband subscriptions remain lower than the EU and CEB averages, while the cumulative growth across all of the SEE economies from 2010 to 2015 was 101%, equal to the EU and the CEB averages (100%). This indicates that the SEE economies are not catching up with the EU and CEB averages. The SEE region has traditionally ranked low in fixed network penetration, because of shortcomings in its wired infrastructure. Mobile network connectivity has gone some way to address this, but the SEE governments recognise that wireless broadband development cannot replace fixed-line infrastructure mainly due to bandwidth limitations – for example, fibre to the home connections deliver 1 Gbps (gigabit per second) as opposed to 337 Mbps (megabits

per second) for mobile broadband. Their strategies therefore prioritise the development of next generation wired infrastructure.

Figure 10.6. **Fixed broadband subscriptions (2010-15)**

Per 100 inhabitants



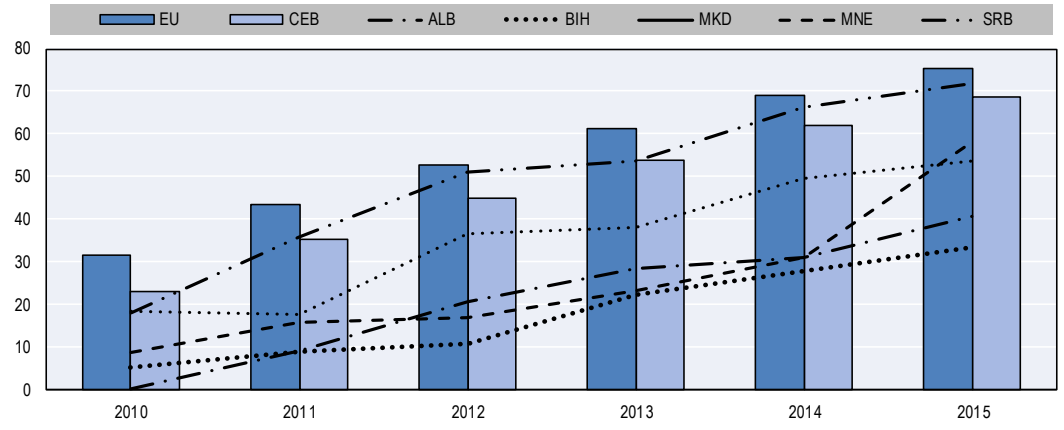
Note: Data for Kosovo not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: ITU (2017), *World Telecommunication/ICT Indicators Database*, www.itu.int/en/ITU-D/Statistics/Pages/publications/wtid.aspx.

StatLink http://dx.doi.org/10.1787/888933705214

Figure 10.7. **Active mobile-broadband subscriptions (2010-15)**

Per 100 inhabitants



Note: Data for Kosovo not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: ITU (2017), *World Telecommunication/ICT Indicators Database*, www.itu.int/en/ITU-D/Statistics/Pages/publications/wtid.aspx

StatLink http://dx.doi.org/10.1787/888933705233

Data collected from statistical offices as part of the assessment process suggest that the penetration of fibre connections is increasing in the SEE region. For example, in Kosovo, fibre connections reached 10% of total broadband connections in 2016. This is the highest of the six economies, although still well below the 20.1% for OECD countries on average (OECD, 2017b). According to data from the International Telecommunication Union (ITU), annual investments in fixed broadband services are growing in Albania, Bosnia and Herzegovina, and Serbia (ITU, 2017). In Albania, sharply accelerating investments reached USD 91 million in 2013 or 0.71% of GDP. However, although data are scarce, annual investments are not regularly this high in any of the six economies and usually range between USD 15 and 35 million per year in each economy.

Another quantitative indicator is the Networked Readiness Index of the World Economic Forum, which measures how economies use the opportunities offered by ICT for increased competitiveness and well-being. On this indicator, the six SEE economies rank closely alongside the CEB states. The Former Yugoslav Republic of Macedonia ranks 46th out of 139 economies, scoring 4.4 out of 7 on this index, closely followed by Montenegro with 4.3. It is interesting to observe that the Czech Republic and Slovenia ranked 36th and 37th respectively in the same assessment, while Croatia was 54th, ranked below Montenegro in 51st place (WEF, 2016).

Regulatory reforms are promoting investment in the ICT sector

Regulatory policies play a pivotal role in ensuring a stable environment that attracts and justifies major investments in technological infrastructure, as well as guaranteeing basic user rights in the digital age. In the challenging ICT sector, the capacity of regulatory frameworks to promote digital development depends on a policy mix of regulatory best practice and market mechanisms to promote competition (e.g. well-designed privatisation of incumbents), innovation and investment.

Most of the SEE economies are actively implementing regulatory frameworks for electronic communications, which is reflected in the average score of over 2.5 out of 5 on the regulatory policy framework indicator (Figure 10.5).

Alignment with the EU 2009 regulatory framework is complete in Albania, Montenegro and the Former Yugoslav Republic of Macedonia, which have all fully privatised their telecom incumbents. Serbia is preparing a new Law on Electronic Communications that should remove all competitive safeguards protecting the state-owned incumbent operator. In Albania the independence of the regulator is guaranteed by the national assembly, and the financial independence of the regulator in Montenegro was achieved through an amendment to the Electronic Communications Law in 2016. In the Former Yugoslav Republic of Macedonia, although the regulator is not precisely following EU regulatory practices in managing its budget independently, its budget is subject to public consultation and any surplus is allocated to projects of public interest (not necessarily in the ICT sector).

Kosovo, however, has still not amended its Law on Finances to provide financial independence to its telecom regulator, while its incumbent operator has still not been privatised after two failed attempts. Bosnia and Herzegovina has yet to complete the transposition of the EU 2009 regulatory framework: a new Law on Electronic Communications is being prepared and its adoption will hopefully improve the economy's compliance with EU regulatory practices. The adoption of the Electronic Communications policy at the state level in March 2017 is a positive step in this direction, but the appropriate legal and regulatory framework also needs to be adopted and to become effective. Moreover, it is noted that full consensus was not achieved at all

levels of the government for the adoption of this policy. The OECD recommendations on regulatory policy and governance could be considered by the government in Bosnia and Herzegovina as an excellent tool to implement the necessary regulatory reforms (Box 10.1).

Box 10.1. **OECD recommendations on regulatory policy and governance**

The *Recommendation of the Council of the OECD on Regulatory Policy and Governance* is the first comprehensive international statement on regulatory policy since the global financial and economic crisis uncovered major failings in governance and regulation, which have undermined trust in public and private institutions alike. Amid ongoing economic uncertainty, establishing a well-functioning national regulatory framework for transparent and efficient markets is central to re-injecting confidence and restoring growth. The recommendation:

- provides governments with clear and timely guidance on the principles, mechanisms and institutions required to improve the design, enforcement and review of their regulatory framework to the highest standards
- advises governments on the effective use of regulation to achieve better social, environmental and economic outcomes
- calls for a "whole-of-government" approach to regulatory reform, with emphasis on the importance of consultation, co-ordination, communication and co-operation to address the challenges posed by the inter-connectedness of sectors and economies.

Source: OECD (2012a), *Recommendation of the Council of the OECD on Regulatory Policy and Governance*, http://dx.doi.org/10.1787/9789264209022-en.

Most of the SEE regulators are facilitating investments in next generation networks, adopting regulations on infrastructure sharing and rights of way,[5] as well as using georeferenced databases to map broadband infrastructure, as for example in Albania and Montenegro. The Former Yugoslav Republic of Macedonia has taken measures to promote competition by lowering spectrum fees. In 2012 the regulator, AEK, decreased the radio frequencies' fee for LTE 800 by 50% (LTE stands for Long Term Evolution, a 4G wireless communications standard), lowering them below the fees for the 900 MHz (megahertz) spectrum, and thus successfully implementing a tender processes for the 800 MHz spectrum acquisition. It further decreased all spectrum fees by 20% in 2014, and finally in May 2017, through an amendment to the by-law on radio frequency fees, decreased fees by 50% for the spectrum above 55 GHz (gigahertz) and by 43-76% for the 2.3-3 GHz and over 3 GHz bands, intended for land mobile broadband services. Nevertheless, there is room for further improvement in facilitating investments in next generation networks in the SEE region. For instance, in Bosnia and Herzegovina processes and fees for network infrastructure construction works have not been harmonised at the municipal level, complicating and discouraging investments in this area.

The SEE economies are still in the process of developing broadband services further as a result of the digital dividend[6] realised by the switchover from analogue to digital broadcasting. The digital switchover is complete in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, but has been delayed in the other three economies. Albania has progressed significantly and is close to completing the analogue switch-off, while the government has decided to subsidise DVB-T2/MPG4 decoders for all families in need. Kosovo is expected to adopt its Digital Switchover Strategy in 2017, which will

be implemented by the Independent Media Commission. Progress has been very slow in Bosnia and Herzegovina, where jurisdiction and equipment ownership issues are still causing significant delays in implementing the switchover.

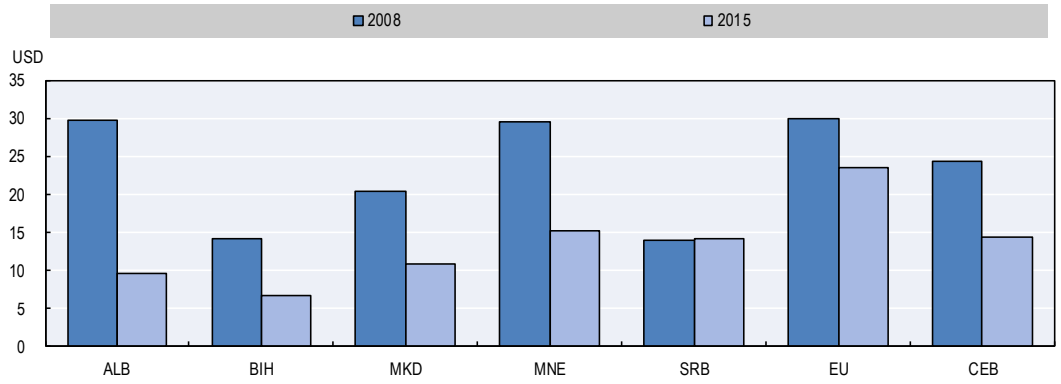
The six SEE economies have made significant progress in ensuring public participation in the ICT regulatory process through public consultations and in regularly publishing reports with indicators monitoring the development of the electronic communications market. On the other hand, regulatory impact assessment (RIA) is unevenly institutionalised and practised in the economies. The Former Yugoslav Republic of Macedonia adopted a new obligatory RIA framework in 2014 and all RIA processes are publicly available online on the website of the National Register for Electronic Regulation. Serbia has established the Secretariat for Public Policy and Montenegro has created the Secretariat for Legislation to manage the RIA process. Albania has also made impact assessments compulsory, but they are usually performed only from a financial perspective. Bosnia and Herzegovina has not yet adopted a RIA methodology. However, none of the economies are consistently practising RIA for every policy or legislative act, even in the case of the Former Yugoslav Republic of Macedonia, which has the most complete RIA framework in place, or in Montenegro and Serbia, where RIA documents are not always made public.

The fixed-broadband monthly subscription charge indicator (Figure 10.8) illustrates the positive impact of these regulatory reforms in ensuring a competitive communications market with more affordable connectivity. Globally, the monthly average price of a basic fixed-broadband connection[7] has fallen from around USD 80 in 2008 to USD 25 in 2015 (ITU, 2016). Subscription costs have also fallen in the six SEE economies, as in the EU Member States (Figure 10.8). However, this indicator requires careful interpretation: since every economy reports the cost of their "basic" broadband connectivity subscription, this can reflect completely different offerings in terms of broadband speed. For example, the EU average monthly charge for a basic broadband connection was USD 23.65 in 2015, but this corresponds to a considerably higher speed (e.g. 100 Mbps in Ireland) than in the SEE economies (where the respective broadband speed is around 2 Mbps). In addition, in 2015 the GDP per capita in purchasing power standards in CEB was 69% of the 28 EU Member States (EU-28), compared to 35% of the EU-28 in the SEE economies, meaning a basic broadband connection was more expensive in SEE than in the CEB or the European Union.

ICT sector support strategies are largely in place

The ICT sector is an important contributor to growth in almost every economy around the world. Between 2001 and 2011, ICT accounted for 30% of GDP growth in the EU and for 55% in the United States (EC, 2015a). Governments in general have been moving away from a "push" role – supporting the sector by ensuring the right environment for the provision of ICT infrastructure and the development of the domestic ICT sector – towards "pull" strategies aimed at promoting digital literacy; establishing an enabling environment for ICT, including an appropriate legal framework; and fostering the development of applications, including local content. Governments are now focusing on supporting the IT sub-sector and the adoption of ICT by businesses as an enabler of innovation and growth.

Figure 10.8. **Trends in fixed-broadband monthly subscription charges (2008-15)**



Note: Data for Kosovo not available. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: ITU (2017), *World Telecommunication/ICT Indicators Database*, www.itu.int/en/ITU-D/Statistics/Pages/publications/wtid.aspx.

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All six SEE economies have adopted strategies to support the ICT sector directly or indirectly. The average score for the ICT sector support strategy indicator is close to 2.5 out of 5, which implies that relevant strategies have been adopted by the six governments, but implementation is still at the early stages in most of the SEE economies (Figure 10.5). These strategies have strengthened cross-government co-ordination and the participation of industry representatives in the preparation and implementation of activities. Serbia and Kosovo have adopted dedicated strategies for the development of the IT industry, promoting exports and outsourcing services, which were driven by the industry itself. The other four economies have incorporated measures into their broader digital strategies to support the ICT sector. They all focus on supporting ICT-related start-ups and establishing innovation funds or hubs and technology parks to facilitate entrepreneurship in this field, as in the case of Kosovo, Albania, Montenegro and Bosnia and Herzegovina. However, in all of the SEE economies, support activities for the IT sector rank fairly low in priority and resource allocation. This results in significant delays in implementing their action plans. The scarcity of financial resources is exacerbated by insufficient planning of financial support schemes, such as innovation vouchers in the Former Yugoslav Republic of Macedonia or start-up loans in Serbia, limiting the programmes' impact. International donor financing has often preceded government policies; for example it has been mobilised for the development of incubators and innovation hubs in Tirana, Albania and in Banja Luka and Mostar, Bosnia and Herzegovina, and also in Pristina, Kosovo.

The contribution (relative weight) of the ICT sector in some of the SEE economies is even higher than the EU average. For example, according to figures received from government statistical offices as part of the assessment process, in the Former Yugoslav Republic of Macedonia, the ICT sector generated more than 8.3% of GDP on average during 2010-15, and 5.8% in Albania and the Republika Srpska of Bosnia and Herzegovina (one of the constitutional and legal entities of Bosnia and Herzegovina[8]). Serbia's ICT sector was the largest in absolute value, contributing EUR 1.5 billion to the economy in 2014 (4.3% of GDP).

The communications sub-sector is the major contributor to ICT sector growth in the SEE economies, but the IT sub-sector (including IT services, software and equipment) has also gained ground. As the world market continues to move towards outsourced software engineering, and offshore systems design and integration, the SEE economies are well placed both geographically and structurally to provide cost-effective, reliable alternatives to more established markets like the Czech Republic or Bulgaria. Many key global players such as Microsoft, Oracle, Google, Hewlett Packard, SAP, IBM, Siemens, Intel and Cisco have already tapped into the potential of the Serbian IT industry by establishing development centres in Serbia or outsourcing services to local IT companies. Geographical and cultural ties, and good literacy levels in German and English, make the region a competitive outsourcing destination for call centres for Western European companies. For instance, Kosovo has strengthened its presence as an outsourcing destination for German IT companies, exploiting links with its diaspora in Germany. The Serbian IT market was worth some EUR 433.1 million in 2014 (Matijević and Šolaja, 2015). It is worth noting, however, that besides the highly knowledge-intensive activities such as software development, the IT sub-sector also covers outsourcing of call centres, which is a lower value-added activity.

However, the assessment also found that excessive government focus on promoting the SEE IT industry as an outsourcing destination is not embraced by some of the local stakeholders in the Former Yugoslav Republic of Macedonia and Kosovo. They have expressed concerns that the outsourcing service provision drains domestic companies and stifles their potential to develop competitive products for the global market by occupying skilled professionals on less than innovative activities.

The way forward for ICT access and use

As the SEE economies look to the future, they might consider a number of additional policy interventions to further support ICT access and use, some of which are inspired by the Recommendation of the Council on Broadband Development (OECD, 2004a).

The Former Yugoslav Republic of Macedonia could prioritise adopting a long-term ICT strategy that promotes broadband development and supports the ICT industry. See also the relevant Action Point IV.1.1.a in the Multi-annual Action Plan for the Western Balkans (WB6 MAP): "Advance right/introduce policy and regulatory measures that would incentivise for investments in high speed broadband networks, including transposition of EU directive 2014/61/EU" (MAP, 2017). Early involvement of all actors in the development of action plans could increase their ownership of these plans, facilitating implementation and promoting accountability.

Kosovo and Bosnia and Herzegovina could intensify their efforts to complete the digital switchover in order to reap the benefits of the digital dividend. They could consider reviewing the process followed so far to identify any obstacles and shortcomings in the operational models and technologies chosen for the digital switchover, and modify them as needed to accelerate completion. Under the Digital Single Market, the European Commission has proposed an EU-wide approach to the use of the ultra-high frequency (UHF) band for the use of the 700 MHz band for mobile service and rural broadband services (EC, 2016b). All the SEE economies should take the opportunity to review this proposal. See also the relevant Action Point IV.1.2.a ("Establish predictable, consistent, and harmonized spectrum") in the WB6 MAP (MAP, 2017).

Albania, Kosovo, Montenegro and Serbia could accelerate the planning and implementation of rural broadband development, exploiting funding opportunities from international donors where available. The economies should identify and carefully analyse white areas and select a suitable intervention model, including public-private partnerships if appropriate, to avoid disrupting market competition. See also the relevant Action Points IV.1.1.b ("Complete outstanding broadband infrastructure mapping and perform analysis of broadband markets and identify network coverage gaps and investments, as well as policy measures required to bridge those gaps") and IV1.1.c ("Establish regular exchange on business incentive models for rural and underserved areas and on the use of PPPs to address low connectivity") in the WB6 MAP (MAP, 2017).

Bosnia and Herzegovina could consider legislative interventions in each entity to harmonise municipalities' fees and processes for constructing technological infrastructure and to accelerate investments in next generation networks, particularly in the Federation of Bosnia and Herzegovina. Bosnia and Herzegovina could also seek to strengthen co-operation between State and entity-level authorities to accelerate the adoption of a legal framework for electronic communications that fully transposes the EU 2003 and 2009 regulatory frameworks (EC, 2015b).

The Former Yugoslav Republic of Macedonia and Kosovo could consider reviewing their policies to examine how they can **strike a balance between promoting their ICT industries as an outsourcing destination and supporting the industry to innovate and export its own ICT products**.

Finally, **all of the SEE economies could consider further increasing their efforts to implement *ex ante* impact assessments of policy and regulatory interventions,** and also to strengthen *ex post* monitoring and evaluation practices. They could consider providing training to the officials tasked with these activities, which often require specialised technical skills.

Digital empowerment

OECD countries have acknowledged the need to develop the digital economy in a strategic manner in order to widen its benefits and respond to key challenges such as reducing unemployment and inequality, and lifting people out of poverty (OECD, 2015a). The EU's Digital Agenda (EC, 2010) emphasises that digitalisation not only promises to increase productivity, but can also help address pressing policy challenges, promoting inclusion by addressing the special needs of disadvantaged social groups (OECD, 2016a).

The digital empowerment sub-dimension examines the adoption and implementation of policies that promote the development of e-content and e-services that enable the digital economy, foster digital skills and deliver the promise for a more inclusive and healthier society. The sub-dimension comprises four qualitative indicators (Figure 10.9):

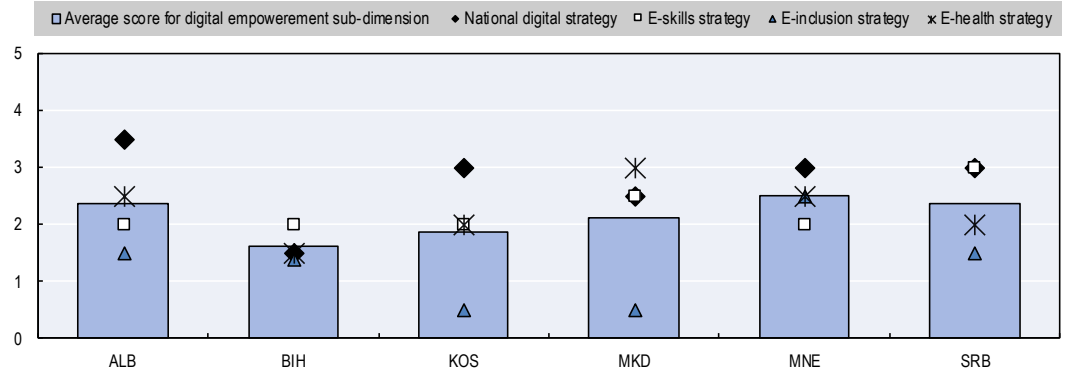
1. The **national digital strategy** indicator measures whether a coherent whole-of-government approach to digitalisation exists and to what extent resulting policy measures are being implemented and evaluated.
2. The **e-skills strategy** indicator assesses whether the economies have adopted an e-skills strategy aiming to equip citizens with the skills required to contribute to and benefit from digitalisation. It also measures how far it has been implemented, and whether its policy actions are being monitored and adjusted. It examines how

ICTs and e-curricula are promoted in education, if relevant competency frameworks are in place and if lifelong learning is supported.

3. The **e-inclusion strategy** indicator measures whether the economies have adopted a strategy to overcome the exclusion of disadvantaged groups from the digital society. It assesses whether accessibility of public websites and e-services meet international guidelines and if accessibility requirements are promoted in public procurement processes for ICT.

4. The **e-health strategy** indicator looks at whether an e-health strategy (to use ICT to improve the efficiency of the healthcare system) has been adopted and is being implemented. It assesses whether economies have the legislation and regulatory components needed for e-health records, information systems interoperability, liability and compliance with international health standards.

Figure 10.9. **Digital empowerment: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705271

The average overall score in the digital empowerment sub-dimension is slightly over 2 out of 5, reflecting the fact that all of the SEE economies have digital empowerment policies and legal frameworks in place, but have only just started to implement them. Montenegro, Albania and Serbia are in the lead, followed by the Former Yugoslav Republic of Macedonia.

E-skills and e-health have both received an average score above 2 across the SEE economies, but the degree of policy implementation varies significantly, mainly depending on each government's capacity to allocate substantial resources or to mobilise donor support.

Kosovo is lagging in the implementation of its policies on e-skills, e-inclusion and e-health. Bosnia and Herzegovina scores below the average, since it only adopted its Information Society 2020 policy in May 2017 and still needs to prepare a two-year entity-level action plan. However, it has not achieved full consensus at all levels of government for the adoption of this policy.

The SEE economies have mostly made little progress in adopting policies for e-inclusion and even less in implementing activities to support participation in the digital economy among all population groups at risk of exclusion due to age, gender, geographical or ethno-cultural diversity. Montenegro stands out as having done more to implement e-inclusion policies than the others.

Cross-cutting digital strategies are becoming better co-ordinated

National digital strategies are an important policy instrument for the successful implementation of digitalisation and to ensure equal access to the benefits of the digital economy. A national digital strategy is cross-sectoral and aims to strengthen an economy's overall competitiveness, economic growth and social well-being (OECD, 2015a). It addresses all members of society (public and private sector) and focuses on supply-side (e.g. infrastructure development) and demand-side (e.g. e-skills) policy objectives.

Overall, the national digital strategies indicator was the highest scoring indicator in this sub-dimension, scoring close to 3 out of 5 (Figure 10.9). Four of the six economies (Albania, Kosovo, Montenegro and Serbia) have adopted policy and legal frameworks and are making progress implementing them. During the last two years, these SEE governments have made significant progress in setting up co-ordination mechanisms (e.g. inter-ministerial co-ordination instruments) to accelerate the implementation of their cross-cutting digital strategies. This progress is reflected in their respective scores (3 or more out of 5) for the digital strategy indicator (Figure 10.9). Bosnia and Herzegovina, however, has not yet started implementing its recently adopted policy for the Information Society 2016-20. In the Former Yugoslav Republic of Macedonia, short-term strategic documents drive digital development, since the economy currently lacks a long-term vision.

Albania established the Integrated Policy Management Group for Good Governance and Public Administration in 2015 to co-ordinate the implementation of its Public Administration Reform and Digital Agenda strategies. Kosovo has adopted the Strategy for Improving Policy Planning and Co-ordination 2016-2018, which outlines an Integrated Planning framework implemented by an inter-ministerial Strategic Planning Committee chaired by the prime minister. It co-ordinates the National Development Strategy with the implementation of all sectoral and cross-cutting strategies, including the Cross-cutting Digital Agenda Strategy 2013-2020 and the Economic Reform Programme, which has incorporated the Kosovo Digital Economy Programme since 2016. Thus, the implementation of the digital strategy fits into an overarching policy plan for the development of the economy.

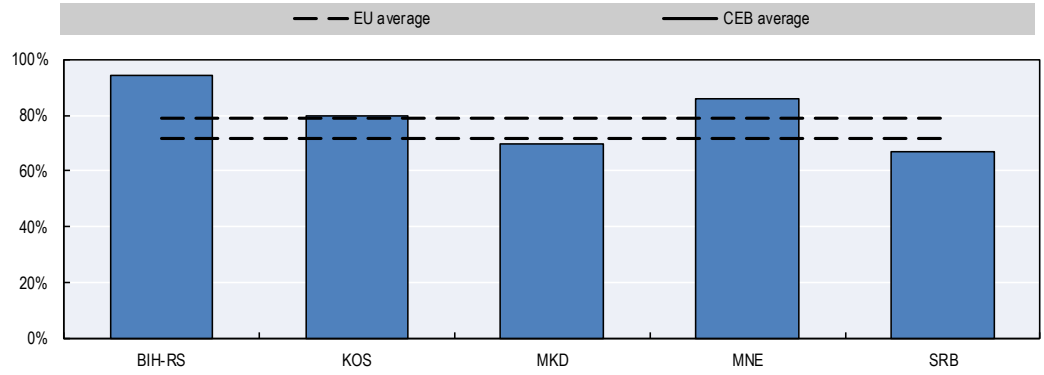
Serbia has created the ministerial Council for Innovative Entrepreneurship & IT to co-ordinate the implementation of the digital agenda strategy, which combines the Electronic Communications and Information Society strategies with the new IT Industry Development strategy. The council was responsible for developing a two-year action plan for 2017-18 to implement the IT industry strategy. Montenegro has transitioned from a well-implemented Information Society Strategy for 2012-2016 to the strategy for the next period, 2017-20. It has put in place a new expert working group to monitor implementation. However, the Ministry for Information Society and Telecommunications ceased operation in November 2016, which could adversely affect the co-ordination and ownership of the new strategy, which is now delegated to three line ministries: economy, education and public administration.

The Former Yugoslav Republic of Macedonia has a lower score for the national digital strategy indicator, since its short-term ICT strategy, which includes ICT infrastructure and services, e-skills, and information society development, only partially covers important aspects of a digital strategy. The economy lacks a long-term vision in this domain and although a long-term national digital strategy was planned for 2016, it was postponed due to the political situation. Bosnia and Herzegovina adopted an information society policy for 2016-20 in May 2017, despite a lack of consensus across all levels of

government. The implementation of this policy has not yet started. The government also agreed to establish 33 working groups for the EU integration process in March 2017, which will be facilitated by the Directorate for EU Integration. The working groups will be formed at ministerial level, comprising representatives from all relevant authorities and bodies at the state, entity and cantonal levels, and will have a catalytic effect on major reforms. One of the working groups – Working Group No. 10 for Information Society and Media – will cover the digital society.

The quantitative indicator measuring the share of individuals accessing the Internet once a week (Figure 10.10) measures how far the digital society has developed and is penetrating society in the SEE economies.

Figure 10.10. **Percentage of individuals accessing the Internet once a week (2016)**



Note: Data for Albania not available. Data for Bosnia and Herzegovina available only for the Republika Srpska. Data for usage in the last 3 months before the survey. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: SEE governments; Eurostat (n.d.), *Digital Economy and Society Database*, http://ec.europa.eu/eurostat/web/digital-economy-and-society/data/database.

StatLink http://dx.doi.org/10.1787/888933705290

Another quantitative indicator – the World Economic Forum's indicator on "importance of ICTs to government vision of the future" – assesses the extent to which the government has a clear plan to use ICT to improve overall competitiveness. The majority of the SEE and CEB economies scored 3-4 out of 7 in 2016 for this indicator, where 7 is the top score (World Bank, 2017b). Albania demonstrated a positive improvement from previous years (from 3.7 to 3.9), while the Former Yugoslav Republic of Macedonia (4.8) and Montenegro (4.3) had the highest score of the SEE economies in 2016. Estonia (5.0) was the clear CEB leader in this assessment, followed by Lithuania (4.2), which scored below Montenegro. Luxemburg (5.7) led the EU in this measure, while all other EU economies scored under 5 (World Bank, 2017b). Nevertheless, the above assessment does not reflect the changes that took place in the last couple of years, which have been described in the current publication.

Skills gaps are being tackled but some groups are at risk of being left behind

The availability of e-skills is vital for the ICT sector, enabling innovation in the digital economy and determining the capacity of individuals to reap the benefits of digital services. Shortages and mismatches in e-skills, and the resulting digital divide, undermine

economic growth and competitiveness in Europe (EC, 2016a). Comprehensive e-skills strategies ensure that education systems provide students and professionals with digital competencies. They should also be strongly linked to e-inclusion strategies to address challenges for groups at risk of exclusion from the digital economy due to age, disability, lack of skills, cultural background, income, or location. The two indicators that assess how SEE economies have addressed strategies for e-skills and e-inclusion are discussed here together.

The SEE economies have started to address e-skills development, but both resources and implementation are limited. This is reflected in the average score for the **e-skills strategy** indicator, which is just above 2 out of 5 (Figure 10.9). This score indicates that although none of the six governments have a dedicated e-skills strategy, they have included relevant provisions in their digital or education strategies. It also indicates that implementation of these strategies is still at the early stages. Albania, Kosovo, Montenegro and Serbia have set up policy frameworks to promote the integration of ICT into education – covering IT infrastructure, connectivity, e-curricula and teachers' training – and to facilitate lifelong learning opportunities for ICT professionals. Serbia scores the highest on this indicator (Figure 10.9), with its information society, education and IT industry strategies covering e-skills development. It has established the inter-ministerial Joint Body for ICT Infrastructure in Education to improve co-ordination of these strategies across the three line authorities (Ministry of Education, Science and Technological Development; Ministry of Trade, Tourism and Telecommunications; and the National Research and Academic Network).

The six SEE economies do not place a high priority on ICT in education and e-skills development, and as a result do not allocate enough financial resources to create digital educational content, use digital tools to enhance learning in the classroom in non-ICT subjects, or use digital applications and devices to enable offline and out-of-classroom learning activities. The SEE economies still depend heavily on donor support to tackle e-skills development, but the programmes which have been implemented have not yet achieved significant results. The Former Yugoslav Republic of Macedonia had started to implement promising ICT programmes in schools during the *2016 Competitiveness Outlook* assessment cycle, but they have not yet achieved permanent results. For instance, the implementation of its e-content strategy focused more on the digitisation of traditional textbooks rather than seeking transformational change in the education system through the use of digital technology. In the Federation of Bosnia and Herzegovina, the development of ICT in education is uneven at the cantonal level, while the Republika Srpska has implemented some programmes that focus on providing teacher training in ICT and equipment. For example, 65 elementary schools were equipped with 408 "e-classrooms" that included 10 200 computers with basic Internet connectivity. The information society policy 2016-20 adopted at the state level in May 2017 addresses e-skills development and provides a unique opportunity for co-ordination and alignment across all levels of government, despite the fact that full consensus was not achieved for its adoption.

Lifelong learning programmes are also limited in the SEE economies. For example, employees in Kosovo need to leave work if they want to follow further education/training programmes because there are no suitable programmes for working professionals. In some of the economies, the private sector is looking to provide solutions to the skills gap for the ICT industry and the limitations of lifelong learning. For example, in Bosnia and Herzegovina the BIT Alliance, an association of 13 of the largest software companies in

Sarajevo, is promoting e-skills development to create a skilled workforce, which is in high demand in the domestic IT industry.

E-skills development in the SEE economies is portrayed by several quantitative indicators. For example, a high percentage of households in some of the economies do not have access to the Internet because they lack the skills. The share is as high as 36% in the Former Yugoslav Republic of Macedonia and the Republika Srpska in Bosnia and Herzegovina, and 33% in Montenegro in 2016, according to data from their statistical offices. In Serbia the figure was approximately 10%. Internet access in schools is fair in the six economies, while Albania made most progress in this respect during 2016. According to the World Economic Forum indicator on Internet access in schools, on a scale of 1-7 (with 7 being the best score), Albania scored 5.2 in 2016 from 4.1 in the previous assessment cycle (WEF, 2016 and 2015). In the 2016 assessment of this indicator, scores for the Former Yugoslav Republic of Macedonia and Serbia dropped from the previous assessment cycle (from 5.5 to 5.2, and from 4.2 to 3.9, respectively), while Montenegro remained almost steady (4.2 to 4.3). Nevertheless, according to data collected during the current assessment from SEE governments, all of Serbia's primary schools have IT equipment and software, the majority of schools have ICT labs, and Internet connectivity is rising to over 65% of schools. The other SEE economies have reported that IT equipment and software are not yet installed or not operational in a large number of their schools.

The percentage of users acquiring education and training through the Internet remains low in all the economies except Serbia. According to Serbia's statistical office, 67% of all Internet users used it for training and education during 2016. However, the share is much lower in the other five economies (e.g. 13% in the Former Yugoslav Republic of Macedonia in 2016 and only 5% in Albania in 2012). According to government statistical offices, even fewer users were taking online courses in 2016: 10% in Serbia, followed by 5.7% in the Former Yugoslav Republic of Macedonia and 3.6% in Montenegro.

The SEE economies have the lowest average score on the **e-inclusion strategy** indicator (below 1.5 out of 5) in the current assessment (Figure 10.9). This score indicates that relevant strategies are either partially in place or even totally absent in the six SEE economies. Only Albania and Montenegro have some provisions for e-inclusion in their digital strategies, but they do not cover all disadvantaged groups, such as the poor or geographically disadvantaged – only people with a disability. Montenegro's Information Society Strategy has identified a number of groups at risk of exclusion and some activities to address them are planned for the future, although none have been budgeted for 2017. In Albania, the new Strategy for Social Protection 2020 addresses the rights of people with disabilities in accessing ICT systems and services.

One positive development is that all the SEE economies (except Kosovo) have adopted e-accessibility guidelines that align with EU Directive 2016/2102 (EC, 2016c) for public-sector websites and e-service portals. The Federal Ministry of Labour and Social Affairs in the Federation of Bosnia and Herzegovina (FBiH) has adopted its Strategy for the Advancement of Rights and Status of Persons with Disabilities in FBiH for 2016-2021, which also addresses e-accessibility. E-accessibility guidelines are compulsory for all public-sector websites in Albania, the Former Yugoslav Republic of Macedonia and Montenegro. Montenegro has actually set a specific target to reach 100% e-accessibility alignment of public-sector websites with international and EU standards by the end of 2017. Even so, the SEE economies are lagging behind EU e-accessibility practices and guidelines, and have made no plans to provide resources to address the issue.

E-health information systems are becoming more integrated

E-health combines the use of ICT for health with new skills and organisational change in healthcare systems. The aim is to improve the health of citizens, with the economic and social value that brings, and to increase efficiency and productivity in healthcare delivery. E-health can have important benefits for national health systems, such as enhancing health-information management, reducing medical errors and cost of care, improving the quality of personnel, contributing to better lifestyles, and improving accountability (Al-Shorbaji, 2012). Many national digital strategies in OECD countries and partner economies target e-health, putting forward measures to ensure high-quality broadband connectivity across the healthcare system, to develop telemedicine further, and to improve the use of electronic medical healthcare records (OECD, 2015a).

The SEE economies score well above 2 out of 5 on average for the e-health indicator (Figure 10.9), signifying that the relevant policy frameworks are in place and are slowly being implemented. Some SEE governments (such as Albania, Montenegro and Serbia) have incorporated e-health and integrated healthcare information system (IHIS) development as priority objectives in their digital strategies. The Former Yugoslav Republic of Macedonia and Kosovo have adopted strategies for the development of an IHIS, while Serbia and Montenegro were drafting such strategies during 2017. Ministries of health in some of the economies are also integrating e-health provisions into their health sector strategies, as in the Federation of Bosnia and Herzegovina. However, Bosnia and Herzegovina lacks constitutional authority at the state level to adopt a policy and legal framework for e-health and the level of development across entities and cantons varies significantly. It has made progress in harmonising e-health indicators through a World Health Organization programme, which involved line ministries and institutions from all levels of government.

There are also some good practices among SEE economies which could be shared across the region. For example, the Former Yugoslav Republic of Macedonia has made headway in co-ordinating and developing e-health services by establishing the Committee for Health and Environment, made up of various ministers and directors of state institutions and chaired by the Prime Minister and co-chaired by the Minister of Health. Its IHIS is in operation and providing services to citizens and healthcare institutions, while the flagship "My appointment" e-service has received attention as a regional example of good practice that the other SEE economies could emulate.

Albania has also made considerable progress in e-health development, recognising the promise of e-health for reforming and revolutionising the current poor provision of health services. In the last couple of years, the government has implemented a bold programme, providing free health check-ups to all citizens aged 40-65 and 900 000 health e-cards to be used by the local family doctor healthcare service. The government intends to extend the programme to the entire population. It has secured EUR 32 million in donor support through a World Bank project to further develop its IHIS and e-services.

Kosovo is a regional pioneer in the development of telemedicine, inaugurating its Kosovo Telemedicine Center (TCK) in Pristina as early as 2002, and opening six additional regional centres since then. The Council of Europe adopted a resolution naming it the best programme for telemedicine in South East Europe, and adopted a proposal for the creation of a regional telemedicine network. The TCK is fully connected to the Albanian Telemedicine Center and has promoted expansion to Montenegro and the Former Yugoslav Republic of Macedonia.

The way forward for digital empowerment

As the SEE economies look to the future, they could consider a number of policy interventions to further support digital empowerment. Action point IV.3.1 of the WB6 MAP ("Develop and strengthen supply of digital skills") also focuses on this area, which coincides with the findings and recommendations in the current analysis (MAP, 2017).

Montenegro could consider prioritising the establishment of a high-level inter-ministerial co-ordination mechanism to strengthen ownership and accountability for implementing its new Information Society Strategy, now that the Ministry for Telecommunications has ceased operation. The good practice example from the Netherlands (Box 10.2) could offer some practical ideas (OECD, 2015b).

The Former Yugoslav Republic of Macedonia could prioritise the development of a long-term digital strategy using public funds and resources, if donor funding cannot be promptly secured, in order to provide a vision for the development of the digital economy to all stakeholders. In this respect, it will also be important to plan regional co-operation aimed at enhancing digital skills for citizens and for professionals, as proposed in Action Points IV.3.1.b ("Pilot a regional intervention aimed at enhancing basic digital skills for citizens to engage online") and IV.3.1.c ("Pilot a regional intervention aimed at enhancing skills for IT specialists, that would be closely linked to the demand from and co-ordinated with digital businesses in WB6 and EU") in the WB6 MAP (MAP, 2017).

Albania, Kosovo and Bosnia and Herzegovina could explore models of co-operation with the private sector to provide and maintain computers and Internet connectivity for every school, especially in rural areas. They could examine universal service obligations, public-private partnership investment models or even social tariffs. They could also leverage the expected increase in rural broadband demand to attract the attention of service providers and telecom operators.

Box 10.2. **Good practice: The National Digital Commissioner of the Netherlands**

The National Commissioner for Digital Government ("DigiCommissioner") was appointed in 2014 to oversee the improvement of financing, governance and use of digital government in the Netherlands. The appointment lasts four years at most. The DigiCommissioner is a good example of how to implement Principle 5 ("Secure leadership and political commitment") of the OECD Council Recommendation on Digital Government Strategies from July 2015.

The DigiCommissioner in the Netherlands has put in place a governance system with top-level civil servants and a ministerial commissioner. This governance system extends to all levels of government (national, regional and local). All major stakeholders from different levels of government and agencies in the Netherlands were involved in the design of the DigiCommissioner, whose office now includes 14 staff members, significantly reducing the number of personnel involved in steering groups and committees on ICT. The mission of the Office of the DigiCommissioner is fourfold: 1) to boost policy development and innovation; 2) to promote the creation of generic provisions for e-government; 3) to secure the management of fundamental services; and 4) to encourage the use of those services. The office connects all levels of government with a common goal to achieve a solid and future-proof digital government.

Source: OECD (n.d. b), "Netherlands: DigiCommissioner", www.oecd.org/gov/netherlands-digicommissioner.pdf.

The Former Yugoslav Republic of Macedonia could consider updating its e-content strategy and reviewing and revising plans for developing and sustaining the e-textbook portal. This would transform teaching and learning by changing the way ICT is taught and used in the classroom.

Kosovo could consider prioritising the development of e-accessibility guidelines, which are aligned with EU Directive 2016/2102. It could also review its Digital Agenda action plans to provide timeframes and accountability for enforcing these guidelines for public-sector websites.

Serbia could include in its draft new law on e-government the obligation for all public-sector websites to apply e-accessibility guidelines, in compliance with EU Directive 2016/2102. The government could also consider designing a training programme to increase digital literacy among people with disabilities, only around 10% of whom are digitally literate (SIPRU, 2014).

Kosovo and the Former Yugoslav Republic of Macedonia could consider updating their strategies for developing IHISs, and Albania could develop its own IHIS strategy, which could include new developments in terms of interoperability, liability and health standards.

All of the SEE economies could consider preparing e-inclusion strategies, identifying all groups at risk of being excluded from the digital economy and addressing their needs appropriately. This is proposed in Action Point IV.3.1.d: "Set up and implement regional training and employability enhancement programme aiming to mobilize and upskill un/underemployed population with particular emphasis on youth, women, and people with disabilities" in the WB6 MAP (MAP, 2017). A good-practice example from the OECD Digital Government Toolkit is Mexico's National Digital Strategy (OECD, n.d. c). This strategy obliges the state to adopt a Universal Digital Inclusion Policy and includes civic innovation and citizen participation in the digital society among its main objectives.

E-business and e-commerce

E-commerce is defined as any monetary transaction made with the help of electronic media. It is a subset of e-business, which encompasses business processes being conducted electronically and businesses that exist online. E-commerce facilitates process innovation among firms, enlarges their market scope, reduces operational costs and lowers barriers to entry, thus intensifying competition (OECD, 2013a). Consumers benefit from easy access to a variety of goods and services, competitive prices, and convenient payment options (OECD, 2016c). The Digital Single Market strategy includes a pillar on better access for consumers and businesses to online goods and services across Europe to address key differences between the online and offline worlds and to break down barriers to cross-border online activity (EC, 2015a). The e-business and e-commerce sub-dimension includes three qualitative indicators (Figure 10.11):

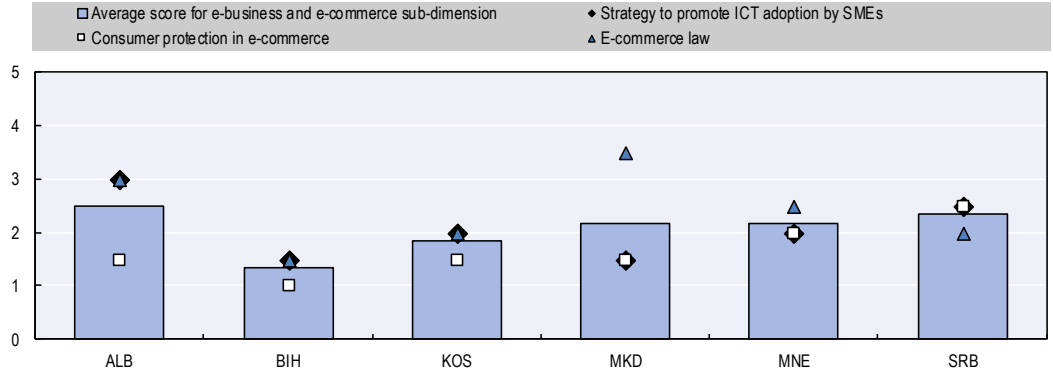
The **promotion of ICT adoption by SMEs** indicator assesses whether a strategy or action plan to promote the adoption of ICTs by SMEs has been adopted, and is being implemented and monitored.

The **consumer protection in e-commerce** indicator assesses whether the adopted framework addresses five key policy issues: information disclosure, fraud and misleading commercial practices, privacy issues, dispute resolution, and redress (OECD, 2013).

The **e-commerce law** indicator assesses the adoption and full implementation of an electronic commerce law which establishes harmonised rules on issues such as the transparency and information requirements for online service providers, electronic contracts and the liability of intermediaries.

As Figure 10.11 shows, Albania and Serbia score the highest in the region for their policies to promote ICT adoption by SMEs. The rest of the SEE governments have not managed to devote sufficient attention or financial resources to awareness raising and capacity-building activities among SMEs to improve skills and trust in digital technologies. All of the economies except Serbia need to do more to align their legal frameworks for consumer protection in e-commerce with the EU framework. Albania and Serbia have adopted consumer protection strategies, while dedicated consumer protection programmes are being implemented in the remaining SEE economies. In Bosnia and Herzegovina, only the Republika Srpska has implemented a consumer protection programme. All of the SEE economies have adopted e-commerce legislation, but all except the Former Yugoslav Republic of Macedonia need to do more to align with the European e-commerce directive (2000/31/EC) (EC, 2000).

Figure 10.11. **E-business and e-commerce: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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The SEE economies are starting to promote digital business practices among SMEs

SMEs can find it harder to benefit from digitalisation than larger companies. Among OECD countries, 40% of large enterprises were participating in e-commerce in 2013, but only 18.9% of small ones (OECD, 2015a). This gap can be largely attributed to insufficient knowledge and financial resources, and barriers to organisational change, such as the absence of internal IT departments and in-house know-how (OECD, 2016a). As the productive structure of the six SEE economies is predominantly composed of SMEs, their adoption of ICT is of great importance.

The SEE economies have gradually started to adopt strategies and plan activities to promote the use of ICT by SMEs by supporting innovation and the introduction of digital business practices, which is reflected in the average score of 2 out of 5 for the promotion of ICT adoption by SMEs indicator (Figure 10.11). The SEE governments are seeking to develop the domestic market and to increase consumption of IT equipment and software, mainly through their digital strategies. Kosovo, Montenegro and Serbia also include this

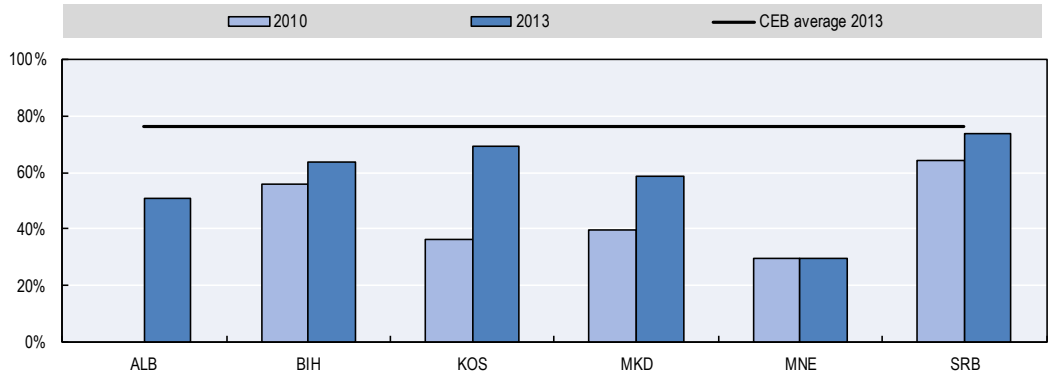
in their IT or horizontal industrial development strategies. As Figure 10.11 above shows, Albania and Serbia score the highest in the region for their policies to promote ICT adoption by SMEs, closely followed by Kosovo and Montenegro. These four SEE economies have set up policy frameworks to support e-business and e-commerce. They offer financial support programmes or loan schemes to existing SMEs and start-ups to foster ICT innovation through the use of IT equipment and software.

However, some of the financial support programmes offered by Albania, the Former Yugoslav Republic of Macedonia and Serbia have failed to produce expected impacts on SMEs' growth and adoption of ICT. There are several reasons for this. One is the rather low amount of money offered per applicant (for example vouchers of EUR 3 000 for ICT innovation in Albania). A second one is the poor planning of similar voucher schemes that led to massive exploitation of resources by a limited number of companies (for example voucher schemes for SMEs looking to develop e-commerce websites in the Former Yugoslav Republic of Macedonia, where a small number of players dominated the market as service providers for SMEs). Another reason is the difficult financial bank-guarantee processes (for example the Serbian programme supporting e-business development for SMEs) and disproportionate administrative project-management burdens. On the other hand, Serbia has run a significant awareness-raising campaign on e-business and e-commerce targeting SMEs, which also included mentoring for e-strategies, through an EU-funded programme. Montenegro also planned financial support schemes promoting innovation for SMEs and online business registration systems under the Digital Business Pillar of the Information Society 2020 Strategy and the new Industrial Policy 2020. Kosovo has managed to secure EUR 2 million under the Kosovo Digital Economy Programme, to implement activities like the development of a Tech Park, awareness-raising and training activities for SMEs. Nevertheless, making funds available to modernise SMEs and to support e-business activities continues to be a challenge for all the SEE economies.

Bosnia and Herzegovina had no relevant policy framework until it adopted its Information Society Strategy 2016-2020 in May 2017, but its implementation has not started yet. In the Federation of Bosnia and Herzegovina, a project to create a one-stop-shop e-registration service for businesses to stimulate ICT adoption by SMEs has identified the need to amend approximately 50 existing laws across all cantons. These are now in the initial stages of preparation. The Republika Srpska does not directly finance SMEs to adopt ICT, but since 2013 it has adopted e-business legislation and is continuing to change the operation of various public administration bodies to facilitate e-business registration and e-taxation services.

The quantitative indicator, the percentage of firms with their own website (Figure 10.12), offers a basic measure of the degree of ICT adoption by companies in the SEE economies. The indicator shows that Serbia has made headway in this respect, followed closely by Kosovo. Based on data from the same source on 2010, all the SEE economies except Montenegro have seen a significant increase in the share of companies that have their own website over the period 2010-13. This clearly illustrates the need for Montenegro to intensify its efforts in promoting the adoption of ICT by SMEs.

Figure 10.12. **Percentage of firms with their own website (2010, 2013)**



Note: CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: World Bank (2017c), "Innovation and technology", www.enterprisesurveys.org/Data/ExploreTopics/innovation-and-technology.

StatLink http://dx.doi.org/10.1787/888933705328

Legal reforms continue to support businesses and consumers in e-commerce

Consumers buying online should be assured of transparent and effective consumer protection that is no weaker than they enjoy in other forms of commerce (OECD, 2016c). The OECD Committee on Consumer Policy has researched and analysed the trends and policy challenges arising from the greater complexity of the online environment and related risks for consumers (OECD, 2016c). Consumers and businesses trying to access content or buy goods and services online can face discrimination on the basis of nationality, residence or geographical location, which run counter to the basic principles of these OECD Council recommendations and the EU principles. The Digital Single Market (DSM) indicates that only 38% of EU consumers feel confident about purchasing from another EU Member State and only 7% of SMEs in the EU sell across borders. If the same rules for e-commerce were applied in all EU Member States, 57% of companies say they would either start or increase their online sales to other EU Member States (EC, 2015a). The SEE economies have recognised that by aligning their legal and regulatory frameworks with the EU in accordance with the DSM, their businesses could gain full access to a sizeable market of EU consumers.

As described above, two qualitative indicators measure whether a legislative and institutional framework is in place to protect consumers in e-commerce, and to gauge the degree of adoption and implementation of e-commerce and related consumer protection legislation (i.e. the consumer protection in e-commerce and e-commerce law indicators in Figure 10.11).

The **consumer protection in e-commerce** indicator received the second lowest score in the current assessment in the digital society policy area. The average score was slightly above 1.5 out of 5.0, indicating that all of the economies except Serbia need to do more to align their legal frameworks for consumer protection in e-commerce with the EU framework. Albania and Serbia have adopted consumer protection strategies, while dedicated consumer protection programmes are being implemented in the remaining SEE

economies. In Bosnia and Herzegovina, only the Republika Srpska had implemented a consumer protection programme.

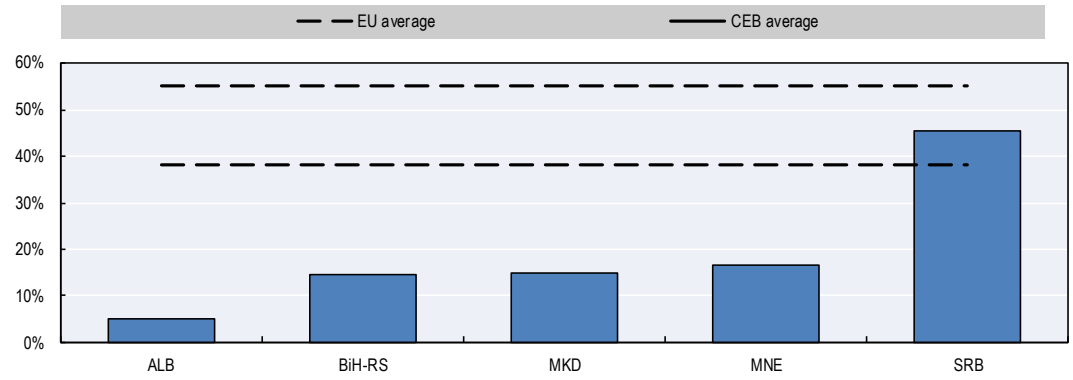
Five of the SEE economies and the Republika Srpska in Bosnia and Herzegovina have a legal framework in place for consumer protection in e-commerce. The legal framework at state level in Bosnia and Herzegovina is outdated, however, and there is nothing in place in the Federation of Bosnia and Herzegovina. All of the economies have adopted a consumer protection strategy or programme that foresees pending legislative interventions, assigns roles and responsibilities to public bodies, and allows for awareness-raising or training activities for consumers. Although these are all generic consumer protection policies, they also refer to e-commerce to some extent. However, the degree of their implementation varies. Serbia, the clear leader in this domain, is the only one of the assessed economies that has adopted a framework for consumer protection which is fully aligned with the EU, including alternative dispute resolution. It has also recently adopted a law for unauthorised advertising, which also refers to e-commerce practices. However, Serbia's Council for Consumer Protection is still facing issues that keep it from becoming fully operational, such as the reimbursement of members' expenses. All the other economies have adopted legislation that is not yet fully aligned with the EU framework. The institutional capacities to deal with e-commerce consumer protection are weak and financial resources for the implementation of consumer protection programmes are scarce in all six economies.

All of the SEE economies have adopted **e-commerce legislation**, but almost all of them need to do more to align it with the European e-Commerce Directive (2000/31/EC). This is reflected by an average score around 2 out of 5 for the e-commerce law indicator (Figure 10.11). The SEE economies have an e-commerce law in place, but some, such as Kosovo and Serbia, have only partially implemented it. In Bosnia and Herzegovina, only the Republika Srpska has updated its legislation on e-commerce. The Former Yugoslav Republic of Macedonia has the most developed framework; in 2010 and 2014, the government conducted a gap analysis of e-commerce legislation and then proceeded to amend the law accordingly. Montenegro has not yet included media and information society services in its e-commerce law, while Serbia still lacks sectoral legislation alignment for e-commerce. The government of Serbia created a dedicated working group in 2017 to tackle the necessary legislative reforms. Kosovo, on the other hand, needs to work with its commercial banks to replace the rigorous processes that are discouraging businesses from adopting e-commerce practices. Its government is currently updating its electronic authentication framework and also preparing administrative instructions for e-commerce operators and their websites in an effort to address bottlenecks.

In assessing the effectiveness of the legal framework in this domain, two quantitative indicators also demonstrate how e-commerce has penetrated the SEE region, including the share of individuals purchasing online (Figure 10.13) and the share of all enterprises selling online (Figure 10.14).

The quantitative data show that e-commerce is developing rapidly in the SEE economies. Although the share of SEE consumers buying online is below the EU-28 average (Figure 10.13), SEE businesses in some economies are more likely to sell online than those in the CEB and even among the EU-28 (Figure 10.14). This implies that companies in the region are eager to seize the opportunities provided by e-commerce to increase market outreach and reduce cost of sales. It is also evident that the implementation of policy and regulatory reforms has created an enabling environment for practising e-commerce over the last few years.

Figure 10.13. **Percentage of individuals purchasing online in the last 12 months (2016)**

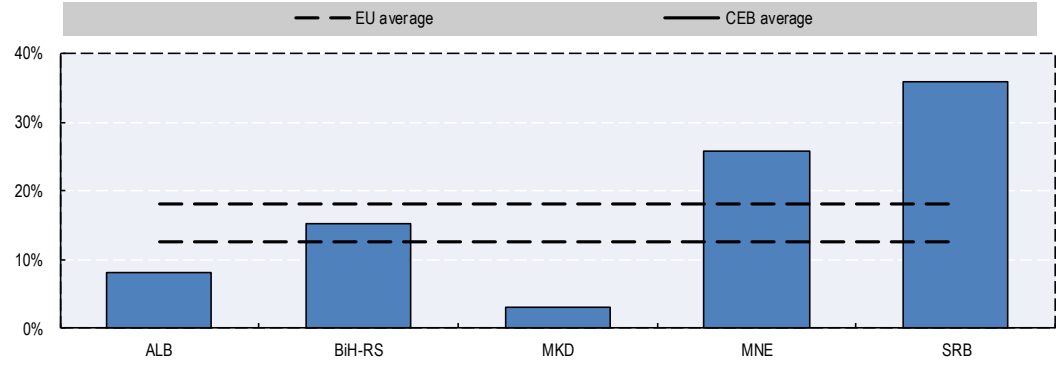


Note: Data for Kosovo not available. Data for Bosnia and Herzegovina available only for the Republika Srpska. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: Government statistical offices; Eurostat (n.d.), *Digital Economy and Society Database*, http://ec.europa.eu/eurostat/web/digital-economy-and-society/data/database.

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Figure 10.14. **Percentage of all enterprises selling online (excluding the financial sector) (2016)**



Note: Data for Kosovo not available. Data for Bosnia and Herzegovina available only for the Republika Srpska. CEB – Central Europe and the Baltics (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia).

Source: Government statistical offices; Eurostat (n.d.), *Digital Economy and Society Database*, http://ec.europa.eu/eurostat/web/digital-economy-and-society/data/database.

StatLink http://dx.doi.org/10.1787/888933705366

The way forward for e-business and e-commerce

As SEE economies look to the future, they might consider a number of policy interventions to further support e-business and e-commerce.

The Former Yugoslav Republic of Macedonia, Serbia and Albania could consider revising those SME financial support programmes that have had limited impact, including ICT voucher schemes and start-up funding programmes. Revised schemes should strike a better balance between the size of funding per applicant and the

total number of beneficiaries, in order to encourage participation. They should also consider their administrative and project-management costs. They could follow Israel's SME and entrepreneurship policy as a good-practice example, particularly the government's national programmes for SMEs, which covered SME financing, innovation and workforce skills, among many others (OECD, 2016f).

Bosnia and Herzegovina could consider developing financial support tools to accelerate the adoption of ICT and digital business practices by SMEs. The authorities designing the support programmes could co-operate with the SEE governments that have already implemented such schemes in order to learn from their recent experiences and to avoid the shortcomings that led to disappointing results. The development of new programmes should be aligned with Action Point IV.4.1.d of the WB6 MAP, which promotes regional co-operation and twinning approaches: "i) Facilitate Business Investments in research and Innovation and in the Creation of Start-Ups, ii). Pilot regional co-operation ('twinning') initiatives among technology/innovation Parks and assess demand and prospects for establishment of regional digital Innovation hubs" (MAP, 2017)

Montenegro could consider establishing a dedicated team within the government to co-ordinate the implementation of the Digital Business pillar of the Information Society Strategy 2020 with the related objectives of the Industrial Policy 2016-20. It could also amend the e-commerce law to include media and information society services. This team could use make use of staff from the former Ministry for Telecommunications and Information Society.

Serbia could resolve the bottlenecks that keep the Council for Consumer Protection from becoming fully operational, in order to improve the government's overall efficiency in implementing its consumer protection strategy and, more importantly, to strengthen evaluation and impact assessment practices.

Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro could accelerate their alignment of consumer protection frameworks in e-commerce with the EU framework. They should consider increasing the staffing of their consumer protection authorities and running capacity-building programmes for employees to improve their responsiveness and efficiency in handling new challenges in the digital economy. All of the economies need to accelerate their efforts to apply best practice in consumer welfare in e-commerce, as highlighted by Action Point I.4.4.d ("Identify and apply the best practice to digital market places to grow SME businesses and drive consumer welfare") in the WB6 MAP (MAP, 2017).

All the SEE economies could consider replicating the Serbian e-business programme as a regional good practice, by increasing the financial resources allocated to awareness campaigns, capacity building and mentoring workshops for businesses looking to adopt e-business practices. Another good-practice example to consider is the ICT-4-BUS Programme sponsored by the Multilateral Investment Fund and the Information Technology for Development Division of the Inter-American Development Bank. This helped SMEs conquer the e-business challenge in Latin America and the Caribbean by improving their business processes and expanding their access to new ICT solutions and services (Ca'Zorzi, 2008). OECD countries offer additional examples of ICT/e-commerce awareness-raising programmes, such as the SME E-business Information Toolkit from Canada's Ebiz.enable programme; and Austria's Let's e-Biz programme, which offers an annual award for the best e-business and multimedia products (OECD, 2004b).

Digital security and privacy

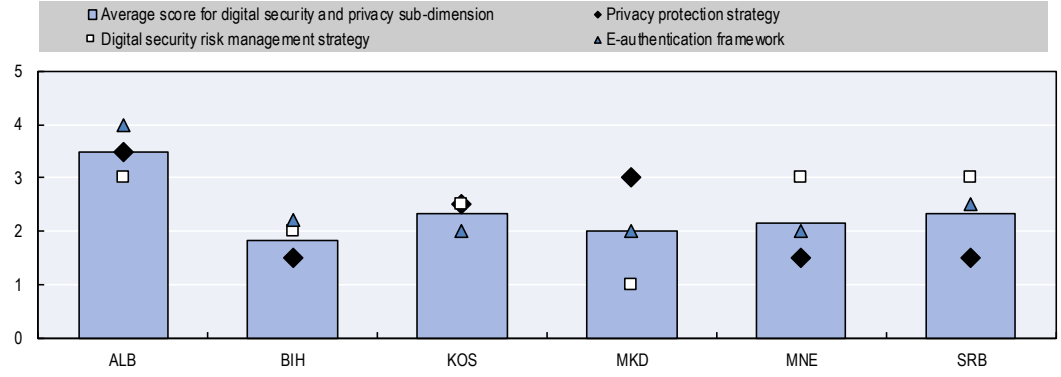
Trust in the digital economy and society is critical if economies are to reap the substantial economic benefits of digitalisation (OECD, 2016a). Threats to digital security and privacy can have a significant impact on individuals' well-being, affecting their reputation and finances, and undermining companies' competitiveness and position in the marketplace. In a 2014 survey, OECD countries identified broadband, security and privacy, in that order, as the 3 highest priority areas out of 31 (OECD, 2014). Economies around the world have a common interest in promoting and protecting the fundamental values of privacy, individual liberties and the global free flow of information, as recommended in the Recommendation of the Council Concerning Guidelines Governing the Protection of Privacy and Trans-border Flows of Personal Data (OECD, 2013c). While effective laws are essential, the safeguarding of privacy today also requires a multifaceted national strategy with high-level intragovernment co-ordination (OECD, 2013b).

The digital security and privacy sub-dimension includes three qualitative indicators:

- The **privacy protection strategy** indicator assesses whether a national privacy protection strategy has been adopted and implemented, and whether its effectiveness is monitored and its elements adjusted accordingly.
- The **digital security risk management strategy** indicator assesses whether a national strategy to foster digital security risk management has been adopted and implemented, and whether regular monitoring processes lead to the appropriate adjustment of relevant policies.
- The **e-authentication framework** indicator assesses whether a policy framework for e-authentication has been adopted and implemented, and if monitoring leads to the appropriate policy adjustment.

The SEE economies score close to 2.5 on average in this sub-dimension (Figure 10.15), which implies that governments have adopted relevant policies and legislation for privacy, data protection and digital security and have also set up a framework for e-authentication and interoperability to foster the development of digital services for citizens and businesses.

Figure 10.15. **Digital security and privacy: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705385

Albania has made the most headway in this sub-dimension, demonstrating strong government commitment to reforms and commendable progress in the last couple of years in cybersecurity policy and implementation of its e-authentication framework. The other SEE economies have not made uniform progress across this sub-dimension. Serbia and Montenegro have advanced the implementation of their digital security strategies, while the Former Yugoslav Republic of Macedonia and Kosovo have made progress in the area of privacy and data protection issues. Serbia is working towards a fully functional e-authentication framework that, along with its national interoperability framework, provides solid ground for e-government and the development of private-sector services.

Digital security and data protection frameworks are being strengthened

As digital innovation becomes more data driven, privacy and digital security become key factors in the digital economy. Although many countries have adopted national digital security strategies, very few have adopted equivalent privacy policy strategies (OECD, 2016d). On the other hand, national digital security strategies can ensure a consistent approach to aspects of digital security and good co-ordination among stakeholders, i.e. the government and public and private organisations. The OECD Recommendation of the Council on Digital Security Risk Management for Economic and Social Prosperity proposes the adoption of a national strategy for the management of digital security risk and outlines the principles that should be followed at all levels of government and in public organisations (OECD, 2015c). These principles promote, among others, awareness raising for all stakeholders, transparency and consistency with human rights and fundamental values in digital risk management, continuous risk assessment for decision making, and the adoption of preparedness and continuity plans.

Although none of the SEE economies has adopted a **privacy protection strategy** that addresses broader privacy issues in the digital economy, their continuous improvement of policies and legislation on data protection is a positive step. This is reflected in the average score of above 2 out of 5 for the privacy protection strategy indicator, which also shows that policy implementation is still at the early stages in most of the SEE economies (Figure 10.15). In fact, the analysis shows that only Albania and the Former Yugoslav Republic of Macedonia have made good progress in implementing their data protection strategies and relevant legislation. Kosovo is closely following the two economies in the lead, while the other three economies have not demonstrated the necessary dedication to set up or to enact relevant policies and legal frameworks, which is reflected in lower scores (Figure 10.15). However, the analysis shows that there is room for development in terms of data and privacy protection practices in all six economies.

Albania, the Former Yugoslav Republic of Macedonia and Kosovo are implementing personal data protection (PDP) strategies and have aligned their legislation with the EU General Data Protection Regulation framework (EC, 2016d), although enforcement is still weak. For example, the Office of the Commissioner for PDP in the Former Yugoslav Republic of Macedonia failed to act in a significant wiretapping incident in 2015 and is yet to implement the Venice Commission's recommendations for amendments to the law (Venice Commission, 2015). Other shortcomings in the practical implementation of data protection are linked to sub-sector legislation in specific fields where the existing legal framework is not appropriate or obsolete. For example, online information portals in the Former Yugoslav Republic of Macedonia are not treated or registered as media companies and are not self-regulated. As a result, the personal data protection regulations applicable for media services or products do not apply to online portals, creating

significant risks of data protection violations. Kosovo is weak in promoting self-regulation and building capacity among public- and private-sector data controllers.

Bosnia and Herzegovina, Montenegro and Serbia have not yet prioritised the adoption of PDP policies and their legal frameworks are largely outdated, though Serbia was drafting a new law on personal data protection in 2017 to align with EC recommendations. The economies allocate limited resources to data protection enforcement, and awareness raising takes a back seat to inspection activities. As a result, public- and private-sector employees controlling personal data do not fully comprehend the privacy aspects, leading to frequent incidents of data abuse. Political or other influence also still impedes the consistency of PDP enforcement. For example, in Montenegro a large number of requests for access to information of public interest still remain unanswered, and in Bosnia and Herzegovina, the head of the PDP Agency has been under prosecution since 2014.

All six SEE economies have increased international co-operation over online child protection. They have developed programmes with a special focus on child trafficking and child safety online within the child protection sector, aiming to raise awareness, establish and reinforce referral and reporting mechanisms, and encourage co-ordination and collaboration among government and non-government stakeholders. These programmes are aligned with the principles of the OECD Recommendation of the Council on the Protection of Children Online, but there is room for further improvement (OECD, 2012b). The OECD recommends that governments adopt clear policy objectives and ensure their enforcement, and underlines the importance of strengthening co-operation with international networks and initiatives, as well as sharing information for quantitative and qualitative international comparative policy analysis. None of these actions are happening regularly in the region, however.

In the area of **digital security risk management strategies**, the average score of nearly 2.5 out of 5 for this indicator shows that most of the SEE economies have set up and are currently implementing relevant strategies and action plans (Figure 10.15). Albania, Kosovo and Montenegro have already adopted dedicated cybersecurity strategies, while the Former Yugoslav Republic of Macedonia, the Republika Srpska in Bosnia and Herzegovina, and Serbia have started drafting their own strategies. Albania, Montenegro, the Republika Srpska and Serbia have also adopted dedicated information security (or cybersecurity) legislation and are making progress in preparing secondary legislation and aligning legal frameworks.

The SEE economies have made significant progress in establishing national Computer Emergency Response Teams (CERTs), formed as units of the telecom regulators in the Former Yugoslav Republic of Macedonia, Kosovo and Serbia. Although Bosnia and Herzegovina was one of the first to adopt a CERT strategy in 2011, it has not yet achieved consensus across the entities on the establishment of a national CERT, while the Republika Srpska is operating its own CERT under the RS Agency for Information Society. All of the national CERTs remain understaffed (2-4 staff each) compared to common EU practices and recommendations, usually due to uncompetitive public-sector salaries that fail to attract candidates with adequate expertise. Other regulatory issues in the public-sector hiring process have also prevented Serbia from starting the hiring process for its national CERT. Montenegro is a regional leader in the number of Computer Security Incident Response Teams (CSIRTs) established in the public sector (29 reported in 2017). Albania, Montenegro and Serbia have defined national critical information infrastructure (CII) that requires CERT/CSIRT operation. Nevertheless, it is still common practice to outsource the maintenance of public websites in Bosnia and

Herzegovina, Kosovo, and Montenegro, while the digital security requirements and standards set for the respective contractors are not always adequate.

Kosovo and Serbia have established dedicated bodies in the field of cybersecurity, and these are examples of regional good practice in high-level co-ordination. Kosovo established the National Council for Cybersecurity to co-ordinate digital security issues and named the Minister of Internal Affairs as National Co-ordinator. Serbia has established the Body for the Co-ordination of Information Security Affairs. In an effort to improve operational efficiency in information security affairs, Albania has also merged its national CERT with the National Authority for Electronic Certificates into the National Authority for Cybersecurity, established in the beginning of 2017.

On the other hand, this *Competitiveness Outlook* assessment found that few enterprises in the SEE economies have formally defined ICT security policies – according to data from government statistical offices just 33% of companies in Albania and 26% in the Former Yugoslav Republic of Macedonia for instance – which demonstrates that awareness of digital security risks is rather low among businesses in the region.

E-authentication frameworks are being updated

E-authentication is critical to establishing trust relationships for e-commerce and e-government. It is an essential component of any strategy to protect information systems and networks, financial data, personal information and other assets from unauthorised access or identity theft (OECD, 2007). Interoperability frameworks allow different authentication schemes to interact and maintain the level of trust.

The SEE economies have clearly recognised that e-authentification frameworks have a key role to play in public administration reform. The average score of nearly 2.5 out of 5 for this indicator shows that all six SEE economies have adopted e-authentication frameworks, mainly through e-signature legislation that has been in place for many years and they are currently at different stages of implementing them (Figure 10.15). These frameworks are currently undergoing significant updating to align them with the EU 910/2014 eIDAS Regulation on electronic identification (EC, 2014). Albania, the Republika Srpska in Bosnia and Herzegovina, Kosovo, Montenegro, and Serbia have updated their legislation to comply with this EU framework. Bosnia and Herzegovina has set up a working group in the Ministry of Communications and Transport to prepare new State legislation on e-signatures which will align with the EU 910/2014 eIDAS Regulation.

All of the SEE economies have adopted national interoperability frameworks (NIFs), although Montenegro needs to update its framework in order to accelerate the pace of e-government development. Not all of these frameworks are consistently being implemented across the region, however. The interoperability frameworks in Albania, the Former Yugoslav Republic of Macedonia and Serbia are functional, although e-government services have not yet been deployed on Serbia's e-NIF framework. The Former Yugoslav Republic of Macedonia is planning to invest in Interoperability 2.0 to make the lowest level of infrastructure interoperable and to harness the power of web technologies (Web 2.0).

Albania has made the most headway in implementing e-authentication, scoring 4 for this indicator (Figure 10.15). The government has assembled all of its e-government legislation into a new law adopted in April 2017 and is increasing the number of services on the e-Albania portal based on its e-authentication and interoperability frameworks.

There is also evidence of implementation progress; for example it had issued 167 000 e-authentication certificates to citizens and 1 236 to public administration officials by early 2017.

Bosnia and Herzegovina has adopted a national interoperability framework as part of its Strategy and Action Plan for Public Administration Reform currently being implemented. Another positive step towards the enactment of e-authentication legislation was the decision to establish the Office for Supervision and Accreditation of Verifiers in November 2016, a move which had been delayed for many years. However, it has not updated its e-signature legislation since 2006, although this was planned for 2017.

Kosovo has made significant progress by adopting new state-of-the-art biometric e-ID technology in compliance with the EU eIDAS Regulation. It is currently piloting its use. The government has created an open source database to enable private companies to develop their own compatible e-services. However, campaigns to publicise this opportunity have been limited. The shortage of public funds to invest in e-government services and e-ID reader infrastructure is a barrier to implementing the new framework.

The way forward for digital security and privacy

As SEE economies look to the future, they could bear in mind the following policy interventions, which align with the Action Points under the WB MAP IV.2.1 on enhancing cyber security, trust services and data protection (MAP, 2017).

Montenegro, Kosovo and Bosnia and Herzegovina could consider increasing their requirements for security standards in public-sector websites, especially when they are outsourced to private companies.

The Former Yugoslav Republic of Macedonia could proceed with adopting the EC Venice Commission recommendations from 2015 to prevent further incidents of personal data abuse and to improve the efficiency of its legal framework and its compliance with EU regulations and principles (Venice Commission, 2015).

Bosnia and Herzegovina could address the uneven development of digital security at the entity level and seek co-ordination across all levels of government by promoting an inclusive public dialogue in a bottom-up effort to prepare a state-level Information Security policy.

Serbia could consider expediting legal and regulatory reforms to resolve barriers to staffing its national CERT and the operational problems of the Body for the Co-ordination of Information Security Affairs, in some cases caused by strict hiring or reimbursement regulations for the public sector meant to address the recent economic crisis. This will allow it to fully exploit the progress it has made in cybersecurity.

Kosovo and the Former Yugoslav Republic of Macedonia could consider reviewing their current legal frameworks for digital security and filling any gaps with dedicated information security laws. The Former Yugoslav Republic of Macedonia could consider amending its interoperability framework to include the private sector and to promote e-services compliance to boost demand for e-authentication products.

Serbia could consider making the e-NIF framework compulsory, identifying and describing the level of e-authentication needed for each type of service – see also Action Point IV.4.1.c ("Align standards, complement interoperability frameworks and introduce a pan-European dimension, in line with EIF") in the WB6 MAP (MAP, 2017). To make the most of the opportunity offered by its newly adopted e-business law and new

technology to simplify e-signatures through mobile phone authentication, the government could allocate additional resources to the Directorate for e-Government to co-ordinate and monitor compliance of existing and new e-services with the new framework.

On personal data protection, **all the SEE economies could consider striking a better balance between resources spent on performing inspections and controls, and those spent on capacity building and awareness raising**. These activities should not just educate public- and private-sector employees, but also the general public on PDP rules and rights, ultimately creating the desired transformational effect on society. New Zealand's approach, presented in Box 10.3, is a good-practice example to consider.

Box 10.3. Good practice: Cross-government programme to improve privacy and security across the state sector in New Zealand

Setting up an effective cross-government programme to improve privacy and security across the public sector can significantly enhance digital risk management and ensure trust in digital services among businesses and citizens. In line with that objective, the New Zealand Government implemented a review by the Government Chief Information Officer (GCIO) in late 2012 of publicly accessible information systems. It subsequently directed the GCIO to undertake a range of actions to improve privacy and security capability across the state sector, which included the establishment of a senior level Governance Group in April 2013, to oversee a work programme of mutually reinforcing initiatives in this domain. This practice implements the OECD Council Recommendation on Digital Government Strategies, Principle 4: reflect a risk management approach to addressing digital security and privacy issues, and include the adoption of effective and appropriate security measures.

ICT.govt.nz is the official site for the New Zealand Government ICT Functional Leader, the GCIO. Among its initiatives is the ICT Common Capabilities Panel for Security and Related Services, which was established in 2013, led by the Department of Internal Affairs. This is a cross-government group of 34 industry experts contracted to provide government agencies with services and advice on a range of security and other related matters.[1] The GCIO also provides tools, advice and guidance to agencies to help them build their capability, including risk assessment tools, cloud consideration tools and Government Enterprise Architecture for New Zealand (GEA-NZ) architecture artefacts.[2] It also leads the development of more integrated and streamlined advice for agencies, such as the Protective Security Requirements which outline the government's expectations for managing personnel, physical and information security.

1. See "ICT Security and Related Services Panel" on the ICT.govt.nz website (www.ict.govt.nz/services/show/SRS-Panel).

2. See the full list on the "Guidance and resources" page of the ICT.govt.nz website (www.ict.govt.nz/guidance-and-resources).

Source: OECD (n.d. a), "Good digital government practices by country" (www.oecd.org/governance/digital-government/toolkit/goodpractices/); OECD (n.d. d), "New Zealand: Cross-government programme to improve privacy and security across the state sector", www.oecd.org/gov/new-zealand-security-privacy.pdf.

Conclusions

The six SEE economies have demonstrated that they are consistently strengthening their digital society policy and regulatory framework to empower businesses and citizens to seize the opportunities of the digital economy. They have brought in investment to develop broadband, and reinforced the role of ICT as a horizontal enabler of growth

through cross-cutting digital strategies, co-ordinated at the highest level with other horizontal and sectoral policies. The SEE economies have also improved their frameworks and institutional settings for cybersecurity and e-authentication to establish a greater level of trust in using digital technologies. They also continue to update their frameworks on e-business and e-commerce to stimulate adoption of ICT and further establish the digital economy.

Nevertheless, the six SEE economies still face a number of challenges. ICT is not yet fully embedded in formal education and the domestic ICT industries persistently identify digital skills gaps as an issue. Their digital society policies do not pay enough attention to e-inclusion, which could mean some underprivileged groups facing digital exclusion. One important step to narrow the digital divide could be to enforce e-accessibility frameworks in e-government services. The SEE economies could also further develop their consumer protection frameworks and strengthen awareness of privacy and data protection to facilitate the adoption of digital technologies. One final positive move would be to improve the design of programmes to support or mentor SMEs, to reduce their risks of exclusion from the digital economy. Addressing these challenges would enable the SEE economies to build a digital society framework that increasingly enables citizens and businesses to benefit from the digital revolution.

Notes

1. Digitalisation refers to "the transformation of the economy and society as induced by the use of information and communication technologies" (OECD, 2016a).
2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
3. Central Europe and the Baltics consist of 11 transition countries: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
4. This means telecoms regulations that are drafted in a technology-neutral way, as defined by Recital 18 of the Framework Directive 2002/21: "…making regulation technologically neutral, that is to say that it neither imposes nor discriminates in favour of the use of a particular type of technology, does not preclude the taking of proportionate steps to promote certain specific services where this is justified, for example digital television as a means for increasing spectrum efficiency" (EC, 2002).
5. The right of telecoms operators and infrastructure owners to use private land without further act of government.

6. The frequency spectrum made available for other applications (such as mobile broadband) when switching from analogue to digital TV broadcasting.

7. 256 Kbps/s is the basic connectivity according to the International Telecommunication Union indicator definition.

8. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

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Annex 10.A1.
Digital society: Indicator scores

Table 10.A1.1. **Digital society: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
ICT access and use						
National broadband strategy	3.0	1.5	3.5	3.0	3.0	3.0
Regulatory policy framework	3.0	1.5	2.5	3.0	3.0	3.0
ICT sector support strategy	3.5	2.0	2.5	2.5	2.0	2.0
Digital empowerment						
National digital strategy	3.5	1.5	3.0	2.5	3.0	3.0
E-skills strategy	2.0	2.0	2.0	2.5	2.0	3.0
E-inclusion strategy	1.5	1.5	0.5	0.5	2.5	1.5
E-health strategy	2.5	1.5	2.0	3.0	2.5	2.0
E-business and e-commerce						
Promotion of ICT adoption by SMEs	3.0	1.5	2.0	1.5	2.0	2.5
Consumer protection in e-commerce	1.5	1.0	1.5	1.5	2.0	2.5
E-commerce law	3.0	1.5	2.0	3.5	2.5	2.0
Digital security and privacy						
Privacy protection strategy	3.5	1.5	2.5	3.0	1.5	1.5
Digital security risk management strategy	3.0	2.0	2.5	1.0	3.0	3.0
E-authentication framework	4.0	2.0	2.0	2.0	2.0	2.5

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Chapter 11.

Transport policy and performance in South East Europe

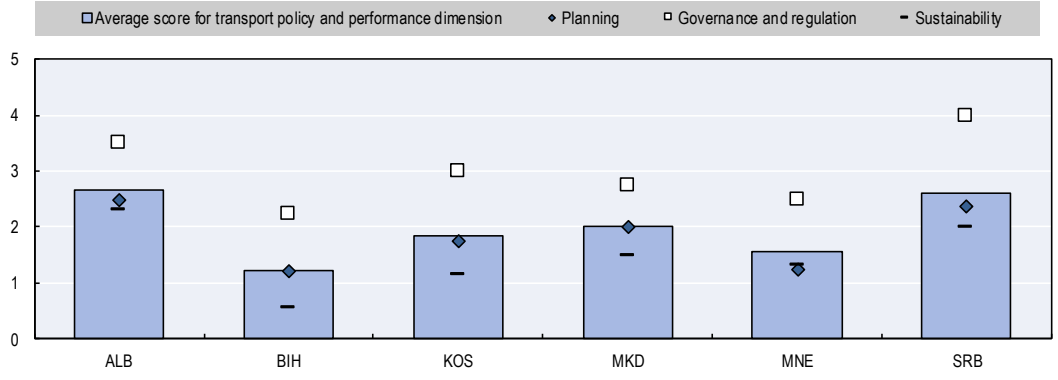
This chapter on transport policy and performance assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of transport competitiveness outcomes in South East Europe (SEE), including the economies' performance against various global indicators, this chapter then focuses on three essential 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, governance and regulation, determines how well transport infrastructure and networks are regulated and operated, with a focus on rail, aviation and roads. The final sub-dimension, sustainability, measures progress towards resource efficiency, environmental protection, reduction of health impacts and increased road safety. The chapter includes suggestions for enhancing policies in each of these sub-dimensions, in order to improve transport performance and in turn foster the competitiveness of these economies.

Main findings

Measuring the performance of transport in South East Europe (SEE) requires a multi-dimensional approach that encompasses planning, governance and sustainability. The SEE economies assessed in this report – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia – have made some progress towards improving the competitiveness of transport systems in recent years. However, the results across the six economies for the three sub-dimensions are mixed, with average scores ranging between 1.2 and 2.7 (Figure 11.1).

In the planning sub-dimension, the SEE economies have made significant efforts to adopt national and sectoral strategies which help to align investment and maintenance spending with common long-term goals, but they have made slow progress on operational aspects such as procurement and asset management. Most of the progress has been made in the area of governance, thanks to wide-ranging legislative and regulatory efforts in recent years. On sustainability, the economies have made the most promising advances in road safety; additional efforts are needed to formulate and implement policies geared towards improving environmental and logistics performance.

Figure 11.1. **Transport policy and performance: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on *the Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

Transport scores between the *Competitiveness Outlook 2016* and *2018* are not directly comparable, as the 2018 assessment now uses the International Transport Forum (ITF) assessment framework, which is more advanced than the 2016 framework, and in some cases sets higher standards. Overall, the main improvements across the economies have been in wide-ranging regulatory reforms in rail and aviation. Moreover, the economies have approved national transport visions and road safety strategies since the 2016 assessment. The slowest progress has been in the fields of procurement, asset management and sustainability.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Achievements

The six SEE economies have developed long-term transport strategies and established high-level project selection processes. The latter apply mainly to investment funded by the European Union (EU), and enable decision makers to have an overview of the infrastructure projects pipeline over time.

Regulatory reforms of transport sectors have continued. There has been substantial progress in introducing and updating legislation to improve the efficiency of the rail, aviation and road sectors, further promoting harmonisation with the EU *acquis*.

Growing interest from private investors is leading to more transport projects considering alternative procurement methods. There are examples of successful public-private partnerships (PPPs) in the aviation and maritime sectors and international consortia are increasingly involved in road and rail projects.

Institutional mechanisms for road safety measures and their implementation have improved. Co-ordinated efforts through national road safety councils and the implementation of stricter policies have led to road deaths falling across the SEE economies.

Remaining challenges and key recommendations

- **Strengthen the effectiveness of both the new transport strategies and the project selection processes.** Many of the economies' strategies currently lack monitoring and implementation plans. A number of large-scale projects fall outside the scrutiny of formal prioritisation processes and have gone ahead despite the lack of public evidence on costs and benefits.
- **Complete transport market reforms.** Although progress has been made, the assessed economies still need to make final yet important harmonisation efforts, such as reforms to open rail markets and airspace management plans. Implementing the large body of legislation and regulations needed will also be a significant challenge for newly formed and at times understaffed authorities and government departments.
- **Address the drivers of logistics performance, a key enabler of trade competitiveness, in a co-ordinated way.** The SEE economies need to enhance their public policy efforts to reduce logistics costs and make freight movements faster and smoother across the region, at both national and international levels.
- **Make the resilience of key transport infrastructure assets a policy priority.** The lack of systematic asset management plans and related maintenance budgets could lead to key assets deteriorating over time. This risk is heightened by growing pressure on existing infrastructure from economic growth and from the impact of climate change.
- **Integrate key aspects of sustainability, such as environmental quality, into transport strategies.** Existing strategies often fail to encompass key aspects of sustainability. The lack of co-ordination between infrastructure investment, regulatory regimes and sustainability goals results in high environmental costs.

Context

The performance of transport infrastructure and markets can play a critical role in improving the competitiveness of the SEE economies. Theoretical and empirical studies have underscored the positive relationship between high-quality infrastructure and economy-wide productivity (IMF, 2015). This relationship is underpinned by a number of mechanisms triggered by improvements in performance for both passenger and freight transport, including the following:

- Good passenger transport connectivity enhances the productive capacity of the economy by improving the functioning of labour markets and facilitating specialisation (Graham, 2014).
- Well-functioning logistics systems facilitate trade by lowering the cost of access to international markets and improving the competitiveness of domestic firms (Arvis et al., 2014).
- High-quality transport infrastructure underpins both the success of firms operating in international markets and an economy's attractiveness to foreign investors (Yeaple and Golub, 2007).

Analysis of transport policy and performance in SEE reveals significant links with other policy areas. Therefore, this chapter builds on information presented in the following chapters:

- **Chapter 1. Investment policy and promotion**, as investment (including in transport infrastructure) is central to economic growth through its contribution to the capital stock and improved access to international markets. The quality of transport infrastructure affects an economy's investment attractiveness and can also determine the destination for foreign direct investment. Since financial resources are limited, policy makers are increasingly interested in the productivity effect of transport investments and cost-benefit analyses take into account the wider economic impacts of transport investments (Melo et al., 2013).
- **Chapter 2. Trade policy and facilitation**, as the transport sector is a key factor in determining the volumes and the direction of trade, while trade policies and facilitation are key factors in the decisions about investment in transport infrastructure. Policy makers should understand how trade will evolve in the future in order to ensure adequate and timely investment in transport infrastructure (ITF, 2016a). Transport logistics can boost trade performance by making the delivery of goods easier, faster and safer. Manufacturing, agriculture and sectors with high export intensity depend on being able to ship goods to consumers quickly, cost-effectively and reliably.
- **Chapter 10. Digital society:** while digitalisation has facilitated supplying services over distance – including across borders – being able to physically deliver goods and services largely depends on physical connectivity, including transport networks, transport service markets, and intermodal connections (OECD/WTO, 2017). Information and communications technology (ICT) can offer solutions to managing the increasing complexity of supply chains, as well as reducing costs and administrative procedures (Arvis et al., 2014);
- **Chapter 13. Environmental Policy**, as the transport sector can play a critical role in reducing emissions across the region and should be a major component of any sustainability strategy. Older vehicle fleets and an inefficient use of fuels lead

to higher levels of pollution, thus increasing the costs to both society and the environment. However, emissions from transport could be reduced by adequate transport policies, e.g. by more stringent regulations on fuel and car models. Simulations for the city of Lisbon show that the introduction of a system of shared mobility could reduce traffic emissions by one-third (ITF, 2016b).

Transport policy and performance assessment framework

Measuring the policy and performance of transport in SEE requires a multi-faceted approach looking at three key sub-dimensions, each of which is linked to different aspects of competitiveness:

1. Planning: are transport policy objectives clearly stated in a coherent vision? Is this vision supported by appropriate project selection, procurement and asset management strategies?
2. Governance and regulation: are stable and transparent regulatory measures in place in order to facilitate and attract investment and the operation of transport systems safely and efficiently? Is harmonisation with the EU *acquis* progressing?
3. Sustainability: as transport activities generate a range of external costs, are SEE economies building resilience and long-term competitiveness as central policy objectives? To what extent are public policies promoting and monitoring progress in this field?

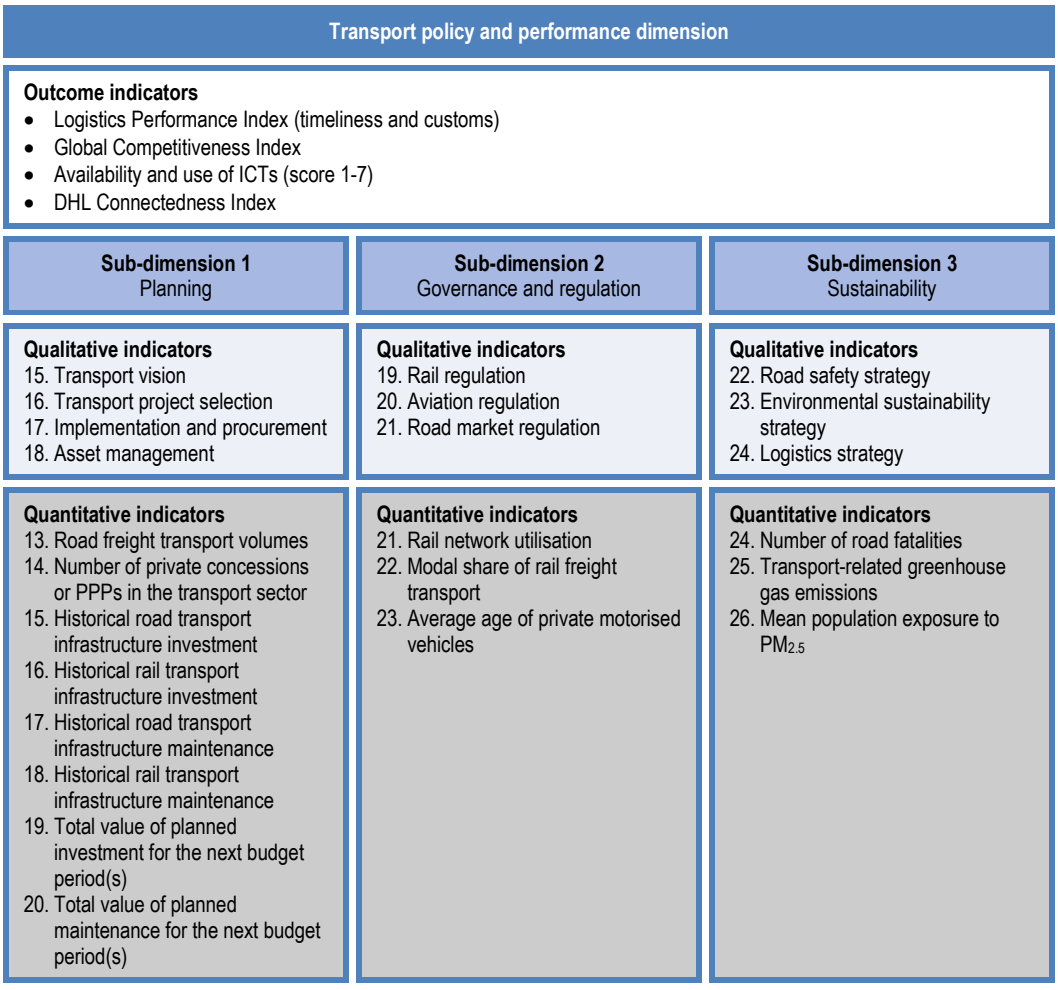
The transport policy and performance assessment framework is presented in Figure 11.2. Each sub-dimension is assessed using both qualitative and quantitative information. Quantitative indicators are based on national or international statistics. Qualitative indicators have been collected from local stakeholders using a questionnaire and, following deliberation, scored in ascending order on a scale of 0 to 5. The results are summarised in Annex 11.A1.[1] On this scale, level 5 represents in most cases an ideal scenario, which is rarely attained by ITF member countries. It thus provides ambitious targets for the SEE economies. For more details on the methodology underpinning this assessment please refer to the methodology chapter.

The framework captures numerous aspects of transport performance; it has been developed based on international good practice and inputs from ITF and sectoral experts. Nonetheless it was not possible to assess all aspects of competitiveness; issues such as urban and waterborne transport could be included in the next review.

Transport policy and performance in SEE economies

This section sets the scene by giving an overview of the six economies' outcome indicators for transport performance (drawing on the Logistics Performance Index, the Global Competitiveness Index and DHL Global Connectedness Index; Figure 11.2). Measuring and analysing outcomes of transport policy and performance means moving beyond a narrow focus on specific sectors at the national level, for two main reasons. First, although each part of the national transport network contributes to economic development, the benefits of transport systems as a whole are greater than the sum of their parts. Second, combined regional efforts in infrastructure investment and administrative reforms can lead to greater improvements than economies acting on their own.

Figure 11.2. **Transport policy and performance assessment framework**



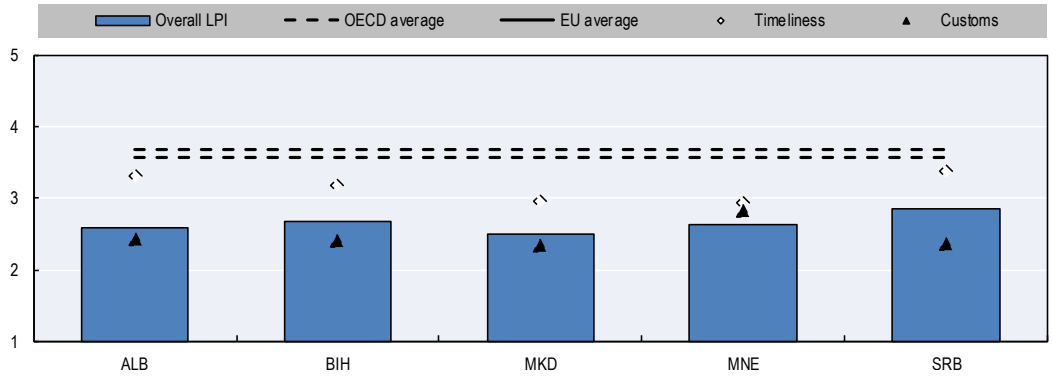
The World Bank's Logistics Performance Index (LPI) is a multi-dimensional assessment and international benchmarking tool focused on trade facilitation (World Bank, 2017a). The LPI is based on surveys of port operators, shippers and freight forwarders, producing a composite index that reflects their responses to the questionnaire. The LPI is oriented towards assessing the transport of manufactured goods rather than bulk commodities, and it is more applicable to higher-value goods. It is most useful when employed in conjunction with an in-depth assessment of trade and transport performance, and it has been used successfully in several countries to instigate discussions of the drivers of logistics performance and the areas where barriers hinder performance (for example, see ITF/OECD, 2016)

The five SEE economies for which data are available perform below both the OECD and the EU averages (Figure 11.3). Over the period 2014-16, their LPI scores averaged between 2.5 and 3.0, with Serbia receiving a marginally higher score than its neighbours. Two components of the LPI, chosen for, among other things, their importance in determining logistics performance, reveal some of the key areas for improvement. The economies perform worst on customs procedures, reflecting the large number of administrative procedures for shippers, and negatively affecting export and import performance. Delays and unexpected costs are perceived as slightly less problematic;

Albania, Bosnia and Herzegovina, and Serbia score over 3 for timeliness of clearance and delivery. Reliability is a key factor for encouraging leading firms in global value chains to invest in the region, so the economies will need to make further improvements in logistics performance to enhance their competitiveness.

Figure 11.3. **Logistics Performance Index (average 2014-16)**

Score 1 (low) to 5 (high)



Note: For Albania the average covers 2012-16. Data for Kosovo not available.

Source: World Bank (2017a), *Logistics Performance Index Dataset* (database), http://lpi.worldbank.org.

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Like the LPI, the Global Competitiveness Index (GCI) of the World Economic Forum measures perceptions rather than physical availability or performance (WEF, 2017). The GCI draws on unique data from the Executive Opinion Survey, which surveys top business executives in all the countries covered by the index. Figure 11.4 shows the most recent scores for the 5 participating SEE economies in the infrastructure domain, the most relevant of the 12 pillars of competitiveness covered by the index. Albania and the Former Yugoslav Republic of Macedonia receive the highest scores, although these are still below both OECD and EU averages. In contrast with the LPI, Serbia received the lowest scores in the GCI among the SEE economies taking part.

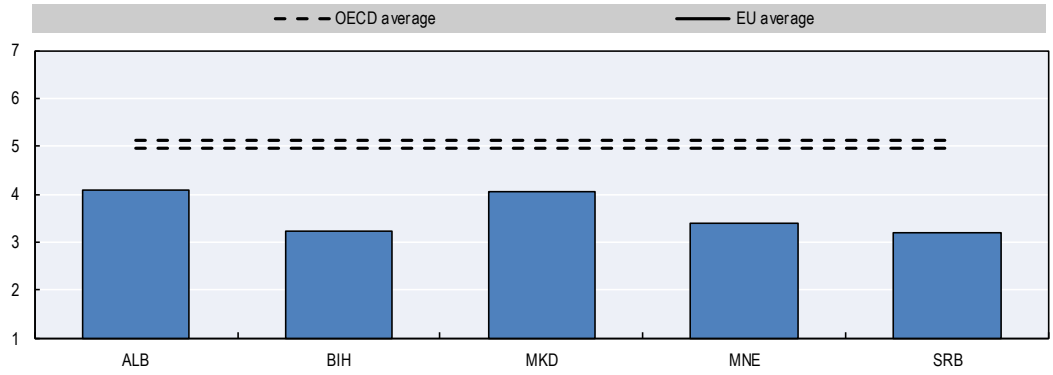
However, Serbia is the top performer in areas such as the availability and use of information and communications technology (ICT) (Figure 11.5).[2] ICT can provide solutions to managing the growing complexity of supply chains, as well as reducing costs and administrative procedures (Arvis et al., 2014). Average scores in the SEE economies for this indicator have increased from 3.4 in 2010 to 4.7 in 2016, and are converging with the top scorers for this measure. This offers encouraging prospects for the removal of non-physical barriers to infrastructure, which are in many cases a key pillar of their recently approved national transport strategies.

In addition to indicators such as the LPI and the GCI, the DHL Global Connectedness Index is an output indicator which assess the integration of economies in global trade flows (DHL, 2016). The DHL Index identifies four specific categories of flows: 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 how important or pervasive interactions with the rest of the world are. "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.[3] The five SEE economies covered by the index fare well for their economic internationalisation (depth) but, given their small size, less so for trade diversification (breadth) (Figure 11.6).

Figure 11.4. **Global Competitiveness Index: Quality of overall infrastructure (2016-17)**

Score 1 (low) to 7 (high)



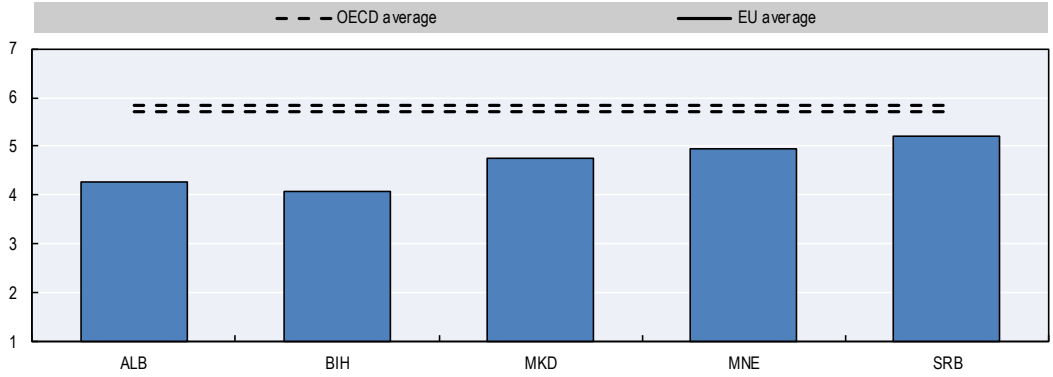
Note: Data for Kosovo not available.

Source: WEF (2017), *Global Competitiveness Index Dataset* (database), http://reports.weforum.org/global-competitiveness-index.

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Figure 11.5. **Availability and use of information and communications technology (2016)**

Score 1 (low) to 7 (high)



Note: Data for Kosovo not available.

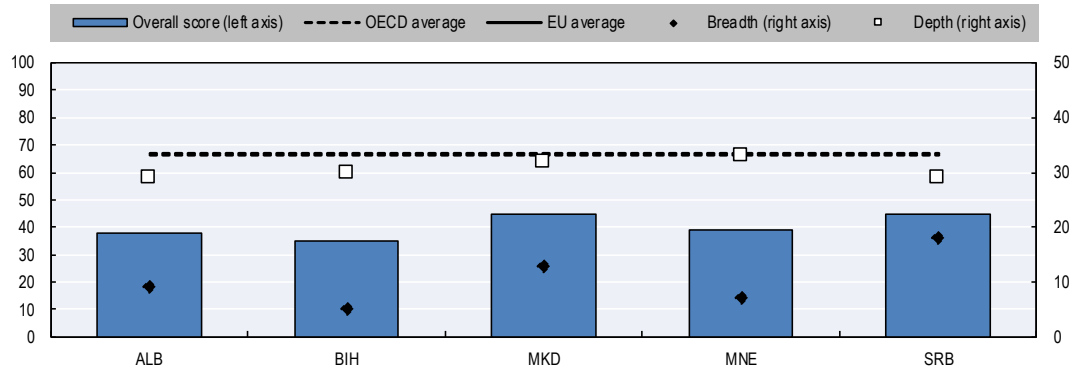
Source: WEF (2016), *The Global Enabling Trade Report 2016*, http://reports.weforum.org/global-enabling-trade-report-2016.

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The multi-dimensional approach to assessing competitiveness through outcome indicators provides a mixed picture. The top performers are different for each specific aspect of competitiveness, but the performance gap between the SEE economies and OECD/EU averages persists.

Figure 11.6. **DHL Connectedness Index (2015)**

Score 0 (low) to 100 (high) for overall score, score 0 (low) to 50 (high) for breadth and depth



Note: Data for Kosovo not available.

Source: DHL (2016), *Global Connectedness Index 2016: The State of Globalization in an Age of Ambiguity*, www.dhl.com/en/about_us/logistics_insights/studies_research/global_connectedness_index/global_connectedness_index.html#.VFff5MkpXuM.

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Outcome indicators suffer from year-on-year variations that depend on external factors (e.g. strikes, weather) 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. The next sections provide this analysis.

Planning

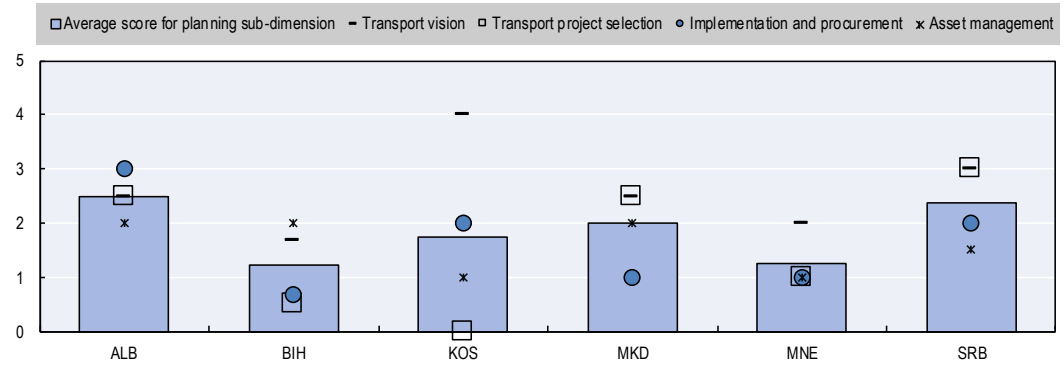
Good planning is essential for ensuring that transport spending, including investment and maintenance, contributes to achieving national goals. Without a clear and transparent process for identifying, prioritising and delivering projects, the SEE economies risk implementing projects that do not provide good value for money from the limited funds available and may jeopardise future investment by institutional and private investors (ITF, 2011a). Regular maintenance, enshrined in asset management plans and budgetary commitments, is essential for protecting the resilience of key networks against the threats of deterioration and structural damage (ITF, 2016c).

The planning sub-dimension measures the extent to which an orderly, coherent, consistent and transparent process is in place for developing transport policy and infrastructure. It does so through four qualitative indicators: 1) transport vision, as expressed in transport strategies; 2) transport project selection, through any project prioritisation frameworks; 3) implementation and procurement; and 4) asset management (Figure 11.7).

The six SEE economies are most advanced in developing their national transport visions and strategies, and establishing high-level processes for project selection, at least for projects co-financed by the EU. However, substantial differences exist between the economies. Albania, Kosovo and Serbia score over 2.5 for transport vision, having adopted and implemented transport strategies, whereas project selection processes are most advanced in Albania, the Former Yugoslav Republic of Macedonia and Serbia. Scores for asset management range between 0 and 2. These are the result of a rapidly changing

environment, as most economies have only recently adopted key documents in the area of planning. The two indicators with the lowest scores are those that typically follow the approval of a strategy, namely implementation and procurement, and asset management.

Figure 11.7. **Planning: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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The SEE economies have recently developed new transport strategies

Economies need a clear and coherent transport vision – i.e. a planning framework at the national level to ensure that the transport sector contributes to the overall vision and ultimately the aspirations of each economy. Each part of the national transport network contributes to economic development, but the benefits of transport systems as a whole are greater than the sum of their parts. Therefore the best strategies focus on intermodal interfaces (road-rail, road-port and rail-port) within a network-wide planning approach with horizontal co-ordination across planning bodies.

All six SEE economies have recently adopted their national transport strategies in an effort to align with international standards (Table 11.1). At the time of writing, the Former Yugoslav Republic of Macedonia and Serbia were completing the final updates to their strategies and Albania has carried out a sustainability impact assessment of its new strategy.

Table 11.1. **Current transport strategies in the SEE economies**

	Current transport strategies	Period covered by strategy
ALB	National Transport Strategy	2016-20
BIH	Framework Transport Strategy	2016-30
KOS	Sectorial Strategy and Multimodal Transport	2015-25
MKD	National Transport Strategy (draft)	2017-30
MNE	Transport Development Strategy	2008
SRB	Transport Strategy (draft)1	2016-25

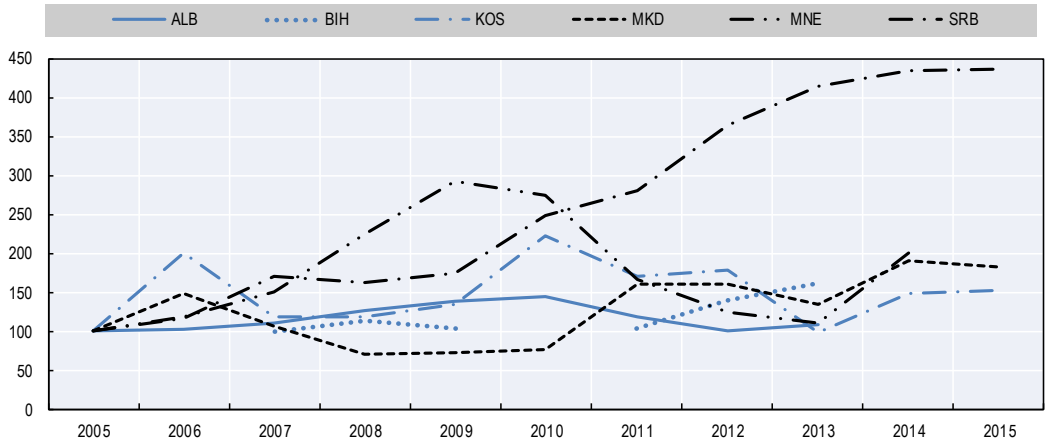
Note: [1] Serbia adopted the Plan for the Development of Rail, Road, IWW, Air and Intermodal Transport in the Republic of Serbia for the period 2015-20.

It is too early to evaluate the impact and hence the effectiveness of any of these strategies in the region. Our analysis shows that all of the strategies have a common focus on removing network bottlenecks such as road congestion and barriers to international transport, harmonising legislation with EU standards, and attracting investment from both

foreign and institutional investors. In light of growing transport volumes, especially on roads (Figure 11.8), removing bottlenecks will be critical to enhancing competitiveness. Harmonising regulations to meet EU standards will also ensure greater integration of the SEE economies into the Single European Transport Area.

Figure 11.8. **Evolution of road freight transport volumes (2005-15)**

Index of tonne-km transported by road; 2005=100



Note: Reference year for Bosnia and Herzegovina is 2007. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: OECD (2017a), "Transport measurement: Freight transport", *Transport* (database) http://stats.oecd.org/Index.aspx?DataSetCode=ITF_GOODS_TRANSPORT; Kosovo Ministry of Infrastructure.

StatLink http://dx.doi.org/10.1787/888933705537

Kosovo's strategy, developed with support from the EU and the South East Europe Transport Observatory (SEETO), is a good example of a multi-modal approach to transport planning. It identifies strategic and operational objectives and measures to address them, and has a series of progress indicators for monitoring and evaluation. At the other end of the spectrum, Montenegro has an older strategy which is still in place but its impact has been limited due to its lack of specific targets and the paucity of data to monitor and assess measures.

While most of the recently approved strategies aim to attract investment in transport infrastructure, with the exception of Albania's, none of them explicitly outline how projects will be selected and prioritised, nor procured. Albania not only requires the economic benefits of projects to be identified, but they also need to be linked to the overall transport vision and meet national objectives.

High-level project prioritisation frameworks have been established

The transport project selection indicator measures the extent to which transport projects are proposed and assessed consistently, realistically and rigorously. On average, the six SEE economies achieve a score of 1.6 for this indicator, ranging from 0 for Kosovo to 3 for Serbia (Figure 11.7). Kosovo's low score for project selection reflects its lack of implementation despite having adopted a formal framework (as confirmed by IMF, 2016). The first step in the process of selecting viable projects is to generate a range of options to address the problems or needs identified. A consistent framework should

then include a clear methodology for decision making, such as socio-economic analysis resulting in a cost-benefit analysis (CBA). In addition to identifying their economic benefits, policy makers should ensure that projects are linked to the overall transport vision and that they fulfil national objectives. Once the project is implemented, the assessment cycle should then involve monitoring and evaluation to ensure that the expected outcomes were achieved.

In the context of the Western Balkans Investment Framework, all six SEE economies have recently established a high-level project selection process, as promoted by the European Commission and SEETO (EC, 2015). This has involved the creation of a National Investment Committee (NIC) in each SEE economy, responsible for defining and managing the prioritised single project pipelines (SPPs) and for programming all available financing sources. Projects are prioritised based on their technical and financial maturity, their alignment with national transport and connectivity agendas, and their adherence to EU standards.

The adoption of this high-level process for project selection has both positive and negative aspects. On the one hand, it promotes a coherent approach to investment planning, including across sectors, since it means in most economies transport projects are assessed alongside energy and environmental projects. The SPP also fosters co-operation across levels of governments both horizontally and vertically. For instance, representatives of all sub-national entities sit on the NIC of Bosnia and Herzegovina.[4] Thirdly, by making the criteria for investment prioritisation publicly available, they are a step towards greater transparency

These new prioritisation frameworks still have limitations which reduce their effectiveness, however. First, the framework only covers projects that are co-financed by the EU and related agencies. At the moment, co-financing is prevalent and a large number of projects are included in the SPP. However, as project financing is further diversified, infrastructure projects with large impacts on transport networks could be excluded from the SPP and go ahead without formal NIC approval. A notable example is the construction of the Bar-Boljare motorway by a Chinese consortium in Montenegro, which falls outside national prioritisation frameworks.

The second limitation relates to criteria for assessing projects. Currently most transport investment projects are not widely subject to CBA and their relative value for money compared to other options is not taken into account, although Serbia has approved a CBA guideline to be applied to road transport infrastructure projects. Good CBAs should be underpinned by simulations for the transport sector which also model other projects and a do-nothing scenario (see Box 11.1 for an example from the United Kingdom). There are some cases where CBAs have been used, which show how valuable such modelling can be. In the Former Yugoslav Republic of Macedonia, for example, a detailed CBA of proposed upgrades to the rail network (for a total of 56 km of track) revealed that it was not advisable to increase the maximum speed for freight trains to 120 km/h, so an upgrade to support a maximum speed of 100 km/h was sufficient to generate the expected economic benefits at lower cost.

Successful implementation requires complementary efforts in procurement and asset management

Following coherent planning and systematic prioritisation, it is crucial for the SEE economies to have a rigorous process for the **implementation and procurement** of transport projects in order to meet planned outcomes and spend funds efficiently. The

most advanced processes for implementation consider a variety of procurement methods and tailor how they procure a project to its characteristics and financial considerations.

On average, the six SEE economies achieve a score of 1.6 for the implementation and procurement indicator, ranging from a score of 0.7 for Bosnia and Herzegovina to a score of 3 for Albania (Figure 11.7). Although the SEE economies have not adopted integrated policy frameworks for the procurement of transport infrastructure projects, they have all approved national public procurement laws. These cover transport projects that are funded at least in part by the government. However, the SEE economies do not systematically follow dedicated guidelines for the procurement of large transport projects, despite efforts to attract private investors to the region and to accelerate infrastructure investment.

Public-private partnerships (PPPs) are a potential avenue for delivering infrastructure more efficiently than traditional public procurement and to relieve public budgets (ITF, 2017). However, the SEE economies have had mixed experience with PPPs; successful bidders have been able to deliver on time and within budget in port and airport projects, but tenders for road projects have often failed. For example, during the first attempt to tender out the Milot-Morine motorway in Albania, projections of capital expenditure exceeded the bidder's estimates. In the Bar-Boljare motorway in Montenegro, the winning consortium failed to secure finance amidst global financial turmoil. These examples confirm that PPPs are not always the most efficient investment vehicle for road investment, depending on both the project characteristics and financial market conditions. Even if it is not possible to definitively state the conditions under which PPPs are recommended, recent studies show that attracting successful PPP investment in infrastructure is highly sensitive to governance issues, such as freedom from corruption, the rule of law, high-quality regulations and low numbers of disputes in the sector (ITF, 2017).

As Table 11.2 shows, Albania has the most active transport PPPs among the assessed economies. This will be further facilitated by a recently updated legal framework (Parliament's Amendments to Law 125/2013 on Procurement) giving further powers to grant concessions and PPPs to the existing PPP Unit in central government. Serbia recently approved a five-year action roll-out plan as part of the EU Twinning Project on strengthening administrative capacity, which should also result in improved procurement processes as concessions are tendered, starting with Belgrade Airport.

Table 11.2. **Active public-private partnerships by transport sector**

	PPPs
ALB	Ongoing: 1 in road, 1 in rail, 4 in maritime, 1 in aviation
BIH	In preparation: 1 in road
KOS	Ongoing: 1 in aviation
MKD	Ongoing: 1 in aviation
MNE	Ongoing: 2 in maritime Under consideration: 1 in aviation
SRB	In preparation: 1 in aviation

Note: PPP – public-private partnership. Active PPPs refers to concessions that have reached financial closure as of May 2017. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

A specific issue is the number of large transport projects in the SEE economies which fall outside rigorous procurement processes and are covered by special laws approved by parliaments. Unsurprisingly, these often are not thoroughly assessed at the project

selection stage. Examples include the aforementioned motorway in Montenegro, the Skopje-Stip and Kicevo-Ohrid motorways in the Former Yugoslav Republic of Macedonia and the R7 motorway in Kosovo. Projects that are not fully scrutinised may encounter a number of obstacles such as partial implementation, unclear monitoring responsibility among government bodies and corruption.

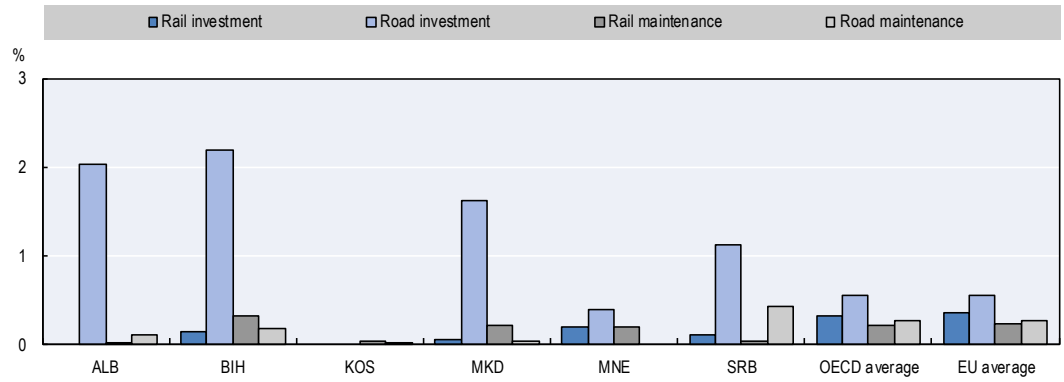
Introducing an **asset management plan** for road and rail network management with explicit links to strategic budgets is essential (Crist et al., 2013). Future budgets should clearly take into account the future needs and vulnerabilities of the road and rail network, and trade-offs with other priorities. If budgets are not fixed in advance then when resources are tight funding for maintenance is often postponed, but deferred maintenance makes transport assets and networks more vulnerable to local or systemic disruptions. In contrast, good plans should aim to optimise the service delivered by infrastructure over its life cycle at an acceptable cost.

The SEE economies are only partially implementing asset management plans. On average, the six economies achieve a score of 1.6 for this indicator, ranging from a score of 2 for Albania, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia to a score of 1 for Montenegro (Figure 11.7). Figure 11.9 illustrates the level of investment and maintenance spending for road and rail networks over a three-year period in the SEE economies, showing that road investment has received the largest share of funding. Levels of investment in Albania and Bosnia and Herzegovina have been particularly high in recent years, at around 2% of gross domestic product (GDP). Stakeholder interviews during the assessment process confirmed that the road budget is also significantly higher than the rail budget in Kosovo. This reflects major road building and rehabilitation programmes being completed across the region. Investment in rail is considerably lower than in roads, and also smaller than OECD and EU averages. Between 2013 and 2015, the SEE economies spent on average between 0.01% (Albania) and 0.32% (Bosnia and Herzegovina) of GDP on rail maintenance, while they spent between 0.02% (Kosovo) and 0.43% (Serbia) of GDP on road maintenance over the same period (Figure 11.9).

Sectoral asset management plans are the exception rather than the norm. The economies with the most advanced plans (Serbia and Albania for the road sector and the Former Yugoslav Republic of Macedonia for the rail sector) have been collecting some performance data on a regular basis and have earmarked maintenance budgets until 2019 (Albania and Serbia for both road and rail, the Federation of Bosnia and Herzegovina for road, and the Former Yugoslav Republic of Macedonia for rail) to address the needs identified. They also link asset management to procurement. Best-in-class procurement should incorporate future maintenance and renewal needs in concession agreements. New airport PPPs across the region represent examples of good practice in this field, linking maintenance and investment budgets to service levels.

Figure 11.9. **Rail and road transport infrastructure investment and maintenance (average 2013-15)**

Spending as % of GDP



Note: Road investment data for Kosovo and road maintenance data for Montenegro were not available. Major rail investment in Albania is due to start in 2017. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: SEE statistical offices and ministries; OECD (2017b), "Transport infrastructure: Transport infrastructure investment and maintenance spending", http://stats.oecd.org/Index.aspx?DataSetCode=ITF_INV-MTN_DATA.

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The way forward for transport planning

Looking ahead, the SEE economies should consider the following potential improvements to their transport planning framework.

All six SEE economies should **monitor the implementation of their recently approved transport strategies**. This requires establishing progress indicators and collecting data at regular intervals to assess progress. Bosnia and Herzegovina, and Montenegro might want to step up their efforts in this field. The economies will then need to update their strategies based on the results of their monitoring activities.

Frameworks for project selection and prioritisation, as well as comprehensive procurement guidelines, could be extended to all large transport infrastructure projects, especially to road building programmes in Kosovo, the Former Yugoslav Republic of Macedonia and Montenegro. In addition to feasibility and alignment with policies, a key criterion for prioritisation is value for money. This is best assessed through CBAs, the customary decision-making tool in many ITF/OECD economies (see Box 11.1 for an example of using CBAs in the United Kingdom).

As private investment in the transport sector continues to increase, **independent authorities such as national audit offices could be given further oversight roles in the procurement and monitoring of PPPs**. Lessons learnt from existing PPPs should be incorporated when procurement frameworks are updated, especially where a larger evidence base exists, as in Albania.

All of the economies could consider introducing compulsory asset management plans – the success or failure of existing plans currently depends upon the good will of individual agencies and/or government departments. Plans should be linked to earmarked

budgets and be monitored through performance indicators; concerns about maintenance budgets were raised, in particular in Kosovo and the Republika Srpska.

The SEE economies could enhance co-operation in order to have a common approach to transport planning. Across all aspects of transport planning, international co-operation will be critical. Such co-operation could encompass the improvement of data collection and analysis as well as the exchange of good practice. Organisations such as the ITF and SEETO aim to offer a platform for such collaboration.

Box 11.1. **Good practice: Transport project appraisal in the United Kingdom**

Infrastructure projects requiring public approval need to undergo a cost-benefit analysis (CBA) test, as part of the established process of socio-economic appraisal of transport investment in the United Kingdom. The UK government provides detailed guidance for project managers and funders, outlining the phases of each assessment: option development, linking proposed projects to desired national/local outcomes; appraisal of sifted options, using CBA to estimate the likely impact of each option; implementation, developing a business case for the preferred option; and monitoring and evaluation, ensuring that the expected cost and benefits materialise.

CBA is a key component of this process. It is important for the CBA to build on inputs from transport models and forecasts – i.e. a reliable evidence base. CBAs should be based on a set of standard values which are either provided by the government or estimated at the local level. Costs and benefits need to be estimated over the life of the project and discounted to an equivalent present value using finance ministry rules. The results need to be presented in suitable form to decision makers, the public and other stakeholders to inform public consultations and debate.

According to the key principles to be followed in the United Kingdom, the appraisal process should include

- a clear rationale for any proposal which must be based on a clear presentation of the problems and challenges that establish the "need" for a project
- consideration of genuine alternatives across networks and modes, not just an assessment of a previously selected option against some clearly inferior alternatives
- a documented process which identifies the best-performing options to be taken forward for further appraisal
- an appropriate level of public and stakeholder participation and engagement during the process.

The transport appraisal process in the United Kingdom is an example of international good practice for establishing a rigorous system of project assessment and prioritisation. Crucially, the process has evolved over time. Starting from a narrow model which traded time and operating costs against capital and maintenance costs, the appraisal process has progressively developed to incorporate wider economic benefits, behavioural responses and environmental externalities linked to transport infrastructure.

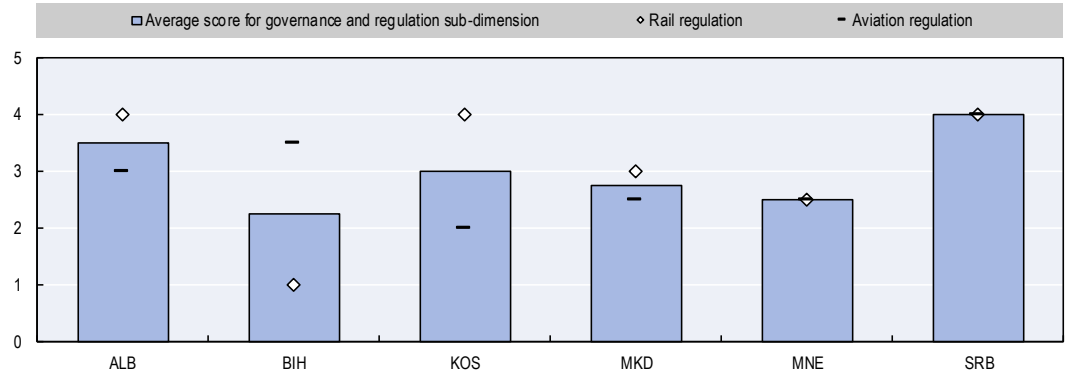
Source: Adapted from MacKie (2010),"Cost-benefit analysis in transport: A UK perspective", http://dx.doi.org/10.1787/5km4q8j8m2f6-en; Department for Transport (2014), *TAG UNIT A1.1: Cost-Benefit Analysis*, www.gov.uk/government/uploads/system/uploads/attachment_data/file/427086/TAG_Unit_A1.1_-_Cost_Benefit_Analysis_November2014.pdf.

Governance and regulation

The transport governance and regulation sub-dimension measures how well transport infrastructure and networks are regulated and operated, with a focus on rail, aviation and roads. Good governance is critical for transport policy and performance. Stable and transparent governance frameworks provide the certainty needed to plan investment and implement strategies and visions. Appropriate regulatory intervention ensures that transport markets operate efficiently and safely.

The governance and regulation sub-dimension comprises three qualitative indicators to analyse progress in rail, aviation and road regulation reforms: 1) rail regulation; 2) aviation regulation; and 3) road market regulation, particularly in the road haulage sector. Of these, only the first two indicators are scored (Figure 11.10). Given the complexity of assessing these rules and the coexistence of regulations at different level, this assessment does not provide a score for the indicator on road market regulation. Although not scored, this indicator is included in order to assess achievements in the road sector.

Figure 11.10. **Governance and regulation: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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A specific goal of transport reforms in the SEE economies is harmonisation with EU rules to create common market conditions. Harmonisation is a precondition for further regulatory advances, such as ensuring that infrastructure charges are related to costs across all modes, providing market access opportunities for new entrants to promote competition, and addressing environmental and health externalities.

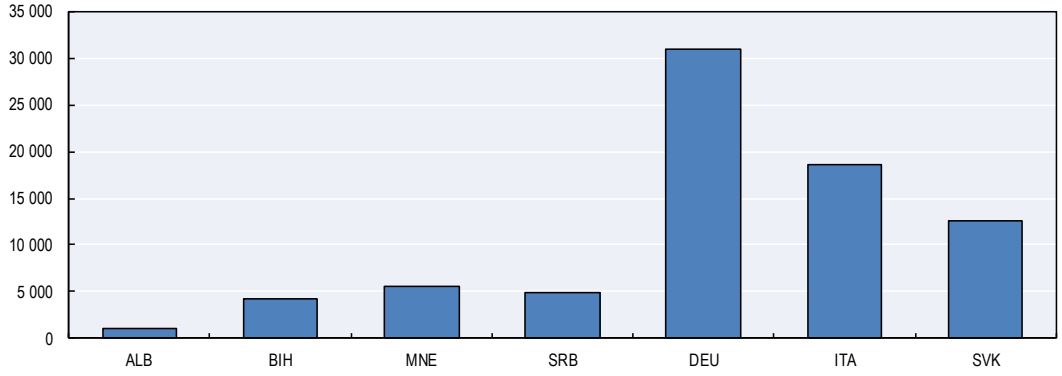
The scores shown in Figure 11.10 highlight the achievements of the SEE economies in the field of governance and regulation. Albania, Kosovo and Serbia have achieved scores of over 3 in rail regulation since they are implementing their rail reforms and the process of opening their rail markets is well advanced. Aviation reforms are most advanced in Bosnia and Herzegovina, and Serbia. Further progress is particularly needed in the area of rail regulation in Bosnia and Herzegovina, while Kosovo, the Former Yugoslav Republic of Macedonia and Montenegro would benefit from further aviation reforms.

Rail use is lagging

The need for effective implementation of structural rail reforms is evident when looking at the performance of the SEE economies in rail. Figure 11.11 shows that the availability of historical rail networks is not enough to ensure that rail is a competitive and attractive transport mode. The level of investment and maintenance in rail transport infrastructure compared to that in road transport infrastructure confirms the predominance of the road sector (Figure 11.9). The quality of the network and the demand by passengers and shippers determines network utilisation. All of the SEE rail networks would benefit from reaching the levels of use achieved by countries such as Germany, Italy and the Slovak Republic. Network utilisation is determined by the quality of the network and demand among passengers and shippers. More use could be achieved by reforming charging regimes and providing incentives for shippers to use rail transport. This would also translate into greater financial sustainability as there would be more train operators to help cover infrastructure costs.

Figure 11.11. **Rail network utilisation (2015)**

Train-km per km of track



Note: Data for Kosovo and the Former Yugoslav Republic of Macedonia not available. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: SEE statistical offices and ministries. Steer Davies Gleave (2015), *Study on the Cost and Contribution of the Rail Sector*, https://ec.europa.eu/transport/sites/transport/files/modes/rail/studies/doc/2015-09-study-on-the-cost-and-contribution-of-the-rail-sector.pdf.

StatLink http://dx.doi.org/10.1787/888933705594

Rail's modal share of freight transport is falling in most of the SEE economies (Figure 11.12), even though rail freight transport is still more important in the region than in most EU Member States, where the average is around 20% (OECD, 2017a). For that situation to change, more resources would need to be directed to the maintenance of rail transport infrastructure. The evolution of rail modal share will be a useful indicator to understand the competitiveness of rail and the SEE economies' ability to cater for growing demand in a sustainable manner.

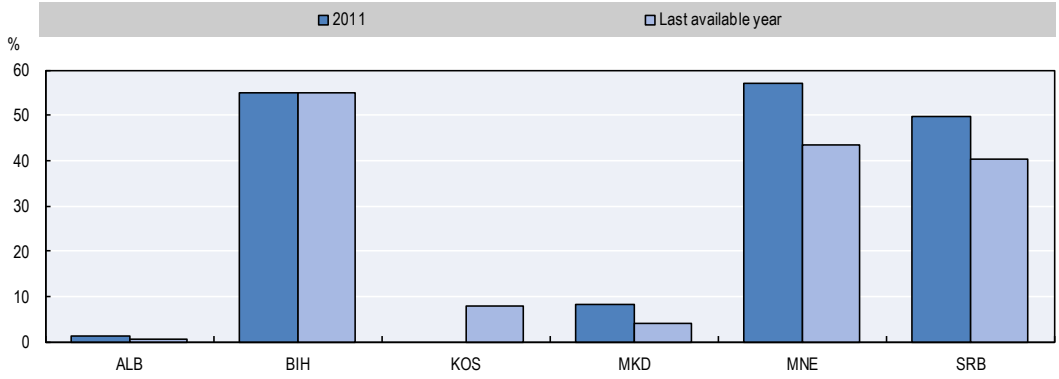
Structural reforms to rail regulation are progressing

Reforms in rail regulation are crucial to achieving harmonisation with EU policies on interoperability, market access, safety and investment in line with the EU's 2011 White Paper goals of creating a "true internal market for rail services" (EC, 2011). Reforms

should encompass two main areas: legislative advances to enshrine key principles in national laws, and administrative progress in creating the appropriate institutional settings to implement those principles. A key long-term outcome of rail reforms is the completion of international rail corridors connecting the SEE economies with export markets across the EU and along neighbouring Eurasian corridors.

Figure 11.12. **Modal share of rail freight transport (2011 and most recent year)**

% of total inland freight transport



Note: The most recent year for Albania was 2013, and for Montenegro 2014 from OECD (2017a). The SEE statistical offices and ministries that participated in the *Competitiveness Outlook* assessments conducted in 2016-17 provided data for Serbia (latest year 2015), and for Kosovo and Bosnia and Herzegovina (latest year 2016).

Source: SEE statistical offices and ministries; OECD (2017a), "Transport measurement: Freight transport", http://stats.oecd.org/Index.aspx?DataSetCode=ITF_GOODS_TRANSPORT.

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On average, the six SEE economies achieve a score of 3.1 on the rail regulation indicator, ranging between 1 for Bosnia and Herzegovina and 4 for Albania and Serbia (Figure 11.10). The SEE economies have made considerable progress in advancing structural rail reforms to bring them in line with the EU *acquis.* They have also progressed in fulfilling the obligations set out in the SEETO memorandum of understanding for a SEE Railway Transport Area and the SEETO Addendum. The most recent reforms have been in Serbia, which adopted comprehensive rail reforms in 2016, and in Albania in 2017. These completed a number of reforms undertaken in the other SEE economies in recent years. Bosnia and Herzegovina has not yet harmonised reforms at the national level, but both entities have made progress in parallel. Thanks to these reforms, all of the economies have completed the vertical and horizontal separation (unbundling) of their rail markets: their infrastructure managers, passenger rail operators and freight operators are independent, at least as far as accounting rules are concerned.

Unbundling and clear rules contained in a transparent Network Statement are preconditions for opening an economy's rail market. Competition in the sector could lead to more efficient operation and in turn lower prices and increase innovation, as seen in EU Member States (Casullo and Zhivov, 2017). Five economies and the Federation of Bosnia and Herzegovina have published a Network Statement, building on common work as part of SEETO's activities to standardise Network Statements. However, liberalisation is proceeding slowly; even where markets are legally open to competition, only a handful of non-incumbent operators have entered, notably in Albania and Serbia. Bosnia and

Herzegovina and the Former Yugoslav Republic of Macedonia have decided to only open their markets fully once they become EU members. Decisions on opening markets should typically be based on market conditions.

Rail will become more attractive to both existing and new operators provided reforms are effectively implemented. However, some barriers will only be lifted through infrastructure upgrades to improve average speeds, including at border crossings. International co-operation, such as along Corridor X (running through Serbia, Kosovo and the Former Yugoslav Republic of Macedonia and part of the One Belt-One Road initiative led by the People's Republic of China) will be key. The completion of works on Corridor X on the Serbian side of the border in 2017 represents an important step forward, and similar efforts will be required in Kosovo and the Former Yugoslav Republic of Macedonia (as well as in Greece) in order to complete this strategic piece of infrastructure.

Aviation reforms are advancing but closer international co-operation is needed

Harmonisation with EU legislation – including cross-border co-operation, performance schemes, the promotion of safety and transparent airport regulations – could promote more efficient aviation services in the SEE economies. The Single European Sky (SES) is part of the European Common Aviation Area Agreement signed in 2006, in which the six SEE economies committed to align some of their aviation regulation with the EU *acquis* in exchange for full access to the single European aviation market. In addition, Directive 2009/12/EC (the Airport Charges Directive, ACD) provides principles and guidelines for airport charges and the interface between airports and their users. Table 11.3 shows progress on four key features of aviation reform in each economy.

Table 11.3. **Key features of aviation reforms in the SEE economies**

	National supervisory authority	Air traffic management plan	Airport Charges Directive 2009/12 adopted	Functional airspace block
ALB	Yes	In preparation	No	Associated member of BLUEMED FAB
BIH	Yes	Yes	Yes	Member of Central European FAB
KOS	Yes	No	Yes	No
MKD	Yes	No	No	Observer in Danube FAB and BLUEMED FAB
MNE	Yes	No	No	Mini-FAB with Serbia
SRB	Yes	Yes	Yes	Mini-FAB with Montenegro

Note: Information reflects progress as of May 2017. FAB – functional airspace block.

The relatively high scores achieved on the aviation regulation indicator reflect the advances made (see Figure 11.10). The process of implementing SES in the SEE economies is supported by specific programmes. Starting with the Implementation of SES in South East Europe (ISIS I) programme (2010-12), progress has been made in transposing EU law into national legislation, as well as capacity building of national supervisory authorities. ISIS II (2013-17) built on this progress and focused on facilitating and monitoring implementation. The final step of the integration project will be the inclusion of the SEE economies, except Bosnia and Herzegovina, in the existing EU FAB.

All of the SEE economies have established a national supervisory authority in charge of market monitoring, with a special focus on air navigation service providers. Their goal is to promote a culture of safety and transparency in the aviation sector. In some cases the

civil aviation authority has taken on these functions, doing away with the need for an additional authority. In most of the SEE economies stakeholders highlighted the importance of international support and capacity building in order to fund and streamline operations, including support from the European Aviation Safety Agency (EASA), the European Organisation for the Safety of Air Navigation (EUROCONTROL) and the European Commission's Directorate-General for Mobility and Transport (DG MOVE).

Air traffic management plans are operational in Serbia and Bosnia and Herzegovina, and are being prepared in Albania. All three economies have some form of cross-border co-operation in place; Bosnia and Herzegovina has the most advanced co-operation as a full member of the Central European functional airspace block. This allows it to enhance safety, optimise airspace management and promote emissions reductions. Kosovo and the Former Yugoslav Republic of Macedonia have been partly hindered from progressing in this area by international disputes. Kosovo is working to establish arrangements with EASA and implement the law on the Air Navigation Service Agency.

Only Bosnia and Herzegovina, Kosovo, and Serbia have transposed the ACD into national legislation. The other three SEE economies have set their airport charges to strike a balance between meeting revenue requirements and attracting air carriers, but have not consulted with users over their levels, and charges do not reflect congestion or environmental costs. In Albania and the Former Yugoslav Republic of Macedonia, charges are or will be set at the network level (i.e. across all of their airports), which does not promote transparency. In recent years, there have been fundamental changes in airport ownership and management, including the introduction of new long-term airport concessions (Table 11.2). New concessions and PPPs also provide an opportunity to review charging regimes.

Road regulations are being aligned with European standards

Further integration of the standards and framework conditions for road freight transport is an important step towards the creation of a Single European Transport Area. This integration will be best attained through the promotion of common European economic, social and environmental rules. These include: 1) effective controls, including at borders; 2) harmonisation of employment conditions in the road transport profession (social *acquis*); 3) cabotage rules allowing freight vehicles to operate across borders to guarantee equal market access opportunities to road haulage companies and reduce empty runs; 4) introduction and modulation of road user charges; and 5) safety legislation.

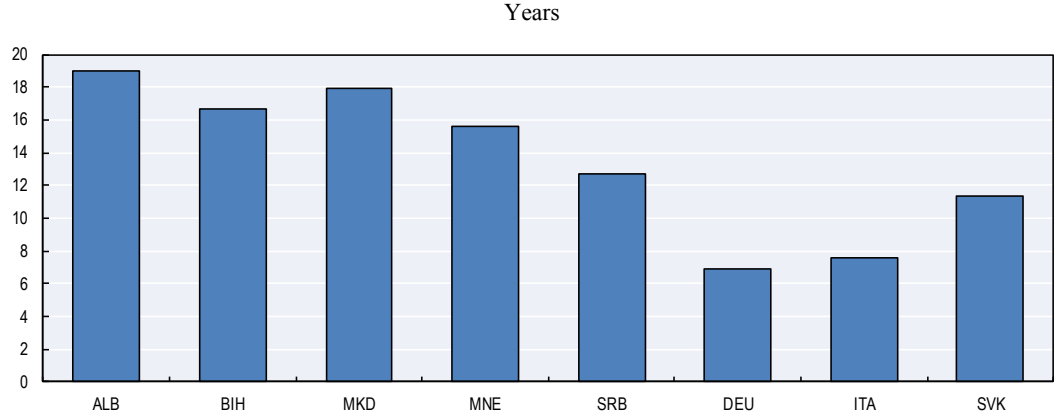
Given the complexity of assessing these rules, and the coexistence of regulations at different levels, this assessment does not provide a score for the indicator on road market regulation.

Overall, the SEE economies have made progress by aligning their national rules with the EU *acquis* on important issues such as working hours, safety standards and the licensing of truck drivers. For what concerns the European road haulage markets, the EU regulates access to the international market through Regulation (EC) No 1072/2009. For non-EU members, the European Conference of Ministers of Transport (ECMT) Multilateral Quota System offers a complementary option to bilateral agreements. This system is managed by the International Transport Forum, which distributes licences[5] to the member countries and monitors the quota rules through the Road Transport Group. Further implementation of the latest ECMT Quality Charter, which entered into force in 2016, will allow the SEE economies to harmonise quality requirements with the EU.

Two specific aspects of regulation are critical to promoting efficiency and safety in the road sector. First, the economies have not sufficiently developed their data collection systems to monitor the road transport market. Second, even where data are collected regularly, the various organisations collecting information do not necessarily consolidate it at the national level. For example, in Albania, private concessionaires, the road authority, the Institute of Transport, the police and the statistical office do not yet combine their road transport data into a single repository.

Data on registration fees for newly registered cars are a prime example of the importance of data collection for improving policies. They show that car fleets in the SEE economies are substantially older than in EU countries such as Germany, Italy and the Slovak Republic (Figure 11.13). Recognising this, the national authorities have introduced changes in registration fees, in order to update car fleets to improve their safety and environmental performance. These changes include incentives and discounts for new vehicles in an attempt to reduce imports of second-hand cars. Decision makers can use detailed car registration data, which are generally available across the region, to estimate the impacts of these incentive schemes on public budgets.

Figure 11.13. **Average age of private motorised vehicles (2016)**



Note: Data from Kosovo not available. Due to unavailability of data, the average age of privatised motorised vehicles in BIH does not include data for the Federation of Bosnia and Herzegovina and the Brčko District and refers only to the Republika Srpska. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17 (national statistical offices for Albania, Former Yugoslav Republic of Macedonia, Montenegro and Serbia; Ministry of Transport and Communication of the Republika Srpska). DEU – Germany; ITA – Italy; SVK – Slovak Republic.

Source: SEE statistical offices and ministries; EEA (2017), *Average Age of Road Vehicles per Country* (database), www.eea.europa.eu/data-and-maps/daviz/average-age-of-road-vehicles-6#tab-chart_1.

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The way forward for governance and regulation

Over the last few years, the SEE economies have made considerable progress in reforming the rail, aviation and road sectors, and they should continue their efforts in this sub-dimension.

International co-operation has been and will remain crucial. SEETO's role in supporting rail reforms, the ISIS programme in aviation and the ECMT quota for road transport have all resulted in successful co-operation. **International co-operation will**

continue to be needed to tackle the remaining challenges, which will require more complex regulatory approaches and increased governance capacity. The recent approval of the Transport Community Treaty between the EU and the Western Balkans (Box 11.2) is a positive step in this direction.

Box 11.2. The Transport Community Treaty between the EU and the Western Balkan Six economies

Transport connectivity was high on the agenda of the 2017 Western Balkans Summit that took place in July 2017 in Trieste, Italy. Notably, Western Balkans partners signed the Transport Community Treaty, which will help integrate transport networks in the region and with the EU and guide related reform measures in the transport sector – building on the positive experience of the 2006 Energy Community Treaty (see Chapter 12, Energy policy).

The ultimate objective of the treaty is to establish an integrated market for infrastructure and land, inland waterways and maritime transport and to align relevant legislation in the SEE economies with EU legislation. The aim of the treaty is also to generate favourable conditions to make transport sector more efficient with a net positive impact on growth and job creation. The region has already benefitted from EU co operation through the introduction of new assessment frameworks for transport projects, and through dedicated co-financing from transport infrastructure. In Trieste, the EU agreed to grant more than EUR 500 million for transport investment in the region.

The Transport Community Treaty will provide impetus for further connectivity reform measures. In a joint ministerial statement, the SEE economies reinforced their commitment to "open markets, create transparent regulatory frameworks, improve safety and reduce costs for businesses and citizens, as well as attract further investments, make further progress to improve border crossing procedures and infrastructure facilities". The expectation is that the treaty will benefit to the accession framework for the Western Balkans by speeding up the alignment of national legislation with the EU acquis on transport and other relevant areas.

Source: EC (2017a), *Establishing a Transport Community between the European Union and the Western Balkans*, https://ec.europa.eu/transport/sites/transport/files/2017-factsheet-commmunitytreaty-wb.pdf; EC (2017b), "Joint statement – Western Balkans Six Prime Ministers meeting", https://ec.europa.eu/commission/commissioners/2014-2019/hahn/announcements/joint-statement-western-balkans-six-prime-ministers-meeting_en.

In the rail sector, **co-ordinated corridor management plans will be necessary** once cross-border infrastructure is in place, notably along Corridor X. As the SEE economies build on effective reforms in the unbundling, access and safety of rail systems, they should consider using competition as an additional lever to stimulate efficiency and increase rail network utilisation.

In the aviation sector, **new and updated legislative packages will provide the appropriate basis for further harmonisation with EU rules**. Further reforms within the ISIS II programme will support the introduction of air traffic management systems in all the SEE economies, making air transport more competitive. Albania, Serbia and the Former Yugoslav Republic of Macedonia could consider accelerating their integration into their respective FABs.

In the road sector, **full implementation of the recently approved Quality Charter as part of the ECMT system** would help to support alignment with EU rules. The Quality Charter establishes qualification standards for companies, managers and drivers.

Stronger evidence through regular data surveys and consolidated road transport models would help the SEE economies identify congestion hotspots and cross-border issues more easily, as well as identifying lower-cost solutions to improving the competitiveness of the road sector, such as reforms in road charges and vehicle taxation.

As recommended by the EC (2016a, 2016b, 2016c, 2016d, 2016e, 2016f) and the ITF (ITF, 2011b), **stepping up administrative capacity through more human, financial and technical resources** will be fundamental to ensuring the effective implementation and relative stability of regulatory regimes in the future. Across all sectors, introducing and updating legislation represents a significant challenge for newly formed and at times understaffed authorities and government departments.

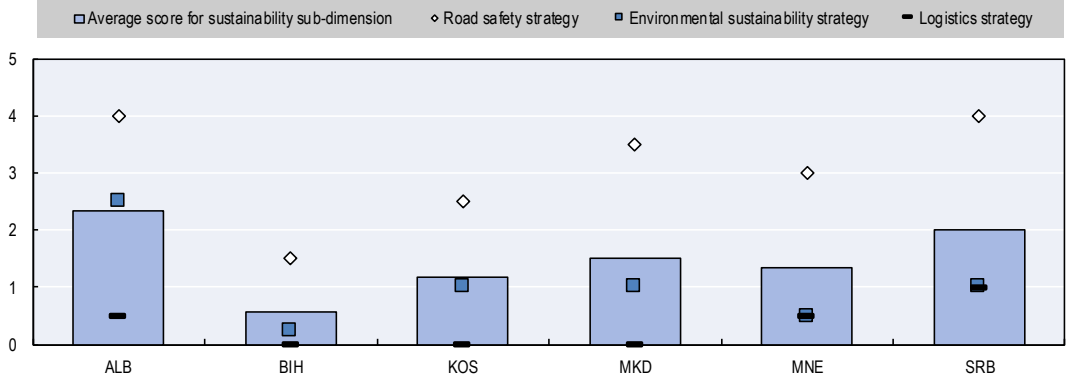
Sustainability

Green transport plays an increasing role in policy formulation in OECD countries, driven by environmental concerns and sustainability objectives (OECD, 2012). As seen above, the six SEE economies have witnessed a rise in motorisation rates and road traffic volumes (Figure 11.8) and a decline in rail modal share (Figure 11.12) in recent years. In the few cases where economies have set modal shift targets, they have not been achieved.

While increasing road transport volumes through better infrastructure allows considerable productivity gains, environmental and safety externalities eventually worsen as volumes continue to grow, with negative effects for both quality of life and competitiveness. The long-term competitiveness of the SEE economies heavily depends on their ability to keep logistics costs down. In addition, environmentally friendly supply chains are associated with better logistics performance in terms of both lower costs and faster deliveries (Arvis et al., 2014) thanks to modal shift, reductions in inefficient cargo movements and consolidation of flows.

The transport sustainability sub-dimension measures progress towards resource efficiency, environmental protection, reduction of health impacts and increased transport safety. It uses three qualitative indicators to analyse the presence and implementation of: 1) road safety strategies; 2) environmental sustainability strategies; and 3) logistics strategies (Figure 11.14).

Figure 11.14. **Sustainability: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705651

Scores vary widely, with those for road safety strategies consistently higher than other indicators. The worst-performing indicator is logistics strategy, for which only Serbia achieves a score above 1. Environmental strategies are most advanced in Albania, which achieved a score of 2.5 for this indicator. The other economies only achieve scores between 0.5 and 2 in this field. This is in line with the global assessment of environmental strategies presented in Chapter 13.

Road safety is a policy priority across the region

Road safety is a priority of EU transport policy; the EU White Paper on transport envisions the harmonisation of road safety technology, improved roadworthiness tests, a comprehensive strategy of action on road injuries and emergency services, promotion of the use of safety equipment, and policies to protect more vulnerable transport users (EC, 2011). The road safety strategy indicator tracks progress in adopting and implementing comprehensive strategies on road safety.

The South East Europe 2020 strategy emphasises alignment with the EU *acquis* in the area of road safety, and road safety is also a priority in the SEETO Multi Annual Plan 2014 (SEETO, 2014). SEETO carries out a variety of activities to support the SEE economies in their struggle to improve road safety. These include the Road Safety Working Group which has drafted Road Safety Audit Regulations and Action Plans for implementation, and provides training and guidelines for road safety auditors in the region.

On average, SEE economies achieve a score of 3.1 on the road safety strategy indicator, ranging between 1.5 for Bosnia and Herzegovina and 4 for Albania and Serbia (Figure 11.14). All of the SEE economies have adopted a national road safety strategy, either as a stand-alone document or as a key component of their national transport strategy. Most strategies provide targets and envisage monitoring reports, but Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo are yet to publish annual updates.

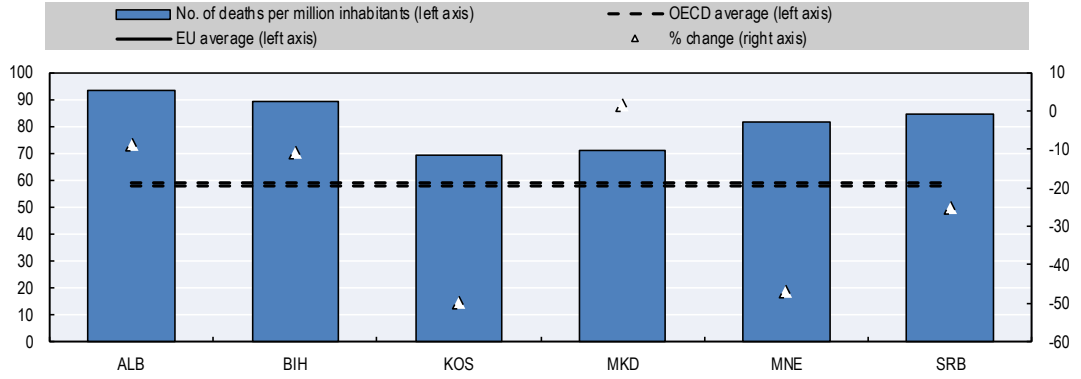
The effectiveness of road safety policies to date can be gauged by the number and reduction of road deaths (Figure 11.15). In 2015, the numbers of road fatalities per million inhabitants were higher in the SEE economies than the EU and OECD averages. Kosovo and the Former Yugoslav Republic of Macedonia performed better than the other economies, while Albania continues to have the highest fatality rate. However, all of the SEE economies except the Former Yugoslav Republic of Macedonia recorded improvements over the period 2005-15, with Kosovo and Montenegro achieving the largest reductions in fatalities.

The economic cost of road crashes at the national level remains high. For example, national estimates place this cost at 4% of GDP in Bosnia and Herzegovina (Ministry of Communication and Transport, 2016). These socio-economic losses were calculated using the gross output or human capital method (World Bank, 2012). According to a recent study by SafetyCube, a European Commission-supported Horizon 2020 project, the cost of road crashes in European countries range from 0.4% of GDP in Ireland to 4.1% of GDP in Latvia depending on the model used (Wijnen et al., 2017).

Two main barriers need to be overcome before road safety strategies can be more effectively implemented. First, responsibilities at the national level are not always clear, particularly over enforcement at roadside checks and vehicle inspections. The creation of national road safety councils, as in Montenegro and Kosovo, could be useful for promoting co-ordination. Such co-ordination is necessary, as safety is the result of

decisions at both national and local level in areas such as regulations, road maintenance and promotion campaigns.

Figure 11.15. **Road fatalities (2015) and percentage change over 2005-15**



Note: Data for Kosovo refer to the period 2005-14. SEE statistical offices and ministries provided economy-specific data as part of the *Competitiveness Outlook* assessment conducted in 2016-17.

Source: SEE statistical offices; Ministry of Infrastructure of Kosovo (2015), *Sectorial Strategy and Multimodal Transport 2015-2025 and the Action Plan for 5 Years*, www.kryeministri-ks.net/repository/docs/SECTORIAL_STRATEGY_AND_MULTIMODAL_TRANSPORT_2015-2025_AND_ACTION_PLAN_FOR_5_YEARS.pdf; OECD (2017c), "Transport safety: Road injury accidents", http://stats.oecd.org/Index.aspx?DataSetCode=ITF_ROAD_ACCIDENTS.

StatLink http://dx.doi.org/10.1787/888933705670

Second, insufficient budgets are often blamed for poor enforcement and data analysis. Currently road safety projects do not typically undergo efficiency analysis as part of national prioritisation frameworks (see the planning sub-dimension), meaning economies might miss out on opportunities to make better use of the limited resources available.

High environmental impacts of transport undermine its sustainability

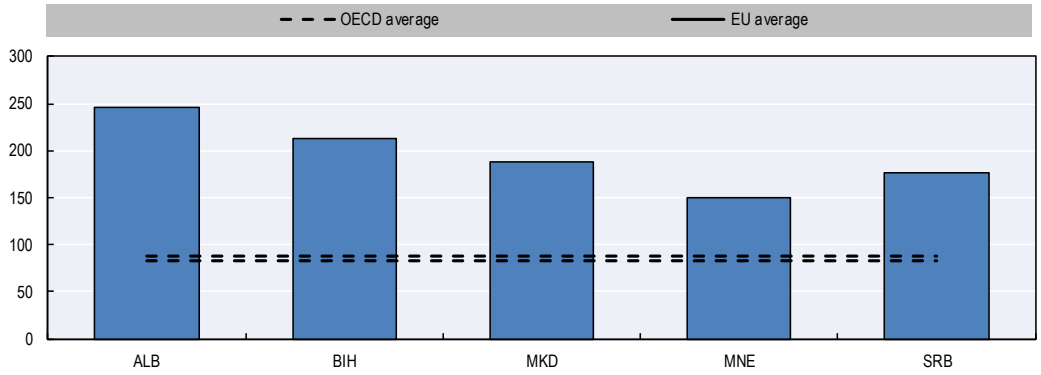
The sustainability of transport heavily depends on its environmental performance; reducing congestion, dependence on fossil fuels and energy consumption would all promote competitiveness as well as improve the quality of the environment. Overlooking today's environmental impacts risks jeopardising future efforts to improve competitiveness across the region.

The environmental performance of the SEE economies in the transport sector is worse than the EU and OECD averages. Figure 11.16 tracks carbon dioxide (CO_2) emissions from transport activities. CO_2 emissions do not just have an impact on global climate change, but also illustrate the dependence of an economy on fossil fuels. When weighted by GDP, emissions are particularly high in Albania and Bosnia and Herzegovina. The economy with the least carbon-intensive transport sector is Montenegro.

Figure 11.17 shows exposure levels to ambient fine particulate matter ($PM_{2.5}$). These are defined as the average level of exposure to concentrations of micro particles which are capable of penetrating into the respiratory tract and causing severe health damage. Exposure is calculated by weighting mean annual concentrations of $PM_{2.5}$ by population in both urban and rural areas. $PM_{2.5}$ is a by-product of transport activity – the high levels of pollution recorded in metropolitan areas in the SEE economies raise questions about the long-term health impacts of urban transport systems.

Figure 11.16. **CO_2 emissions from transport per unit of GDP (2014)**

Tonnes per unit of GDP



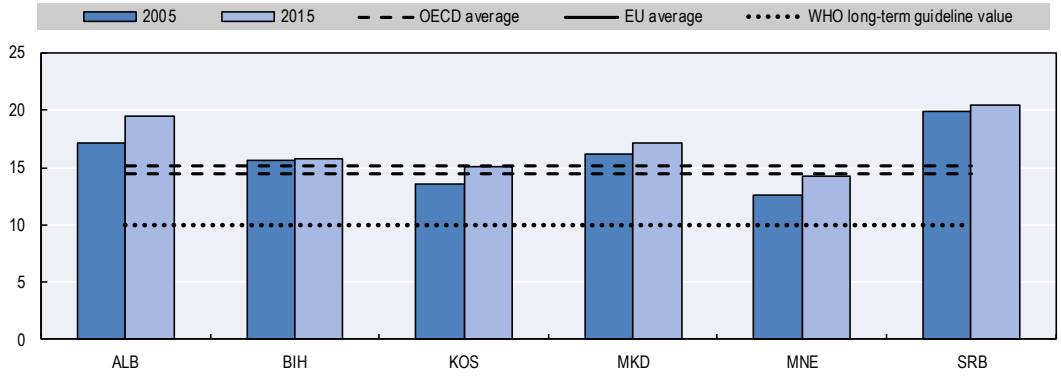
Note: Data for Kosovo not available.

Source: IEA (2016) "CO_2 emissions by product and flow", http://dx.doi.org/10.1787/data-00430-en; World Bank (2017b), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933705689

Figure 11.17. **Exposure to $PM_{2.5}$ in metropolitan areas (2005 and 2015)**

Micrograms per cubic metre



Note: Data refer to the macro-region of the capital; $PM_{2.5}$ – fine particulate matter.

Source: OECD (2017d), "Air quality and health: Exposure to air pollution", http://stats.oecd.org/Index.aspx?DataSetCode=EXP_PM2_5_FUA; WHO (2006), *WHO Air Quality Guidelines for Particulate Matter, Ozone, Nitrogen Dioxide and Sulfur Dioxide: Summary of Risk Assessment*, http://apps.who.int/iris/bitstream/10665/69477/1/WHO_SDE_PHE_OEH_06.02_eng.pdf.

StatLink http://dx.doi.org/10.1787/888933705708

On average, SEE economies achieved a score of 1 for the environmental sustainability strategy indicator, with scores ranging between 0.3 (Bosnia and Herzegovina) and 2.5 (Albania) (Figure 11.14). The SEE economies have not yet developed comprehensive environmental sustainability strategies to reduce the environmental impact of their transport systems. Nonetheless, there are examples of policies to improve environmental performance across the region. Albania has drafted a cross-sector Environmental Strategy (to be adopted by the end of 2017) which contains emission targets (such as reducing

$PM_{2.5}$ concentrations by 12% in the medium term) and enforcement measures (such as vehicle emissions controls). Bosnia and Herzegovina has approved a State Action Plan on emission reductions from aviation, launching four environmental research projects in 2016, while Serbia plans to increase the use of electric vehicles. Cities are also taking action: Belgrade city council in Serbia has launched a new Action Plan for the Development of Transport Infrastructure in Belgrade accompanied by a strategic environmental assessment, and Albania's capital Tirana has laid out similar goals in its long-term plans.

Long-term competitiveness needs efficient logistics chains

Well-functioning logistics, both domestically and internationally, are a precondition for national competitiveness (Arvis et al., 2014). Physical, administrative and informal restrictions can be obstacles to the movement of goods, and congestion causes bottlenecks which hinder the expansion of international trade across the SEE economies. Removing these barriers would have a positive impact on long-term economic growth and competitiveness while contributing to environmental and safety goals.

The logistics strategy indicator measures whether the SEE economies are developing and implementing integrated logistics strategies that that promote an international corridor approach and intermodal solutions. On average, SEE economies score 0.3 for this indicator, ranging between 0 (Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo) and 1 (Serbia) (Figure 11.14). While none of the SEE economies have a dedicated, comprehensive logistics strategy, the majority of national transport strategies include elements of logistics performance improvements, such as:

- Co-modality: there are promising plans to enhance transhipment facilities in the region, for example the creation of new intermodal terminals in the Former Yugoslav Republic of Macedonia (Trubarevo), Albania (Durres terminal), Bosnia and Herzegovina (Tuzla), Kosovo (Fushe Kosove) and Serbia (Batajnica, Belgrade).
- Technology and regulation: Serbia leads the way in this field, for instance having reached a high level of interoperability in inland waterways including by actively participating in the EU Strategy for the Development of the Danube Region and signing relevant agreements with its neighbours.
- Corridor approach: Albania is working on enhancing logistics performance along the Durres-Tirana corridor which has been identified as a priority for road investment, rail rehabilitation and terminal development.

A growing number of countries in the OECD are developing comprehensive logistics strategies, but reforms in this area are slow and complex – the low scores in the SEE economies should be viewed as a starting point which can be improved upon over time, following good practices such as those described in Box 11.3. Logistics strategies that promote co-modal solutions are most effective when applied to key corridors that host large freight volumes.

Box 11.3. Good practice: Dedicated logistics strategies in International Transport Forum member countries

Several ITF member countries have made efforts to develop dedicated national logistics strategies, extending beyond freight transport policies.

Germany is the reference case in this area, given its industrial and commercially leading position in Europe and the prominence given to its freight transport and logistics system, a key element of its competitiveness. Three of the six biggest global logistics providers are based in Germany (DHL, DB Schenker, and Kuehne and Nagel), and the country is first in the World Bank's LPI ranking. After developing a strategic Freight Transport and Logistics Masterplan, building on a dialogue phase that involved all stakeholders, Germany adopted its Freight Transport and Logistics Action Plan – Logistics Initiative in 2010. Its key objectives are to:

- strengthen Germany's position as a logistics centre
- enhance the efficiency of all modes of transport
- interconnect different transport infrastructure modes in an optimum manner
- ensure that transport growth is compatible with environmental protection and climate change mitigation
- support good working and training conditions in the freight transport industry.

In France, following an initiative by parliament, a national conference on logistics was organised in 2015. This was prepared by a scientific committee and established the current situation and future developments. The government has approved France's first strategic plan for logistics (France Logistique 2025), centred around six main topics and A dedicated steering committee has been established.

1. workforce skills and education
2. compatibility of logistics chains in regional and urban areas
3. research and innovation in logistics technology and management
4. optimising infrastructure usage
5. harmonising and simplifying regulation
6. performance measurements.

Morocco is a significant example of an emerging country that considers logistics as a key factor in its development. The Ministry of Transport is also named the Ministry of Logistics, and has a dedicated agency, the Moroccan Agency for the Development of Logistics, in charge of implementing a national strategy approved at the highest state level. The strategy includes the development of a network of logistics centres in Morocco's main regions, as well as new infrastructure necessary to modernise the sector.

The International Transport Forum also supports the creation of national logistics observatories alongside the development of logistics strategies, for example supporting the Turkish and Chilean governments in this area. In order to evaluate the impact of logistics sector on social and economic development, logistics observatories need to be able to access and disseminate meaningful activity data and develop key performance indicators to track the competitiveness of freight transport services and logistics operations. Observatories should also develop robust statistical and analytical methodologies in collaboration with international and national experts.

Source: Adapted from Savy (2016), *Logistics as a Political Issue*, http://dx.doi.org/10.1080/01441647.2016.1182793; ITF/OECD (2016a), *Logistics Development Strategies and Performance Measurement*, www.itf-oecd.org/sites/default/files/docs/logistics-strategy-performance-management.pdf.

The way forward for sustainability

As the growth in transport generates a range of external costs and can raise logistics costs, the six SEE economies need to make sustainability, resilience and long-term competitiveness part of their central policy objectives.

Full implementation of road safety strategies will require further efforts to co-ordinate enforcement actions and policies at the national level, building on the progress made to date. The Former Yugoslav Republic of Macedonia in particular should aim to start reducing road fatalities and collisions. International co-operation can also be extremely helpful in this field, through dedicated fora such as SEETO and the International Road Traffic and Accident Database (IRTAD). Serbia's involvement in IRTAD has helped it to benchmark its safety legislation against OECD/ITF countries and to identify the most vulnerable users through in-depth data analysis.

The environmental costs of transport activity are high across the region and **the SEE economies may wish to adopt new instruments and policies at the national, sectoral and sub-national levels to reduce negative impacts such as pollution**. These could include reformed schemes to charge polluters for their emissions to internalise environmental costs. The SEE economies should consider promoting data collection efforts and impact assessment studies to identify the most efficient path towards reducing emissions from transport. Renewing the vehicle fleet, promoting a modal shift away from roads and introducing cleaner technologies should be key elements of any strategy, in line with EU goals to reduce CO_2 emissions and break the transport system's dependence on oil.

There is room to **improve logistics strategies further across the region**. Logistics costs can be brought down through co-ordinated efforts focusing on co-modal solutions along international corridors. As greener logistics not only promote better environmental performance, but also improve competitiveness, this offers the SEE economies a win-win opportunity, building on international best practice.

Conclusions

The six SEE economies have made good progress towards improving their transport competitiveness. New strategies at the national level, if effectively implemented, will provide high-level guidance for infrastructure planning and regulatory harmonisation. Recently approved frameworks for project selection enable decision makers to prioritise projects in a more transparent way. Legislative and regulatory advances (in rail, aviation and road markets) are set to accelerate harmonisation with EU rules and to provide more certainty to private investors. Better institutional mechanisms and stricter policies for road safety have helped to reduce road fatalities across the region.

A number of challenges lie ahead in the transport sector. The economies should align their plans for infrastructure development, sustainability and logistics performance more closely to exploit synergies. They ought to apply new frameworks for economic scrutiny of investment projects, and recommended procurement guidelines, to all major transport projects. In addition, they need to factor in maintenance needs to all decision making at the early stages to ensure that, over time, they rebalance their public budgets away from new investment and towards making their infrastructure more resilient. Appropriate human, financial and technical resources will be fundamental for ensuring effective implementation of newly approved policies and strategies – including better data and simulation models.

Across all aspects of transport policy, international co-operation will be critical and the SEE economies should aim to make the most of existing programmes as well as the Transport Community Treaty.

Notes

1. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
2. The indicator on the availability and use of ICT is not specific to transport. It evaluates the availability and quality of information and communications technology as approximated by the use of mobile telephones and the Internet by the population at large, by companies, for business transactions and by the government to interact with citizens. It also takes into account the quality of Internet access, as broadband access has become the norm, to fully leverage the potential of the Internet and hence also promote ICT in the infrastructure sector.
3. The breadth of an economy's merchandise exports, for example, is measured by the difference between the distribution of its exports across destination countries and the rest of the world's distribution of merchandise imports.
4. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
5. These licenses enable hauliers to undertake an unlimited number of multilateral freight operations in the 43 European states participating in the system.

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Annex 11.A1.
Transport policy and performance: Indicator scores

Table 11.A1.1. **Transport policy and performance: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Planning						
Transport vision	2.5	1.7	4.0	2.5	2.0	3.0
Transport project selection	2.5	0.5	0.0	2.5	1.0	3.0
Implementation and procurement	3.0	0.7	2.0	1.0	1.0	2.0
Asset management	2.0	2.0	1.0	2.0	1.0	1.5
Governance and regulation						
Rail regulation	4.0	1.0	4.0	3.0	2.5	4.0
Aviation regulation	3.0	3.5	2.0	2.5	2.5	4.0
Road market regulation[1]	X	X	X	X	X	X
Sustainability						
Road safety strategy	4.0	1.5	2.5	3.5	3.0	4.0
Environmental sustainability strategy	2.5	0.3	1.0	1.0	0.5	1.0
Logistics strategy	0.5	0.0	0.0	0.0	0.5	1.0

Note: 1. Given the complexity of assessing these rules and the coexistence of regulations at different level, this assessment does not provide a score for the indicator on road market regulation. X – this indicator was assessed and not scored.

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Chapter 12.

Energy policy in South East Europe

This chapter on energy policy assesses the policy settings, strategies, processes, and institutions in six South East European economies. After a brief overview of energy trends and performance in South East Europe, including the reliability of energy supplies, energy intensity and trends in prices, the chapter then focuses on four essential sub-dimensions. The first, governance and regulation, examines the extent to which overarching energy policy is comprehensive and has clear objectives, and the ability of the national regulatory agency to carry out its critical role. The second sub-dimension, sustainable development, evaluates policies on renewable energy and energy efficiency. The third, energy security, considers policy frameworks for electricity and gas, and emergency and crisis management. Finally the fourth sub-dimension, energy markets, analyses progress towards the formation of a single regional market. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions in order to manage energy well, which in turn would foster the competitiveness of these economies.

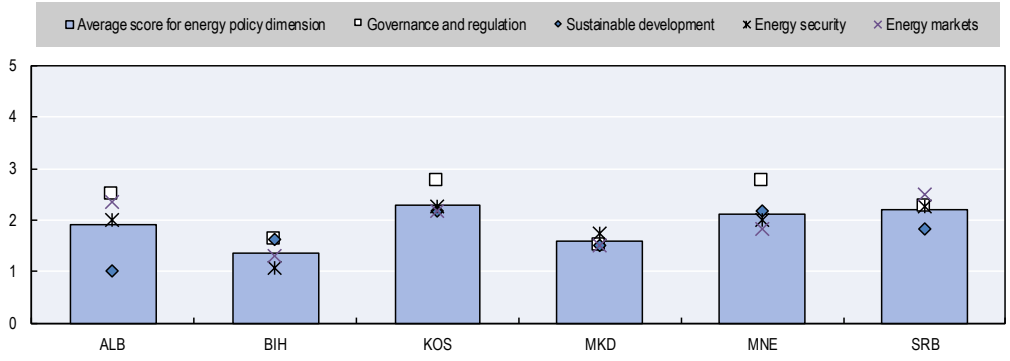
Main findings

It is difficult to overstate the fundamental importance of the energy sector for any economy. Energy enables production and consumption, transforming the lives and well-being of all citizens. Energy policy which delivers a reliable, environmentally sustainable energy supply at efficient prices enhances productivity and thereby advances the competitive potential of the entire economy.

Energy sector reform improves competitiveness by moving away from vertically integrated structures, restricting regulation to the core networks which are natural monopolies, and introducing competition into the energy services that are supplied over the networks (Newbery, 2002).

Taken together, the six SEE economies assessed in this report – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia – score an average of 1.9 for the energy policy dimension. This indicates that they have all taken important steps to establish comprehensive policy, legal and regulatory frameworks across all four sub-dimensions: governance and regulation, sustainable development, energy security and energy markets. Scores higher than 2 signify that some implementation of policy has taken place and effective monitoring of progress is planned or undertaken (Figure 12.1).

Figure 12.1. **Energy policy: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

No direct comparison with the 2016 *Competitiveness Outlook* assessment can be made, because this is the first time that the energy sector has been assessed.

Achievements

All six assessed SEE economies have taken steps to improve the competitiveness of their energy sectors. They have either developed policy frameworks that set direction and objectives across sub-dimensions, or are actively developing comprehensive policy

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

frameworks. Kosovo and Serbia have the highest average scores across the entire energy policy dimension (2.3 and 2.2 respectively), due in large measure to their relatively strong performance in establishing Third Energy Package-compliant legislative and regulatory frameworks,[1] and their progress in implementing their policy frameworks.

All six economies recognise the positive competitiveness effect of regional energy market formation, and have committed to the Western Balkans Connectivity Agenda,[2] which is a strong high-level driver of reform.

The six SEE economies have identified gaps in their energy infrastructure. Working together and with the Energy Community Secretariat, they have established a priority list of ten Projects of Energy Community Interest (PECI): six projects on electricity transmission, three projects on gas transmission and one on oil transmission. The ten selected projects will benefit from streamlined issuing of permits and the possibility of regulatory incentives, cross-border cost allocation, and funding under the European Union's (EU) Instrument for Pre-Accession Assistance and the Neighbourhood Investment Facility. In addition, two electricity and eight gas projects have been approved as Projects of Mutual Interest with the EU.

Remaining challenges and key recommendations

- **Remain committed to reforming national and regional energy markets.** Energy sector reform is an ongoing and intense challenge. It will require sustained political and institutional will if the economies are to achieve both national and regionally shared objectives by implementing the adopted legislative and regulatory frameworks.
- **Adopt and implement urgently the EU Third Energy Package-compliant primary and secondary legislation.** At present compliance with the EU Third Energy Package is patchy at best, but is an essential prerequisite for the interoperability of the SEE and EU energy systems, as well as for improving the productivity and competitiveness of the sector at regional and national levels.
- **Ensure that energy policy strategies and action plans set out measurable objectives and outcomes**. Current strategies and policies do not always include well-defined objectives and outcomes and therefore lack focus. As a consequence reform may be slow, and the evaluation and monitoring of progress is problematic.
- **Implement energy policy fully, including action plans and strategies.** Key aspects of several sub-dimensions have not been implemented. In particular, the strategies and action plans in the sustainable development sub-dimension have not been fully implemented, which is disappointing given the considerable potential for renewable energy sources (RES) and energy efficiency to give the SEE region and economies a significant competitiveness boost. The sustainability of the energy sector and the competitiveness of the region's economies is further threatened by plans for substantial new investments in coal-fired power plants.
- **Strengthen administrative and institutional capacity and provide additional resources**. Adequate institutional and administrative capacity is a prerequisite for effective energy sector reform. However in assessing almost every sub-dimension concerns were raised about insufficient human and/or financial resources within some national and municipal administrative authorities and regulatory agencies. Pressure on skills and financial resources is likely to increase due to the dynamic

nature of EU energy policy, and as administrative and regulatory institutions expand their competence across the whole range of energy sector functions.

Context

Energy policy typically addresses three overarching objectives: energy security, environmental protection, and competitiveness and economic development. These objectives are particularly pertinent for the SEE economies, which have important energy challenges. All six SEE economies are generally net importers of energy, which means that security of supply is a concern. Similarly the region as a whole urgently needs to modernise its energy infrastructure, which is degraded and sparse in places. As a result, consumers and industry experience somewhat unreliable power supplies, and access to energy is further constrained by the affordability of power. Achieving the required levels of investment will be especially challenging in the current macroeconomic context. The region as a whole has relatively high greenhouse gas emissions, limited deployment of renewable energy sources other than large-scale hydropower, and relatively high total energy intensity compared to its European Union (EU) neighbours.

For these and other reasons, including political instability, energy sector reform is arguably one of the most complex issues facing the six SEE economies. It is also one of the most urgent because these challenges act as a brake on productivity. As the SEE economies work to align their power sectors with the EU energy market, they are implementing liberalisation programmes which will restrict regulation to the core networks, which are natural monopolies, and introduce competition to the energy services that are supplied over the networks. Incumbent state-owned and vertically integrated enterprises are being unbundled and new market participants encouraged to enter the sector. This approach, which is the basis for EU energy policy, rests on evidence that competition in energy services improves efficiency and encourages innovation (Newbery, 2002), thus increasing competitiveness.

At a time when the nations of the world are coming to regard the transformation to a low-carbon energy system as one the key priorities (IEA, 2016b), the sheer scale of the task of energy sector liberalisation places a considerable burden on institutions. This burden is only intensified by the rapidly increasing focus on environmental protection. But while the six SEE economies face shared challenges, they also share strong resource endowments, including unexploited renewable energy potential, some of which could already be cost competitive (IRENA, 2017), and they have significant potential for improving energy efficiency.

The importance of energy to competitiveness and economic development means it has links to many other policy areas. The most pertinent policy overlaps covered in this *Competitiveness Outlook* include:

- **Chapter 1**. **Investment policy and promotion** are more likely to succeed where energy supplies are secure. These affect an economy's investment attractiveness but can also constitute important destinations for foreign direct investment. The transition to low-carbon economies requires the mobilisation of investment in green energy infrastructure, renewables and energy efficiency.
- **Chapter 11. Transport policy,** through measures to increase the share of electric transport in urban areas.

- **Chapter 13. Environmental policy,** through measures such as raising awareness and shaping consumer behaviour to reduce greenhouse gas emissions, improve air quality and reduce energy intensity.
- **Chapter 15. Tourism,** as the policy of expanding tourism across the region implies an increased demand for power, particularly in the hot summer months when air conditioning places a heavy load on electricity systems.

Energy policy assessment framework

This chapter presents an analysis of energy policy in the SEE region. The analysis focuses on the following four broad sub-dimensions:

1. Governance and regulation: is the energy sector subject to strong governance? Are policy objectives clear and measurable? Is the national regulatory agency independent of political and other influences?
2. Sustainable development: are renewable energy and energy efficiency policies prioritised? Are policy frameworks and rules to support investment in renewables and energy efficiency transparent and market-based? Are measures to increase public awareness of energy efficiency and renewable energy sources in place?
3. Energy security: does energy policy reflect supply and demand so that consumers and businesses can rely on a continuous energy supply? Are investment plans informed by robust estimates of future demand and consistent with obligations under international treaties and agreements? Are firm plans in place to deal with a major supply interruption?
4. Energy markets: are companies in the energy sector vertically integrated and vulnerable to monopolistic behaviour, or are they managed and operated by separate entities? Is access to transmission grids by third parties allocated on a transparent and fair basis? Are energy markets open to energy trade across borders underpinned by harmonised market rules on a regional level?

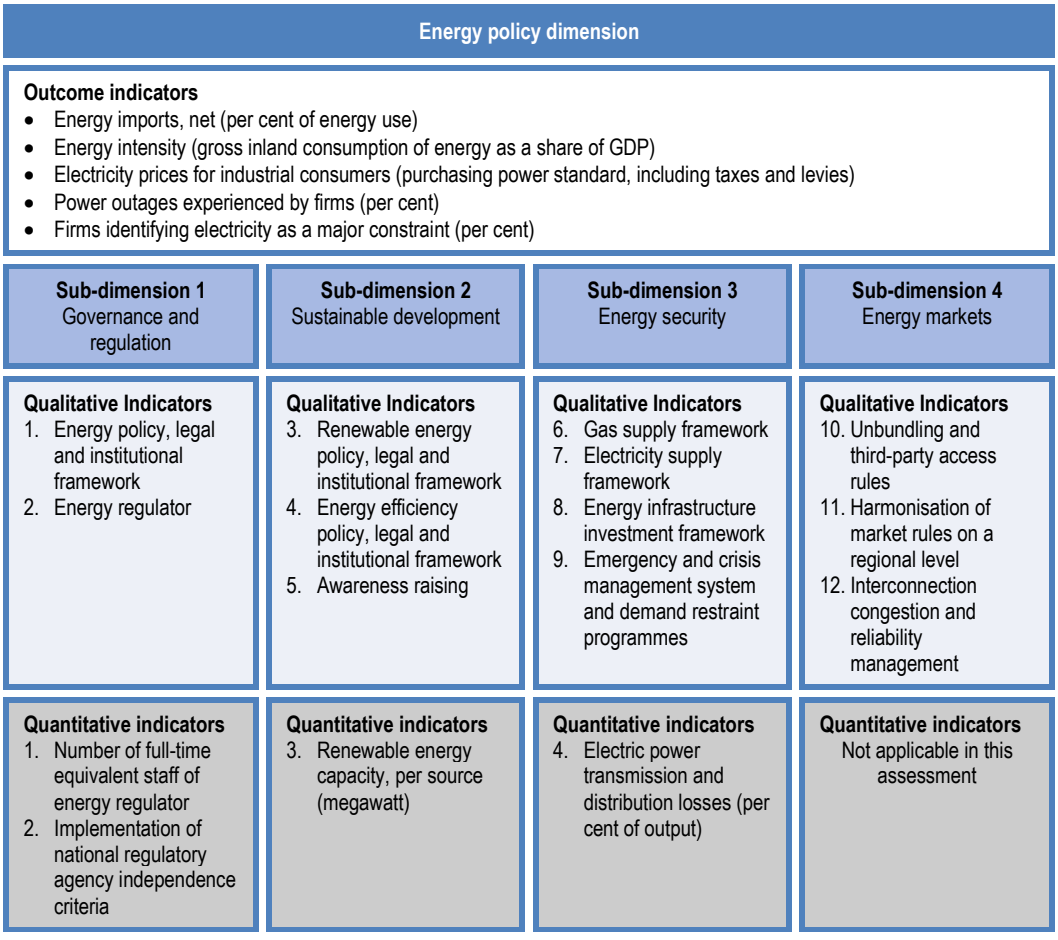
Figure 12.2 shows how the sub-dimensions and their constituent indicators make up the energy policy dimension assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Quantitative indicators are based on national or international statistics. The qualitative indicators have been scored in ascending order on a scale of 0 to 5, and are summarised in Annex 12.A1.[3] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Energy policy performance in the six SEE economies

In addition to the potential to release well-recognised improvements to competitiveness, three factors motivate SEE energy sector reform. First, the six SEE economies are either candidates or potential candidates for accession to the EU, which means that they are committed to aligning their legislative and regulatory frameworks for energy with those of the EU. Second, since the financial crisis of 2008, the scope for macroeconomic support has become weaker, which creates an imperative for private (rather than public) investment. Third, existing energy networks are relatively weak and much of the installed generation capacity is in need of replacement. Taken together, these factors imply significant investment requirements.

Energy policy in the SEE economies should be considered with reference to EU energy policy – they are intimately related through the Energy Community, to which all SEE economies are Contracting Parties. The key objective of the Energy Community is to create an integrated pan-European energy market across the EU and its neighbours by extending EU energy market rules across the SEE region. Membership of the Energy Community requires economies to harmonise their energy policies, legislation and regulatory frameworks with those of the EU, and is a necessary condition to attract private-sector investment to the region.

Figure 12.2. **Energy policy assessment framework**



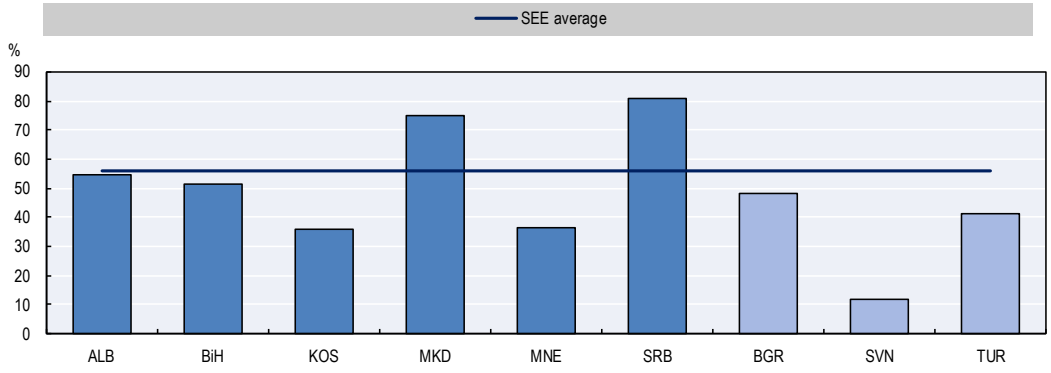
The first objective of energy policy is to ensure a secure and reliable energy supply. Achieving this objective can be a challenge in a region where energy infrastructure – particularly electricity transmission and distribution networks – is sparse (e.g. in rural areas), or degraded due to, among others, underinvestment. Consumers and businesses in the SEE economies sometimes go without electricity due to issues with both quality of supply and affordability.

Figure 12.3 reveals that, on average, almost 56% of firms in the SEE economies experienced electrical outages in 2013 (World Bank, 2017a). While not radically different from similar economies Bulgaria, Slovenia and Turkey, this is particularly significant for the six assessed economies given that access to natural gas supplies is patchy at best, with Albania, Kosovo and Montenegro not connected to gas pipelines. This means that

businesses and industry rely on the electricity sector to a large degree. This uncertainty in energy supply is detrimental to consumer welfare and, crucially, undermines national competitiveness. Reliable energy supplies are critical to the competitiveness of local industries and businesses, and an important signal for potential investors.

The six SEE economies are committed to improving energy infrastructure, and considerable progress has been made in recent years. The pipeline of investments in energy infrastructure in place aims to improve energy security further, address remaining historic weaknesses and accommodate rapid technological change. These include key infrastructure projects, especially cross-border projects that link the energy systems of more than one EU/Energy Community country, supported under the initiatives Projects of Energy Community Interest and Projects of Common Interest.[4]

Figure 12.3. **Percentage of firms experiencing electrical outages (2013)**



Note: BGR – Bulgaria; SVN – Slovenia; TUR – Turkey.

Source: World Bank (2017a), *Infrastructure* (database), www.enterprisesurveys.org/data/exploretopics/infrastructure#all-countries.

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The commercial and technical availability of energy can be enhanced by regional markets enabling demand to be met from abroad. Currently, while infrastructure to support cross-border trade in electricity is relatively good compared to for example that between EU Member States, capacity is not used optimally. Often unilaterally declared congestion over the interconnectors is a binding constraint on the extent to which security of supply can be boosted in this way. However, as Contracting Parties to the Energy Community, the SEE economies have agreed to form a regional SEE energy market. In 2016 they reinvigorated their commitment by participating in the Western Balkans Six (WB6)[5] and Central and South-Eastern European Gas Connectivity (CESEC)[6] regional initiatives.

Security of supply is linked to sustainable development through the diversification of fuel sources. The six SEE economies enjoy a good energy resource endowment, with large deposits of coal and lignite, and all except Kosovo have substantial hydropower potential. Historically these mature technologies have dominated electricity generation, and indeed still do. By virtue of substantial hydroelectric installed capacity and the extensive use of firewood, the six economies use a higher proportion of renewable energy than the EU average, although neither of these energy sources is necessarily produced sustainably. For example, the widespread use of firewood for domestic heating in many SEE households is beginning to pose a serious threat to forests (SEE Change Net, 2016a, 2016b).

The SEE economies have around 8.5 gigawatts (GW) of installed hydropower capacity, of which 0.6 GW is in small hydropower plants (ECS, 2017b). In addition to the substantial large hydropower capacity, several economies have plans to install more hydropower plants (both large and small). In Montenegro, for example, plans to develop two new large hydropower plants have been in place for almost a decade. In Albania developments of medium-sized plants have gained momentum lately and are progressing well. For example the Banja hydropower plant on the Devoli River was commissioned in 2016 and is operational. Although these and similar plans have the potential to deliver emissions reductions, they raise serious questions about the wider environmental impact and potentially important negative effects on local communities and on tourism. Large hydropower plants change the surrounding environment, affecting land use, homes and natural habitat. For example they may obstruct fish migration and affect populations.

However despite the contribution of hydropower, the large proportion of coal and lignite burned across the region means that greenhouse gas emissions per unit of national income are relatively high. For example, carbon dioxide (CO_2) emissions in Austria – measured in kilograms per USD of gross domestic product (GDP), purchasing power parity (PPP) adjusted – were 0.1 kg per PPP USD of GDP in 2014. In Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia the respective CO_2 emissions were 0.2, 0.6, 0.3, 0.2 and 0.4 kg per PPP USD of GDP (World Bank, n.d.). There is considerable scope to increase both the security of supply and the sustainability of the energy sector by diversifying fuel sources.

In addition to hydropower potential, the six economies are endowed with solar irradiation and wind speeds which would make solar photovoltaic (PV) and onshore wind cost competitive in many locations (IRENA, 2017). However, installed capacity of these technologies is practically non-existent at present (see Table 12.1). Renewables are promoted through a range of policy initiatives including rules for grid connection of renewable generation, obligations for the purchase of renewable power specified in secondary legislation such as grid codes and rule books, and subsidies to generation from renewables. All six SEE economies operate subsidy schemes to encourage the use of renewables. Feed-in-tariffs (FITs) oblige the public energy supplier to pay an agreed tariff for the electricity generated from renewable energy sources which provides the generator with a guaranteed revenue stream and so reduces the risk profile of projects. The details of renewable subsidies vary by economy, for example the technologies that are covered, the tariff rate and the duration of the subsidy.

In common with most other countries, the six SEE economies subsidise energy produced by traditional technologies. Subsidies on coal-based power generation, which imposes costs in terms of local air pollution and greenhouse gas emissions (Box 12.1), are widespread in the region. The International Monetary Fund (IMF) has found that within the SEE economies, Bosnia and Herzegovina, and Serbia had the highest post-tax energy subsidies as a proportion of GDP (37% and 35% respectively), while the share for the Former Yugoslav Republic of Macedonia was 19% and Montenegro 17% (IMF, 2015). In Albania, where electricity is almost totally generated from hydropower, energy subsidies amount to 2% of GDP. Data for Kosovo were unavailable. The level of energy subsidy for any economy is clearly inversely related to the consumption of coal (and lignite) used in electricity production. Given the potential welfare gains and improvement to competitiveness, as well as the reduced strain on public finances that could be derived from removing these subsidies, subsidy reform is a strong motivation for diversifying energy sources, specifically towards renewables. However it is undeniably a difficult policy choice which requires strong political support and the willingness to take a long-term view.

Box 12.1. The problem with energy subsidies

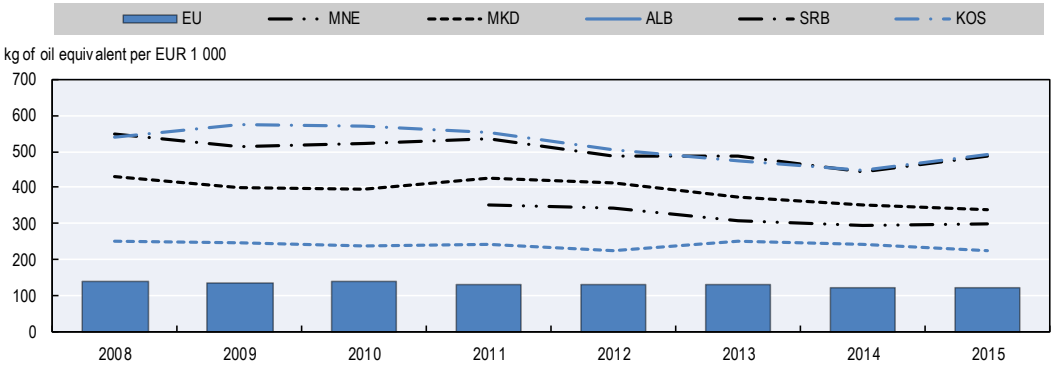
Energy subsidies, specifically the post-tax energy subsidies which arise when consumer prices are below supply costs, plus a tax to reflect environmental damage and an additional tax applied to all consumption goods to raise government revenues, are pervasive in almost all countries. The IMF has estimated that eliminating post-tax subsidies could raise global economic welfare by around 2.2% of GDP (IMF, 2015). Subsidies include not only direct payments to producers or consumers, but also tax concessions, price control mechanisms (i.e. tariffs and quotas) and environmental externalities such as pollution, and the associated human ill-health and habitat degradation due to burning fossil fuels (OECD, 2013). Energy subsidies:

- damage the environment by causing premature deaths, exacerbating congestion and increasing greenhouse gas (GHG) concentrations
- impose large fiscal costs which can constrain economic growth and damage competitiveness
- inhibit investment in energy efficiency, renewables and energy infrastructure
- are inefficient as a means of supporting vulnerable households.

The energy intensity (the energy required to produce one unit of GDP) of the six SEE economies is high compared with the EU average (Figure 12.4). Energy intensity is related to economic structures (e.g. industry, transport and residential sectors) and the status of an economy's structural transformation (e.g. Serbia has a large industrial sector, while Albania welcomes many tourists, fuelling a demand for air conditioning). While a shift towards services will, other things being equal, tend to reduce the energy intensity, the real energy efficiency gains will be derived from policies designed to increase the efficiency with which energy is used in the production of goods and services (or consumed by households).

Figure 12.4. **Energy intensity (2008-15)**

Gross inland consumption of energy divided by GDP



Note: Data for Bosnia and Herzegovina not available. Data for Montenegro from 2011.

Source: Eurostat (2017a), *Energy Intensity of the Economy* (database), http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsdec360.

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Energy efficiency can be improved across the SEE economies, including in the energy sector itself and in energy transformation. The challenges here vary from sector to sector, but in short, the more sectors are exposed to market forces, the more energy prices will drive investment in energy efficiency. In sectors less exposed to competition, there may be more market failures that have to be addressed. And reform of the energy transformation sector is critical to reduce the large amount of energy simply wasted through inefficiencies in turning primary energy supplies into final consumption. Another element to be aware of is the rebound effect, where paradoxically increasing energy efficiency can lead to greater overall energy use (Box 12.2).

Box 12.2. **Being aware of the rebound effect**

Technological progress may increase how efficiently energy resources are used, but the total use of energy resources may increase because greater energy efficiency can lead to increased demand (the rebound effect). For example, the gradual shift in the United States towards smaller vehicles, which began after the 1974 oil shock, went into reverse as cars got more fuel efficient. Disentangling these effects is complex because lower oil prices contributed to this result, but the rebound effect appears to be a factor. Somewhat different implications arise when the energy is being consumed by a business: it means more output per unit of energy consumed, whereas for households it may mean increased final consumption of heat or electricity, and hence an increase in welfare. This is particularly relevant where access to energy is limited by affordability. While there is some debate about the cost-effectiveness of energy efficiency investments, some authors argue for a nuanced analysis of energy efficiency policies which focuses on the economic efficiency of policy in the broadest sense, and explicitly evaluates the effect of the policy on people's welfare effects (e.g. Fowlie et al., 2015; McKinsey & Company, 2009; Gillingham et al., 2014).

Electricity prices in the SEE economies are higher than in the EU. Figure 12.5 shows that, measured by purchasing power standard, average prices for industrial customers in Bosnia and Herzegovina, and Serbia are slightly above the EU average, while those in the Former Yugoslav Republic of Macedonia and Montenegro are somewhat higher. Given the reliance on electricity resulting from limited gas availability, relatively high electricity prices undermine national and regional competitiveness, send a negative signal to potential investors and may constrain access to energy for both industrial and domestic consumers.

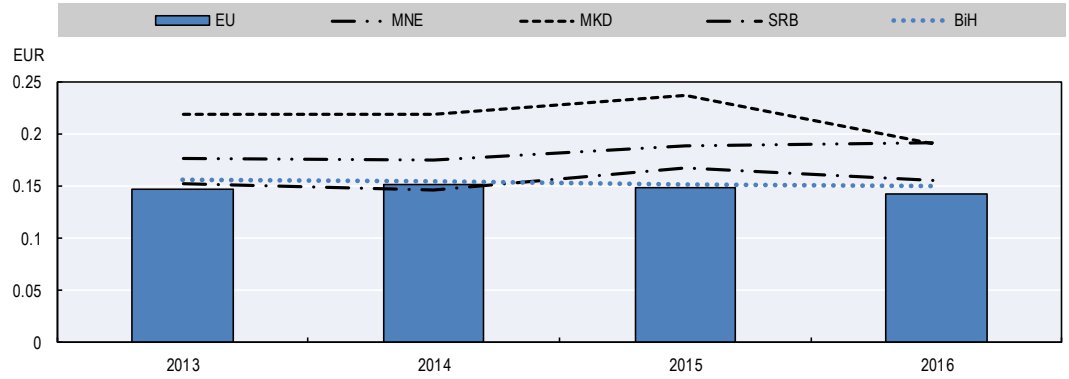
In response to a World Bank survey around 20% of firms in the region reported that electricity was a constraint to their business in 2013 (Figure 12.6). Clearly this constraint involves two aspects: the quality of the electricity supply, and the affordability of electricity. We note that the quality of supply has improved in recent years, particularly in Kosovo. Even so, with the majority of firms unable to resort to gas for their power needs, most economies have scope to improve access to electricity for businesses.

Governance and regulation

Good governance and a strong set of regulatory institutions underpin liberalised energy sectors. Good governance is derived from sound policies with clear objectives developed with the strong involvement of stakeholders, and that identify where accountability lies. Regulatory agencies must be competent to discharge a complex suite of responsibilities ranging from the most basic – ensuring that demand for power and investment requirements are met – to securing the efficient operation of the system and ensuring it has the flexibility to respond to new technologies (Newbery, 2002). The role of national regulatory agencies is particularly significant in countries where there is a tradition of high levels of state involvement in the energy sector, and/or state ownership of assets.

Figure 12.5. **Electricity prices for industrial customers (2013-16)**

Purchasing power standard per kWh, including taxes and levies

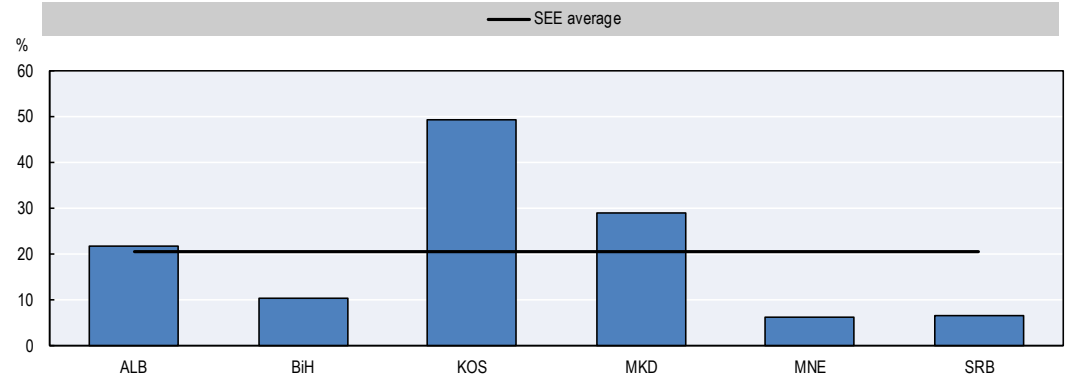


Note: kWh – kilowatt hour. Data for Kosovo and Albania not available.

Source: Eurostat (2017b), *Electricity Prices for Non-household Consumers* (database), http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nrg_pc_205&lang=en.

StatLink http://dx.doi.org/10.1787/888933705803

Figure 12.6. **Share of firms identifying electricity as a major constraint (2013)**



Source: World Bank (2017a), *Infrastructure* (database), www.enterprisesurveys.org/data/exploretopics/infrastructure#all-countries.

StatLink http://dx.doi.org/10.1787/888933705822

To encourage private investment, the regulatory agency must introduce rules which establish a level playing field so that potential investors, and all market participants more generally, are confident of being treated as favourably as any incumbents. For example, rules for investment in renewable generation, including the permit-issuing process and the terms of access to the grid for the energy generated, should be transparent and non-discriminatory. Similarly, the governance and operation of the regulator itself should be such that it is evidently independent of political or other outside influences.

Regulatory agencies also have a critical role in sectoral reform since they are instrumental in policy formulation, implementation and monitoring. As EU accession countries, the SEE economies are required to adopt and implement a set of laws and regulations relating to energy sector governance and regulation aligned with the

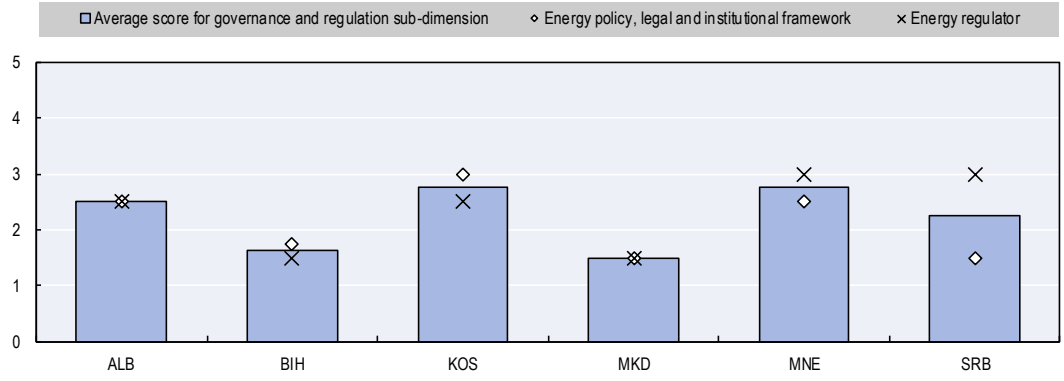
requirements of the EU Third Energy Package. National regulators perform important duties in this long and sometimes politically sensitive process.

The governance and regulation sub-dimension comprises two qualitative indicators:

- The **energy policy, legal and institutional framework** indicator evaluates the overall energy policy framework. A comprehensive policy framework, supported by strong primary and secondary legislation and accountable independent institutions, provides the economies with goals against which they can measure progress, and sends strong signals to investors about stability of returns which cover both the general energy policy framework and the regulatory environment.
- The **energy regulator** indicator evaluates the extent to which the national regulatory authority in each economy is equipped to carry out its functions effectively, and the extent to which it does so in practice.

Scores for these indicators are presented in Figure 12.7. Overall the SEE economies score an average of 2.2 out of 5 for the governance and regulation sub-dimension. That means that they have established an overarching energy policy that spans the various policy areas, and have proceeded to implement a proportion of the policies and strategies.

Figure 12.7. **Governance and regulation: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Energy policy, legal and institutional frameworks are progressing

On average the six SEE economies score 2.1 out of 5 for the overall energy policy, legal and institutional framework indicator. Individual scores range from 1.5 to 3 (Figure 12.7). The variation reflects the reality that several economies have made insufficient progress in two key aspects which are basic requirements for all the economies. The first is transposing a legislative framework that is fully aligned with the Third Energy Package. The second is the adoption of overarching strategies and policies based on stakeholder consultation which have both clear and measurable objectives, and defined actions and measures with timelines and budgets to meet them. Achieving both results in a score of 2, while more dynamic implementation and co-ordination of policy and legislation warrants a higher score.

The picture is mixed on the adoption of a comprehensive energy sector policy framework, including Third Energy Package-compliant legislation and clear, costed strategies and action plans. Albania, Kosovo and Montenegro have adopted primary

legislation that is broadly compliant across the energy sector and are drafting energy strategies and action plans which include the gas sector. However for all six economies, the adoption of secondary legislation is not consistent across the sector. Serbia is due to adopt a new energy strategy though the associated action plan for the sector is lagging somewhat behind.

Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia, score below 2. This indicates that they are still developing policy, legal and institutional frameworks and that relevant legislation is not adopted and/or fully aligned with the relevant Energy Community *acquis*. In the Former Yugoslav Republic of Macedonia, at the time of the assessment, the energy law was not yet Third Energy Package-compliant and a clear strategy for the whole sector, including measurable objectives, is not in place.

Progress on the legislative and policy framework in Bosnia and Herzegovina is complicated by its constitutional structure[7] and the fact that the state has limited responsibility for energy policy. In general, competence for energy lies with the entities, though there are exceptions. For example the State has some role in energy efficiency and renewables. The Republika Srpska has generally succeeded in adopting legislation and developing action plans to a slightly greater extent than Federation of Bosnia and Herzegovina. But it is fair to say that both in Bosnia and Herzegovina as a whole and the Former Yugoslav Republic of Macedonia, the legislative framework and implementing strategies and action plans are still in progress.

Energy regulators struggle with resource and independence issues

As discussed above, the energy regulator plays a crucial role in energy sector reform. The six SEE economies achieve an average score of 2.3 out of 5 for the energy regulator indicator (Figure 12.7). Scores range from 1.5 to 3. Montenegro and Serbia achieve 3, reflecting their well-developed sets of strategies for implementing the Energy Community *acquis* and energy sector development which address the need for capacity building and institutional development. Similarly both have clear strategies for the operation and objectives of the regulatory agency.

Resource shortages and limited institutional capacity affect many regulators and other institutions across the six SEE economies. For example, in Albania, Kosovo, Montenegro and Serbia the lack of both financial resources and skilled staff across the range of energy policy areas limits their regulators' effectiveness and ability to carry out their responsibilities fully, while the institutional structure of Albania's regulator was found to be inflexible and outdated. In the Former Yugoslav Republic of Macedonia and in Bosnia and Herzegovina, key problems relate to the restricted scope of competences within the agencies which limits their ability to implement Third Energy Package-compliant legislation.

Employment in national regulatory agencies has tended to rise over the past ten years in most economies. However the remit and workload of regulators are also expected to continue to grow over the foreseeable future as the WB6 and CESEC initiatives absorb more time and because of the dynamic nature of EU energy policy.

Regulatory independence underpins energy sector reform and ensures that regulators are free to act in the best interests of consumers. To achieve this objective, they should be protected from political influence and insulated from the regulated companies. That is, regulators should be both politically and functionally independent and not subordinate to any public body (ECRB, 2015). Potential investors regard regulatory independence as critical since it gives them confidence that all market participants will be treated equally

and transparently, without favouring incumbents. Transparency and fair treatment are important during the market reform phase that the SEE economies are undergoing, as the task of adopting legislation and developing policy is central. Regulators also play an important role in holding market participants to account in implementing policy and upholding their decisions as energy markets become more mature.

The SEE national regulators are expected to adopt and implement the best-practice independence criteria set out in the Energy Community *acquis,* and the Third Energy Package, which stresses the importance of regulatory independence. On the face of it, the national regulators have generally achieved a reasonable level of implementation of Energy Community Secretariat (ECS) independence criteria, although Bosnia and Herzegovina lags behind its neighbours (ECS, 2016). However the test of the true functional independence of the national regulators is their willingness to use the independence granted to them under the law and to take and uphold impartial decisions – the evidence for this is limited (ECRB, 2015).

The way forward for governance and regulation

Creating a Third Energy Package-compliant legislative framework is an early and critical milestone on the path of energy sector reform. **Where economies have yet to transpose and adopt Third Energy Package-compliant legislation, this should be done without delay.** In Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina would benefit from building on the working version of the framework strategy which will feed into the Bosnia and Herzegovina comprehensive strategic framework. The Republika Srpska would benefit from converting strategic objectives into concrete action plans including an implementation timeline.

But even with these frameworks in place, there is much work to be done in all SEE economies to **implement legislation through detailed, measurable strategies and associated action plans** for both indicators.

All SEE economies should ensure their national regulatory agencies have adequate human and financial resources to meet their obligations. Regulators should also have complete control of their institutional structures since they must be able to select how to deploy their resources to respond to changing EU and Energy Community legislative agendas and priorities. The test of regulatory independence is demonstrated by actions and decisions, therefore all regulators are urged to ensure that they are insulated from political and other influence by taking robust decisions and holding market participants to account where necessary. This will become increasingly important as SEE energy markets mature, new participants enter the markets and the regional market develops.

Sustainable development

Sustainable development in the context of this study focuses on renewable energy sources (RES) and energy efficiency. Given the mounting pressure on existing non-renewable energy sources globally, and the reliance of the six SEE economies on electricity as the main form of energy, the benefits of diversifying the energy mix through the expansion of RES has considerable potential to improve the competitiveness of the energy sector and the wider economy.

The SEE region as a whole has remarkably strong technical potential for renewable energy, particularly hydropower, wind and solar PV. Wind speeds in many locations are favourable and the region has generally high irradiation values. Further, the deployment

of large volumes of solar PV in SEE could be cost competitive. A recent study estimated that up to 15 GW of wind and 3.7 GW of solar PV could be deployed in the SEE economies cost-competitively today. By 2030 it may be possible to deploy up to 53 GW of wind and almost 13 GW of solar PV cost-competitively (IRENA, 2017).[8]

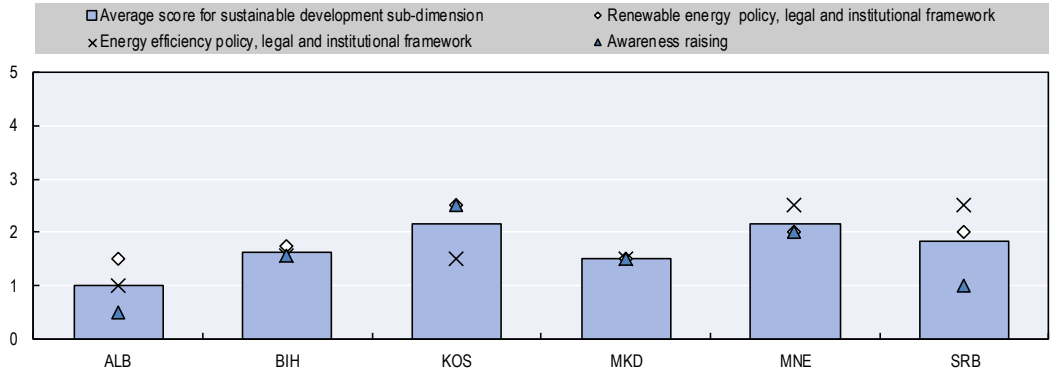
The SEE economies are in general more energy intensive than EU economies. For example, in 2015 the energy intensity of Kosovo and Serbia was almost five times the EU average, and even the least energy intensive of the SEE economies, Albania, was approximately 1.8 times as energy intensive as the EU average (Figure 12.4). This implies that there are large potential energy efficiency gains to be achieved across the region's economies. As noted above, energy intensity is related to both economic structures and structural transformation, and the large gains in energy efficiency will result from increasing the efficiency of energy use both in production of goods and services, and in domestic energy consumption.

The sustainable development sub-dimension includes three indicators:

- The **renewable energy policy, legal and institutional framework** indicator measures the extent to which policy intended to promote the use of renewables is in place, and how far it is implemented.
- The **energy efficiency policy, legal and institutional framework** indicator analyses the policy framework and action plans for energy efficiency measures, and the extent of implementation.
- The **awareness raising** indicator evaluates the policy framework for raising awareness of the importance of energy efficiency and RES among the public, businesses and in the public sector. Awareness-raising campaigns have been shown to be effective in changing behaviour by empowering consumers to make informed choices, and also in highlighting funding available for energy efficiency.

Overall, SEE economies scored an average of 1.7 out of 5 for the sustainable development sub-dimension (Figure 12.8).

Figure 12.8. **Sustainable development: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705860

National renewable energy and efficiency action plans exist, but implementation is at an early stage

Globally, the sustainability aspects of energy policy have gained considerable traction over the past few years, and the SEE economies have engaged with this agenda. The SEE economies together score 1.9 out of 5 on the **renewable energy policy, legal and institutional** framework indicator (Figure 12.8). This means that on average they generally have policy and action plans in place, including a National Renewable Energy Action Plan (NREAP), though implementation is some way behind. A score of 1.8 out of 5 for the **energy efficiency policy, legal and institutional framework** indicator suggests that the SEE economies have also begun to develop energy efficiency plans, including a National Energy Efficiency Action Plan (NEEAP). This is important in the light of the relatively high energy intensity of SEE economies and the scope for energy efficiency savings.

Despite having NREAPs and NEEAPs generally in place, there is some way to go in implementing them. Sustained pressure from the international community and the need to comply with international agreements, such as the Paris Agreement, will mean that governments will come under concerted and increasing pressure to not only develop but to fully implement their policies to address sustainable development.

Albania, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia score an average of 1, 1.6 and 1.5 out of 5, respectively, across all three indicators shown in Figure 12.8. These economies are in the process of developing comprehensive legal and regulatory frameworks to support sustainable development, but more work is required. For example, Albania adopted an NREAP in early 2016 but has not adopted an updated NEEAP, and other essential elements of the legislative framework are still under development. However, Albania did establish the Energy Efficiency Agency in late 2016. The Former Yugoslav Republic of Macedonia adopted its third NREAP in July 2017 but it does not comply with the Third Energy Package because it includes 2030 RES targets rather than 2020 targets. Bosnia and Herzegovina adopted the NREAP in 2016, but adoption of the NEEAP is pending.

Montenegro – with an average score of 2.2 across all three indicators – is the only economy to have adopted both the NREAP and third NEEAP, and its legislative framework is largely Third Energy Package-compliant, although secondary legislation is missing. Kosovo (average score of 2.2) has a legal and regulatory framework for sustainable development covering all three indicators, which mainly transposes the key requirements of the Third Energy Package. However, adoption of important elements of the sustainable development regulatory and legislative framework is still pending, including the third NEEAP and the Energy Efficiency Law to transpose the Energy Efficiency Directive.

Serbia (average score of 1.8 across all three indicators) adopted the third NEEAP in 2016 and transposition of the energy efficiency policy framework is relatively well developed. However the NREAP is non-compliant in many areas and deployment of RES remains almost negligible.

All the SEE economies are struggling to fully implement their NREAPs and NEEAPs where they have been adopted. In some cases this is due to missing primary and/or secondary legislation. For example, although Serbia has a relatively high level of compliance with the Third Energy Package, it lacks secondary legislation on energy labelling. In Albania legislation on biofuels for transport has been blocked for some time.

Across the sustainable development sub-dimension, numerous examples of enabling legislation and regulation are missing, which is hampering progress.

All six economies are also constrained by lack of institutional capacity and resources: almost every economy reports shortages in staff numbers and skills for working on sustainable development. Shortages are experienced in both ministries and municipalities. Similarly, financial resources constrain the ability of economies to implement their sustainable development policies.

Having said that, all SEE economies as Contracting Parties to the Energy Community have shown progress in the sustainability sub-dimension. For example Albania, Bosnia and Herzegovina, and Kosovo have adopted primary legislation in the past year (ECS, 2017a). Overall, however, existing policy measures have generally delivered only modest investments in solar and wind generation to date as shown in Table 12.1, which gives snapshots of installed capacity in solar and wind in 2010 and in 2016 (IEA, 2016a).[9]

Table 12.1. **Installed capacity: Wind and solar (2010 and 2016)**

Megawatts

		2010	2016
ALB	Wind	0.0	0.0
	Solar	0.0	0.0
KOS	Wind	1.4	1.4
	Solar	0.6	0.7
MKD	Wind	0.0	37.0
	Solar	0.0	17.0
MNE	Wind	0.0	72.0
	Solar	0.0	0.0
SRB	Wind	0.0	17.1
	Solar	0.0	10.1

Note: No data available for Bosnia and Herzegovina.

Source: IEA (2016a), *World Energy Statistics 2016*, http://dx.doi.org/10.1787/9789264263079-en.

StatLink http://dx.doi.org/10.1787/888933705955

For the past decade or so, historic anxieties about energy dependence have been reinforced as environmental concerns have had an increasingly powerful influence on the energy mix (Chalvatzis and Hooper, 2009) and questions have been raised about the effect of intermittent RES on the operation and stability of power grids. Although large shares of renewables do not necessarily destabilise power systems (IEA, 2016c), this perception remains, and may partially explain the apparent reluctance to drive through the reforms required to achieve significant progress on sustainable development. Similar negative perceptions surround energy efficiency policies, which are sometimes regarded as "expensive" or "unaffordable", particularly in times of macroeconomic stress. But international experience shows that this perception is not always well founded and that energy efficiency policies, including those relating to standards, can be highly effective (Boxes 12.3 and 12.4).

Box 12.3. **Good practice: Improving energy efficiency**

The United Nations General Assembly has declared 2014-24 the International Decade of Sustainable Energy for All (SE4All). One of the key objectives of the SE4All initiative is to double the global rate of improvement in energy efficiency by 2030. There are many clear benefits to improving energy efficiency, including increased energy security, a more sustainable environment, improved quality of life and economic competitiveness. However attempts to increase energy efficiency are undermined by inadequate national policy and legislative frameworks, or a failure to implement them fully. To overcome this inertia, countries have developed ambitious but ineffective energy efficiency polices aimed at households and utilities.

Well-designed fiscal policies can harness synergies between different policy priorities for any country. There is clear evidence that energy efficiency measures can be cost effective. For example, starting in 2014, Italy offered a 55% tax deduction for energy efficiency investments in the residential sector (subsequently increased to 65% for some measures). Between 2007 and 2013 more than 1.8 million applications were approved and households accessed around EUR 23 billion of investments, at a cost of about EUR 13 billion in undiscounted forgone tax revenue. In 2012 alone, more than EUR 2.8 billion was invested in over 250 000 energy efficiency measures, including 2.3 million m^2 of window replacements and 1.2 million m^2 of rehabilitated solid surfaces.

Experience from the United States has shown that standards (energy efficiency mandates) and other policies delivered through utilities can be powerful drivers of energy efficiency improvements. The regulated utility Efficiency Vermont reported that in 2016 households saved around USD 9 million though their residential services.

Source: UNECE (2015), *Best Policy Practices for Promoting Energy Efficiency: A Structured Framework of Best Practices in Policies to Promote Energy Efficiency for Climate Change Mitigation and Sustainable Development,* www.unece.org/fileadmin/DAM/ECE_Best_Practices_in_EE_publication_1_.pdf; Efficiency Vermont (2017), *2016 Annual Report*, www.efficiencyvermont.com/Media/Default/docs/plans-reports-highlights/2016/efficiency-vermont-annual-report-2016.pdf.

Box 12.4. **Good practice: Energy efficiency in European buildings**

In 2014, building stock accounted for 30% of the European Union's (EU) greenhouse gas emissions. This equates to approximately 40% of the EU's total energy consumption. As the number of buildings is continually rising, energy consumption and CO_2 emissions will also rise if energy performance minimum requirements are not applied.

Residential buildings dating from between 1945 and 1980 are the major culprits as they consume the most energy. The Energy Performance of Buildings Directive (EPBD) combines provisions on minimum energy performance requirements with certifications, providing both a constraint and an incentive to improve the energy performance of buildings.

A good example of embracing energy efficiency in buildings can be seen in the Brussels Capital Region, where all new buildings and large renovations must be built following passive house standards. The region has also introduced numerous initiatives to stimulate demand and enhance building supply. For example, in 2012 it launched the so-called Exemplary Buildings call for proposals in order to stimulate new constructions and renovations. The winning projects received funding and expert support. Not long after, buildings with extremely high energy and environmental performance started appearing across the region. Six Exemplary Buildings calls have resulted in more than 350 000 m^2 of new passive buildings, and 621 000 m^2 of newly constructed and renovated surfaces. As a result of its valiant efforts, the European Commission awarded the Brussels Capital Region the EU Sustainable Energy Award in 2012.

Box 12.4. **Good practice: Energy efficiency in European buildings** (*continued*)

In 2013, with the support of the EU and in partnership with the Energy Community Secretariat, the *European Bank for Reconstruction and Development* (*EBRD*) established the Regional Energy Efficiency Programme (REEP) for the SEE economies to improve energy efficiency. While the establishment of REEP is a welcome step forward, much still needs to be done on energy efficiency. In particular, following feedback from the Energy Community's Energy Efficiency Coordination Group it became clear that there is an urgent need to extend REEP to the residential sector (EBRD, 2017).

Source: EU (2017), *Good Practice in Energy Efficiency: For a Sustainable, Safer and More Competitive Europe*, https://ec.europa.eu/energy/sites/ener/files/documents/good_practice_in_ee_-web.pdf; EBRD (2017), "Western Balkans Regional Energy Efficiency Programme Phase II - Policy Dialogue (REEP Plus)", www.ebrd.com/work-with-us/procurement/pn-50669.html.

Awareness raising is the "low-hanging fruit" for sustainable development

Across the six SEE economies, the least developed area of policy is in raising awareness among the public, businesses and in the public sector of the need for energy efficiency and the use of renewables. With an average score of 1.5 out of 5, it is clear that while the economies have started to develop awareness-raising strategies and action plans, they face challenges in implementing them.

The SEE economies have taken different approaches to policies for awareness raising. For example some have integrated awareness raising in their energy efficiency and RES policies. In others, for example Albania, policy directed at shaping behaviour to promote energy efficiency and the use of RES is almost entirely lacking. Overall the paucity of awareness-raising measures means that opportunities to reduce emissions and improve the welfare of large numbers of households are being missed.

The way forward for sustainable development

As the six SEE economies look to the future, they should reconsider their policies for sustainable development. It is obvious from the average score of 1.7 for this sub-dimension that the development of Third Energy Package-complaint polices and action plans is a significant challenge for several of the assessed economies. For those with compliant policy frameworks, renewed emphasis on **full implementation of existing policies and revision of those which are not delivering** is the only way that they can achieve the transition to a sustainable energy sector. The establishment of the Energy Community Climate Action Group in September 2017 is a welcome step in this respect.

The SEE economies should be determined and ambitious in their strategies and action plans to improve energy efficiency. The International Energy Agency (IEA) has estimated that approximately 40% of the emissions reductions required by 2050 to limit warming to less than 2°C could potentially come from energy efficiency (IEA, 2016b). The scope for energy efficiency is high across all the economies.

Measures aimed at **raising awareness should be prioritised** since they are a particularly effective method of developing community and industry interest in and commitment to both energy efficiency and renewables projects.

There is scope and an urgent need to **boost skills in ministries and municipalities** so that the full range of sustainable development policies are developed and implemented. Similarly, increasing financial resources for the promotion of RES and energy efficiency would increase the competitiveness and resilience of economies.

The effectiveness of policies, strategies and action plans to increase the installation of renewable energy technologies should be renewed. The abundant solar and wind resources in the SEE region, combined with the dramatic fall in investment costs of these technologies, means that they already represent an economically viable alternative to fossil-fuel power plants. To date the installed capacity of these technologies remains very low.

Plans for substantial new investment in coal-fired power plants should be reassessed. Rigorous environmental impact assessments conducted to international best practice standards need to be undertaken and made available for public scrutiny. Planned new investment in coal-fired power plants of around 6 GW across the region is inconsistent with commitments to meet EU carbon targets agreed by all the SEE economies under the Paris Agreement. Given the lifespan of coal-fired power plants, this raises the real prospect of new coal plants becoming stranded assets if their operation is prematurely curtailed by existing climate policy obligations. The overall effect would be to diminish both energy sector and economy-wide competitiveness.

Investments in new large hydropower power plants must be subject to stringent environmental impact assessments. These should be carried out to international best practice standards and made available for public scrutiny. Hydropower already provides around one-third of the electricity in the SEE economies, and numerous new hydropower plants (large and small) are planned. The environmental impact of additional large hydropower plants should be reconsidered, bearing in mind the potentially negative effects of large hydropower on tourism and the natural environment.

Energy security

Energy security, the uninterrupted availability of energy sources at an affordable price (IEA, 2014a), is perhaps the most pressing energy sector concern for most countries. Energy security is directly linked to the competitiveness of economies through the strong relationship between economic growth and the reliability of energy sources, including electricity, gas and oil/petroleum products. The trade-off between the short-term social and political need for affordable energy, and the long-term sustainability of power systems, is particularly acute in the six assessed SEE economies where improving energy security will require substantial infrastructure investment. The smooth implementation of market liberalisation in order to increased infrastructure investment in the region requires adequate and effective mechanisms to protect consumers.

Concerns regarding security of supply tend to focus on two issues. Countries that are self-sufficient in energy production may have concerns about preparing for energy emergencies and their ability to react to growing demand. Countries which import energy may be vulnerable if they rely predominantly on imports of a single fuel or from a single country.

Energy security comprises long-term and short-term elements. In the long term it is principally about investment in energy infrastructure, so that energy supply keeps pace with economic development. In the short term energy security concerns the preparedness of energy systems to respond to shocks, such as the 2009 Ukraine-Russian Federation gas

dispute. Clear policies and measures to increase energy security improve the competitiveness of the sector and send positive signals for investors across the energy system and economies more generally.

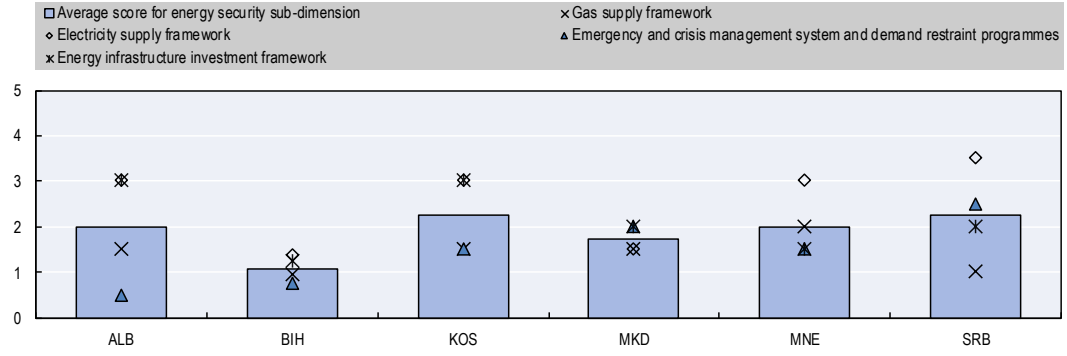
The region as a whole has limited domestic production of gas (Serbia only) and there exist no functioning gas markets in Albania, Kosovo or Montenegro. However economies across the region have ambitions to create gas markets and are developing enabling legislative and regulatory frameworks in preparation.

The energy security sub-dimension consists of four qualitative indicators (Figure 12.9):

- The **gas supply framework** indicator assesses the gas sector in the SEE economies.
- The **electricity supply framework** indicator identifies the reliability of the electricity sector as well as its functional efficiency.
- The **energy infrastructure investment framework** indicator is a measure of the health of the framework to support investment to replace ageing or damaged energy infrastructure and to build new capacity to meet future demand.
- The **emergency and crisis management systems and demand restraint programmes** indicator captures two specific characteristics which reflect the robustness of energy systems: 1) the degree to which well-co-ordinated and comprehensive decision-making structures and programmes provide protection from and a rapid response to external shocks, for example load curtailment in the event of a serious electricity supply interruption; and 2) the existence of effective action plans to manage demand, for example short-term plans for rationing transport fuel, and longer-term programmes to shift consumer behaviour, such as savings campaigns.

The average score for all six SEE economies for the overall sub-dimension is 1.9 out of 5.

Figure 12.9. **Energy security: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933705879

Frameworks for electricity are more advanced than for gas

Efficient operation of electricity and gas systems can only be achieved with clearly stated policy objectives, strategies and action plans supported by appropriate legislation and regulation, including market rules and network codes. The technical nature of electricity systems in particular means that the framework is especially complex and

extensive. As Contracting Parties to the Energy Community, all the SEE economies are required to adopt and implement electricity and gas legislation which complies with the EU Third Energy Package requirements. This is a substantial undertaking, particularly given the relatively small size of the economies (and governments) and widespread concerns over institutional capacity.

The average score for the **electricity supply framework** indicator is 2.6, which is considerably higher than the average score for the **gas supply framework** indicator (1.4), reflecting the paucity of gas networks in the region and correspondingly greater emphasis on electricity as the main source of power. Overall the gas supply infrastructure is poor over large areas of SEE and the provision of gas to consumers is patchy at best. Although Albania, Kosovo and Montenegro have no gas sectors at present, they have ambitions to create them.

However, even within the electricity supply framework, there is substantial variation in scores. Serbia scores 3.5, while Albania, Kosovo and Montenegro all score 3. These scores suggest that all four economies have put the requisite frameworks in place and that they are broadly aligned with the Third Energy Package. These economies have also gone some way in terms of active policy implementation. In contrast, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia scored 1.4 and 1.5 respectively on the electricity supply indicator.

Serbia has adopted a legislative framework that will generally support Third Energy Package-compliant implementation, for example the rules on licensing and certification, switching supplier, vulnerable customers, organised electricity market operation, transmission and distribution network codes, pricing methodologies for transmission and distribution network usage, pricing methodologies for guaranteed supply, and pricing methodologies for connection to the transmission and distribution system (for more information on the Third Energy Package, see EC, 2011). The notable exception remains the unbundling of transmission from distribution. Co-operation between ministries and agencies is strong and it is clear that stakeholder engagement in policy development is well embedded.

Albania, Kosovo and Montenegro have all brought their legislation largely into line with the Third Energy Package and are making progress with adopting secondary legislation, for example in the areas of unbundling, capacity allocation and price deregulation, that will enable full implementation.

While taking the first steps towards establishing an appropriate legal and regulatory framework for electricity, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia are falling behind their neighbours in transposing and adopting Third Energy Package-compliant legislation and regulations. For Bosnia and Herzegovina there is much work to be done at both the state and entity levels to update obsolete legislation. The Federation of Bosnia and Herzegovina would benefit from aligning its framework strategy with the new Bosnia and Herzegovina energy strategy. The Republika Srpska should finalise and adopt its draft law mandating a shift towards a more market-based electricity sector as soon as possible. The Former Yugoslav Republic of Macedonia needs to make a concerted effort to bring its electricity sector framework up to best-practice standards. Its economy's legislation does not comply with the Third Energy Package in many respects, including unbundling, third-party access to networks and market opening/price regulation.

With respect to the gas supply framework, only Montenegro achieved a score of 2; all the other economies scored between 1 and 1.5, meaning that most are at a relatively early stage in constructing comprehensive policy frameworks for gas. This position reflects the

poor gas infrastructure across the region, and the lack of indigenous gas supplies. Of the SEE economies, only Serbia has any domestic gas production, which meets around 20% of domestic demand. Despite its domestic gas production sector, Serbia's plan for the gas sector is still under development, and its primary and secondary legislation does not comply with the Third Energy Package.

Gas supplies from the Russian Federation dominate SEE gas imports and Gazprom is the main supplier of gas (and crude oil) to the entire region (Kovačević, 2017). It appears that the lack of institutional capacity in ministries and regulators – a point widely emphasised during this assessment – coupled with the substantial volume of work required to align energy sector legislation with the EU, has resulted in the prioritisation of the electricity sector policy framework. This is not surprising given the dominance of electricity as the main form of energy in all the SEE economies. Nevertheless the reliance on essentially a single source of imported gas, and the poorly developed gas infrastructure, highlight a real vulnerability for all the economies in terms of energy security. This vulnerability is rendered more acute by regular electricity outages, though their frequency has decreased in recent years (discussed below).

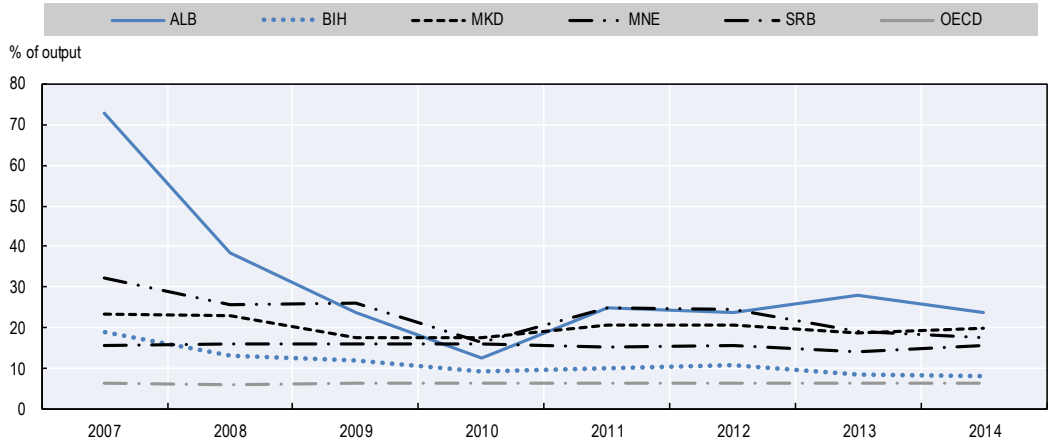
Investment in energy infrastructure is being guided by legislative and policy frameworks

Weak energy infrastructure has a negative effect on competitiveness as firms cannot rely on a constant electricity supply, and unreliable supply sends a negative message to potential investors. An average of 56% of firms across the region experienced electrical outages in 2013 (see Figure 12.3 above).

While there are many factors which explain the prevalence of outages across the region, one important factor is the weak energy infrastructure, which is in dire need of investment. Figure 12.10 presents data on electric power transmission and distribution losses[10] between 2007 and 2014. The figure shows that these network losses are consistently well above the OECD average. However, in Bosnia and Herzegovina losses had almost fallen to the OECD average by the end of the period, and on average network losses across the five SEE economies have fallen over the period. High losses mean higher prices, reduced competitiveness and higher-than-necessary emissions, since a significant proportion of the power that is generated is wasted. This effect is compounded by the persistent nature of the problem.

In addition to the need to repair infrastructure, two additional factors lie behind the pressing need for investment in energy infrastructure. The first is a requirement to upgrade infrastructure to meet future demand patterns. For example, as the SEE economies continue to develop, many are planning to increase tourism which will affect the demand for power. This has happened in Croatia, which has switched to a summer peaking system[11] in recent years to respond to the growth in tourism and accompanying demand for air conditioning. While the six SEE economies typically have significant hydropower generation capacity, the increasing extremes of weather associated with climate change may render these electricity systems vulnerable in prolonged periods of very dry weather, especially as they are likely to coincide with heavy demand for air conditioning during the summer months. The second factor is the need to replace the large proportion of the generation capacity that is due to retire in the next ten years, while simultaneously building an energy system that allows the economies of the region to comply with their sustainability obligations under the Paris Agreement by investing in new clean energy technologies.

Figure 12.10. **Transmission and distribution losses (2007-14)**



Note: The figure shows the share of electric power transmission and distribution losses in electricity production. No data available for Kosovo.

Source: World Bank (2017b), "Electric power transmission and distribution losses (% of output)", http://databank.worldbank.org/data/reports.aspx?source=2&series=EG.ELC.LOSS.ZS&country=ALB,BIH,KSV,MKD,MNE,SRB.

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National regulatory agencies (NRAs) play an important role in facilitating and stimulating investment in energy infrastructure. One of their roles is to ensure a stable and predictable regulatory environment so that investors are confident that they will be subject to the consistent application of rules and regulations, including for example the licencing and permit granting procedures undertaken by regulators. NRAs are also required to support the adoption and implementation of the incentive regulatory framework for infrastructure (Regulation 347/2013/EU).

It is the role of NRAs to design regulatory incentives for investment and to approve the investment plans of regulated companies such as transmission system operators. The Energy Community Regulatory Board has agreed with SEE governments a set of guidelines for NRAs on their role in the promotion of new investments in trans-European energy infrastructure based on the EU guidelines (ECRB, 2013). NRAs are therefore required to develop regulatory investment incentives to promote new infrastructure investment. For example, they are required to co-ordinate with neighbouring NRAs on the allocation of costs and their inclusion in regulated network tariffs for cross-border projects. This kind of co-ordination is challenging and although all NRAs are working towards this objective, the pace of progress is slow.

Partnerships which include international financial institutions (IFIs) can be a powerful mechanism for mobilising investment in energy infrastructure. For example, the Western Balkans Investment Framework (WBIF), a joint initiative between the EU, IFIs, bilateral donors and the SEE governments, supports energy infrastructure investment projects through the provision of finance and technical assistance. A range of energy infrastructure projects has been supported through other partnerships, for example in Montenegro the EBRD and the German Development Bank (KfW) provided loan finance and grants for an overhead line between Pljevlja and Lastva. In June 2017 the EBRD signed a memorandum of understanding with the Energy Community which allows EBRD and KfW to explore new opportunities for co-operation on broad sustainability issues.

Despite a clear willingness for IFIs and other partnerships to invest in the region, the relatively slow rate of energy sector reform and the sheer scale of investment required present significant challenges.

The performance of the six SEE economies against the energy infrastructure investment indicator is variable (Figure 12.9). The average score is 2.1 out of 5. In all the SEE economies plans are in place or under development to replace degraded and ageing infrastructure. Bosnia and Herzegovina scores 1.3, which means that while it has started to establish a policy and legal framework to bring in investment in energy infrastructure, the process is still in the development stage. Serbia and the Former Yugoslav Republic of Macedonia are a little further on, with scores of 2. These economies have policy frameworks in place and their legislation for investment generally complies with the Energy Community *acquis*. Two economies, Albania and Kosovo, score 3 because they have built on policy and legislative frameworks that support investment in infrastructure and show evidence of implementation, public participation in policy development and good institutional co-ordination.

However, there is much progress to be made across all six economies on price regulation, which undermines investment signals. Regulated prices undermine competition. Prices which are set below the cost of supply will discourage new entrants from entering the market since they will make losses. If prices are set above the cost of supply then suppliers grow rich at the expense of consumers, and given substantial barriers to entry in energy markets, potential new suppliers are unable to enter the market.

Developing robust emergency and crisis management frameworks is a widespread challenge

All six SEE economies are long-term net energy importers (Figure 12.11), although the proportion of net energy use covered by imports in 2015 varied from around 53% for the Former Yugoslav Republic of Macedonia to 13% for Albania, where the energy mix is dominated by large hydropower plants. The vulnerability of most of the SEE economies to external shocks is compounded by the lack of market integration between SEE energy systems, comparatively weak physical interconnection with neighbouring systems, and relatively low levels of oil and petroleum stocks.

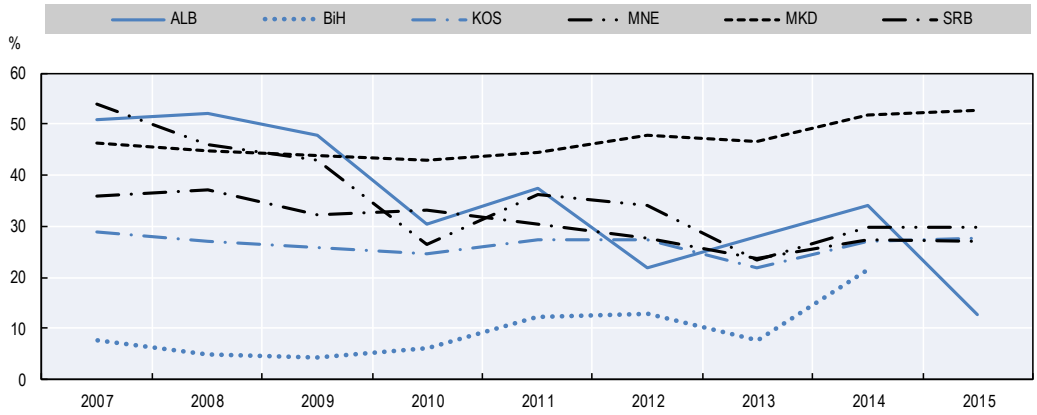
The global nature of oil markets and their ability to deliver unforeseen shocks mean that emergency oil stocks are a powerful tool to insure against supply disruptions. The SEE economies are heavily reliant on imported petroleum and related products used mainly for transport. Serbia is in the process of building emergency oil stocks, but the other economies are still going through the process of developing policy or transposing/adopting legislation. Developing financial tools such as contracts based on call options – where the holder, for example a utility company, has the right (but not the obligation) to buy electricity at an agreed price at an agreed time – may be a feasible alternative to physical capacity and protect against volatile prices.

The average score for the indicator on emergency and crisis management systems and demand restraint programmes is 1.5 out of 5 (Figure 12.9). This suggests that in all six SEE economies, policy and legal frameworks require considerable attention. The pressing need for all the economies – apart from Serbia and the Former Yugoslav Republic of Macedonia – is to put in place robust policy and legislation. For Serbia and the Former Yugoslav Republic of Macedonia, which score 2.5 and 2 respectively, the challenge now is to implement their frameworks. Because all the SEE economies are very small,

co-operation over seasonal generation adequacy, emergency preparedness and mutual emergency support will be important to ensure security of supplies.

Figure 12.11. **Energy dependence (2007-15)**

% of energy dependence on imports



Note: Energy dependency shows the extent to which an economy relies upon imports in order to meet its energy needs. The indicator is calculated as net imports divided by the sum of gross inland energy consumption plus bunkers.

Source: Eurostat (2017c), *Energy Dependence* (database), http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsdcc310.

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The way forward for energy security

It is important that progress towards market liberalisation and regional integration is maintained in order to attract investment and enhance security of supply. The region as a whole has an urgent need to invest in energy infrastructure so as to improve supply security. However, accelerating progress with market liberalisation and integration will also help to secure supplies. The current legal and institutional reforms – and in particular price deregulation – will ensure the sustainability of investment, and regional integration will reduce the total investment required by diminishing the overall requirement for emergency resources.

The pace of implementing planned reforms and legislation should be accelerated to give investors the confidence to commit to long-term and large-scale investments in the economies' energy sector. A crucial early step will be for all the SEE economies to ensure rapid progress in adopting and fully implementing reform policies and legislation that comply with the requirements of the Third Energy Package.

The SEE economies should continue to work with international financial institutions. Investment is required in all areas of energy infrastructure; however, investment which supports the transition to low-carbon economies, for example in energy efficiency and in strengthening grids to accommodate variable renewables, is particularly important. Improving energy efficiency and diversifying the generation mix to include more renewables will improve security of supply.

NRAs should evaluate their activity to promote investment in energy infrastructure. It is suggested they should take urgent steps to speed up the adoption of and implementation of the incentive regulatory framework for infrastructure and the investment incentives agreed with the Energy Community Regulatory Board.

Energy markets

Energy markets provide a platform for energy trade, and range widely in size, type and level of competitiveness. Differences in energy market performance are influenced by all aspects of the energy sector, including governance, legislation, market structure, the regulatory framework, the energy mix and infrastructure. Vertically integrated markets which display monopolistic behaviour, with subsidies or poorly regulated prices and relying on inadequate infrastructure, are the least competitive and most unlikely to attract private investment. This kind of market structure is typical of pre-liberalisation energy sectors in most countries, including the six SEE economies.

By contrast, the most competitive markets are those that allow access to many participants, require the least government intervention in price setting, and have infrastructure in place to enable trade in products. For example, OECD member countries' experience of energy market liberalisation is that markets for electricity that are co-ordinated and integrated across borders into regional markets, deliver consumer benefits, including more competitive prices and greater supply security (IEA, 2005).

Regional market integration has been a focus of EU electricity sector reforms since around 2006, when regional initiatives were established in both electricity and gas. More recently, it has become clear that regional integration of electricity markets is required to achieve least-cost emissions reductions (IEA, 2014a). The potential gains from balancing resources, if they are shared effectively among the economies, include increased technical possibilities for balancing capacity provision, lower overall balancing costs, and alignment of the costs of balancing service provision with the costs of making them available (ECS, 2014).

Overall, regional markets increase competitiveness at both national and regional levels. The SEE economies have recognised these benefits and have committed to a set of reforms to capture them. In 2015 all the SEE economies signed up to the Western Balkans Six (WB6) initiative with the objective of increasing connectivity of the electricity sectors and market coupling in the SEE region. Measures aim to remove barriers to integrating electricity markets at the national level, while at the same time increasing regional co-operation and strengthening regional institutions. The success of the WB6 initiative relies on the full and effective implementation of harmonised rules and the provisions of the Third Energy Package.

The energy markets sub-dimension includes three indicators (Figure 12.12):

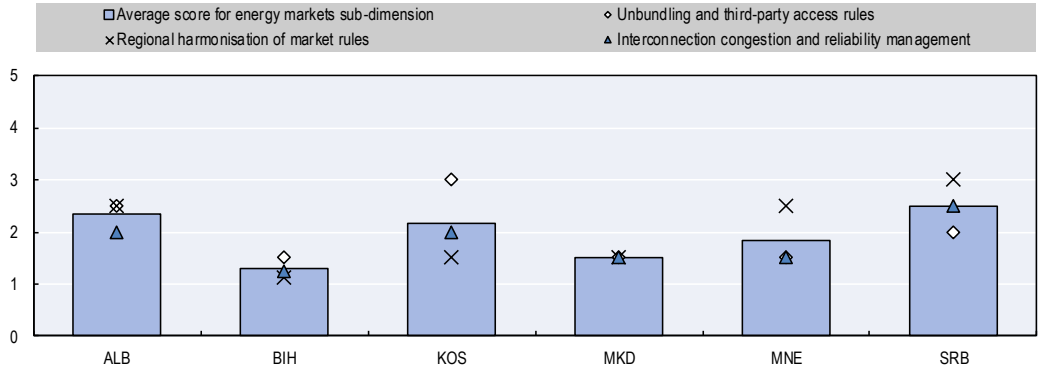
- The **unbundling and third-party access** indicator captures two related features of electricity and gas markets:[12] 1) unbundling, i.e. the extent to which different parts of the energy sector (e.g. transmission, generation, distribution and retail supply in electricity) are owned, managed and operated by separate entities; and 2) the ability of third parties and market entrants to gain access to the transmission and distribution networks on non-discriminatory, transparent terms. For example, can electricity generated by a new wind farm gain access to the transmission network on equal terms to electricity generated in an existing power plant?
- The **regional harmonisation of market rules** indicator measures the extent to which the technical rules which control the operation of the electricity networks and which have a cross-border impact are harmonised across the six SEE economies. The rules and codes define the standards for the pan-European energy

market and are intended to ensure the effective operation of electricity and gas transmission systems to meet energy policy goals: security of supply, sustainable development of the sector and competitive markets. The extent to which rules are harmonised indicates the ease with which producers and consumers of energy are able to trade across borders.

- The **interconnection congestion and reliability management** indicator demonstrates how efficiently the electricity interconnectors are managed as this affects the cost-effectiveness with which energy products reach consumers.

Across the SEE economies as a whole, the average score for the energy markets sub-dimension is 1.9 out of 5, though Kosovo and Serbia have quite divergent scores for the three indicators.

Figure 12.12. **Energy markets: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Legislative and regulatory frameworks are unbundling and facilitating non-discriminatory third-party access to networks

The average score across the SEE region for unbundling and third-party access is 2 out of 5, indicating that broadly speaking a policy framework is in place (Figure 12.12). At 3, Kosovo has the highest score: structural reform is underway and arrangements for non-discriminatory access to the grids are in place. Kosovo has also transposed legislation for unbundling and third-party access, including congestion management in electricity, that complies with Third Energy Package requirements. It also shows evidence of implementation, although certain elements remain to be implemented, including finalising market opening and publishing network tariffs.

Albania scores 2.5 for this indicator. It has unbundled transmission from generation and trade in a way that complies with the Third Energy Package, but has yet to unbundle supply from distribution. Albania has not implemented secondary legislation which would secure Third Energy Package compliance.

Serbia scores 2 because its unbundling model for electricity does not comply with Third Energy Package, and because it has yet to unbundle the gas transmission system operators and storage and distribution companies.

Montenegro scores 1.5. It has the legislative framework for ownership unbundling in place, and the transmission system operator has applied for certification. The unbundling of the distribution system operator is legally finalised, and a separate legal entity (CEDIS)

has been established. CEDIS owns the distribution network as well as operating and maintaining it.

Bosnia and Herzegovina also scores 1.5. It has taken steps to develop comprehensive legal and regulatory frameworks for unbundling and third-party access, although progress is quite limited.

The 1.5 score for Former Yugoslav Republic of Macedonia reflects that it has adopted market rules and grid codes in electricity, but its electricity unbundling is not fully Third Energy Package-compliant, while third-party access will only be transposed in the draft new energy law.

Harmonisation is proceeding at variable speeds across the economies

SEE economies are committed to forming a regional electricity market which will be part of the pan-European energy market (Box 12.5). A successful regional market requires harmonised technical rules and codes for operating electricity (and gas) networks and interconnectors. This is important for reliability and to facilitate trade in energy products nationally and across borders. The rules for balancing resources, for example, are critical for supply security and have an important impact on consumer costs.

SEE economies score 2 out of 5 on average for the regional harmonisation of market rules indicator (Figure 12.12). The scores for Serbia (3), Montenegro (2.5) and Albania (2.5) show that they have moved beyond transposing legislation that complies with the Third Energy Package, and have begun implementing legislation and policy. Serbia has established a day-ahead market which complies with the Network Code and which is based on an EU-style solution. Albania's Market Model has been adopted and a power exchange is under development.

The economies of Bosnia and Herzegovina, Kosovo and the Former Yugoslav Republic of Macedonia scored 1.1, 1.5 and 1.5 respectively for this indicator. For all three, policy for harmonising rules is only in the early stages of development. On a positive note, however, all have begun to implement soft measures, described in Box 12.5. In Bosnia and Herzegovina, the harmonisation issue comes under the authority of the State rather than the Federation of Bosnia and Herzegovina, and the Republika Srpska, although co-operation from all parties is necessary.

Box 12.5. **Regional progress towards "soft" harmonisation measures**

The governments of the six assessed SEE economies are committed to the formation of a single market. In 2016 they renewed their commitment to this objective by agreeing to strengthen the regional institutional structures required and to eradicate legislative and regulatory barriers at the national level. Steps on the path to a regional electricity market were taken at a WB6 summit in Vienna in August 2015. The measures set out clear actions and a timeline for developing the regional electricity market. The SEE economies have agreed to implement four categories of measures at the national level – so-called soft measures. These include spot market development, cross-border balancing, regional capacity allocation, and cross-cutting measures which include increasing the effectiveness of national administrative bodies. Since the 2015 summit over 50% of soft measures have been implemented by the six governments, with Serbia and Montenegro implementing over 60%, Albania, Bosnia and Herzegovina, and Kosovo 40-50% and the Former Yugoslav Republic of Macedonia just under 40% (ECS, 2017a). Stakeholders from all six neighbouring economies have joined the initiative, focusing on market coupling and cross-border balancing at the regional level.

Interconnection congestion and reliability management requires further development

Networks and interconnectors that are well managed and reliable are able to deliver faster responses, higher quantities and more competitive prices. Cross-border electricity markets based on the regional co-operation of system operators in terms of capacity calculation and making capacity available to markets will increase efficiency and benefit all consumers. However managing congestion over the interconnectors while ensuring the reliability of transmission networks poses considerable challenges.

The capacities of interconnectors are defined by neighbouring transmission system operators and used by market participants to conduct electricity trade across borders. However individual transmission system operators may be inclined to restrict capacities due to concerns over the secure operation of the transmission network, with the unfortunate consequence that electricity trade may be sub-optimal. In other words, there is a potential tension between freeing up interconnector capacity and network reliability. This is a highly complex system which requires high levels of co-ordination among transmission system operators and adherence to an agreed set of auction rules and of practices. The development of an SEE regional electricity market is to a large extent dependent on developing robust mechanisms for regional capacity allocation. The SEE average score for this indicator was 1.8 (Figure 12.12), suggesting that all SEE economies have much work to do to facilitate optimal cross-border trade in electricity.

In 2014 the SEE Coordinated Auction Office (SEE CAO) began conducting regional capacity allocation through auctions for cross-border capacity. The SEE CAO continues to develop rules to harmonise cross-border capacity calculations in electricity and is working with NRAs to determine the cause of lack of consistency and irregularities in some of the measures calculated.

The way forward for energy markets

The six SEE economies should maintain their strong engagement with the regional co-operation process. The WB6 initiative is relatively new but is already seen as an important policy driver for the economies. Combined with investment in physical infrastructure (i.e. interconnectors) continued progress towards forming a regional market will increase the competitiveness of all SEE economies and of the region as a whole. Sustained political will to overcome barriers to market integration will be essential if the long-term benefits to competitiveness are to be captured for the citizens of the WB6 economies. Box 12.6 explains the factors that were important for the highly successful Nordic regional electricity market, and which could offer some valuable ideas for the SEE governments.

SEE economies should increase their efforts to implement Third Energy Package-compliant unbundling of their energy sectors and to facilitate third-party access to networks. Unbundling the operation of different parts of the electricity and gas sectors is a key requirement of integrated and competitive markets, and the development of transparent rules to permit non-discriminatory third-party access to networks are key requirements of integrated and competitive markets. Together, unbundling and third-party access minimise potentially monopolistic behaviour at the national level and establish conditions for new entry.

Box 12.6. Good practice: Improving energy performance through regional co-operation

Regional co-operation is increasingly seen as an important milestone on the path to the pan-European Energy Union project. In 2006 the Regional Initiatives process created seven regional markets for electricity. In 2015 the Third Energy Package set out the regulatory, institutional and political background for achieving this goal. The SEE economies are committed to becoming the "eighth region", which extends the Energy Union to the south east. Analysis of EU regional market formation shows that successful co-operation has been based on flexibility rather than a one-size-fits-all approach, but also that a clear framework can motivate regional initiatives and protect against possible risks. The EU's seven electricity regional markets co-operate on energy in different ways, but possibly the best known and most successful is the Nordic electricity market.

The Nordic electricity market combines the wholesale markets of Norway, Sweden, Finland and Denmark. Electricity is traded on a common market, Nord Pool Spot, and electricity is produced where the cost of production is lowest. The key elements that have underpinned the formation of the successful Nordic electricity market are:

- Clear political vision guiding the process, closely aligned interests and a high level of trust between the countries.
- Participation of all relevant stakeholders in research projects, policy studies and working groups to develop knowledge of the Nordic area in terms of energy technologies and systems.
- A step-by-step approach to the development of frameworks required to achieve the shared objectives.
- Continuity and sufficient flexibility, with institutions set up to further Nordic regional cooperation receiving high level support from ministries in the Nordic member states and from the Nordic Investment Bank.

Source: Benelux Union (2016), *A Toolbox for Regional Energy Cooperation: Regional Steps Towards an Energy Union*, www.benelux.int/nl/publicaties/publicaties-overzicht/toolbox-regional-energy-cooperation.

Conclusions

Energy sector reform is a deeply complex and arduous process, particularly in those economies starting from state ownership and operation. The six SEE economies have shown that they are committed to raising productivity by reforming their energy sectors. Their participation in initiatives, including the WB6 and CESEC, demonstrates a strong commitment to the formation of a regional energy market. The WB6 and CESEC initiatives, combined with the dynamic nature of EU energy, place increasing demands on resources. However, all SEE economies have taken steps to develop legal and regulatory frameworks covering all sub-dimensions of the energy sector and encouragingly, progress is generally good in the fundamental governance and regulation sub-dimension. This is critical because the governance and regulation indicators set the direction for the remaining sub-dimensions.

Given the enduring and comprehensive nature of energy sector reform, it is not surprising that a number of challenges remain. Although these challenges vary from economy to economy, one of the most pervasive is the institutional capacity required to

realise effective energy market reform. Both skills and financial resources are required across all sub-dimensions, and in all institutions. Similarly, all economies continue to struggle with implementing sustainable energy policies and would benefit from complementary reform measures in environmental and investment policy in particular. A challenge that faces all governments is to mobilise the sheer political will and determination that will drive through a decades long programme of reform, and in particular to achieve an integrated SEE regional energy market. On that point, the history of energy market reform is unequivocal.

Notes

1. The EU Third Energy Package aims to make the energy market fully effective and create a single EU gas and electricity market. As Contracting Parties to the Energy Community the assessed SEE economies are required to align their legislation with the Third Energy Package. See EC (2011).
2. See EC (2017) for more information on the Connectivity Agenda.
3. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
4. For more information visit the following European Commission webpages: Projects of Common Interest (https://ec.europa.eu/energy/en/topics/infrastructure/projects-common-interest) and Priority Projects of the Energy Community (https://www.energy-community.org/regionalinitiatives/infrastructure/selection.html).
5. The Western Balkans 6 Initiative (also known as the Berlin Process) supports the six SEE economies in strengthening regional co-operation and driving growth and jobs. The WB6 Initiative is implemented in developing energy infrastructure, energy connectivity and sustainability. For more information please see https://www.energy-community.org/regionalinitiatives/WB6.html.
6. The Central and South-Eastern European Gas Connectivity Initiative sketches a joint approach to address the natural gas diversification and security of supply challenges. For more information see https://www.energy-community.org/regionalinitiatives/CESEC.html.
7. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
8. Total cost-competitive potentials depend on assumptions regarding cost of capital.

9. Several new wind and solar PV projects are under construction and expected to come online in 2017 or 2018.

10. The share of electric power transmission and distribution losses in electricity production.

11. i.e. the demand for electricity is at its highest in the summer rather than the winter.

12. All the SEE economies have plans to develop active gas sectors; however the gas sectors are far less developed than the electricity sectors. The focus of this sub-indicator is therefore on electricity, though in accordance with the Third Energy Package, the unbundling and third-party access rules indicator also reflects the status of rules and legislation in the gas sector.

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Annex 12.A1.
Energy policy: Indicator scores

Table 12.A1.1. **Energy policy: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Governance and regulation						
Energy policy, legal and institutional framework	2.5	1.8	3.0	1.5	2.5	1.5
Energy regulator	2.5	1.5	2.5	1.5	3.0	3.0
Sustainable development						
Renewable energy policy, legal and institutional framework	1.5	1.8	2.5	1.5	2.0	2.0
Energy efficiency policy, legal and institutional framework	1.0	1.6	1.5	1.5	2.5	2.5
Awareness raising	0.5	1.6	2.5	1.5	2.0	1.0
Energy security						
Gas supply framework	1.5	0.9	1.5	1.5	2.0	1.0
Electricity supply framework	3.0	1.4	3.0	1.5	3.0	3.5
Emergency and crisis management system and demand restraint programmes	0.5	0.8	1.5	2.0	1.5	2.5
Energy infrastructure investment framework	3.0	1.3	3.0	2.0	1.5	2.0
Energy markets						
Unbundling and third-party access rules	2.5	1.5	3.0	1.5	1.5	2.0
Regional harmonisation of market rules	2.5	1.1	1.5	1.5	2.5	3.0
Interconnection congestion and reliability management	2.0	1.3	2.0	1.5	1.5	2.5

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Chapter 13.

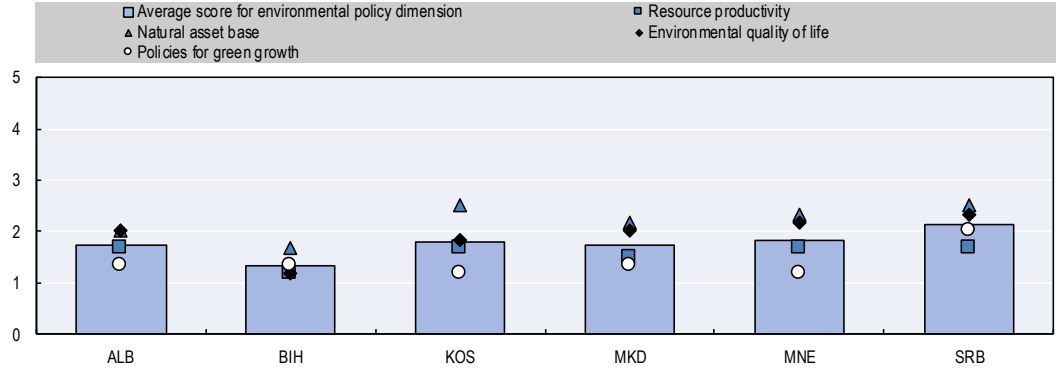
Environmental policy in South East Europe

This chapter on environmental policy assesses the quality of legal and policy frameworks and the extent of their implementation in six South East Europe (SEE) economies. It uses four sub-dimensions based on the OECD Green Growth measurement framework to assess progress towards environmentally sustainable development within the socio-economic context of the SEE economies. The first sub-dimension, resource productivity, describes the efficiency with which economic activities use natural resources. The second sub-dimension, natural asset base, examines the accessibility and ability of natural stocks to provide environmental inputs for development, and highlights potential risks to growth from a declining natural asset base. The third sub-dimension, environmental quality of life, assesses the interactions of environmental conditions and risks to people's quality of life and well-being. The final sub-dimension, policies for green growth, gauges whether policies foster green business opportunities while addressing concerns on income distribution. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions to strengthen green growth, which in turn would foster the competitiveness of these economies.

Main findings

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 in South East Europe (SEE), none of the six SEE economies assessed in this chapter – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro, and Serbia – have yet put in place a sufficiently coherent policy framework to grow and boost competitiveness in an environmentally sustainable way. While all six SEE economies have started preparing policy frameworks for green growth, none have fully completed them. This is reflected in their average dimension and sub-dimension scores, most of which are lower than 2 (Figure 13.1). The most advanced sub-dimension across the six SEE economies is the natural asset base where limited policy frameworks are mostly in place for managing land, biodiversity, forestry and water. The six SEE economies are dependent on the European Union (EU) and other donor support for policy development and infrastructure. Policy frameworks are most advanced in Serbia, as indicated by it being the only economy to score over 2 on average. Bosnia and Herzegovina's scores lag behind its SEE regional peers due to its complex constitutional arrangements and organisational structure.[1]

Figure 13.1. **Environmental policy: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

Over the past two years, progress has been made in some areas of environmental policy in the six SEE economies. They have adopted strategies dedicated to climate change mitigation, although measures for climate change adaptation lag behind. The assessed SEE economies, except Kosovo, are signatories to the United Nations Framework Convention on Climate Change's Paris Agreement, and Albania, Bosnia and Herzegovina, and Serbia are parties to it. The SEE economies have made progress in reaching advanced levels of alignment with the EU's water and floods directives. Water supply and sanitation policy frameworks are largely in place, but infrastructure

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

development continues to rely on donor support. However, there has been limited progress in establishing and implementing river basin management strategies. Air pollution remains high and is a serious threat to public health, especially in urban areas.

Achievements

All six SEE economies are starting to enact environmental legal and policy frameworks. Overarching environmental strategies and legislation on core environmental topics are in place. Strategies to adopt environmental legislation aligned with the EU *acquis* have also been developed.

Overall, the populations in the six SEE economies have good connections to improved water supply and sanitation facilities. Albania and Montenegro have made considerable progress in expanding access to improved sanitation facilities in the last decade and Kosovo has increased access to the public water supply with support from donors and the EU. However, access to public wastewater treatment facilities in urban areas remains below the OECD average.

The six SEE economies have adopted legislation and developed a general policy vision for land-use management, but policies differ in their coverage of local and regional spatial plans, as well as the level of the capacity and financial resources secured to support policy implementation.

Remaining challenges and key recommendations

- **Integrate environmental considerations and international commitments into the main economic and sectoral policies.** The implementation of the Sustainable Development Goals and selected multilateral environmental agreements (MEAs) should be enhanced by integrating them into the relevant sectoral policies and legal frameworks – for example, addressing flooding and drought in agriculture in line with the United Nations (UN) Convention to Combat Desertification.
- **Accelerate the transition to a low-carbon and circular economy.** The current energy mix is highly dependent on fossil fuels, resulting in high carbon dioxide (CO_2) emissions and poor outdoor air quality. Hence, energy policy frameworks need to be fully aligned with climate change objectives, and policies supporting energy efficiency and renewable energy sources with high potential, such as wind and solar photovoltaics (PV), need to be implemented. Measures to reduce illegal dumping, minimise landfill waste, expand recycling programmes and execute extended producer responsibility schemes should be fully defined and implemented.
- **Increase the use of economic instruments to incorporate environmental costs and benefits into budgets.** The tax burden should be shifted away from labour towards environmentally harmful consumption and production patterns. Although the polluter pays principle is legislated, it is not effectively applied. User fees (e.g. for water and waste) should be fully collected and should be higher to promote efficient resource use or deter pollution. Widespread environmentally harmful subsidies, especially in the energy sector (e.g. subsidised coal and transport fuels), should be phased out.
- **Define clear roles and responsibilities in the institutional frameworks for environmentally sustainable development** to strengthen policy implementation, enforcement and compliance. Water and land use are two areas of particular concern given the number of vertical and sectoral actors.

- **Improve framework conditions for green investment and innovation.** Measures which provide incentives for businesses to adopt greener technologies – e.g. to use materials and energy more efficiently – should be put in place and promoted effectively. Innovation systems, and research and development should increase their focus on the environment.
- **Strengthen natural asset management.** Although limited policy frameworks for the management of land, biodiversity, forestry and water (including some river basin management strategies) are generally in place, they are not implemented adequately due to a lack of capacity at local levels and insufficient budgets. Uncoordinated, uncontrolled use of water and land increases the risk of losing valuable river ecosystems.
- **Institutionalise the collection of key environmental statistics, and policy monitoring and evaluation activities.** Despite increasing numbers of environmental quality monitoring stations, data are not systematically collected or published. Accordingly, timely and accurate data should be collected to enable the government to design and monitor progress in implementing environmental policies and to better inform the public, decision makers and the authorities on environmental conditions and issues.

Context

Economic competitiveness and social development in the long term depend on a country's ability to decouple growth from natural resource use, to abate pollution and to enhance the quality of physical and human capital. Green investment and innovation are key to underpin sustained growth and give rise to new economic opportunities. Current business models need to adapt to account for climate change, resource bottlenecks, air and water pollution, and irreversible biodiversity loss. Indicators that raise awareness, measure progress, and identify opportunities and risks are critical in a country's path towards green growth (OECD, 2017a).

The assessment framework of this chapter is based on existing OECD approaches to monitoring the environmental aspects of socio-economic development. The OECD Green Growth Strategy outlines four main steps: align economic and environmental objectives; implement policy frameworks to price pollution and promote efficient resource use; address green growth's social implications; and implement mechanisms to evaluate and monitor progress (OECD, 2011a, 2015a). The OECD green growth indicators assess progress towards four main objectives: increasing the environmental and resource productivity of the economy; maintaining the natural asset base; improving the environmental dimension of quality of life; and strengthening economic opportunities and policy responses (OECD, 2017a). OECD member and non-member countries, as well as international organisations such as those participating in the Green Growth Knowledge Platform (the Global Green Growth Institute, UN Environment and the World Bank), have found OECD green growth indicators useful in supporting their transition towards a low-carbon, resource-efficient economy (OECD, 2015a).

Policies that affect the environment are typically cross-cutting. Several governmental organisations may be responsible for different parts of any environmental issue. Policy design and implementation therefore need to be well integrated in key economic and sectoral policies – both vertically (international, national, sub-national) and horizontally (inter-sectoral) across line ministries, including energy, transport, agriculture and health

(OECD, 2015a, 2015b). Environmental considerations should be reflected in economic and sectoral policies, and vice versa. In addition to government co-ordination, environmental policy frameworks must be equipped with tools that allow them to address the environmental implications of economic activities across all sectors. Therefore, this chapter is related to all other dimensions in the *Competitiveness Outlook*. However, it has particular links to the following chapters:

- **Chapter 4. Tax policy** can provide incentives for adopting resource-efficient technologies and discouraging environmentally harmful practices.
- **Chapter 12. Energy policy** and the structure of a country's energy mix can have major environmental costs due to CO_2 emissions and outdoor air pollution. The success of climate change mitigation strategies depends on how well energy strategies are aligned with them. In addition to outdoor air pollution, energy generation can have other serious environmental impacts as is the case with hydropower.
- **Chapters 14 and 15. Agriculture and tourism** are key sectors of the SEE economies that depend on high-quality natural assets (e.g. water, land and biodiversity) and are particularly vulnerable to the negative effects of pollution – for instance outdoor air pollution can reduce crop yields, and litter can deter tourists. In turn, these sectors themselves use natural resources and can be sources of local and transboundary pollution; their activities must therefore be regulated to reduce any negative environmental impacts.

Environmental policy assessment framework

The environment dimension in the *2018 Competitiveness Outlook* examines the extent to which the six SEE economies have established effective policies to facilitate greener growth. Without seeking to be exhaustive, it considers four broad sub-dimensions:

1. Resource productivity: are natural resources used efficiently to gain a cost-competitive edge? Do policies aim to reduce the carbon- and energy-intensity of the economy? How well are circular economy principles integrated into policies? Does municipal waste management include recycling programmes?
2. Natural asset base: are natural assets being conserved and managed effectively in order to sustain long-term competitiveness and growth? Do policies safeguard water, land, forestry and biodiversity resources?
3. Environmental quality of life: what is the environmental impact of economic development on people's well-being? Does the environment maintain a healthy and productive workforce? What kind of access do the public have to environmental services and amenities like improved water supply and sanitation? Are they exposed to pollution and industrial risks?
4. Policies for green growth: do policies provide sufficient incentives to create green business opportunities while addressing concerns on income distribution? Do they facilitate the transition to green growth (e.g. markets for environmental products and services) and remove barriers to that transition (e.g. environmentally harmful subsidies)?

Figure 13.2 shows how the sub-dimensions and their constituent indicators make up the environmental policy assessment framework. Each sub-dimension is assessed through quantitative and qualitative indicators. The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Quantitative indicators are based on national or international statistics. Qualitative

indicators have been scored in ascending order on a scale of 0 to 5, and are summarised in Annex 13.A1.[2] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 13.2. **Environmental policy assessment framework**

Environmental policy dimension			
Outcome indicator • Economic structure – gross value added of agriculture, industry and services			
Sub-dimension 1 Resource productivity	**Sub-dimension 2** Natural asset base	**Sub-dimension 3** Environmental quality of life	**Sub-dimension 4** Policies for green growth
Qualitative indicators 1. Circular economy framework 2. Climate change adaptation and mitigation framework 3. Municipal solid waste management framework	**Qualitative indicators** 4. Water management framework 5. Biodiversity and forest management framework 6. Land-use management framework	**Qualitative indicators** 7. Air quality framework 8. Water supply and sanitation system 9. Industrial waste management framework	**Qualitative indicators** 10. Environmental policy framework 11. Environmental taxes, subsidies, charges and fees 12. International co-operation framework
Quantitative indicators 1. Carbon productivity 2. Carbon emissions 3. Planned coal-fired thermal power plant capacity 4. Material productivity 5. Waste treatment 6. Per capita municipal waste generation 7. Share of population with access to municipal solid waste collection services	**Quantitative indicators** 8. Freshwater resources and abstractions 9. Wildlife resources 10. Share of protected terrestrial and marine areas 11. Forest area 12. Land use	**Quantitative indicators** 13. Mean population exposure to $PM_{2.5}$ 14. Air pollutant emissions per capita 15. Share of population with access to improved water sources and sanitation facilities, and connected to a sewage system and wastewater treatment 16. Contaminated sites	**Quantitative indicators** 17. Revenue from environmental tax 18. ISO 14001 sustainability standards uptake

Environmental performance in SEE economies

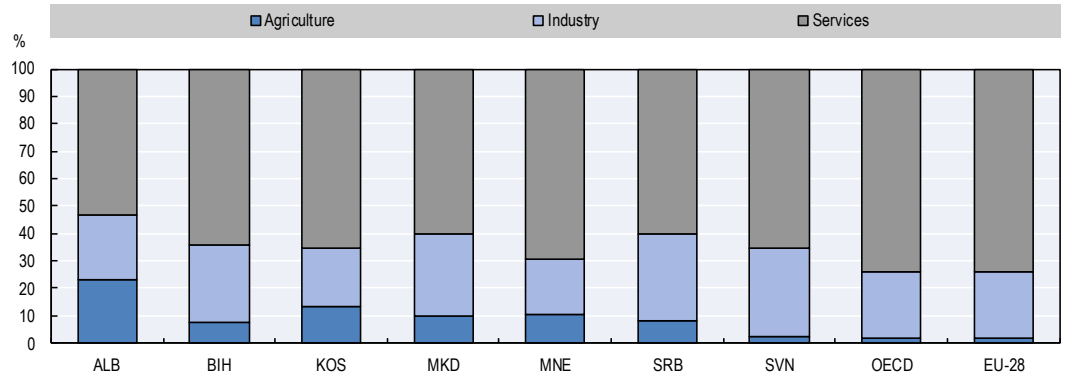
The links between the economy and environment are abundant and complex. The six economies lack data measuring economic productivity adjusted to take into account natural resource use and pollution, such as environmentally adjusted multifactor productivity growth. Instead, the composition of value added between economic sectors 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 six SEE economies, with an average of about 62% of gross domestic product (GDP) (Figure 13.3). However, this share is smaller than in the OECD and EU, where services contribute about 74% on average in each region. On average, industry contributes about 25% to value added in the six SEE economies, as in OECD and EU countries. The share of agriculture in the six

SEE economies makes up 12% on average and ranges from 8% in Bosnia and Herzegovina to 23% in Albania. This is significantly larger than OECD and EU averages, which are each at about 1.5%.

Figure 13.3. **Composition of value added by economic sector (2016)**

% of GDP



Note: SVN – Slovenia.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Resource productivity

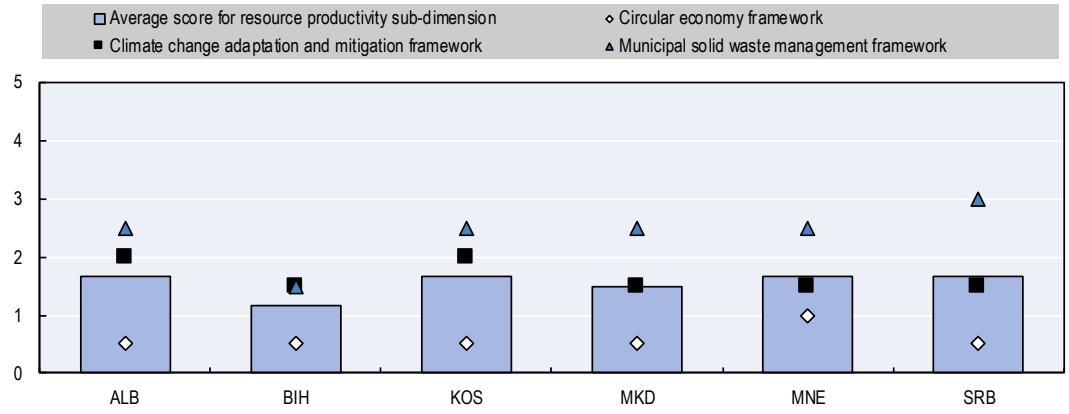
An economy that uses fewer resources to produce more output reaps both economic and environmental benefits, by reducing input costs, and generating less waste and lower greenhouse gas emissions (OECD, 2017b). As such, increasing how productively carbon and materials are used in an economy is critical in supporting this objective. Three qualitative indicators assess the existence and degree of implementation of frameworks which support resource productivity: 1) climate change adaptation and mitigation; 2) circular economy; and 3) municipal solid waste management.

The six SEE economies are at a similar performance level in the resource productivity sub-dimension, though Bosnia and Herzegovina has the greatest room for improvement. On average, the six economies score 1.6 overall, indicating that policy frameworks are under development but still to be adopted (Figure 13.4). This suggests that they have considerable potential for using their available natural resources more productively. Municipal solid waste management is the most advanced area with five economies scoring above 2, indicating that policy frameworks are in place and implementation has begun. However, circular economy initiatives are just beginning, with the assessed economies scoring no higher than 1. The economies have developed climate change mitigation strategies, but their energy mixes do not align yet with their mitigation goals.

Climate change mitigation objectives are defined but not reflected in energy mixes

Climate change is a serious challenge that poses major risks to economies, societies and the environment (OECD, 2017b). Adaptation measures address climate risks such as flooding and decreased agricultural yields, while mitigation activities aim to limit the level or rate of climate change by reducing resource inputs and emissions.

Figure 13.4. **Resource productivity: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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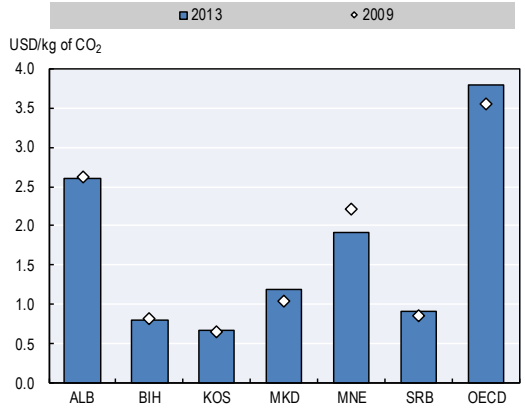
Carbon productivity (economic output per unit of CO_2 emitted) has not seen significant improvement in any of the six SEE economies over the last few years. Albania and Montenegro have the highest carbon productivity levels due to their reliance on hydro-generated electricity (over 50% in 2014), but they still fall short of the OECD average (Figure 13.5). Even in these relatively carbon-productive economies, however, CO_2 emissions grew faster than GDP between 2009 and 2013. Other economies, notably the Former Yugoslav Republic of Macedonia and Serbia, have lower levels of CO_2 productivity but have reduced their CO_2 emissions as their GDP has grown.

Electricity generation and heat production account for the majority of CO_2 emissions in the assessed economies– ranging from 67.1% in the Former Yugoslav Republic of Macedonia to 75% in Kosovo (Figure 13.6). The exception is Albania, where electricity and heating contribute only 2.9% of total emissions because almost 100% of its electricity generation is hydropower. Albania's CO_2 emissions come mainly from transport, which at 60% represents the largest share among the six economies (the others range between 13.7% in Bosnia and Herzegovina and 23.4% in Montenegro).

Apart from Kosovo, the assessed economies are all signatories to the UN Framework Convention on Climate Change and its Paris Agreement. Albania, Bosnia and Herzegovina, and Serbia have also ratified the Paris Agreement and therefore are parties to it. As requested by the Paris Agreement, the five economies have submitted their Nationally Determined Contributions, which outline their post-2020 climate actions. They focus on resource and energy efficiency gains as well as increased renewable energy use. Kosovo's draft climate change strategy includes similar objectives.

Climate change mitigation strategies are at various stages across the six economies, while climate adaptation measures are less developed. Bosnia and Herzegovina has adopted a climate change strategy which encompasses both mitigation and adaption; Albania and Kosovo expect their draft strategies and action plans to be adopted by the end of 2017, and Serbia's in 2018. The Former Yugoslav Republic of Macedonia's National Communication on Climate Change includes an action plan for climate change mitigation, potential mitigation measures in sectors and potential adaptation measures. Montenegro has adopted a climate change mitigation strategy and expects to adopt its draft climate change adaptation strategy in 2018. However, concrete initiatives are at an early stage of implementation across the six economies.

Figure 13.5. **Production-based CO_2 productivity (2009 and 2013)**



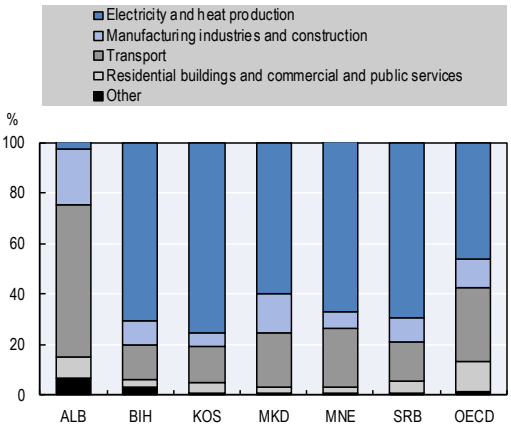
Note: Production-based CO_2 productivity reflects the economic value generated (in terms of real GDP) per unit of CO_2 emitted. Production-based emissions refer to gross direct CO_2 emissions from fossil-fuel combustion, emitted within the territory.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Figure 13.6. **CO_2 emissions by sector (2014)**

% of total CO_2 emissions



Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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A key challenge across all the assessed economies is that energy strategies are not fully aligned with climate change mitigation goals. Even where the strategies are well aligned, implementation is generally weak. In particular, plans to increase electricity generation capacity with large-scale coal-fired thermal plants contradict climate objectives (see Chapter 12, Energy policy). Over 7 gigawatts (GW) of coal-fired thermal power plant capacity has been announced, pre-permitted or permitted across the six SEE economies, predominantly in Bosnia and Herzegovina (3.5 GW) and Serbia (2.9 GW), but also in Kosovo (0.5 GW), the Former Yugoslav Republic of Macedonia (0.425 GW) and Montenegro (0.254 GW) (Endcoal, 2017).

Most of the existing renewable energy produced in the region comes from large hydropower plants. However, there is great untapped potential for renewable energy in all the economies, especially in solar PV and wind. This, combined with the dramatic fall in these technologies' generation costs, makes them a viable alternative. There is also a need to increase energy efficiency (see Chapter 12, Energy policy).

The circular economy is emerging as a concept

While there is no single accepted definition of a circular economy, it is generally understood as reduced demand for certain natural resources and the materials that are derived from them. The resources usually emphasised are minerals (both metallic and non-metallic), fossil fuels, and various biotic resources such as forestry, fish and other biomass. Relatively little attention tends to be given to other resources, such as land or water. In certain conditions, a circular economy approach can have a variety of benefits – lower production costs, increased competitiveness, reduced dependency on commodity

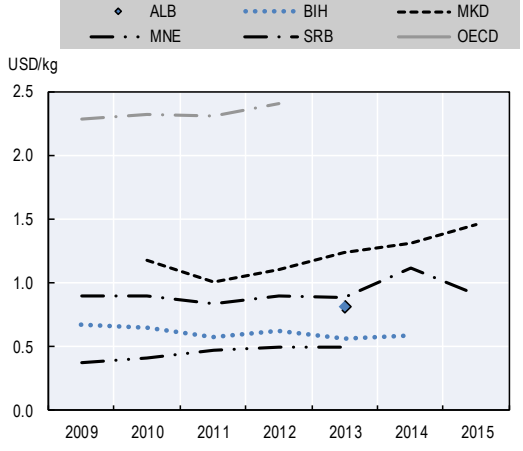
imports and fewer negative environmental impacts. There are three key approaches to promoting resource efficiency: 1) extended producer responsibility systems; 2) green public procurement; and 3) business partnerships along the value chain (Box 13.1). The EU's circular economy initiative and resulting amendments to its waste-related directives strengthen the case for the six economies to develop a circular economy framework as part of their EU accession process.

The six SEE economies have markedly lower levels of material productivity (economic output per unit of domestic material consumption) than the OECD average, with only modest improvements over the past five years (Figure 13.7). Improvements in many European countries took place after 2008, following the financial crisis and the decreased industrial output and demand for materials, particularly in construction (OECD, 2017a).

Recycling rates in all six economies are very low, although Albania, and to a much lesser extent Montenegro and Serbia recover some waste through recycling (Figure 13.8). However, the 22% of solid waste recycled in Albania is lower than the EU average of 35% and far short of its own 2020 target of 55%. In Albania, recycling firms have allegedly complained that the lack of recyclable materials meant that recycling was not economically viable, leading to controversial legislative changes in 2016 that lifted a 2013 ban on the import of waste, providing the waste was to be recycled, not landfilled or incinerated. By contrast, EU countries landfill almost 50% of their waste; the remainder is reintroduced into the economy as energy through incineration, materials for backfilling and recycled materials.

Figure 13.7. **Material productivity (2009-15)**

GDP in constant 2010 USD per unit of domestic material consumption



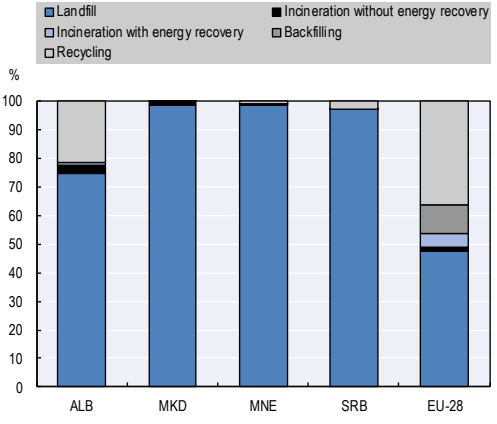
Note: Material productivity is defined as the monetary value (in terms of real GDP) generated per unit of materials used (in terms of domestic material consumption) for non-energy materials. Data for Kosovo not available. All available data are included.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Figure 13.8. **Waste treatment by type (2014)**

% of total waste treated



Note: Data for Bosnia and Herzegovina, and Kosovo not available.

Source: Eurostat (2017a), "Treatment of waste by waste category, hazardousness and waste operations", http://ec.europa.eu/eurostat/data/database.

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The six SEE economies have made progress in transposing the EU directives that underpin key circular economy principles to a high degree: waste (2008/98/EC), landfill (1999/31/EC), waste electronic equipment (2012/19/EU) and end-of-life vehicles (2000/53/EC). Most of the assessed economies refer to circular economy principles in their waste strategies; most are also currently drafting waste strategies which plan to include measures to develop the circular economy, particularly for waste diversion through recycling and energy recovery through incineration. Some of the assessed economies have already started running initial awareness-raising activities and waste recycling programmes. Montenegro has included a circular economy objective in its National Sustainable Development Strategy for 2030, but has not yet implemented any action plans or concrete initiatives. Montenegro's law on public procurement also includes environmental protection and energy efficiency criteria.

Strategies for managing municipal solid waste are in place but need sustainable funding

Effective management of municipal solid waste minimises risks to public health and the environment. Key components of municipal waste management include adequate collection service coverage and suitable cost, as well as appropriate treatment – including the separate collection and recycling of waste, discussed above as they are also key components of a circular economy.

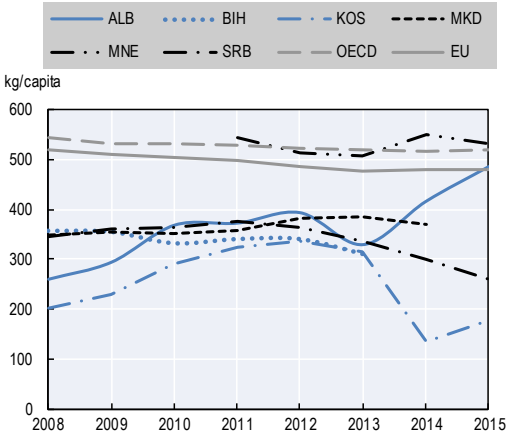
In all six economies except Montenegro, waste generation per capita has been below the OECD average, although recent increases in Albania's waste generation rates indicate that it is approaching OECD levels (Figure 13.9.A). Serbia, on the other hand, has recently its reduced waste generation rates. The continued prevalence of unregulated burning and illegal dumping of waste in the region poses problems to the environment and public health through groundwater, soil and air pollution; it also prevents statistical offices from capturing waste generation rates accurately. In recent years, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have all provided at least 75% of their populations with solid waste collection services. While this represents the majority of their populations, it still falls short of universal coverage and levels in most OECD countries. For example, their regional neighbour Slovenia has achieved full coverage since 2011 (OECD, 2017c). However, most recent increases in service coverage in the assessed SEE economies have been modest – with the exception of Serbia, which has seen more progress, and the Former Yugoslav Republic of Macedonia, which has seen a decline (Figure 13.9.B). Coverage of waste collection services is less universal in Albania and Kosovo.

All six SEE economies have strategies in place that define responsibilities and objectives for municipal solid waste management. With the exception of Bosnia and Herzegovina, where the current policy framework on waste management is less developed and focuses primarily on landfilling, the other five economies have adopted waste policy frameworks with clearly defined and measurable objectives and have started to implement them. Serbia's implementation is quite advanced thanks to its sufficient institutional capacity and good co-ordination with responsible local authorities.

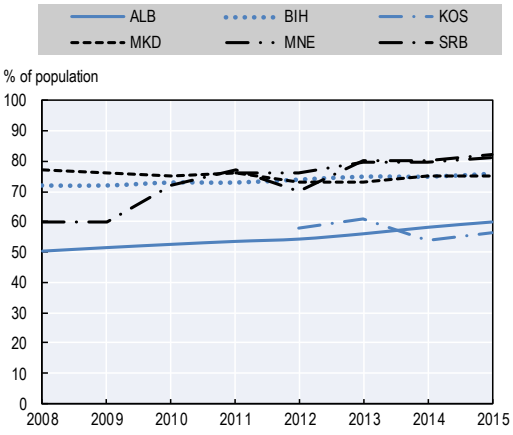
Across the six SEE economies, waste disposal tariffs remain too low to cover the costs of municipal waste collection, let alone the costs of infrastructure construction or maintenance. Therefore, projects to construct new municipal solid waste collection and treatment infrastructure are mostly funded by international financial institutions, particularly by the EU Instrument for Pre-Accession Assistance, rather than by domestic investment. In Serbia, by contrast, the private sector has funded recent waste management infrastructure projects.

Figure 13.9. **Municipal waste generation and coverage of collection services (2008-15)**

A. Municipal waste generation per capita



B. Coverage of municipal waste collection services



Note: Municipal waste generation data for Montenegro unavailable before 2011, for Bosnia and Herzegovina after 2013, and the Former Yugoslav Republic of Macedonia after 2014. Waste management companies in Kosovo's Gjilan municipality did not provide data in 2014. Access to municipal waste collection services unavailable for Kosovo before 2012 and in Montenegro before 2011.

Source: ASK (2017), "Municipal waste", *Environment Database*, http://ask.rks-gov.net; BHAS (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from BHAS; Eurostat (2017b), "Municipal waste by waste operations", http://ec.europa.eu/eurostat/data/database; INSTAT (2017), "Urban and inert solid waste", www.instat.gov.al; OECD (2017d), "Municipal waste", *OECD Environment Statistics* (database), http://dx.doi.org/10.1787/data-00601-en; MakStat (2016), "Municipal waste", www.stat.gov.mk; MONSTAT (2016), "Municipal waste", www.monstat.org; SEPA (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from SEPA; World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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The way forward for resource productivity

The six SEE economies need to implement climate change mitigation objectives in the energy sector to reduce reliance on fossil-fuel sources in the energy mix. In particular, they all need to fully align their energy strategies with climate change objectives, consistently revising them with the long-term goal of decarbonisation in mind. Where policies are already aligned, implementation needs to be strengthened. The economies also need to consider the total economic, environmental and social costs of a carbon-intensive pathway when assessing their plans to expand electricity generation capacity via large-scale coal-fired thermal power plants. The full environmental, social and economic impact of planned hydropower also needs to be considered. The six SEE economies could explore ways to take advantage of the great technical potential of renewable energy, particularly wind and solar PV, coupled with newly affordable technology.

The six SEE economies should develop and adopt climate change adaptation policies. They could draw on the OECD's *Climate Change Risks and Adaptation: Linking Policy and Economics* (OECD, 2015c) to consider an iterative process for understanding, planning for and managing climate risks such as flooding. This process involves identifying risks, characterising risks, choosing and exploring policy responses, and feedback and learning.

The six SEE economies should strengthen legal and policy frameworks for a circular economy. They should continue to work towards fully adopting legislation and regulation that support circular economy principles, such as the EU directives on packaging waste (1994/62/EC) and waste batteries and accumulators (2006/66/EC). They should also adopt and implement coherent sectoral strategies with circular economy principles and measures – for example, Montenegro's national development strategy includes the circular economy as a key objective. They should raise more awareness of circular economy principles, develop recycling programmes and establish markets for secondary materials to help decrease landfill volumes, increase resource productivity and create business opportunities. Finally, all six SEE economies should enhance their approaches to addressing resource efficiency along product life cycles, for example through extended producer responsibility schemes, green public procurement, and partnerships between businesses working along value chains in which one company's waste becomes another's material input (Box 13.1).

Box 13.1. **Good practice: OECD policy guidance on resource efficiency**

The OECD *Policy Guidance on Resource Efficiency* (OECD, 2016a) discusses the key trends and identifies the main principles that should be used to develop resource efficiency policies. It offers policy guidance in four main areas: 1) choosing and designing policy instruments; 2) combining instruments in an effective policy mix; 3) integrating resource efficiency into cross-cutting and sectoral policies; and 4) strengthening data and analysis to support policy development and evaluation.

The guidance recommends that policy mixes address each of the main stages of a product's life cycle and that interactions between different instruments be examined to identify synergies and avoid overlaps. It describes examples of policy instruments targeting different stages of the product life cycle and discusses their strengths and weaknesses.

The policy guidance highlights three key approaches to address resource efficiency along product life cycles:

1. Extended producer responsibility (EPR) involves producers taking responsibility for collecting, sorting and treating end-of-life products, following the polluter pays principle. Effective EPR systems operate according to good governance principles. Opportunities to integrate informal workers into formal waste management systems can reduce the socio-economic risks associated with waste picking.
2. Green public procurement seeks to establish resource efficiency criteria for public purchases which can stimulate innovation and increase demand for green products. To that end, efficiency criteria should be integrated into all stages of the public procurement process: tender specification, selection and implementation.
3. Partnerships involving businesses working along value chains are useful when an actor cannot achieve resource efficiency objectives on their own. Business co-operation can help develop more innovative approaches – for example one company's waste can become another's material input.

The policy guidance calls for an economy-wide approach to resource efficiency. It recommends incorporating principles into national sustainable development strategies and seeking synergies with other policy areas, such as climate change and transport. It also calls for innovation to create the green technology needed to develop new resource-efficient business models. Finally, it advises strengthening data collection on material flows and economic analysis of resource efficiency to further support the development and evaluation of policies in this area.

Source: OECD (2016a), *Policy Guidance on Resource Efficiency*, http://dx.doi.org/10.1787/9789264257344-en; OECD (2016b), *Extended Producer Responsibility: Updated Guidance for Efficient Waste Management*, http://dx.doi.org/10.1787/9789264256385-en; OECD (2015d), *Going Green: Best Practices for Sustainable Procurement*, www.oecd.org/gov/ethics/Going_Green_Best_Practices_for_Sustainable_Procurement.pdf.

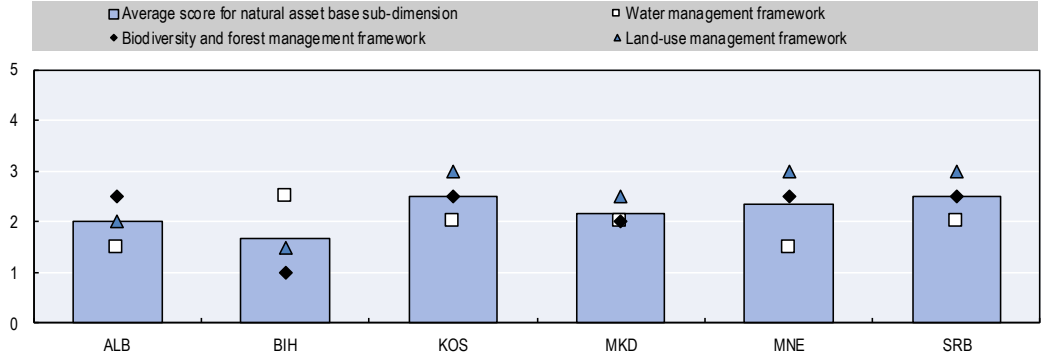
The economies should only consider options for municipal waste management infrastructure that are environmentally sound and cost effective. The waste treatment method and infrastructure capacity should match projected levels of waste. The cost needs to take into account the whole life cycle of the project – including projected levels of waste and associated operational costs such as maintenance. Fee collection rates and the fees themselves for waste collection should be gradually increased to cover the cost of the service and infrastructure. An independent regulatory authority, if managed by experts, could have the technical competence to set appropriate prices.

Natural asset base

South East Europe is geographically diverse, with fertile plains, mountainous regions and a significant portion of the Adriatic coast. Its natural resources are unevenly distributed, including its fresh water, forests and fish. The region's widely varied habitats also host rich biological diversity. These combined assets form the foundation for economic activity and human welfare, and policies should favour activities that use them sustainably over those that deplete or degrade them, to ensure that their benefits are available for future generations. Three qualitative indicators assess the presence and implementation of management frameworks for: 1) water; 2) land use; and 3) biodiversity and forests.

On average, the six SEE economies score 2.2 on the natural asset base sub-dimension, signifying that policy frameworks are mostly adopted (Figure 13.10). Across these economies, land use, forestry and biodiversity policies are the most advanced, and implementation is beginning. Water management strategies and legislation are largely in place, but implementation is lagging behind. Bosnia and Herzegovina is the exception – water management policies have begun to be implemented, although institutional complexity still hinders the adoption of coherent land-use, biodiversity and forestry policies and legislation.

Figure 13.10. **Natural asset base: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Freshwater resources management requires greater co-ordination

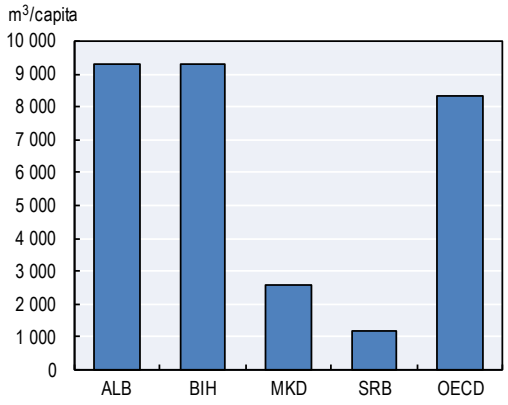
South East Europe is home to rich, diverse and interconnected transboundary freshwater resources, from the karstic regions of the Dinaric Alps and the Adriatic coast to the Danube, Drin and Vardar river basins and the ancient lakes of Ohrid, Prespa and Skadar. These resources not only support human life and irreplaceable biodiversity, but also drive economic activity and contribute to the competitiveness of the SEE economies.

Water resources are distributed unevenly throughout the region, with economies like Albania and Bosnia and Herzegovina harbouring far larger per-capita quantities of renewable internal freshwater resources than the Former Yugoslav Republic of Macedonia and Serbia (Figure 13.11.A). There is considerable diversity in how water is used among the assessed economies. In contrast to most OECD countries, where agriculture uses the largest share of water resources, in Albania, the Former Yugoslav Republic of Macedonia and Montenegro households account for the largest share (Figure 13.11.B). In Serbia, the industrial sector accounts for more than 80% of total freshwater abstractions, with cooling for electricity production making up 75% of all water used (Eurostat, 2017c).

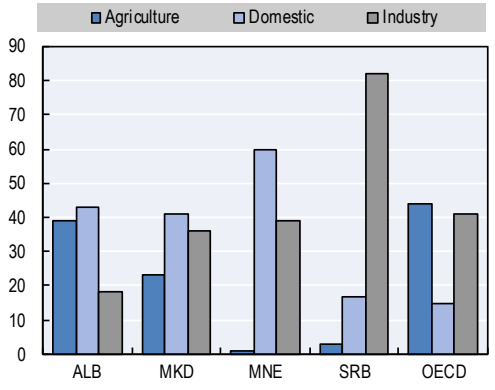
Water stress levels vary greatly among the assessed economies. At high levels, it can put economies at risk of low river flows, water shortages, desertification and reduced food production. Of the assessed economies with available data, Serbia has the greatest risk of high water stress with its lowest per-capita water resources and the highest per-capita water abstractions, although the latter remains below the OECD average.

Figure 13.11. **Freshwater availability and use**

A. Renewable internal freshwater resources per capita (2012)



B. Freshwater abstractions by sector (2014)



Note: Freshwater resources data for Kosovo and Montenegro unavailable. Freshwater abstractions data for Bosnia and Herzegovina and Kosovo unavailable.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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The river basin approach to water management aligns administrative and hydrological boundaries to improve water policy implementation, in line with the EU Water Framework Directive (2000/60/EC). Progress has been made in all six SEE economies towards laying the groundwork for integrated water resource management and river basin management plans by adopting legislation and strategies. Donors have driven the international co-ordination of transboundary river basins – such as the Sava River basin which crosses Bosnia and Herzegovina, Croatia, Montenegro, Serbia and Slovenia; and the Drin River basin shared by Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro. However, transboundary co-ordination efforts are hampered by poor domestic co-ordination among water-related government institutions, exacerbated by

an unclear division of roles and responsibilities. Bosnia and Herzegovina, despite lacking a national strategic framework for water resources, has established functioning entity-level frameworks and agencies dedicated to managing river catchments. The Former Yugoslav Republic of Macedonia, Kosovo and Serbia have adopted water management strategies that are well aligned with the EU's water and floods directives. Albania and Montenegro have made progress in developing water policy frameworks, but insufficient inter-ministerial co-ordination has slowed the process.

The large-scale floods of 2014 underline the importance of effective water management in the region. The most affected economies, such as Bosnia and Herzegovina, and Serbia, have redoubled their efforts to improve flood prevention measures. However, Bosnia and Herzegovina has not begun to implement these measures yet and it is unclear when it will.

Biodiversity protection needs to advance further

South East Europe's richly varied geography is mirrored in the diversity of its flora and fauna. Although some species are immediately recognisable as valuable resources for economic activity, such as the hardwood and softwood trees for the timber industry or certain fish species for commercial fisheries, others are of value in less easily quantifiable ways – as vital components in ensuring the quality and survival of their ecosystem.

A strong policy framework for biodiversity conservation and sustainable use should limit the pressures of human activity. Key pressures on biodiversity include changes in land use, overexploitation of natural resources, pollution, climate change and invasive alien species (Karousakis et al., 2012). In OECD countries these pressures are growing, as is the number of endangered animal and plant species. It is difficult to precisely assess the effect of human pressures on biodiversity overall in the six SEE economies due to insufficient data, but some of the available data show that, as in OECD countries, the number of threatened species is increasing. Current data show fish, molluscs and other invertebrates together make up more than 65% of the number of threatened species in each of the assessed economies apart from Kosovo for which no data is available (IUCN, 2017).

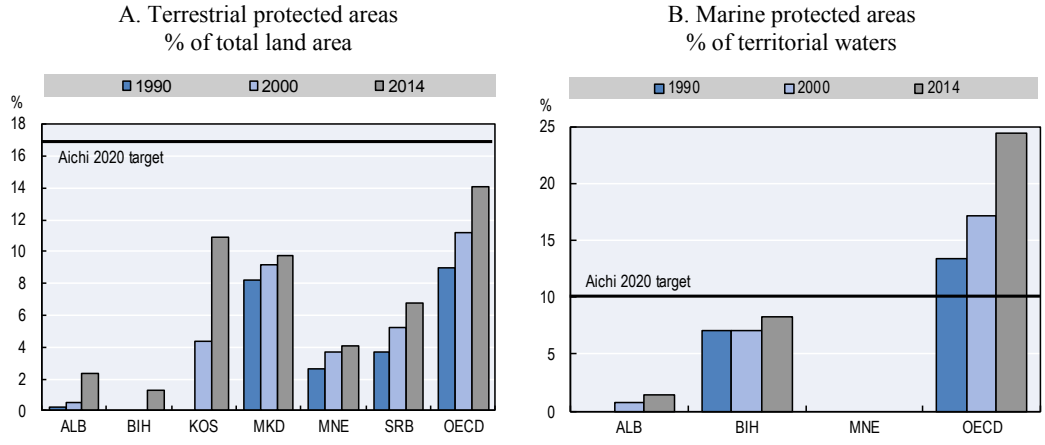
All the assessed SEE economies have adopted policy frameworks for biodiversity conservation apart from the Former Republic of Macedonia which has a draft. The implementation of the Former Yugoslav Republic of Macedonia's first biodiversity strategy was hampered by insufficient financial resources and institutional capacity, as well as poor co-ordination among the relevant bodies. The same combination of issues affects policy implementation in the other five economies, particularly in Bosnia and Herzegovina, where efforts to co-ordinate entity-level policy making and consistent, nationwide implementation have not been enough to overcome the complexity of their institutional set-up.

All the assessed economies except Kosovo are parties to the Convention on Biological Diversity, which includes 20 headline Aichi Biodiversity Targets (UN Environment, n.d.). 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." All six SEE economies have made some progress towards these targets, but most have been slow to designate new areas and have been considerably outpaced by

progress across the OECD (Figure 13.12.A). With over 10% of land area designated as protected, Kosovo and the Former Yugoslav Republic of Macedonia are leaders among the six SEE economies. Kosovo made considerable progress between 2000 and 2014, increasing its share of protected land from about 4% to 11%, while in the Former Yugoslav Republic of Macedonia, progress has been more gradual. Bosnia and Herzegovina had only protected a negligible share of its territory by 2000; despite a jump to 1.4% by 2014 it is not on course to achieve the Aichi target. Albania's share, although slightly higher, makes it similarly unlikely that it will reach 17% by 2020.

The three economies with marine territorial waters have been slow to establish marine protected areas (Figure 13.12.B). Montenegro, whose coastline and marine areas are increasingly under pressure from rapid developments in coastal tourism, is the only one of the three without any designated marine protected areas. Bosnia and Herzegovina's limited territorial waters should make it relatively easy to reach the Aichi goal of 10% by 2020. Albania, with its longer coastline, has more of a challenge, exacerbated by its slow progress in designating marine protected areas – it had barely reached 1.5% by 2014.

Figure 13.12. **Terrestrial and marine protected areas (1990, 2000 and 2014)**



Note: Kosovo data for terrestrial protected areas not available for 1990. The Former Yugoslav Republic of Macedonia, Kosovo and Serbia have no marine territorial waters.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators; MESP and AMMK (2015), *State of Environment in Kosovo 2015*, www.ammk-rks.net/repository/docs/Anglisht-final.pdf.

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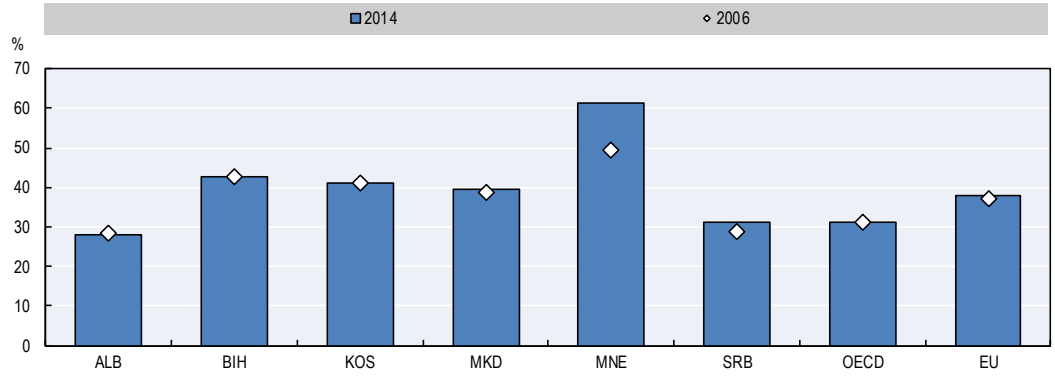
Forestry protection laws need to be more strongly enforced

Forests not only provide timber and other forest products, but also valuable ecosystem services. Healthy forests support irreplaceable reservoirs of biodiversity, act as carbon sinks and play an important role in regulating water, soil and air quality (OECD, 2017a). In flood-prone South East Europe, forests contribute to water management and, in particular, bolster flood resilience by absorbing excess rainwater in times of greater precipitation (EEA, 2015). Unlike some OECD countries, the six SEE economies are relatively rich in forests; they cover a larger share of territory than the OECD average in all assessed economies except for Albania and, to a lesser degree, Serbia.

With the exception of Albania, the share of land area covered by forests has remained constant or has moderately increased (Figure 13.13). Albania experienced rapid deforestation throughout the 1990s (forest area dropped from 7 900 to 7 700 km^2 between 1990 and 2000) followed by a period of recovery up until 2005 (rising to over 7 800 km^2); however, recent years have seen steady decreases. The current level of 7 750 km^2 is close to the low point at the end of the 1990s. Information from qualitative surveys shows that there is growing concern about deforestation across the six SEE economies. Threats to forests include illegal logging, unregulated real estate projects and illegal tree felling for firewood, especially in the winter (SEE SEP, 2016).

Figure 13.13. **Forest area (2006 and 2014)**

% of total land area



Note: Data for Kosovo unavailable before 2007.

Source: ASK (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from ASK; FAO (2017), *FAOSTAT* (database), http://faostat.fao.org.

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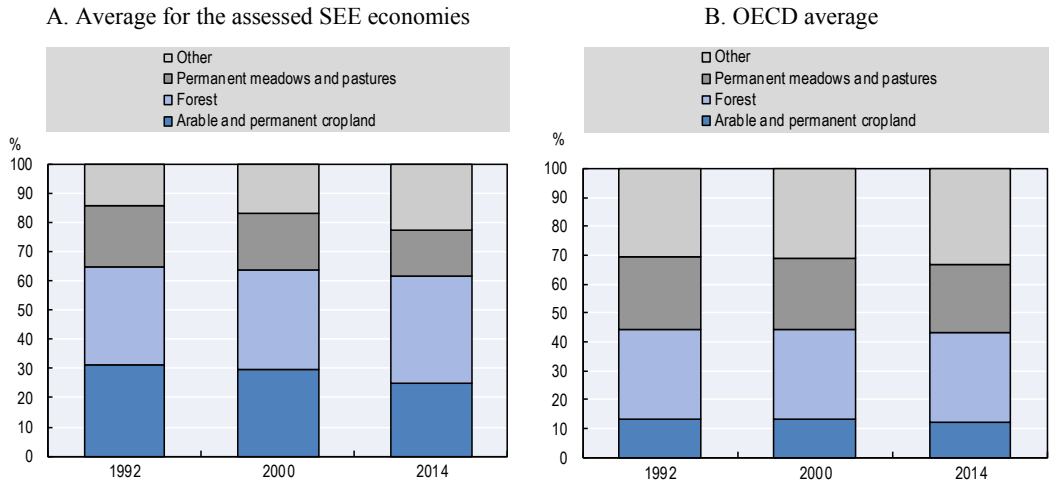
Albania, Kosovo, Montenegro and Serbia have adopted policy frameworks for forest management. The Former Yugoslav Republic of Macedonia is revising policies to align them with EU principles. Bosnia and Herzegovina's forestry framework lacks a strategic policy document at the state level, and the entity of the Federation of Bosnia and Herzegovina does not have a dedicated law for forests. To address this, in 2015 Albania adopted a ten-year moratorium on the commercial exploitation of forests, which began in 2016. Even when legal and policy frameworks are in place, local forest management capacity and enforcement are insufficient.

National and sub-national levels of land-use strategies are mostly in place

Land-use management shapes the spatial distribution of people, economic activity and environmental assets, with significant impacts on economic competitiveness, citizen well-being and environmental sustainability. The six SEE economies have the challenge of balancing, on the one hand, the pressure to convert land for urban development, agriculture, logging and mineral extraction, and on the other hand, the far-reaching consequences of land-use change for the environment. The heightened risks of soil degradation and desertification in the region – driven by various factors including unsustainable resource exploitation and development practices, and climatic factors – have warranted its inclusion in an annex dedicated to implementing the United Nations Convention to Combat Desertification in Central and Eastern Europe (UNCCD, 1994).

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 SEE economies than it does in OECD economies (Figure 13.14). Their share of agricultural land has, however, decreased in recent years. This trend is particularly marked in Montenegro, whose share of arable land had all but disappeared in 2014 (Figure 13.15). Kosovo's comparatively high population density puts greater pressure on available land and soil resources.

Figure 13.14. **Land use (1992, 2000 and 2014)**

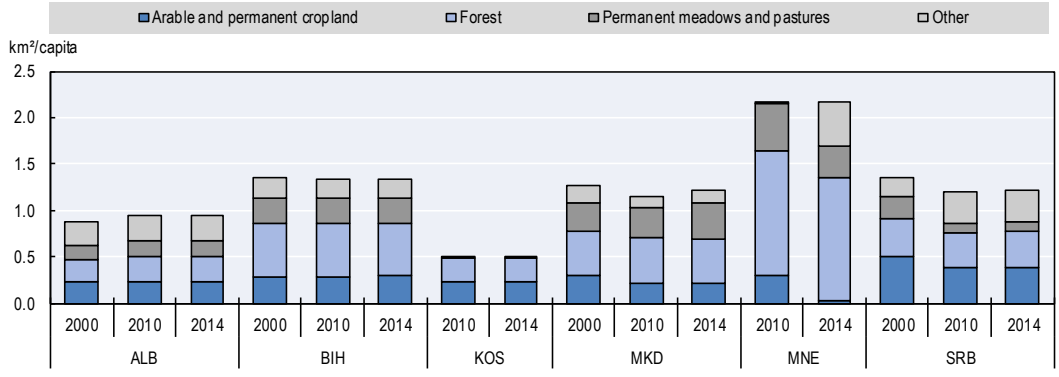


Note: Data reported as "Serbia and Montenegro" for 2000 and 1992. Data for Kosovo unavailable.

Source: FAO (2017), *FAOSTAT* (database), http://faostat.fao.org.

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Figure 13.15. **Per capita land use (2000, 2010 and 2014)**



Note: Data reported as "Serbia and Montenegro" for 2000 and 1992. Data for Kosovo in 2000 unavailable. Arable and permanent cropland data for Kosovo reflect utilised agricultural area.

Source: ASK (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from ASK; FAO (2017), *FAOSTAT* (database), http://faostat.fao.org.

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Most of the six economies have begun implementing land-use policies and addressing the challenge of illegal construction. All six have adopted basic legislation and outlined a general policy vision for land-use management, but they differ in the extent to which local and regional spatial plans are developed and aligned, as well as in the capacity and financial resources to support policy implementation. Kosovo, Montenegro and Serbia have designed and implemented functional land-use and spatial planning systems with accompanying local and/or regional plans. The Former Yugoslav Republic of Macedonia has also established a legal framework for land-use management and a national spatial plan; its local and regional plans cover a significant part of its territory. Albania is complementing its general policy framework with legally mandated spatial plans and capacity-building measures in municipal and regional structures. Albania has banned illegal buildings following stronger enforcement and the introduction of an electronic application process for permits. Bosnia and Herzegovina has adopted spatial plan legislation in both entities, but insufficient municipal funds and capacity have hindered them from developing and implementing local plans. Although inter-entity co-operation remains a concern in Bosnia and Herzegovina for spatial planning, some effective inter-entity and entity-state co-ordination has taken place, such as for planning highway networks.

The way forward for the natural asset base

All six SEE economies **need to make more efforts to implement existing water management strategies effectively.** To be effective, these strategies need to be complemented with integrated river basin management plans, taking into account the water resources' natural characteristics, including for transboundary river basins. This also means clearly defining the roles of government bodies, as well as co-ordination mechanisms among relevant government (in many cases, the ministries of agriculture and environment) and local implementing bodies. The OECD *Council Recommendation on Water* (2016c) and its forthcoming tool box can provide useful guidance for water sector reforms in the six SEE economies. France's decentralised and participatory approach to water management and financing is an example of how this can look in practice (Box 13.2).

To **strengthen forest management**, governments need to dedicate more resources to the relevant local authorities for capacity building and to strengthen forest law enforcement. They should strengthen efforts to combat illegal logging by punishing illegal behaviour and increasing the benefits of sustainable forest management, as well as reducing rewards for illegal logging by differentiating between legally and illegally sourced wood and closing markets. See *The Economics of Illegal Logging and Associated Trade* (Contreras-Hermosilla, Doornbosch and Lodge, 2007) for more detail. Further policy options to address deforestation are described in *Initial Review of Policies and Incentives to Reduce GHG Emissions from Deforestation* (Karousakis, 2006). Bosnia and Herzegovina needs to develop a coherent state-level forest management strategy, through greater co-ordination between the entity-level bodies in charge of existing strategies. The Federation of Bosnia and Herzegovina needs to adopt a dedicated law for forest protection.

The six SEE economies need to step up their efforts to meet the Aichi Biodiversity Target for protected areas. Terrestrial protected areas are particularly lacking in Albania, Bosnia and Herzegovina, and Montenegro. Serbia, the Former Yugoslav Republic of Macedonia and even Kosovo are unlikely to meet the 2020 target at current rates. As human pressures increase, Albania and Montenegro need to establish marine protected areas. Beyond protected areas, these economies should consider economic

instruments for biodiversity conservation and sustainable use such as biodiversity-relevant taxes, biodiversity offsets and payments for ecosystem services. The Recommendation of the Council on the Use of Economic Instruments in Promoting the Conservation and Sustainable Use of Biodiversity (OECD, 2004) provides useful guidance in this regard.

More resources for capacity building at the local level are needed to develop and implement aligned and well-designed regional and local spatial plans. Better local capacity for processing and enforcing permits will also help combat the ongoing problem of illegal construction. Despite considerable progress in spatial planning and land-use management in the six SEE economies, unregulated and illegal building activity continues to put pressure on land resources. Montenegro and Serbia should continue to develop their register of buildings without permits and continue their legalisation procedures for these buildings.

Box 13.2. **Good practice: Water management in France**

French water policy is based on using environmental taxation to finance measures to manage water resources in a decentralised, participatory system. The system includes six water agencies that implement national and EU policies at the local level for seven catchment basins, under the Ministry of Sustainable Development.

Water financing and pricing is based on two principles. First, the "water pays for water" principle means the water sector should not receive subsidies from government budgets, but subsidies from within the water sector are acceptable. Local spending on investment and operating costs must be covered by collecting user fees in the public sector (for drinking water and sanitation) and the private sector (for industrial activities and agriculture). Second, the "polluter pays" and "user pays" principle extends the first principle to recover the cost of pollution.

A variety of taxes target water abstraction and pollution to internalise the environmental costs of various activities. The tax rate can be higher than the standard rate when the water resource is in a geographical zone subject to increased environmental pressures or is more sensitive to a particular negative externality. These geographical zones are defined at the municipal level.

Each water agency has its own basin committee, comprising elected representatives of sub-national government, water users and state representatives. Having these diverse stakeholders in a decision-making body facilitates consultation between different sectors and makes taxes easier to accept, as users understand they are making an investment in their own water infrastructure. Furthermore, basin committee representation including the different user categories and the representative appointment process is regularly reviewed and adjusted to strike the right balance in the range of actors.

The basin committees regularly review and update the subjects and rates of taxation to reflect new priorities as new sources of pollution emerge. Contributions from different users are updated based on analyses of user contributions, benefits and the degradation of aquatic environments, to keep the system more equitable.

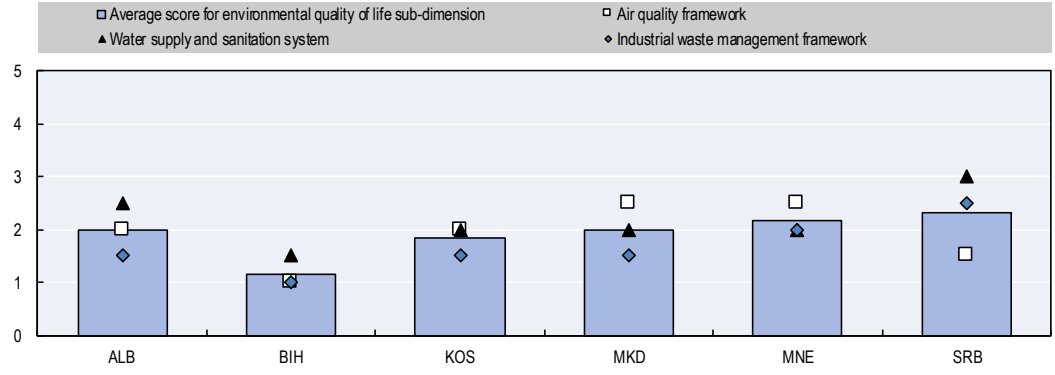
Source: OECD (2015e), "Financing water quality management and investment in infrastructure: Water policy in France: A decentralised and participatory system", www.oecd.org/environment/resources/France-case-study-financing-water-quality-and-investment-diffuse-pollution.pdf.

Environmental quality of life

Environmental services such as clean water, sanitation and green space; and environmental risks such as natural disasters and air pollution; directly affect people's quality of life and well-being. Air pollution is a significant environmental health risk resulting in premature deaths and respiratory diseases which can reduce labour productivity. It can also result in reduced crop yields (OECD, 2016d). Similarly, while high-quality water supply and sanitation services strengthen public health by reducing health risks, the absence of such services increases health costs and decreases labour productivity. Finally, poorly managed industrial waste can result in contaminated land, with serious health and environmental ramifications. Three qualitative indicators assess the existence and degree of implementation of frameworks for 1) air quality; 2) water supply and sanitation; and 3) industrial waste management.

On average, the six SEE economies score 1.9 for this sub-dimension, indicating that these three policy frameworks are mostly adopted (Figure 13.16). On average, frameworks for air quality and water supply and sanitation are in place, while frameworks for industrial waste management lag behind. Serbia has made the most progress in implementing both its water supply and sanitation framework and its industrial waste management framework. Meanwhile, Bosnia and Herzegovina has some room to catch up to its peers in each area.

Figure 13.16. **Environmental quality of life: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

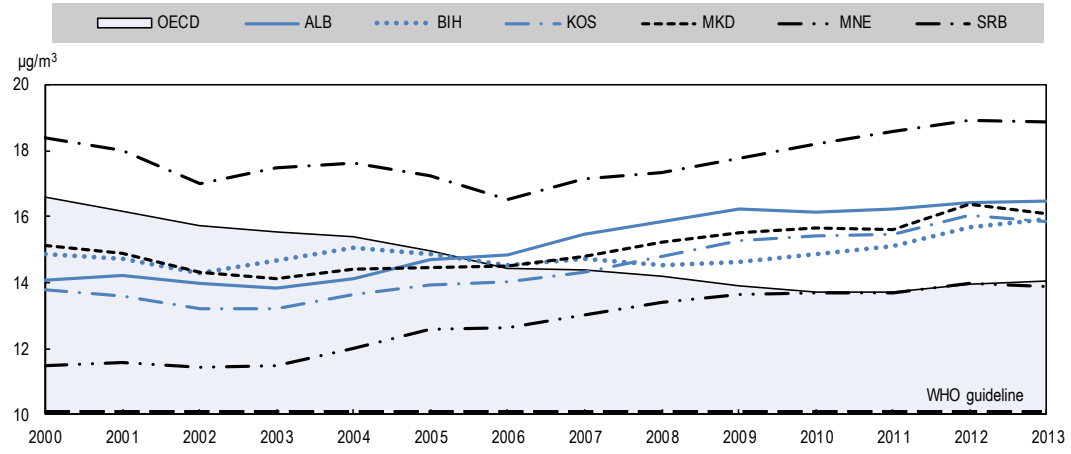
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Action is needed to address high levels of air pollution

Air pollution increases mortality and morbidity rates through greater incidence of pulmonary disease. A sicker population spends more time receiving care in hospitals, which leads to higher healthcare expenditures, lost working days, decreased quality of life and lower life expectancy. Air pollution – through high concentrations of ground-level ozone (O_3) and fine particulate matter ($PM_{2.5}$) – also reduces crop yields. Non-OECD, non-EU European economies including South East Europe were found to be among the most susceptible to changes in crop yields caused by air pollution, especially wheat, with a model predicting up to a 20% decrease in yields by 2060 (OECD, 2016d). Given that agriculture accounts for a considerably larger portion of the economy than in the OECD, these economies could be particularly vulnerable to the negative effects of air pollution.

The exposure of each assessed SEE economy's population to $PM_{2.5}$ has steadily increased over the past decade, while over the same period, abatement efforts in the OECD have reduced fine particulate matter ($PM_{2.5}$) exposure considerably (Figure 13.17). The exposure levels in the SEE economies are well above the World Health Organisation Air Quality Guideline for annual $PM_{2.5}$ exposure (10 micrograms per cubic metre, $\mu g/m^3$). Even this level of exposure is associated with elevated risk of disease. Despite improvements in the early 2000s, Serbia's $PM_{2.5}$ exposure has increased to reach 2000 levels, and remain the highest in the region. Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia and Kosovo, which had lower exposure rates at the turn of the century, have all surpassed the OECD average for particulate matter concentrations; Montenegro's comparatively clean air has deteriorated rapidly in recent years and is now on a par with the OECD average. Across the assessed economies, the problem is even worse in winter, when the local topography, traffic and low-quality household heating using wood or coal lead to extreme smog.

Figure 13.17. **Mean population exposure to $PM_{2.5}$ air pollution (2000-13)**



Note: $\mu g/m^3$ – micrograms per cubic metre; $PM_{2.5}$ – fine particulate matter. All data points are moving five-year averages.

Kosovo data points are the population-weighted averages of macro-regional data for Kosovo, Kosovska Mitrovica, Kosovsko Pomoravlje, Peć and Prizren macro-regions. Serbia data are the population-weighted averages of macro-regional data concerning the remaining 25 macro-regions.

Source: OECD (2017e), "Exposure to air pollution", *OECD Environment Statistics* (database), http://dx.doi.org/10.1787/env-data-en.

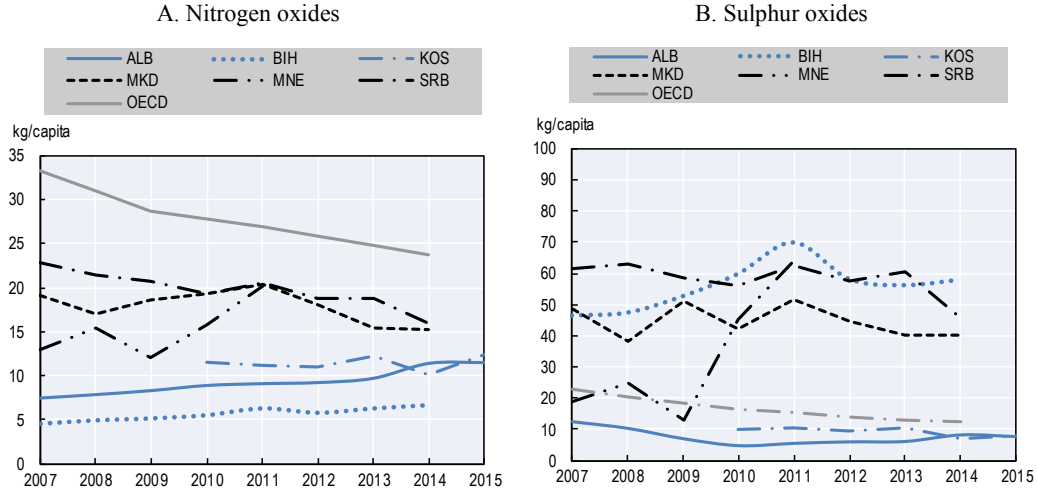
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Motor vehicle emissions in densely populated areas are a major source of exposure to nitrogen oxides (NO_X). NO_X emissions per capita among the six SEE economies are well below the OECD average, although Albania and the Republika Srpska in Bosnia and Herzegovina have gradually increased their emissions in recent years (Figure 13.18.A). At the same time OECD countries and Serbia have curbed theirs.

Exposure rates of sulphur oxides (SO_X) vary more widely across the six economies. Apart from Albania, a major factor of the assessed economies' high emission rates of SO_X is their reliance on coal-fired power plants, some of which are not equipped with the appropriate filters. Four of the economies – Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia – release far more SO_X per

capita than Albania and Kosovo, which emit slightly lower levels than the OECD average (Figure 13.18.B). Bosnia and Herzegovina's emissions are even higher than they appear in this figure, since data were only available from one of its two entities. Fuel standards in Bosnia and Herzegovina, which allow considerably higher sulphur content in both diesel and petrol fuels than in the other five economies, contribute to its high emission rates (FuelsEurope, 2017).

Figure 13.18. **Air pollutant emissions per capita (2007-15)**



Note: Data for Bosnia and Herzegovina refer to the Republika Srpska only. Data for Kosovo refer to emissions from its coal-fired power plants only.

Source: ASK (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from ASK; EPAM (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from EPAM; MOE (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from MOE; MOEPP (2016), "Air pollution", www.moepp.gov.mk/?page_id=746&lang=en; RHMZRS (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from RHMZRS; SEPA (2016), "Competitiveness in South East Europe: A Policy Outlook 2018: Environmental Policy Questionnaire", Responses to the OECD received from SEPA; OECD (2014a), "Air and GHG emissions" (indicator), http://dx.doi.org/10.1787/93d10cf7-en.

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The Former Yugoslav Republic of Macedonia and Montenegro have adopted air quality frameworks and begun developing corresponding action plans for areas with higher levels of air pollution. Legislation in Montenegro and the Former Yugoslav Republic of Macedonia is fairly well aligned with the EU *acquis* on air quality (such as Directive 2008/50/EC on ambient air quality); both economies also maintain well-functioning networks of automatic monitoring stations. Albania and Kosovo have adopted policy frameworks with clearly defined objectives and legislation that is nearing alignment with EU directives (including Directive 1999/30/EC relating to limit values for sulphur dioxide), but implementation has been lacking. Albania has a network of basic air quality monitoring stations, including stations that continuously perform measurements of SO_2, NO_x, carbon monoxide, benzene, O_3, coarse particulate matter (PM_{10}), fine particulate matter ($PM_{2.5}$) and lead. Kosovo's Hydrometeorology Institute maintains a basic network of stations that contribute to monitoring, but consistent real-time automatic monitoring is

required to ensure immediate action if limits are exceeded. Serbia's framework is largely in place and some local air quality plans have been adopted, but no plans exist for polluted areas. Bosnia and Herzegovina has adopted some air pollution control legislation, but it needs to be strengthened and implemented; it still lacks an effective national air monitoring network. The EC regulation on the European Pollutant Release and Transfer Register provides for collecting information on pollutant releases from large industrial facilities. Serbia and Kosovo have this system in place and are reporting, while the rest of the assessed economies are making progress but are not yet reporting aside from Montenegro which is still at an early stage.

Water supply and sanitation strategies are relatively advanced

Access to clean drinking water and sanitation reduces health risks and costs, resulting in increased labour productivity. On the other hand, insufficiently treated wastewater pollutes surface water and ecosystems (OECD, 2011b).

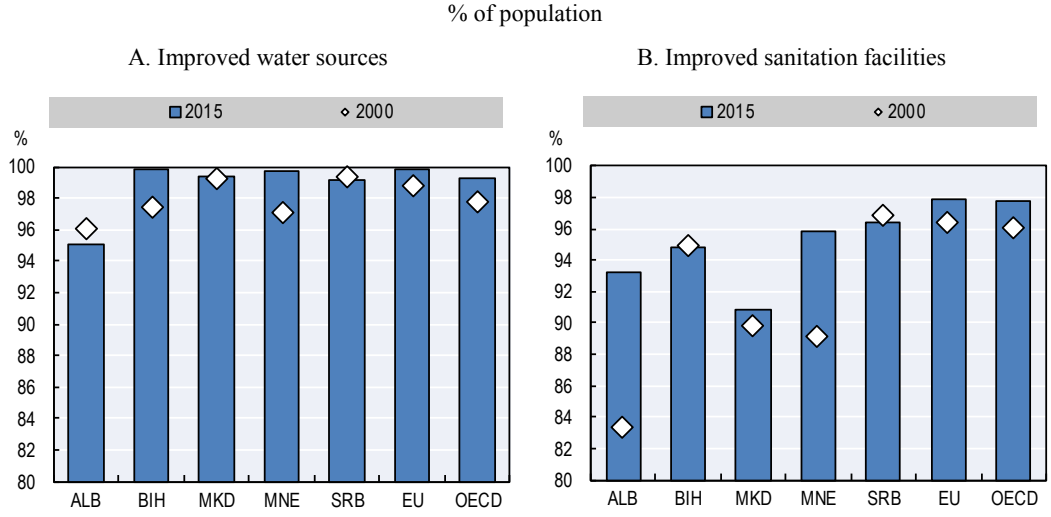
Access to an improved water source (e.g. household connection, public standpipe or protected dug well) is nearly universal in all assessed economies, except Kosovo – for which data are unavailable (Figure 13.19.A). Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia have maintained rates above 99% over the past few years, in line with the EU and the OECD. Access in Albania is less universal, at 95%. A smaller share of the population is connected to the public water supply – 87% in Kosovo (2015), 83% in Serbia (2015), 81% in Albania 76% in Montenegro (2012), 75% in the Former Yugoslav Republic of Macedonia (2012), and 56% in Bosnia and Herzegovina (Eurostat, 2017d; Michaud et al., 2015; WSRA, 2016).

Over 90% of the populations in the assessed economies are connected to improved sanitation facilities (e.g. connection to a public sewer or septic system, pour-flush latrine, simple pit latrine) (Figure 13.19.B). Albania and Montenegro have made considerable progress over the past decade. However, the assessed economies are still below the OECD and EU level of about 98%.

Data on sewage systems and wastewater treatment are less comprehensive, but they seem to indicate a similar general upward trend. From 2010 to 2015, the share of population connected to a sewage system increased in Albania (to 50%), in Kosovo (from 48% to 65%), in Montenegro (from 66% to 68%) and in Serbia (from 52% to 59%). While the majority of these economies' populations now enjoy access to sewage systems, far fewer people are connected to wastewater treatment facilities. The share of the population whose wastewater is connected to a sewage treatment plant in Montenegro was 18% (2012), 13% in Albania (2013) and the Former Yugoslav Republic of Macedonia (2012), in Serbia 11.8% (2015), 3.6% in Bosnia and Herzegovina (2015) and in Kosovo since 2011 a pilot treatment plant has covered less than 1% (Michaud et al., 2015; UNSD, 2017; WSRA, 2016). By way of comparison, Slovenia – an OECD member with relatively low coverage – reached a rate of almost 60% in 2015 (OECD, 2017a).

Water supply and sanitation strategies are relatively advanced among the six SEE economies. Serbia has adopted a strategy that is aligned with the EU Water Framework Directive (2000/60/EC) and prepared a preliminary implementation plan. Serbia's new strategy shifts away from the traditional water quality management approach based exclusively on environmental quality standards. Instead, it has opted for a combined approach consisting of proactive pollution mitigation measures and stricter enforcement when environmental quality standards are not met. Albania has adopted a strategy for

Figure 13.19. **Access to improved water sources and sanitation facilities (2000 and 2015)**



Note: Data for Kosovo unavailable.

Source: World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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water supply and sewerage which is accompanied by a plan for investments in the sector, and is in the process of aligning its legislation with the EU *acquis*. Kosovo has a policy framework with clearly defined objectives in place, but water and sanitation investment plans are not based on river basin plans. Although both the Former Yugoslav Republic of Macedonia and Montenegro have adopted policy frameworks, they still have shortcomings. The mechanism for funding the objectives in the Former Yugoslav Republic of Macedonia's framework is unclear, while the framework in Montenegro is not in line with the EU *acquis*. In Bosnia and Herzegovina, some water supply and sanitation measures are included in integrated water management strategies, but the large number of agencies involved in water supply and sanitation and the lack of co-ordination between them have slowed progress.

Water supply and sanitation infrastructure projects are still largely dependent on donor funding throughout the assessed economies, and water tariffs remain too low to cover service costs. The long-term affordability of new infrastructure maintenance under these conditions appears doubtful. Albania and Kosovo have taken a good first step by entrusting water tariff-setting responsibilities to independent water regulators and gradually increasing tariff levels. The Former Yugoslav Republic of Macedonia has also transferred competence for water tariff regulation to an independent body, its energy regulatory commission.

Industrial waste management is progressing

Industry, mining and construction activities all have the potential to be highly polluting. Effective industrial waste management safeguards the environment and public health from these risks.

In Serbia, legislation is mostly aligned with the EU *acquis*, including environmental liability (Directive 2004/35/EC). Data on hazardous waste are scarce and as no hazardous waste disposal facilities exist, it must be exported for treatment. However, these issues are addressed in the new waste strategy that Serbia is currently developing. Montenegro is progressing towards full transposition of the EU Directive 2010/75/EU on industrial emissions, and its legislation is almost fully aligned with other EU directives on industry and environmental liability. Albania, Kosovo and the Former Yugoslav Republic of Macedonia have adopted limited industrial waste management policy measures as part of broader waste management strategies. They have all made progress in transposing the EU directive on industrial emissions, although a lack of capacity is hampering the issuance of integrated permits (see environmental policy framework qualitative indicator). Bosnia and Herzegovina has adopted strategies and legislation that cover some aspects of industrial waste management, but the framework does not meet all the EU directives' requirements.

Little has been done throughout the region to clean up sites contaminated in the past. None of the six SEE economies has adopted plans with clear targets and secure budgets to address this, and little data are available on the issue. According to the Kosovo Agency of Statistics, Kosovo cleaned up 2 of its 27 contaminated sites between 2011 and 2013. Although Albania, Montenegro, and Serbia have identified contaminated areas they have not proceeded to clean them up (no data have been supplied for Bosnia and Herzegovina or the Former Yugoslav Republic of Macedonia).

The way forward for environmental quality of life

The six SEE economies need to improve their air quality monitoring systems. They could consider installing automatic all-day monitoring stations set up for real-time data production, especially for pollutants with immediate human health risks like fine particulate matter and ground-level ozone. Economies should encourage self-reporting by industries by implementing the Pollutant Release and Transfer Register. They should align abatement targets with policy developments in other sectors, particularly to reconsider the planned expansion of coal-fired power generation capacity.

The economies should funnel more investment into treating more wastewater to reduce effects on the environment. All six SEE economies should seek to wean themselves off donor funds and finance more projects from water tariffs and domestic government budgets. They should transition towards tariffs that cover the costs of service and, eventually, infrastructure.

Most of the six SEE economies have identified historically contaminated sites, according to available but limited data. However, they have taken little action to clean them up. As a first step, **they could consider drafting targeted clean-up action plans** with associated budgets and financial plans for contaminated sites.

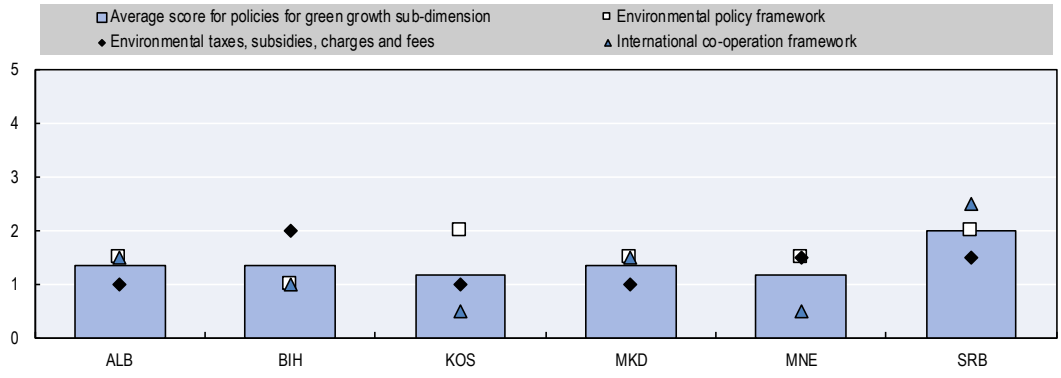
All six SEE economies have comparatively underdeveloped industrial waste management strategies, but have made good progress in transposing EU directives, such as the one on industrial emissions. **They should ensure that when they transpose these directives they also develop the required capacity** to ensure that environmentally risky activities comply with legal environmental liability; that they are insured for potential liabilities; and that waste owners demonstrate financial assurance for closure costs and post-closure care of hazardous waste.

Policies for green growth

Effective policies can facilitate green growth – that is, fostering economic growth and development while ensuring that natural assets continue to provide the resources and environmental services on which citizen well-being relies (OECD, 2011a). Policies and regulation can spur innovation and new markets for greener technology and new jobs. Prices and taxes address negative externalities by encouraging emissions mitigation and resource productivity at the least cost, while potentially raising revenues for governments (OECD, 2016e). Investor confidence grows through stable and predictable policy responses to environmental issues. Because policies that affect the environment are typically cross-cutting, environmental considerations should be reflected in economic and sectoral policies, and vice versa. In addition to government co-ordination, environmental policy frameworks must be equipped with tools that allow them to address the environmental implications of economic activities across sectors. Three qualitative indicators assess the existence and degree of implementation of frameworks for 1) environmental policy; 2) environmental taxes, subsidies, charges and fees; and 3) international co-operation.

On average, the six SEE economies score 1.4 on this sub-dimension overall, indicating that policy frameworks are yet to be adopted (Figure 13.20). Across the assessed economies, environmental policy frameworks are mostly in place, but environmental taxes and international co-operation mechanisms are largely lacking. Serbia is the most advanced in all these areas, with the rest of the assessed economies at a similar level.

Figure 13.20. **Policies for green growth: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Environmental policy frameworks need to be reinforced in key economic and sectoral policies

Effective governance for green growth engages a wide variety of government bodies in a co-ordinated way to achieve its clear, strategic, long-term vision that links national economic and social objectives. In addition to government co-ordination, environmental policy frameworks must be equipped with tools that allow them to regulate the environmental implications of economic activities across all sectors. In particular, environmental impact assessment (EIA) and strategic environmental assessment (SEA) ensure that environmental concerns are identified and addressed before projects are undertaken. Integrated pollution prevention and control (IPPC) regulation requires industrial activities with a high pollution potential to have a permit. While other tools

exist, these three are particularly relevant for the six SEE economies because they have associated EU directives, the adoption of which supports the economies' goal of EU membership.

The assessed SEE economies have a variety of policies and tools to co-ordinate environmental objectives across the environment, economic development and sectoral policies. Every SEE economy has either a dedicated strategy for environment approximation or has it included in a wider approximation strategy and/or environment strategy. Montenegro's overarching sustainable development strategy includes environmental objectives as does the Former Yugoslav Republic of Macedonia's draft strategy. The entities in Bosnia and Herzegovina, Kosovo, and Serbia have strategies on environmental protection and Albania has a draft one. The Former Yugoslav Republic of Macedonia and Serbia have sustainable development councils, but they appear to be inactive. In Montenegro, their sustainable development council has been a useful forum to convene stakeholders from across the government (Government of Montenegro, 2017). Although Bosnia and Herzegovina has the Inter-Entity Steering Committee for the Environment to facilitate entity co-ordination, its fragmented and complex administration is still a challenge to policy and legal co-ordination. In 2017, Serbia established a separate ministry for environmental protection.

The transposition of the SEA and EIA Directives (2001/42/EC and 2014/52/EU) is nearly complete in Albania, Kosovo and Serbia, and it is progressing well in the Former Yugoslav Republic of Macedonia and Montenegro. In Bosnia and Herzegovina, both constituent entities are aligning their legislation with the EU directives, but their complex institutional set-up has held back progress. In terms of implementation, SEAs are not regularly conducted. While EIAs are being carried out throughout the assessed economies, they do not follow standard procedures and fail to act as an effective tool for minimising negative environmental impacts of projects. The poor quality of assessments can be attributed to insufficient public engagement and transparency during the decision-making process; a lack of financial resources and guidance; and inexperienced, poorly equipped staff. Capacity problems also hinder the regulating authorities' ability to monitor permit holders' environmental performance and enforce environmental standards (SEE SEP/WWF Adria, 2015).

Integrated pollution prevention and control legislation exists in all six SEE economies, although Montenegro's permitting is not based on best available techniques (BAT) principles. Institutions are in place across the assessed economies, including an environmental permitting authority and enforcement agency, but implementation is at an early stage – both in issuing appropriate integrated permits and enforcing them effectively.

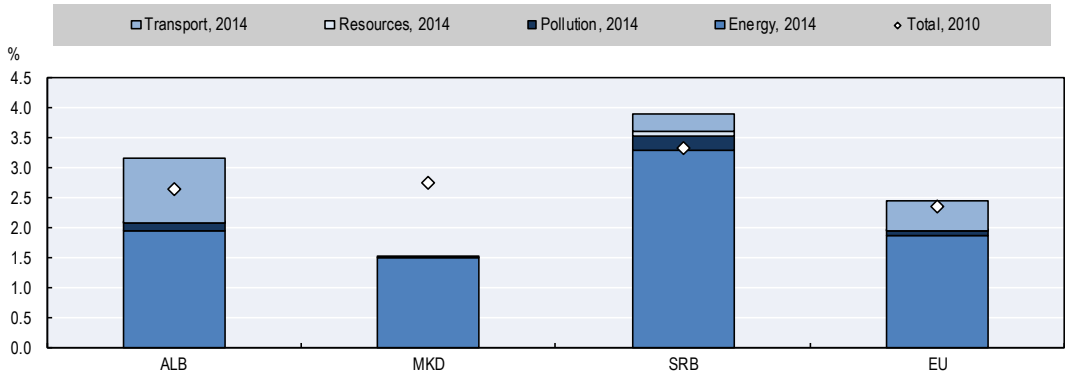
Taxes, subsidies, charges and fees should better reflect environmental costs

Economic instruments, such as taxes, subsidies and emissions trading systems, offer an economically efficient alternative to command-and-control regulatory instruments. By placing the tax burden more directly on environmentally harmful consumption and production patterns, well-designed environmental taxes provide incentives for abatement with more flexibility than prescriptive technology standards, allowing firms to achieve abatement at lowest cost. Government support measures for environmentally harmful economic activity should be phased out to avoid undermining environmental policies; for example, subsidies for carbon-intensive fossil fuels counteract climate change mitigation goals (OECD, 2017a). For data on energy subsidies in the six SEE economies, see Chapter 12 (Energy policy).

The tax mix in the SEE economies is tilted towards a higher tax burden on labour and indirect taxes (social security contributions and value-added taxes) and a lower tax burden on corporate and personal income tax rates. As such, social security contributions and value-added taxes are the largest sources of tax revenue in the assessed SEE economies (see Chapter 4, Tax policy, for more information). The tax burden and corresponding revenues related to environmental taxes is lower. Similar to the EU, taxes on energy consumption in the assessed SEE economies generate the most environmentally related tax revenue (Figure 13.21).

Figure 13.21. **Revenue from environmental tax (2010 and 2014)**

% of GDP



Note: Bosnia and Herzegovina, Kosovo, and Montenegro data not available. Albania data are provisional; the Former Yugoslav Republic of Macedonia data not available for transport.

Source: Eurostat (2017e), "Environmental taxes by economic activity", *Environment* (database), http://ec.europa.eu/eurostat/data/database; World Bank (2017), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933706354

In the six SEE economies, the polluter pays principle is enshrined in legislation, but the design of taxes and charges does not reflect this principle in practice. Most of the assessed economies collect excise taxes on fuel, but there is no consistent price on carbon emissions through taxes on activities such as coal mining or an explicit carbon tax. In the OECD, carbon tax systems are not common, with nationwide carbon taxes implemented or scheduled for implementation in only 17 OECD member countries and a handful of sub-national districts, but the popularity of carbon pricing schemes is growing quickly (World Bank Group, 2016).

All six SEE economies have introduced a number of environmental charges and taxes, but many are set at levels too low to provide incentives to change production and consumption behaviour. The tariffs on electricity, water supply and sanitation, and waste collection are too low to achieve cost recovery or encourage sustainable consumption.

In Bosnia and Herzegovina, both constituent entities have established environmental funds to mobilise resources for environmental projects – these are the only functioning environmental funds among the assessed economies. Environmental funds have also been proposed in Kosovo and Montenegro. Albania has recently established a fund to subsidise energy efficiency measures. Serbia had an environmental fund, but it was abolished in 2012.

Implementation of international agreements and standards should be enhanced

Environmental concerns can be transboundary, and policy responses must be co-ordinated across borders to address them effectively and equitably. Multilateral environmental agreements (MEAs) brokered through organisations like the United Nations (particularly the UN Environment Programme and the United Nations Economic Commission for Europe), are important tools for creating transboundary norms. Competitiveness concerns may also encourage governments that find it difficult to act individually for political reasons to seek co-operative solutions to environmental problems through MEAs. While the assessed economies, aside from Kosovo, are signatories to key MEAs as described throughout the chapter, efforts to integrate the associated commitments into policies and implement them are at an early stage.

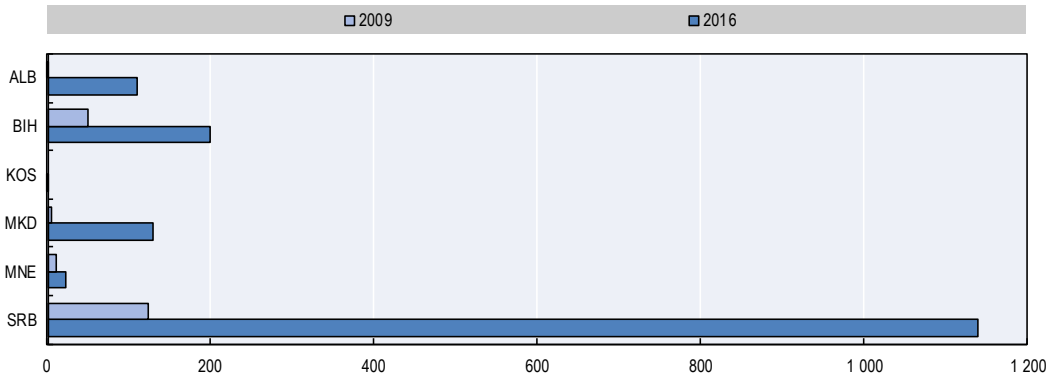
International co-operation measures can directly promote the environmental aspects of economic activities. These measures can be as diverse as encouraging corporate social responsibility, introducing environmental labelling and information schemes, and removing the barriers to trade in environmental goods and services.

Some corporate social responsibility strategies do exist in the six SEE economies, including for environmentally responsible business conduct. Serbia has adopted a Strategy on Development and Promotion of Socially Responsible Business Operations, which focuses not only on corporate social responsibility but also on attracting investment. Albania and the Former Yugoslav Republic of Macedonia also have corporate social responsibility action plans. Montenegro has a policy document on corporate social responsibility, and its broader development strategy also contains measures to encourage corporate social responsibility. Corporate social responsibility activities in the six SEE economies have largely been driven by private-sector initiatives and organised through networks of participating firms, but in Bosnia and Herzegovina and Kosovo these networks have not been complemented with or supported by government actions.

Ecolabelling schemes have arisen following consumer demand to be able to easily identify and purchase environmentally preferable products. As such, businesses see environmental labels as a market advantage, especially when exporting to more developed countries where demand for goods with ecolabels is stronger. Governments may administer mandatory and voluntary programmes. Successful ecolabels are those that are accepted by consumers, such as those in the EU (Earley and Anderson, 2003). Both Albania and Serbia have begun issuing voluntary ecolabels in line with EU regulations. The remaining assessed economies have some legislation in place, but have yet to issue them.

Non-governmental environmental labelling programmes include the International Organisation for Standardisation (ISO) 14000 series. Several companies and organisations, particularly in Serbia, have adopted the environmental management standards set by the ISO 14001, which defines criteria for an effective environmental management system. The uptake of ISO 14001 standards has not, however, been universal in the assessed economies, and Serbia has far outpaced its peers, especially since 2013 (Figure 13.22). ISO standards are not by any means a replacement for effective environmental assessments, especially since the certificates have no environmental performance component.

Figure 13.22. **Number of ISO 14001 certificates (2009 and 2016)**



Note: Data for Kosovo unavailable before 2016.

Source: ISO (2017), *ISO Survey of Management System Standard Certification* (database), http://isotc.iso.org/livelink/livelink?func=ll&objId=18808772&objAction=browse&viewType=1.

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The way forward for green growth policies

The six SEE economies have scope to **strengthen how environmental issues are addressed in overarching economic development and sectoral policies** – especially energy, transport and agriculture. *A Framework for Assessing Green Growth Policies* provides guidance on assessing policies with economic efficiency and growth objectives (de Serres, Murtin and Nicoletti, 2010). They should strengthen both horizontal and vertical co-ordination mechanisms. In Bosnia and Herzegovina there is a need to enhance the coherence of their environmental policies at the national level.

The six SEE economies should strengthen the collection of key environmental statistics and policy monitoring and evaluation activities. High-quality, basic statistics on the environment are essential for creating evidence-based policy across economic development and sectoral policy areas. They should make monitoring and evaluation activities routine and comprehensive to assess the state of the environment and the effectiveness of environmental policies. See Box 13.3 for an example of how Slovenia practices environmental policy and monitoring.

In the six SEE economies, the progress made in transposing EU legislation on SEAs and EIAs needs to be coupled with capacity building and quality-control measures to **improve the efficacy of environmental impact assessments**. Assessment documents should be made publicly available and stakeholder consultations (that include representatives of the private sector, civil society and academia) should be carried out systematically over sufficiently long periods.

The six SEE economies should continue their efforts to **strengthen integrated pollution prevention and control permitting procedures**, including an integrated analysis and public participation. They should carry out subsequent enforcement activities using risk-based inspections and set fines at a level high enough to dissuade infractions.

The six SEE economies should strengthen their use of economic instruments. While specific environmental taxes are collected in the six SEE economies and excise taxes on fuel are common, there is scope to broaden the tax base, reduce exemptions and

in some cases increase tax levels or introduce explicit carbon pricing schemes. Taxes could be shifted from labour towards environmental resource use and pollution, in line with the objective of the European Union's Seventh Environment Action Programme, which guides EU environmental policy until 2020.

Box 13.3. **Good practice: Environmental policy monitoring and evaluation in Slovenia**

Slovenia has established effective monitoring and evaluation practices by building on the OECD Green Growth indicator framework. This framework highlights key, actionable information aligned with Sustainable Development Goals in a concise and standard way, and is aligned with the System of Environmental and Economic Accounting guidelines.

Applying the framework, a committee selected 14 of the most relevant OECD Green Growth indicators as the basis for monitoring and evaluation. These indicators included emissions productivity, energy productivity, air pollution, budget for green research and development, and environmental taxes.

The committee then complemented the indicator set with five of their own indicators, such as separate waste collection, drinking water pollution and agricultural area, to best fit its national context. The statistics are reported with engaging, easy-to-understand figures in the statistical office's *Green Growth Indicators for Slovenia Report* (Žitnik, Šteharnik and Rutar, 2014) and on its website. Statistics are updated once a year and published on their website.

Slovenia has found both the process and the resulting report useful in raising awareness of environmental issues across policy areas, improving co-operation across government institutions, and strengthening the monitoring and evaluation of their progress towards green growth.

Slovenia is one of over 20 countries to date that have tailored the OECD Green Growth indicator framework to suit their national circumstances in pursuit of green growth, assessing their progress towards green growth with key, internationally comparable environmental indicators. International organisations, including those participating in the Green Growth Knowledge Platform (the Global Green Growth Institute, UN Environment and the World Bank) have also used the OECD Green Growth measurement framework and related indicators in their own reports, such as *Moving Towards a Common Approach on Green Growth Indicators* (GGKP, 2013) and *Measuring Inclusive Green Growth at the Country Level* (GGKP, 2016).

Source: Žitnik, Šteharnik and Rutar (2014), *Green Growth Indicators for Slovenia*, https://www.oecd.org/greengrowth/Green%20growth%20indicators%20in%20Slovenia%202014.pdf; OECD (2017a) *Green Growth Indicators 2017*, http://dx.doi.org/10.1787/9789264268586-en; and OECD (2014b), *Green Growth Indicators 2014*, http://dx.doi.org/10.1787/9789264202030-en.

The six SEE economies should evaluate the performance of existing and design of planned environmental funds. The OECD has produced a large body of useful guidance on evaluating the performance of public environmental funds, particularly in emerging and transition economies – see *Good Practices of Public Environmental Expenditure Management* (PEEM) (OECD, 2003). This builds on the *St. Petersburg Guidelines on Environmental Funds in the Transition to a Market Economy* (OECD, 1995). The OECD more recently extended the guidelines' application to all public agencies managing environmental expenditure programmes; see the OECD Council recommendation on good practices for PEEM (OECD, 2006).

While the assessed SEE economies have made progress by becoming parties and signatories of MEAs, **more efforts are needed to meet the commitments MEAs entail** – for example meeting their objectives as set by their Nationally Determined

Contributions under the Paris Agreement and the Convention on Biological Diversity's Aichi Biodiversity Targets.

The six SEE economies need to put an enabling policy environment in place to attract green investment and innovation, such as to exploit the potential use of renewable energy technologies. The OECD Centre on Green Finance and Investment develops policies, institutions and instruments for green finance and investment (OECD, 2017f). The OECD Guidelines for Multinational Enterprises outlines how governments can enable responsible business conduct, including environmental considerations, through effective regulation and measures (OECD, 2016f). Both are valuable resources for the six SEE economies to help them seize available opportunities through ambitious and effective green growth policies.

Conclusions

All six SEE economies are making progress in putting policy, legal, regulatory and institutional frameworks in place to achieve environmental objectives. They have, in particular, made progress in transposing key EU environmental directives and have developed strategies to approximate the remaining legislation. All assessed SEE economies except Bosnia and Herzegovina have adopted legislation for SEAs and EIAs, but further efforts are needed to use them consistently and effectively across economic sectors. Public participation in decision making needs to be enhanced. The six SEE economies have limited legal and policy frameworks in place to manage land, biodiversity, forestry and water. They need to adopt those elements that are still missing and reinforce their implementation and enforcement. For effective implementation, the economies need to define clear roles, responsibilities and co-ordination mechanisms among relevant government bodies at the central, regional and local levels, accompanied by sufficient funding and staff.

In order to pursue green growth, the six SEE economies need to integrate environmental considerations into their economic and sectoral policies. A critical area is climate change mitigation, where international commitments are unlikely to be achieved unless energy mixes are diversified away from fossil fuels and in particular large-scale coal-fired thermal power plants. Air pollution from energy production, transport and industry is a serious environmental risk that also demands a co-ordinated approach. Furthermore, the six SEE economies should increase the use of economic instruments such as taxes, charges and fees to provide incentives for efficient resource use, and remove environmentally harmful subsidies on fossil fuels and coal. Finally, the economies need to routinely collect high-quality, basic statistics on the environment to inform evidence-based policy. They should lay the foundations of routine, comprehensive monitoring and evaluating of the state of the environment and the effectiveness of environmental policies.

Notes

1. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.

2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

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Annex 13.A1.
Environmental policy: Indicator scores

Table 13.A1.1. **Environmental policy: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Resource productivity						
Circular economy framework	0.5	0.5	0.5	0.5	1.0	0.5
Climate change adaptation and mitigation framework	2.0	1.5	2.0	1.5	1.5	1.5
Municipal solid waste management framework	2.5	1.5	2.5	2.5	2.5	3.0
Natural asset base						
Water management framework	1.5	2.5	2.0	2.0	1.5	2.0
Biodiversity and forest management framework	2.5	1.0	2.5	2.0	2.5	2.5
Land-use management framework	2.0	1.5	3.0	2.5	3.0	3.0
Environmental quality of life						
Air quality framework	2.0	1.0	2.0	2.5	2.5	1.5
Water supply and sanitation system	2.5	1.5	2.0	2.0	2.0	3.0
Industrial waste management framework	1.5	1.0	1.5	1.5	2.0	2.5
Policies for green growth						
Environmental policy framework	1.5	1.0	2.0	1.5	1.5	2.0
Environmental taxes, subsidies, charges and fees	1.0	2.0	1.0	1.0	1.5	1.5
International co-operation framework	1.5	1.0	0.5	1.5	0.5	2.5

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Chapter 14.

Agriculture in South East Europe

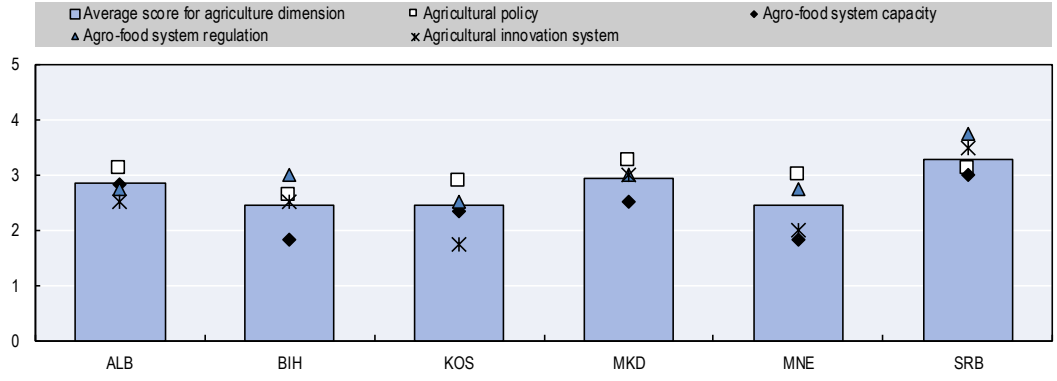
This chapter assesses the extent to which policies in six South East European (SEE) economies support competitiveness, innovation and structural change in agriculture. After an overview of the economic, social and environmental context of the agriculture sector, the chapter then focuses on four sub-dimensions. The first sub-dimension, agricultural policy, examines key policies and instruments focused on the agriculture sector – including domestic producer support, trade and tax. The second sub-dimension, agro-food system capacity, assesses rural infrastructure capacity, highlighting irrigation, labour mobility, skills and education. The third sub-dimension, agro-food system regulation, describes how well regulations for inputs and natural resources safeguard public safety and how burdensome it is for farmers to comply with them. The final sub-dimension, the agricultural innovation system, assesses the research and development frameworks to create new technologies and the extension services to support farmers in adopting them. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions to enhance productivity and sustainability in their agriculture sectors, which in turn would foster the competitiveness of these economies.

Main findings

In many countries, the agriculture sector has the potential to contribute significantly to economic development, reduce poverty and increase food security. The six South East European (SEE) economies assessed in this chapter – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – are endowed with rich natural resources which allow their agriculture sectors to be economically significant, both in terms of value added and employment. To achieve the sector's full economic potential, policy frameworks must lay the foundations for sustainable growth in agricultural productivity. Increasing the sector's competitiveness through innovation and structural change are key pathways. Available data on agricultural productivity show some improvements in crop and livestock yields, and a small increase in labour productivity – but they remain mostly well below the average European Union (EU) levels.

All six SEE economies have basic operational policy frameworks for agriculture which aim to increase agricultural production and rural development. This is reflected in the six SEE economies' average dimension and sub-dimension scores, most of which are above 2 (Figure 14.1). However, the current structure of agricultural producer support across the region is market distorting, and thus unlikely to bring about long-term productivity gains. The highest scoring sub-dimension is on agro-food system regulation. Regulations for agricultural inputs are largely in place, while those for encouraging efficient natural resource use and preventing pollution are being developed. Basic rural infrastructure is accessible. While agricultural extension services are operational, policy frameworks to facilitate agricultural research and development are at an early stage. Monitoring and evaluation activities are limited – indeed, a few economies lack key agricultural statistics.

Figure 14.1. **Agriculture: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Comparison with the 2016 assessment

While the *2016 Competitiveness Outlook* did not include a chapter on agricultural policy, the environmental policy chapter included measures on irrigation and agri-environmental instruments. No significant progress has been noted in either of these two indicators over the last two years. Although all six SEE economies have taken steps to develop and adopt either individual sustainable irrigation strategies or sets of strategy-setting documents, coherent policy frameworks for improving sustainable irrigation are yet to be developed. Agri-environmental measures still remain at an initial planning and implementation stage. Currently, there are no major agri-environmental measures designed to protect soil, water, air, climate or biodiversity. However, they are emerging: the Former Yugoslav Republic of Macedonia and Serbia provide support for endangered livestock breeds, and the Former Yugoslav Republic of Macedonia for set-aside (taking a share of planted land out of cultivation) and green manure (a crop that is grown and ploughed under to improve the soil). In addition, all six SEE economies provide support to organic farming.

Achievements

The six SEE economies have agricultural strategies in place with accompanying annual programmes and budgets. However, they are at varying levels of readiness for the EU's Instrument for Pre-Accession Assistance in Rural Development II (IPARD II); a few of them have already used IPARD I or similarly structured programmes.

The assessed economies have reasonably well-developed rural infrastructure. Most rural areas have functioning roads, electricity, and information and communications technology (ICT), which enables rural producers to connect to markets for inputs and their crops, and to access critical information including on weather and technology.

Agricultural education, research and extension systems are in place in all six SEE economies. All SEE economies provide agricultural vocational education and training and university education, and have agricultural research institutes and functioning extension services.

The six SEE economies have regulations in place for key agricultural inputs. Regulations for seeds, fertiliser and tractors protect public health and compliance is not overly burdensome.

Remaining challenges and key recommendations

- **Strengthen inter-sectoral co-operation.** Low levels of co-operation, co-ordination and synergies between agriculture and other sectors hold back the performance of rural infrastructure for agriculture, irrigation systems and agricultural education and research.
- **Reorient agricultural producer support towards better productivity and sustainability objectives.** The current composition of producer support has a large share of payments for commodity output and input use which is unlikely to facilitate long-term productivity gains and competitiveness. Income support does not facilitate structural adjustment. Public resources which provide general services for the sector are better positioned to support productivity and sustainability objectives.
- **Fully implement farmland consolidation plans.** Small, fragmented farms limit productivity by hindering economies of scale and do not optimise natural resource use. While land transfer regulations in general do not pose a barrier, some economies need to make significant efforts to reform cadastres and clarify property rights.

- **Enhance the quality and impacts of the agricultural innovation system.** Increase investment in research and development, both public and private. Enhance the resources and human capacities of extension services and encourage private consultants to supply them.
- **Enhance environmental objectives across agricultural policy frameworks.** The economies' current agricultural legislation, producer support, rural development measures, education, research and extension do not provide sufficient incentives for the efficient use of natural resources nor safeguard them from pollution. Economies should continue to transpose the EU Nitrates Directive and prepare to implement the associated agri-environmental measures associated with the IPARD programme.
- **Strengthen policy analysis to better inform policy development.** Build the necessary databases to inform policy analysis, including data on agricultural economic accounts, employment and output. Monitoring and evaluation practices for the EU and other donor-funded programmes such as IPARD are well established, but monitoring and evaluation activities should be expanded to cover government programmes. Use basic data and evaluation findings to inform new policies more consistently.

Context

Increasing global demand for agricultural products coupled with a changing climate mean that long-term agricultural productivity and sustainability must be improved. Both overarching and sector-specific policies that facilitate structural change, innovation and sustainable resource use will improve the competitiveness of the agricultural sector. On the other hand, policies that create market distortions and encourage the inefficient use of agricultural resources hinder agricultural competitiveness.

This chapter draws on an OECD framework to analyse policies for innovation, productivity and sustainability in the food and agricultural sectors (OECD, 2015). It assesses how well economy-wide policies create incentives and disincentives for innovation, structural change, resource use and the adaptation to and mitigation of climate change. These constitute key drivers of productivity growth and sustainable resource use. Given the wide scope of policies which affect the competitiveness of the agriculture sector this chapter relates to all the others in this *Competitiveness Outlook;* however, the following chapters are especially relevant:

- **Chapter 2. Trade policy and facilitation** are key in determining agricultural global value chain (GVC) participation and in creating agricultural domestic value added. Barriers to imports reduce engagement in GVCs along with the domestic returns from agro-food exports. On the other hand, non-tariff measures based on more transparent and science-based arrangements can increase the domestic value added generated by exports (Greenville et al., 2017).
- **Chapter 13. Environmental policy** plays an important role in agriculture, which is a major user of natural capital – e.g. land, soil, water, biodiversity – and can degrade the natural resources it depends on through inappropriate practices. Furthermore, despite being threatened by climate change, agriculture also contributes to it.

Agriculture assessment framework

The agriculture dimension in the *2018 Competitiveness Outlook* examines the extent to which the six assessed SEE economies have established policies to support productive and sustainable agricultural sectors. Without seeking to be exhaustive, it considers four broad sub-dimensions which are critical to an agricultural sector that facilitate economic growth and well-being across the population:

1. Agricultural policy: Do agricultural policies and instruments provide incentives for farmers to meet market demand for agricultural products efficiently? Do they facilitate structural change?
2. Agro-food system capacity: are the quality and accessibility of rural infrastructure and irrigation systems good enough to meet the needs of agricultural producers and businesses? Are agricultural producers educated enough to adopt new technologies and diversify their income activities?
3. Agro-food system regulation: how effectively do regulations for natural resources and agricultural inputs protect the environment and safeguard public safety? How difficult is it for farmers and agri-business to comply with them?
4. Agricultural innovation system: how effective is the agricultural research and development system? Do agricultural extension services support agricultural producers in adopting more productive and sustainable technologies?

Figure 14.2 shows how the sub-dimensions and their constituent indicators make up the agriculture dimension assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative indicators. Quantitative indicators are based on national or international statistics. Qualitative indicators have been scored in ascending order on a scale of 0 to 5, and are summarised in Annex 14.A1.[1] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Agricultural performance in SEE economies

Agriculture has traditionally played an important role in the six SEE economies. The sector's contribution to gross domestic product (GDP) and employment is higher than in OECD and EU countries (Table 14.1). However, this contribution has been falling throughout the assessed economies – with the relative weight of agriculture in Serbia's GDP more than halving from 2000 to 2015 (from 19.9% to 8.1%). In the Former Yugoslav Republic of Macedonia, by contrast, the agricultural share in GDP has hovered at around 11% since 2000.

Agriculture is a major user of natural resources (Table 14.1). It uses about 40% of total land on average in the six SEE economies, except in Montenegro where it uses 17%. This average lies between the OECD average (35.6%) and the EU average (43.8%). The sector's share of freshwater withdrawals among the economies varies widely – from 39.5% in Albania to less than 3% in Serbia and Montenegro. Except for Albania, the assessed economies use a smaller share of their freshwater resources in agriculture than the OECD average (43.9%) and the EU average (29.7%).

Figure 14.2. **Agriculture assessment framework**

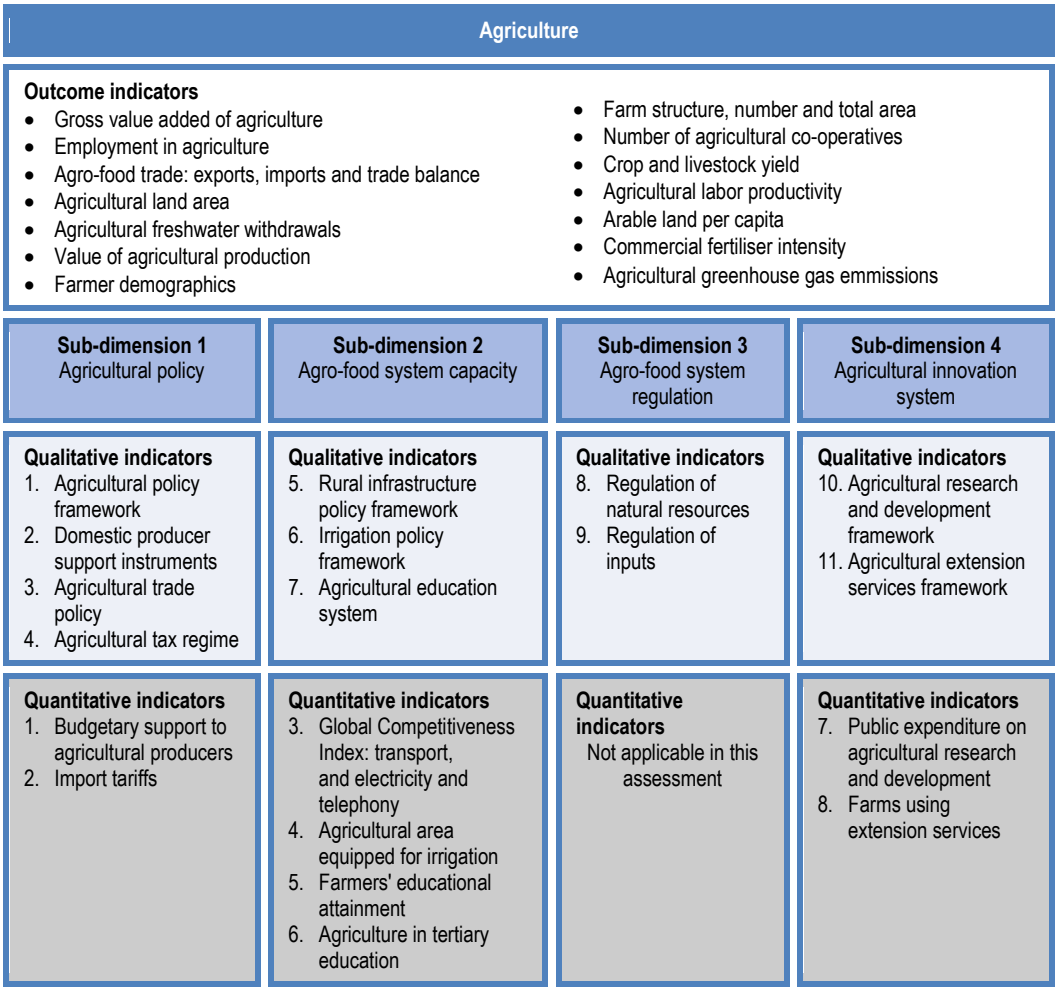


Table 14.1. **Importance of agriculture in the economy (2015)**

%

	Gross value added	Employment	Exports	Imports	Total land area*	Total freshwater withdrawals*
Albania	23.0	41.3	6.5	16.8	42.8	39.5
Bosnia and Herzegovina	7.6	17.9	9.4	18.4	42.2	-
Kosovo	12.6	-	19.3	12.1	38.0	-
Former Yugoslav Republic of Macedonia	11.4	17.9	12.0	11.8	50.1	22.8
Montenegro	10.2	-	18.7	24.7	17.1	1.1
Serbia	8.2	19.4	21.6	8.4	40.1	2.8
OECD	1.5	4.8	10.6	8.9	35.6	43.9
EU	1.6	4.5	11.3	10.5	43.8	29.7

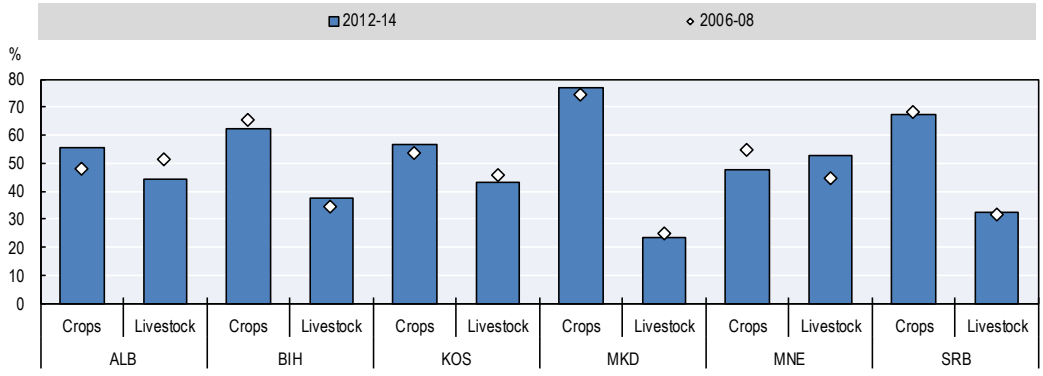
Note: * data from 2014; – data unavailable.

Source: ASK (2015a), "Agriculture census 2014", http://ask.rks-gov.net; OECD (2017a), "OECD System of National Accounts", http://stats.oecd.org; World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators; UN Comtrade (2017), *UN Comtrade* (database), http://comtrade.un.org; FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org; FAO (2017b), *AQUASTAT* (database), www.fao.org/nr/water/aquastat/main/index.stm.

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In the last ten years, while agricultural output has fluctuated across all SEE six economies, it has generally increased. Furthermore, there has been significant variation in the scale of growth across economies. While in Serbia, output increased by about 60% from 2007 to 2015, Kosovo's level of output has remained quite stable. Crops accounted for a greater share of total output value than livestock in 2012-14 in all but one of the assessed SEE economies (Figure 14.3). In the Former Yugoslav Republic of Macedonia, crops contributed the greatest share – making up almost three-quarters of the total output value. Montenegro was the exception, with its share of livestock output being slightly greater than crop output. Since 2006-08, the composition of total output value has seen an increase in the share of crops in Albania and Kosovo, and an increase in the share of livestock in Bosnia and Herzegovina and Montenegro. The composition is fairly stable in the Former Yugoslav Republic of Macedonia and Serbia.

Figure 14.3. **Value of agricultural production (2006-08 and 2012-14)**



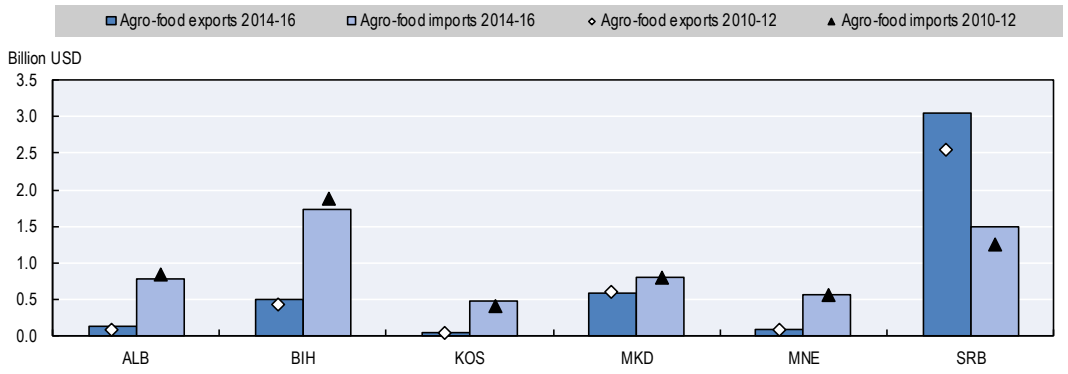
Note: Values based on constant international dollars except Kosovo, which is based on current euros.

Source: ASK (2016a), "Economic accounts for agriculture", http://ask.rks-gov.net; FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org.

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All the assessed economies except Serbia are net importers of agro-food products (Figure 14.4). On average, agro-food accounts for about 14% of total exports across the six SEE economies and 16% of total imports (2014-16). From 2010 to 2016, most of the assessed economies saw growth in agricultural exports, except for Kosovo and Montenegro, where levels have not changed significantly. Albania leads with exports more than doubling, followed by Serbia, which increased its exports by 40%. In half of the assessed economies imports slightly increased, in Montenegro they fluctuated around the same level, and in Albania and Bosnia and Herzegovina they decreased by almost 10% and 3% respectively. As a result, the negative agricultural trade balances in Kosovo and the Former Yugoslav Republic of Macedonia increased; in Montenegro the balance remained quite stable while in Albania and Bosnia and Herzegovina their negative balances decreased. Serbia's positive trade balance increased. The main origins and destinations for agro-food products to and from the six SEE economies are the European Union and the SEE economies themselves, each being areas with preferential trade agreements (through individual Stabilisation and Association Agreements between each SEE economy and the EU, and the Central European Free Trade Agreement in the SEE region).

Figure 14.4. **Agro-food trade (2010-12 and 2014-16)**



Notes: Data in current USD. Agro-food definition does not include fish and fish products. Agro-food codes in H0: 01, 02, 04 to 24, 3301, 3501 to 3505, 4101 to 4103, 4301, 5001 to 5003, 5101 to 5103, 5201 to 5203, 5301, 5302, 290543/44, 380910, 382360.

Source: ASK (2016b), "International trade statistics", http://ask.rks-gov.net; UN Comtrade (2017), *UN Comtrade* (database), http://comtrade.un.org.

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In 2016, the rural populations of the assessed SEE economies accounted for significant shares of their populations. Shares ranged from 36% (Montenegro) to 60% (Bosnia and Herzegovina) – much higher than the OECD (20%) and European Union (25%). Between 2000 and 2016, the share of the rural population was relatively stable in Bosnia and Herzegovina, Serbia (44%) and the Former Yugoslav Republic of Macedonia (43%). By contrast, the rural population decreased by 14% in Montenegro and by 29% in Albania – leaving 42% of the population in rural areas in Albania (no data available for Kosovo) (World Bank, 2017a).

Agriculture is an important employer and source of income in the rural economy, though sources are becoming more diversified. The agricultural labour force in the assessed SEE economies is mainly unpaid family labour, of which nearly 40% are women – except in Kosovo where they account for about one-third of the agricultural labour force (ASK, 2015a ; FAO, 2017a). The agricultural labour force is older than in other sectors, with, for example, the median age of farmers is 50 in Bosnia and Herzegovina, 52 in Kosovo and 59 in Serbia (ASK, 2015a; BHAS, 2016a; SORS, 2013). Those working in agriculture have mostly completed at least primary education and have a basic level of proficiency in literacy and numeracy (Table 14.2).

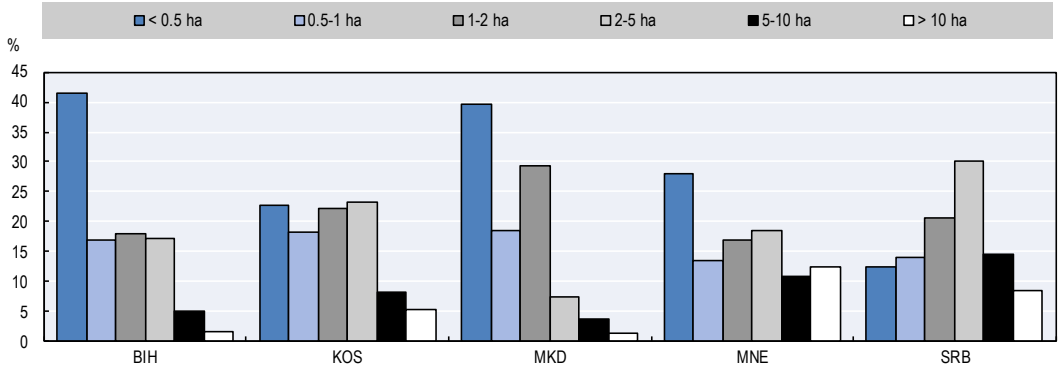
An estimated 1.65 million farms operate across the six SEE economies. Average farm holding sizes are small – half of the economies have average farm sizes of less than two hectares: Albania (1.3 ha), Bosnia and Herzegovina (1.6 ha), and the Former Yugoslav Republic of Macedonia (1.9 ha) (BHAS, 2016b; INSTAT, 2017; MAKSTAT, 2014). While average holding sizes are bigger in Kosovo (3.2 ha), Montenegro (5.8 ha) and Serbia (5.4 ha), they are still much smaller than the EU average of 16.1 ha (ASK, 2015a; Eurostat, 2017a; MONSTAT, 2017; SORS, 2013).

Holdings smaller than 5 ha are the most numerous (Figure 14.5). In the assessed SEE economies, 88% of farms are under 5 ha and operate on 44% of the total agricultural area. Compared to Kosovo and Serbia, Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia have a greater share of very small farm holdings; about 40% of

farm holdings are under 0.5 ha and operate on about 5% of the total land area in these two economies. Montenegro has a significant share of holdings under 0.5 ha (28%), yet it also has the largest share of farms over 10 ha (13%) of the assessed economies. By contrast, farm holdings between 2 and 5 ha are the most numerous in Serbia, accounting for 30% of holdings and using 17% of the land. At the other end of the spectrum, farms greater than 10 ha use significant portions of the land in Serbia (57%) and in Kosovo (44%). Meanwhile, farms larger than 10 ha only use about a quarter of the land in Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia.

Figure 14.5. **Distribution of farm size**

% of farm holdings by size during the 2000s



Note: Data for Bosnia and Herzegovina are for 2001, Kosovo are for 2014, the Former Yugoslav Republic of Macedonia are for 2001, Montenegro are for 2016, and Serbia are for 2012. Data categories for the Former Yugoslav Republic of Macedonia are 1-3 ha and 3-5 ha. Data for Albania unavailable.

Source: ASK (2015a), "Agriculture census 2014", http://ask.rks-gov.net; BHAS (2016b), "Population census 2013", www.bhas.ba; MakStat (2014), "Farm structure survey 2013", www.stat.gov.mk; MONSTAT (2017), "Farm structure survey 2016", www.monstat.org/userfiles/file/fss/Saopstenje%20FSS-final%2029_12_2017%20eng.pdf; SORS (2013), "Census of agriculture 2012 in the Republic of Serbia", www.stat.gov.rs.

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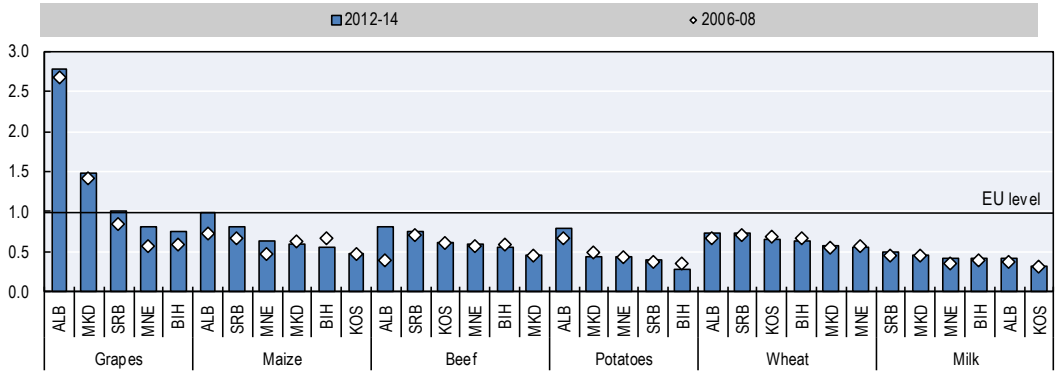
Even where land is concentrated in larger holdings, the farm structure is broadly based on small family enterprises. This differs from countries with distinctly dualistic agriculture, where many smallholders use a small proportion of natural resources and large farms use a greater share of the land, such as in Brazil, where over 50% of the land is used by farms larger than 500 ha; or the European Union, where over 50% of the land is used by farms of over 100 ha (Eurostat, 2016; IGBE, 2006). The vast majority of farms in the six SEE economies remain small, family owned and highly fragmented.

Given this large number of small, fragmented farms, agricultural co-operatives could be a useful way to help them integrate into the agro-food value chain. However, agricultural co-operatives do not play a major role in these economies, following a history of mandated collective farming under communism. According to one survey of a subset of the registered co-operatives in the Former Yugoslav Republic of Macedonia, procuring inputs and marketing were the most common activities conducted (Caccamisi, 2016). Of the 62 countries surveyed in the World Bank report, *Enabling the Business of Agriculture 2017*, Serbia was one of a few countries to set out minimum capital requirements to establish a producer organisation and to limit producer organisation membership to one member per household (World Bank, 2017b). Minimum capital

requirements may be a barrier to agricultural co-operative growth, as capital formation is a challenge for smallholder farmers. Limiting household membership in agricultural producer groups may hinder women's participation.

Since 2006 the six SEE economies have seen some improvements in crop and animal yields, especially in grapes (Figure 14.6). The yields of principal crops and livestock have moved closer to average EU levels, while half of the economies met or surpassed those levels for grapes. However, yields for some key products, such as milk and potatoes, remain less than half of the EU average for most of the six SEE economies. Of the assessed economies, Albania has the highest yields for all reviewed products except milk.

Figure 14.6. **Crop and livestock yields as ratios of European Union yields**



Note: The ratios are based on smoothed three-year yield averages. For Kosovo, data for grapes and potatoes are unavailable, data for milk are for 2007-09, and data for beef are for 2008-10.

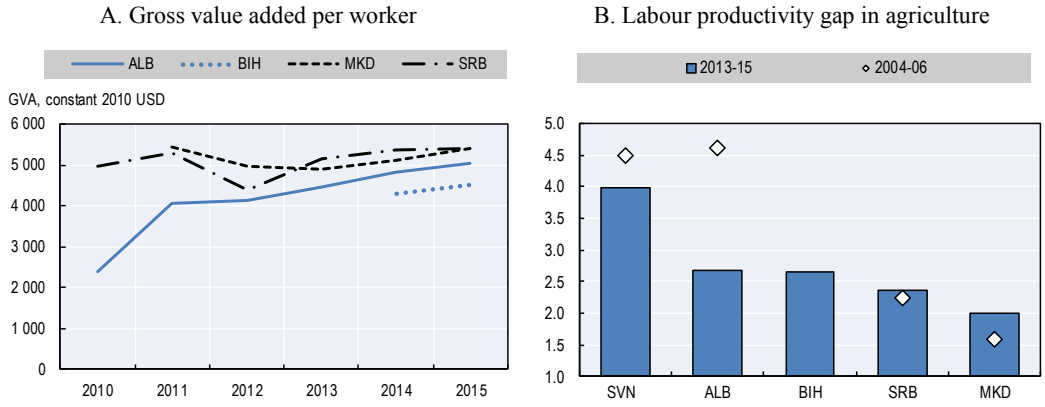
Source: ASK (2015b), "Agricultural household surveys", http://ask.rks-gov.net; FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org.

StatLink http://dx.doi.org/10.1787/888933706487

Agricultural labour productivity has increased in Serbia and Albania since 2004, while in the Former Yugoslav Republic of Macedonia it has fluctuated (Figure 14.7.A). The average agriculture gross value added (GVA) per worker in the EU and OECD is more than four times the average amount of about USD 5 000 in the assessed SEE economies (World Bank, 2017a). The labour productivity gap between agriculture and the non-agricultural economy has dropped significantly in Albania, but increased in Serbia and the Former Yugoslav Republic of Macedonia (Figure 14.7.B). Non-agricultural labour is more than twice as productive as agricultural labour across the assessed economies. While the labour productivity gap is larger in their regional neighbour Slovenia, agricultural labour productivity is roughly twice as high. The persistent gap between agricultural and non-agricultural labour productivity indicates that agriculture plays a buffer role in these economies. In the absence of more productive labour options in agriculture and other sectors of the economy, agriculture absorbs excess labour.

Agriculture in the six SEE economies is a significant user of natural resources and puts pressure on the environment (Table 14.1). It uses a large share of land, similar to OECD and EU average levels, except for Montenegro, which uses less. The available data for SEE economies show that they use a smaller share of fresh water than the OECD and EU average levels, except for Albania, whose share is similar.

Figure 14.7. **Agricultural labour productivity**



Notes: GVA – gross value added; SVN – Slovenia. The labour productivity gap in agriculture is measured as the ratio between GVA per worker in non-agricultural sectors and GVA per worker in agriculture. Data for Bosnia and Herzegovina unavailable before 2014. Data for the Former Yugoslav Republic of Macedonia not available in 2010. Data for Kosovo and Montenegro not available.

Source: World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933706506

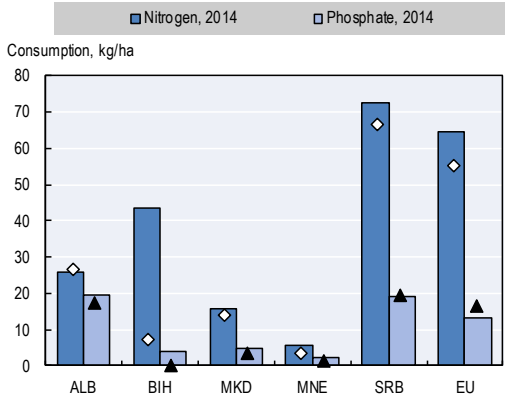
The share of agricultural land has decreased since 2000, particularly in Montenegro (see Chapter 13, Environmental policy). There is more arable land per capita in Serbia (0.37 ha per person) and Bosnia and Herzegovina (0.26 ha per person) than the EU average of 0.21. For example, the northern part of Serbia (Vojvodina) and parts of Bosnia and Herzegovina along the River Sava and River Neretva, are typical arable regions, with an abundance of fertile land. In Kosovo, the low value (0.10 ha per person) reflects that it is the most densely populated economy of the region. The low figure for Montenegro (0.01) reflects its small share of agricultural land, despite it being the least densely populated economy of the six.

Nutrients such as nitrogen and phosphate are vital to crop productivity. Too few nutrients can decrease soil fertility, while too many increase the risk of polluting soil, air and water through eutrophication (OECD, 2014). Most of the assessed SEE economies (except Serbia) apply relatively small amounts of mineral fertiliser (Figure 14.8). In Bosnia and Herzegovina, fertiliser application rates jumped in 2009. In Serbia, the rate of mineral fertiliser application is above the EU average, encouraged by fertiliser subsidies based on payment per hectare. However, whether the intensity of input use is low or high, safeguarding the air, soil and water from pollution through appropriate practices is the critical issue. However, the lack of comprehensive monitoring of nutrients and pesticides prevents a broader assessment of nutrient flows and balances.

Most of the assessed economies have seen a reduction in greenhouse gas (GHG) emissions from agriculture since 2000. Only in Bosnia and Herzegovina did emissions jump in 2009 due to increased use of commercial fertilisers (FAO, 2017a). Agriculture's contribution to total GHG emissions in the six SEE economies in 2008-10 was higher than the EU and OECD averages (Figure 14.9). It is significantly higher in Albania, at 32% of total GHG emissions. This reflects two key factors – Albania's distinct energy sector and economic structure. While all the other assessed economies have widespread

coal-fired electricity generation which significantly contributes to their largest source of GHG emissions, the energy sector, Albania's electricity generation is almost 100% hydropower, whose emissions are not measured. Additionally, agriculture plays a greater role in Albania's economy than the other assessed economies – contributing a greater share of its gross value added.

Figure 14.8. **Commercial fertiliser intensities per area of agricultural land (2006 and 2014)**

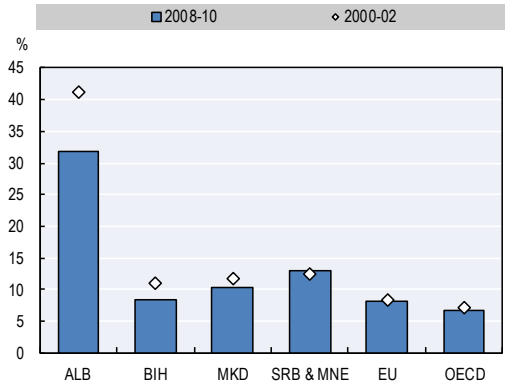


Note: Commercial fertiliser intensities are the apparent consumption of fertilisers for agriculture production (in nutrient contents) divided by the area of agricultural land.

Source: FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org.

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Figure 14.9. **Share of agriculture in total greenhouse gas emissions (2000-02 and 2008-10)**



Note: Excluding land use, land-use change and forestry. Data for Kosovo unavailable. The most recently available data for Montenegro and Serbia, 2003-05, reported.

Source: FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org.

StatLink http://dx.doi.org/10.1787/888933706544

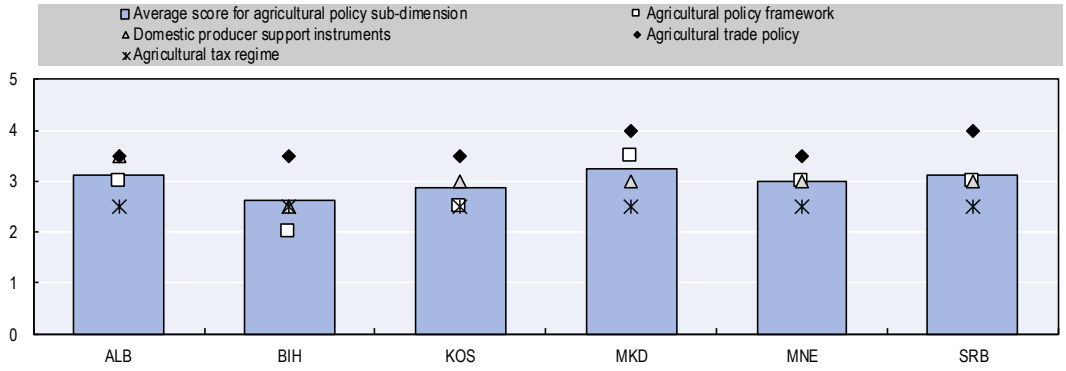
Climate change is a challenge for agricultural productivity and sustainability in the six SEE economies. Seasonal average temperatures are predicted to rise throughout the region – by 1°C in Bosnia and Herzegovina by 2030, and by 1.9°C in the Former Yugoslav Republic of Macedonia, 2.4-3.1°C in Albania and 1.5-2.2°C in Serbia by 2050. More extreme weather – with intense precipitation, floods and droughts – is predicted across the six SEE economies. Rainfall is predicted to decrease. These changes could reduce crop yields across the six SEE economies, especially for maize, and increase exposure to agricultural pests. Livestock productivity in Albania, Kosovo and Montenegro could fall (Callaway et al., 2010; USAID, 2016a, 2016b, 2017a, 2017b; World Bank, 2010).

Agricultural policy

How countries structure their support to farmers is arguably as important as the total level of that support. To accomplish policy goals, governments have many measures to choose from (including direct support, taxes and trade), all of which have different implications for agricultural production, trade and incomes. Some options are more suitable for targeting specific policy objectives or beneficiaries than others (OECD, 2016a). Four qualitative indicators assess the existence and degree of implementation of: 1) agricultural policy frameworks; 2) domestic producer support instruments; 3) agricultural trade policies; and 4) agricultural tax regimes.

The key elements of agricultural policy in the six SEE economies are mostly in place, reflected in the average score of 3 for this sub-dimension (Figure 14.10). Agricultural trade policy is the most advanced area, while agricultural tax regimes are less developed. Albania, the Former Yugoslav Republic of Macedonia and Serbia lead the assessed economies in this sub-dimension. Albania leads in the design of their producer support instruments, the Former Yugoslav Republic of Macedonia leads in IPARD implementation and Serbia's agricultural trade policy is relatively stronger.

Figure 14.10. **Agricultural policy: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Agricultural policy frameworks are in place

Most of the assessed SEE economies have adopted medium to long-term strategies for agriculture and rural development. The exception is Kosovo, which does follow a strategy despite it not being adopted. Similarly, nearly all economies (except Serbia) have annual programmes or action plans. In pursuit of their goal of EU membership, key agricultural policy objectives in all six SEE economies largely follow those set by the EU Common Agriculture Policy (CAP) – "to improve agricultural productivity, so that consumers have a stable supply of affordable food, and to ensure that EU farmers can make a reasonable living" (EU, 2017). However, agricultural strategies, programmes and action plans in the six SEE economies are rarely subject to in-depth monitoring and evaluation, and findings are rarely reflected in the formulation of new ones.

All six SEE economies are working towards setting up and implementing the EU's Instrument for Pre-Accession Assistance in Rural Development (IPARD) programmes and operating structures (IPARD Agency and Managing Authority). IPARD has the objectives to assist implementation of the *acquis* regarding the CAP and to support the sustainable adaptation of the agricultural sector and rural areas candidate and potential candidate countries (EC, 2017). Complying with its strict implementation rules (including financial management, monitoring, evaluation and reporting) requires significant ongoing political and institutional efforts. It is also a challenge for SEE producers to fill out application forms and comply with environmental requirements. The Former Yugoslav Republic Macedonia has implemented the IPARD I Programme (2007-13) and used IPARD I funds through to the end of 2017, while Albania and Montenegro have implemented IPARD-like schemes. IPARD II Programme (2014-2020) funds have not been dispersed yet. The Former Yugoslav Republic of Macedonia has been granted entrustment of IPARD II implementation. Preparations in meeting IPARD II system

requirements are advanced in Albania, Montenegro and Serbia. However, preparations in Kosovo and Bosnia and Herzegovina are not as advanced. Bosnia and Herzegovina's institutional complexity is a significant challenge to setting up basic operating structures.[2]

Support to agricultural producers could better support productivity and sustainability objectives

The extent to which producer support relies on measures that distort agricultural output and input markets is key in agricultural policy, affecting producers' ability to innovate. OECD analysis finds that border protection, supply controls, domestic price administration, output-based payments and variable input subsidies have the greatest potential to distort markets (OECD, 2016a). These policies reduce incentives for producers to use production factors (labour, machinery, land, water, etc.) more efficiently and to innovate to become more competitive. Distorting policies such as these not only shield producers from competition, but are also inefficient in transferring income to the intended beneficiaries. Furthermore, they encourage riskier behaviour by producers, exposing them to more market and natural risks. Broad-based income support decoupled from commodity production is more effective in transferring income to producers and preserves more flexibility in their options to undertake new activities or switch to new products. If this support is conditional on the adoption of environmentally friendly practices, it could facilitate more sustainable resource use. However, even if decoupled from production choices, income support slows the structural adjustment that is needed to facilitate economies of scale, attract new entrants and thus foster innovation and productivity growth (OECD, 2016a).

For OECD countries and a number of key partners, the OECD calculates indicators of support, including support to producers and support to the sector. The producer support estimate (PSE) is the annual monetary value of gross transfers from consumers and taxpayers to agricultural producers, measured at farm-gate level, arising from policy measures that support agriculture, regardless of their nature, objectives or impacts on farm production or income. A component of the PSE is market price support arising from the gap between domestic market prices and border prices (OECD, 2016b). As data on market price support in the six SEE economies are currently unavailable, support indicators only include budgetary support. As a result, assuming that market price support is positive in the six SEE economies, support values are probably lower than they otherwise would be. Budgetary support to agricultural producers in the six SEE economies ranged from less than 1% of gross farm receipts in Albania to 6% in the Former Yugoslav Republic of Macedonia in 2013-15 (Figure 14.11.A). Among economies monitored by the OECD, this level of support places the six SEE economies among those with agricultural sectors ranging from relatively open to very open, such as New Zealand (0.1%) and Brazil (2.9%). It is substantially lower than the EU (18%) and OECD (14%) averages.

Budgetary support to agricultural producers in all the assessed SEE economies except Bosnia and Herzegovina is mostly generated by measures that are less market distorting (Figure 14.11.A). Only in Bosnia and Herzegovina is this support generated predominantly through the most distorting measures (58%), including payments based on output, and variable input use without input constraints. From 2013-15, both entities supported dairy and seedlings, while the Republika Srpska also supported wheat, oilseeds, tobacco, vegetables, fruit and seeds. On the input side, the Republika Srpska supported fuel. Producer support in the Former Yugoslav Republic of Macedonia also has a significant share of the most distorting measures (33%), mainly payments based on output on the following items from 2013-15: dairy, tobacco, vegetables and fruit for processing, cereal

seeds, seedlings and chicks. In Albania and Kosovo, the most distorting measures only make up 0.1% of gross farm receipts (APM Database, 2016).

The largest category of producer support measures in Serbia, the Former Yugoslav Republic of Macedonia and Kosovo is payments based on current area and animal numbers, with production required. Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia practice the most diverse payments on current area and animal production – each of them having as many as 23 crop and livestock payments (APM Database, 2016).

In the OECD, total support to agriculture is measured by the total support estimate (TSE), the annual monetary value of all gross transfers from taxpayers and consumers arising from policy measures that support agriculture. This includes the PSE as already described above; the general services support estimate (GSSE), which is the value of transfers that create enabling conditions for the primary agricultural sector through developing private or public services and through institutions and infrastructures; and an estimate of transfers to consumers from taxpayers, which may increase the demand for agricultural commodities. As data on market price transfers from consumers are not available for the six assessed economies, total budgetary transfers to agriculture are calculated as the sum of budgetary support to agricultural producers, GSSE and transfers to consumers In the Former Yugoslav Republic of Macedonia, Kosovo and Serbia, the total budgetary transfers to agriculture make up an equal or greater share of GDP than the EU average of 0.5% (Figure 14.11.B). In the remaining economies where the total budgetary transfers to agriculture represent a smaller share of GDP – Albania, Bosnia and Herzegovina, and Montenegro – support to agriculture places a lower burden on the economy.

In all the assessed SEE economies except Albania, total budgetary transfers to agriculture are dominated by transfers to individual producers (Figure 14.11.B). Not including Albania, producer budgetary support ranges from 93% of total support to agriculture in Bosnia and Herzegovina to 60% in Montenegro. Excluding Albania, transfers to general services to agriculture in the assessed economies range from 5% of total budgetary support in Bosnia and Herzegovina to 35% in Montenegro. This composition is not far off the EU average of 15%. Albania's composition of total budgetary support to agriculture differs more from its regional neighbours, with its focus on general services accounting for 68% of total support to agriculture. In contrast to their SEE neighbours and the EU, in Kosovo and Albania the share of transfers from taxpayers to consumers is about 12% of total budgetary support to agriculture, in between the OECD average of 20% and EU average of 1%. This largely reflects investment support for constructing facilities to collect, store and process agricultural products.

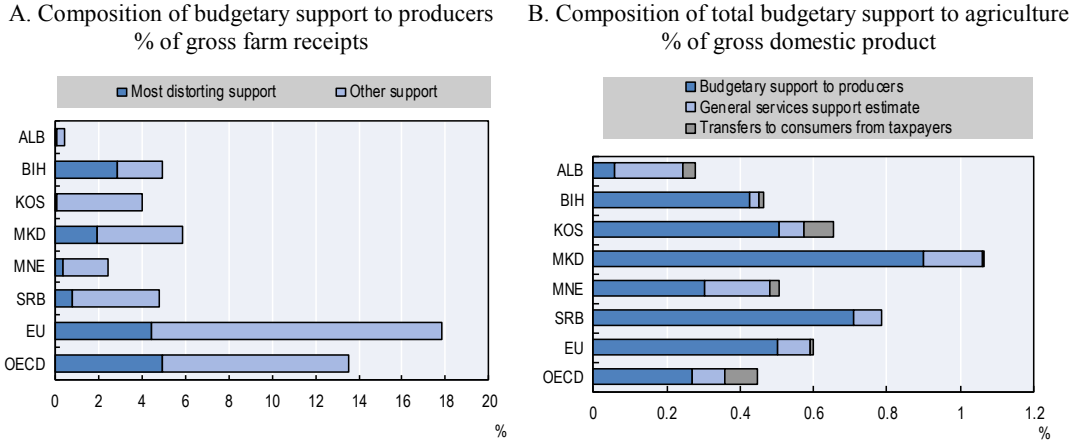
Measures aiming to protect natural resources are absent in all six SEE economies. Environmental cross-compliance requirements are gradually emerging.

Agricultural trade measures do not directly subsidise nor prevent agricultural exports

On the one hand, a liberal agricultural trade policy connects SEE agricultural producers to global value chains, but on the other it exposes them to greater competition from other countries, forcing them to become more competitive. The six SEE economies are relatively well integrated into the world trading system. All six economies are signatories of the Central European Free Trade Agreement (CEFTA), through which they have achieved full tariff liberalisation on trade in agricultural goods. Albania, the Former

Yugoslav Republic of Macedonia and Montenegro are members of the World Trade Organization (WTO). The remaining three economies have begun to implement the WTO required institutional and legislative provisions through CEFTA. Bosnia and Herzegovina and Serbia are currently negotiating their accession to the WTO (see Chapter 2, Trade policy and facilitation).

Figure 14.11. **Budgetary support to producers and total budgetary support to agriculture (2013-15 average)**



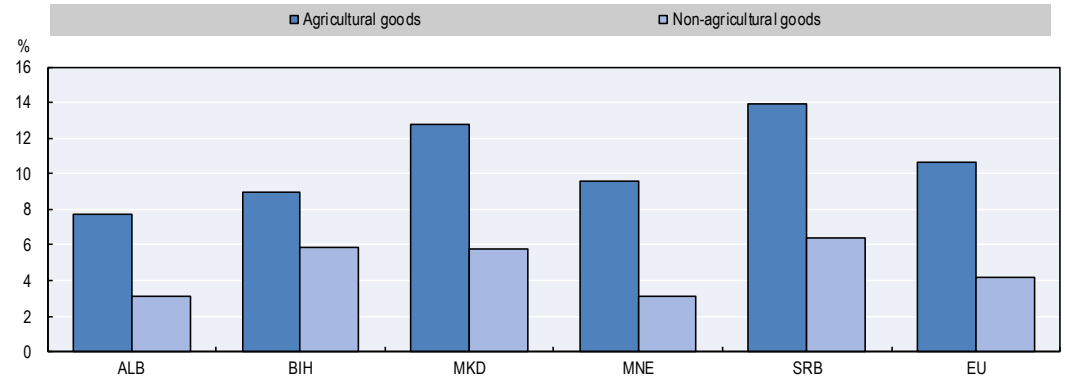
Note: Data on market price support in the six SEE economies are currently unavailable so support indicators only include budgetary support. As a result, assuming that market price support is positive in the six SEE economies, support values are probably lower than they otherwise would be. Data for agricultural output for Albania is 2009-11, for the Former Yugoslav Republic of Macedonia 2012-14, and for Montenegro 2012-13.

Source: Adapted from APM Database (2016), *Agricultural Policy Measures Database*, http://app.seerural.org/agricultural-statistics; ASK (2016a), "Economic Accounts for Agriculture", http://ask.rks-gov.net; BHAS (2016c), "Competitiveness in South East Europe: A Policy Outlook 2018: Agriculture Questionnaire", Responses to the OECD received from the Bosnia and Herzegovina Agency for Statistics; INSTAT (2012), "Statistical yearbooks through 2011", www.instat.gov.al; MAKSTAT (2015), "Economic Accounts for Agriculture", www.stat.gov.mk; MARD (2015), "Strategy for the Development of Agriculture and Rural Areas 2015-2020", www.minpolj.gov.me/ResourceManager/FileDownload.aspx?rid=253749&rType=2&file=Strategija%20razvoja%20poljoprivrede%20i%20ruralnih%20podrucja%202015-2020.pdf; OECD (2017b), "Producer and consumer support estimates", *OECD Agriculture Statistics* (database), http://dx.doi.org/10.1787/agr-pcse-data-en; SORS (2016b), "Economic accounts for agriculture in the Republic of Serbia 2007-2015", www.stat.gov.rs; World Bank (2017a), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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None of the six SEE economies employ trade measures that directly subsidise or prevent agricultural exports – i.e. export subsidies, export credit support, export duties or export prohibitions. Across the economies, there is some protection against imports of agro-food products, with the most commonly protected groups across the region being dairy products, and beverages and tobacco. However, tariffs on agricultural products and inputs are relatively low, especially in SEE regional agreements (where most of the SEE export agricultural products are bound) and bilateral trade agreements. The six SEE economies' tariff profiles reveal a distinct agricultural bias. The average import tariffs on agricultural goods are higher than for non-agricultural goods (Figure 14.12). On average, the assessed economies' simple average "most favoured nation" (MFN) tariffs, both for agricultural (10.6%) and non-agricultural goods (4.9%), are on par with EU averages.

Figure 14.12. **Import tariffs for agricultural and non-agricultural goods (2015)**



Note: Simple average most favoured nation tariffs. Data for Kosovo unavailable.

Source: WTO/ITC/UNCTAD (2016), "World tariff profile 2016", http://unctad.org/en/PublicationsLibrary/wto2016_en.pdf.

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Although the assessed SEE economies do not impede agro-food trade by employing trade-adverse instruments, incomplete implementation of sanitary and phytosanitary measures and inspection procedures hinders trade. For more information, see Chapter 2 (Trade policy and facilitation).

Agricultural tax regimes should be examined further

Tax policy influences the conduct, structure and behaviour of farms, input suppliers and food companies. Taxes on income, property and land, and on capital transfer, including land may affect structural change, while differential tax rates on specific activities (e.g. exempting payments for environmentally friendly practices from taxes), resources, or input use may affect sustainability (OECD, 2015). In general, in contrast to a sectoral approach for farming, including farming in economy-wide, social safety nets or tax systems could be more efficient, effective and equitable to address instability or low incomes (OECD, 2005). The six SEE economies impose relatively low corporate and personal income tax rates while levying relatively high rates in indirect taxes such as value-added tax (VAT) and social security contributions. For more information, see Chapter 4 (Tax policy).

Taxes associated with agricultural activities largely fall under overarching tax policies, but special agricultural tax provisions exist, including for capital gains taxes and property taxes. A large number of small farmers in the six SEE economies operate in the informal sector. As such, they produce mostly for themselves and their extended families, selling their surplus products locally for cash, without any receipts. This suggests, for instance, that informal agricultural businesses are not entitled to a refund for any VAT they have paid on their inputs. Indeed, being outside of the tax system results in hidden costs. The six SEE economies would therefore benefit from a more in-depth analysis of how their tax regime affects their agricultural sector. This would include an analysis of the preferential tax regimes, the impact of VAT on informal agricultural sectors and tax administration strategies. As a starting point, the six economies should start with calculating the tax revenue forgone as a result of the special tax regimes for the agricultural sector, as well as the economic impact of those incentives.

The way forward for agricultural policy

The six SEE economies should reorient agricultural policy towards long-term productivity outcomes. While producer support in the form of payments based on output and variable input use can have short-term effects on production levels, they ultimately distort the market, and do not support long-term competitiveness. As such, the six SEE economies should shift away from this form of support, especially in Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia where they make up a significant share. The economies should increase the share of producer support dedicated to general services for the sector, balanced across key areas such as infrastructure, knowledge and inspection to strengthen the foundation for long-term productivity growth.

The six SEE economies should enhance environmental sustainability objectives and corresponding measures. They should carefully structure their producer support targeting environmental practices to meet basic standards, such as those set out in EU regulations. These payments can act as temporary support leading to a transition in farmers' attitudes and practices – but should not be a permanent core payment. Furthermore, the measures should not be structured in such a way as to pay commercial farms for agri-environmental farming activities that they already practise.

Rural development is becoming a more prominent policy focus, driven by the six SEE economies' activities to align their policies with those of the EU. **The economies should continue to set up and strengthen the institutional frameworks, administrative procedures and databases required for EU integration and utilisation of EU funds,** notably IPARD-related components such as the Paying Agency and Farm Accountancy Data Network. They should continue to develop and implement measures that facilitate rural economy diversification and off-farm employment. This could include developing financing mechanisms to help smaller producers access IPARD investment funding, by allowing their co-investment to be paid in instalments instead of in full at the beginning.

The six SEE economies should strengthen policy analysis to better inform policy development. They should build the necessary databases including agricultural economic accounts, employment and output to inform policy analysis. Monitoring and evaluation practices for EU and other donor-funded programmes such as IPARD are well established – monitoring and evaluation activities should be expanded to cover government programmes. The basic data and evaluation findings should then inform new policy design and implementation more consistently. Public consultation mechanisms and activities should be strengthened to better take stakeholder priorities into account.

The six SEE economies should continue to avoid measures that impede the export or import of agro-food goods and maintain the current relatively liberal tariff rates. However, to engage more in global value chains, better administration of sanitary and phyto-sanitary measures is still a significant challenge to be addressed, as described in Chapter 2.

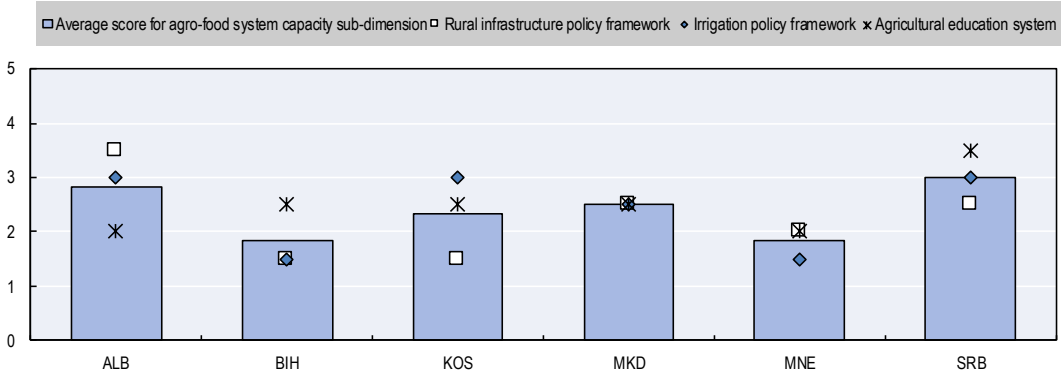
The six SEE economies should conduct additional analysis on how preferential tax concessions support agricultural policy objectives and whether they distort markets. Part of this analysis could include estimating the associated tax expenditure – that is, the amount of tax revenue forgone due to a special exemption which the government would have otherwise collected.

Agro-food system capacity

Infrastructure connects the economic system, allowing the movement of production factors, goods and information between people and across markets. It therefore plays a large role in determining the location of and types of economic activities that can develop, including in rural areas. Irrigation in particular can be important in increasing agricultural productivity. Education lays the foundation for farmers to adopt productivity and sustainability enhancing agricultural technology, as well as diversify their income activities from agriculture. Higher education facilitates the base for agricultural research and extension activities. Three qualitative indicators assess the agro-food system capacity sub-dimension: 1) rural infrastructure policy framework; 2) irrigation policy framework; and 3) agricultural education system.

The agro-food system capacity of the six SEE economies is mostly in place, indicated by the average score of 2.4 (Figure 14.13). Serbia and Albania are the most advanced of the six, with frameworks in all areas in place and some implementation under way. Montenegro and Bosnia and Herzegovina have the most room for improvement in putting frameworks in place. No area is significantly more or less advanced across the six economies.

Figure 14.13. **Agro-food system capacity: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Rural infrastructure policy frameworks exist, and some are being implemented

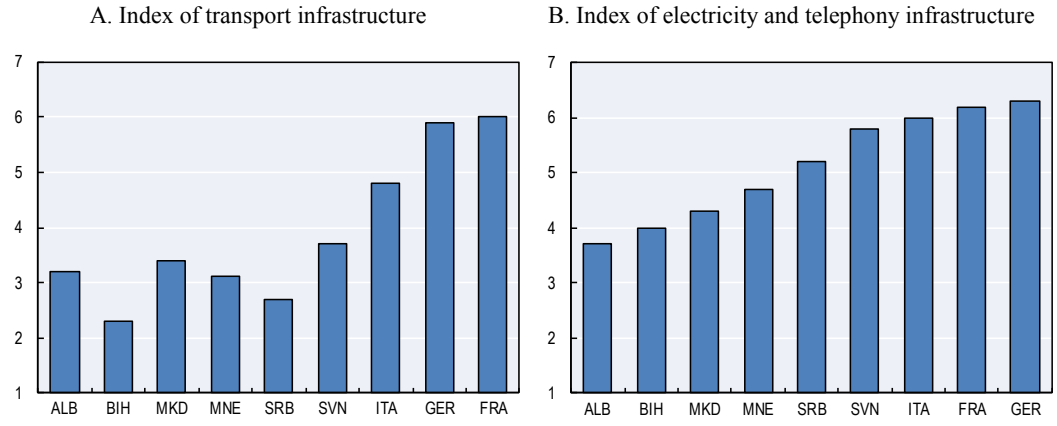
Rural infrastructure – electricity, roads and ICT – is key to the delivery of and access to important services, playing a critical role in linking farmers and related businesses to markets and encouraging innovation. Although basic rural infrastructure is largely in place in most areas in the region, it may not be fully used for agricultural purposes. For example, a survey in the Republika Srpska found that despite Internet access in farming households, only a small fraction used it for agricultural purposes (e.g. learning about new techniques or buying or selling agricultural inputs and products).

In terms of the density and quality of rural roads and electricity, as with ICT penetration, the assessed economies' performance is relatively modest. According to the Global Competitiveness Index, the assessed SEE economies have a lower transport infrastructure index than European countries such as France, Germany and Italy as well as regional neighbour Slovenia (Figure 14.14.A). In the electricity and telephony

infrastructure index, the economies are also lagging behind (Figure 14.14.B). Serbia is approaching EU levels, while Albania has more catching up to do. Electricity infrastructure is present in most rural areas and the electricity supply is stable. However, the SEE economies occasionally experience electricity cuts, forcing those with storage facilities for agricultural produce to buy generators.

Figure 14.14. **Global Competitiveness Index: transport, electricity and telephony infrastructure (2016-17)**

Scale 1 to 7 (best)



Note: Data for Kosovo unavailable. FRA – France; GER – Germany; ITA – Italy; SVN – Slovenia.

Source: WEF (2016), *The Global Competitiveness Report 2016-2017: Full Report*, www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf.

StatLink http://dx.doi.org/10.1787/888933706639

All six economies have some policy frameworks for rural infrastructure and implement programmes supporting investment in electricity, roads and ICT in rural areas. However, these policy frameworks are often split between institutions at the sectoral level (e.g. ministries of agriculture and infrastructure) and at the local level. None of the economies have an integrated policy framework specifically targeting rural infrastructure. Co-ordination of strategic planning is often lacking or ad hoc. Monitoring and evaluation of rural infrastructure project implementation is also weak, except for donor-funded projects such as the EU's IPARD.

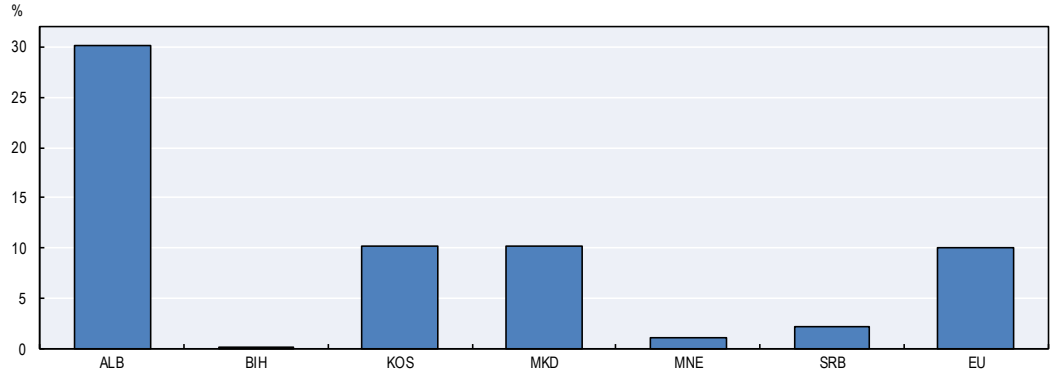
Current funding for rural infrastructure is often insufficient to finance larger rural infrastructure maintenance or construction projects. Important funding mechanisms include government funding and international donors, and in some cases public-private partnerships. Central governments often provide co-financing support for rural infrastructure projects to municipalities or local communities. Most rural development programmes provide support to rural infrastructure. However, this support is rather limited in size; for instance, in 2015 Montenegro's Ministry of Agriculture and Rural Development financed as many as 40 rural infrastructure projects from a total budget of EUR 533 000. The World Bank and the European Bank for Reconstruction and Development (EBRD) have funded several large infrastructure projects (notably roads and ICT). Although these do not exclusively target rural areas, many of them are implemented in rural areas.

Policy frameworks for irrigation remain at an initial planning and implementation stage

Well-managed irrigation systems with efficient technology can use precious water resources more efficiently to increase agricultural productivity while safeguarding the environment. Moreover, irrigation is becoming an important measure for adapting to climate change, given the expected increase in air and soil temperatures and lower rainfall.

The percentage of agricultural land equipped for irrigation in Albania exceeds the EU average, while Kosovo and the Former Yugoslav Republic of Macedonia approach it (Figure 14.15). However, Bosnia and Herzegovina and Montenegro have very low shares of land equipped for irrigation: just 0.1% and 1% respectively. While irrigation systems are being modernised and most commercial farms use drip or low-pressure sprinkler irrigation, many small-scale farmers still use less efficient water conveyance and application systems, such as open canals and surface irrigation.

Figure 14.15. **Share of total agricultural area equipped for irrigation (2014)**



Source: ASK (2015a), "Agriculture census 2014", http://ask.rks-gov.net; FAO (2017a), *FAOSTAT* (database), http://faostat.fao.org.

StatLink http://dx.doi.org/10.1787/888933706658

Irrigation objectives and measures are defined across the six SEE economies, but comprehensive plans for infrastructure and water use aligned with river basins are at varying stages of development. Across the economies, irrigation infrastructure is addressed in either or both their strategies on water, and on agriculture and rural development. IPARD measures in most of the assessed economies include irrigation infrastructure. Additionally in Albania, an irrigation and drainage programme is in place and a strategy is in the process of adoption. Dedicated plans are under preparation in Kosovo and Montenegro. Stakeholders have limited involvement in setting up irrigation policy frameworks across the assessed economies, with the exception of Serbia which carries out water planning at national and basin levels with public consultation (World Bank, 2017b).

Central governments provide financial support for constructing and maintaining large irrigation infrastructure (often co-financed by the World Bank or EBRD), such as irrigation channels, dams and drilling wells. In Bosnia and Herzegovina, while there is no government funding, there is a World Bank project that addresses irrigation infrastructure. The management of irrigation schemes has been decentralised in most of the six SEE

economies. There are a range of water management authorities at regional and local levels, notably in Albania and Kosovo. All ministries of agriculture except those in Bosnia and Herzegovina provide some form of support to farmers to purchase individual irrigation machinery and equipment, such as water pumps, (drip) irrigation pipes and sprinklers. However, this support is rather limited, sometimes only enough to install an irrigation system on about a hectare.

While environmental and socio-economic impact assessments of irrigation programmes may be legally mandated, in practice they exist only for donor-funded projects. The existing irrigation programmes do not sufficiently address the potential adverse effects of intensive irrigation, such as overexploitation, soil salinisation or the depletion of groundwater. In general, water charges are low, not fully covering operation and maintenance costs, much less infrastructure costs. Water pricing is usually not based on volume but rather by area, which does not provide incentives for efficient water use. Price is largely determined by the "ability to pay" principle. Furthermore, collection rates are low, especially among smallholder farmers.

Agricultural education systems are in place but strategies are not

In an evolving agro-food sector, the ability to adopt technology that enhances productivity and sustainability is key. Education enables both the development of new technology and its adoption by producers (OECD, 2015). All six SEE economies are committed to compulsory primary education, and as a result literacy rates among farmers are close to 100%. However, some elderly farmers have not completed primary education. The economies with data report that the share of their farmers who have partially or fully completed primary education ranges from 34% in Montenegro to 61% in Serbia. The share of farmers who have completed secondary education ranges from 33% in Serbia to 53% in Montenegro (Table 14.2).

Table 14.2. **Farmers' educational attainment**

%

	No formal education	Primary education	Secondary education	Tertiary education
Kosovo (2014)	3	40	43	14
Former Yugoslav Republic of Macedonia (2013)	3	44	45	8
Montenegro (2010)	4	34	53	9
Serbia (2012)	0	61	33	6

Note: Data for Serbia refer to farm managers. Data for Albania, and Bosnia and Herzegovina unavailable.

Source: ASK (2015a), "Agriculture census 2014", http://ask.rks-gov.net; MAKSTAT (2014), "Farm structure survey 2013", www.stat.gov.mk; MONSTAT (2012), "Agricultural census 2010", www.monstat.org; SORS (2013), "Census of agriculture 2012 in the Republic of Serbia", www.stat.gov.rs.

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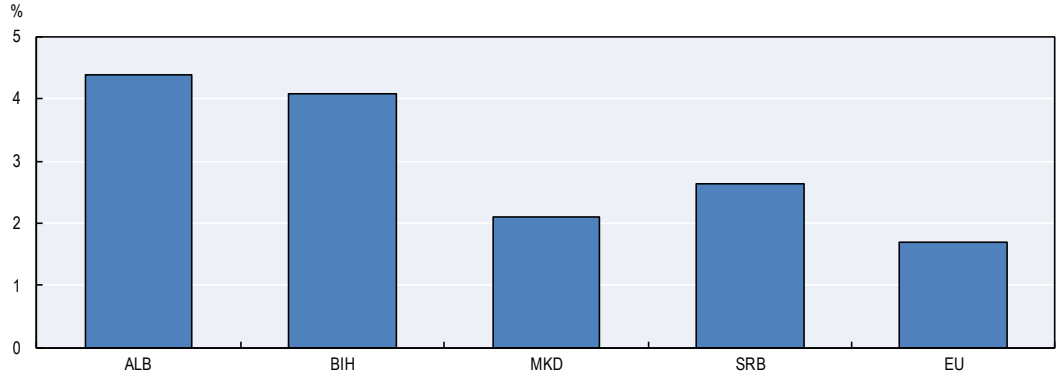
While higher percentages of tertiary education graduates completed agriculture programmes in Albania (4.4), Bosnia and Herzegovina (4.1), the Former Yugoslav Republic of Macedonia (2.1) and Serbia (2.6) than the EU average (1.7), these shares are still likely to be insufficient for the sector's needs given the relatively high contribution that agriculture makes to the economies' GVA (ranging from 7% to 23%) (Figure 14.16). Despite this probable deficit of university graduates in agriculture, keeping current agricultural graduates in the sector is a challenge. While exact data are unavailable,

during OECD field trips to the assessed economies, officials and experts noted that a lack of adequate skills among agricultural graduates was a significant factor driving them to seek employment in other sectors.

The six SEE economies have yet to develop training needs assessments for agricultural education. There is no information on the match between the agricultural education system (such as profile and number of students admitted, curricula, specialisation directions, and knowledge and skills attained) and labour market demand. Furthermore, farmers and the agri-business sector are rarely involved in consultation processes for designing and implementing the agricultural education system. Consequently, the current agricultural education systems are not well adapted to labour market needs and are not responsive to the private sector's need for a well-educated and skilled labour force.

Figure 14.16. **Agriculture in tertiary education (2015)**

% of graduates from agriculture programmes



Note: Data for Montenegro and Kosovo unavailable. The Former Yugoslav Republic of Macedonia data are for 2014.

Source: UNESCO (2017), *Data for the Sustainable Development Goals* (database), www.uis.unesco.org/Pages/default.aspx.

StatLink http://dx.doi.org/10.1787/888933706677

Vocational education and training (VET) and higher agricultural education is available in all six SEE economies through public and private institutions accredited by ministries of education. However, none of the six SEE economies has a strategy specifically targeting agricultural education. Co-ordination between the ministries of education and agriculture is weak across all six economies. Almost the entire agricultural education system rests on the prevailing public education organisations and public funding. However, private VET and university education institutions are emerging (notably in Montenegro and Serbia) and some of these also provide agricultural education. The private sector is more engaged in agricultural VET than in university education. VET is occasionally carried out through projects and programmes financed by the agricultural ministries – this is a fairly common practice in Bosnia and Herzegovina. However, the agricultural VET in all six economies is still marginal and less developed than university education.

Although all SEE economies have an adequate number of organisations providing agricultural VET and university education, their programmes do not offer a sufficient level of knowledge or the practical skills required by farms, extension services and other

organisations. The agricultural education system is still largely geared towards building students' capacities to memorise and reproduce information, rather than systems analysis and problem-solving skills (e.g. using case studies and simulation games). Courses rarely employ group work or work on a project cycle including project design, writing, budget preparation, implementation, and monitoring and evaluation. Instead, most agricultural education in the six economies is still organised around strictly separated specialisations with little attention to inter- and trans-disciplinary approaches. Training in public institutions is nearly always provided by the host organisation, with a limited inflow of guest lecturers, and rarely allows students to earn credit points elsewhere. However, there are some encouraging changes in this respect, particularly thanks to the EU ERASMUS student exchange programme, which is particularly popular in Albania and Kosovo.

Although the agricultural education programmes in most of the six economies include some training on natural resource management and climate change, these topics are addressed marginally and insufficiently. The agricultural education systems in all six economies are subject to occasional monitoring and evaluation. However, this rarely provides a deep analysis. Findings are more descriptive than analytical, with hardly any impact on policy making or formulating new education strategies and programmes. Monitoring and evaluation in the six economies is performed by the education authorities with little involvement by the agricultural sector. Exact figures on expenditures for the agricultural education system in the economies are largely missing.

The way forward for agro-food system capacity

The six SEE economies would benefit from better inter-sectoral co-ordination in formulating and implementing cross-cutting frameworks for agro-food system capacity. Rural infrastructure would benefit from better co-ordination between the agriculture and infrastructure authorities; irrigation policy from better co-ordination between the agriculture and water authorities; and the agricultural education system from closer co-operation between the agriculture and education authorities. In addition, greater co-operation between sectoral institutions (e.g. ministries) and regional/local level institutions (e.g. counties, municipalities) would enable more effective implementation of rural infrastructure and irrigation policies. All six SEE economies would benefit from tailored monitoring and evaluation schemes to track policy implementation progress and to serve as the basis for corrective action plans. Stakeholder involvement in setting up rural infrastructure and irrigation policy frameworks is limited and could be improved.

The six economies could make additional efforts through awareness raising and training to ensure that agricultural activities make full use of existing rural infrastructure, notably ICT, to improve farmer access to production technology and markets. Agricultural advisory services could also offer services online or through cell phones. Farmers would also benefit from improved Internet coverage in rural areas. Kosovo could consider making additional efforts to provide a more stable electricity supply in rural areas.

The six SEE economies would benefit from improving their irrigation policy frameworks, in particular by assessing and addressing the environmental impacts – and adopting the programmes they have prepared, notably Bosnia and Herzegovina and Montenegro. A sound cost-benefit analysis for each irrigation programme should be conducted, applying realistic water charges that are sufficient to cover irrigation infrastructure operation and maintenance as well as the environmental and social costs of irrigation. Irrigation should not be promoted in areas where it is not economically

feasible. For example on rich soils a good alternative could be to promote measures that increase soil organic matter. It would be beneficial for SEE agriculture to practise more water-saving irrigation techniques, and to test solar-powered irrigation schemes. Water charges should be based on volume to provide incentives for its efficient use; they should be gradually increased to reflect capital costs, opportunity costs of water scarcity and environmental externalities.

The quality of the agricultural education system could be strengthened by introducing more multi- and inter-disciplinary subjects, such as the agri-environment, and system analysis and problem solving. Facilitating student exchanges both at domestic and international levels is another important measure. The economies should also facilitate discussion between agricultural education institutions and the agro-industry to identify bottlenecks for sector development. They could promote public-private partnerships (notably for VET) and co-operation with farmers and the agro-industry in creating and updating training packages. Albania would particularly benefit from strengthening its agricultural VET education. The monitoring and evaluation system in agricultural education in all six SEE economies could be strengthened to ensure that targets and objectives are met and the findings used to improve the existing education policy.

The six SEE economies would benefit from completing statistics on farmer demographics, notably their education. This would enable more targeted policies and agricultural extension activities to the level of education. In regards to agricultural higher education, an assessment of agricultural graduates' early careers would help understand the factors which cause them to stay in or leave the agriculture sector.

Agro-food system regulation

Effective regulation protects the environment and safeguards public safety while minimising the compliance burden for farmers and agri-businesses. The agro-food system regulation sub-dimension uses two qualitative indicators to assess the presence and degree of implementation of: 1) regulation of natural resources, such as land, soil, water, air, climate and biodiversity; and 2) regulation of inputs, such as seed, fertiliser, and agricultural machinery.

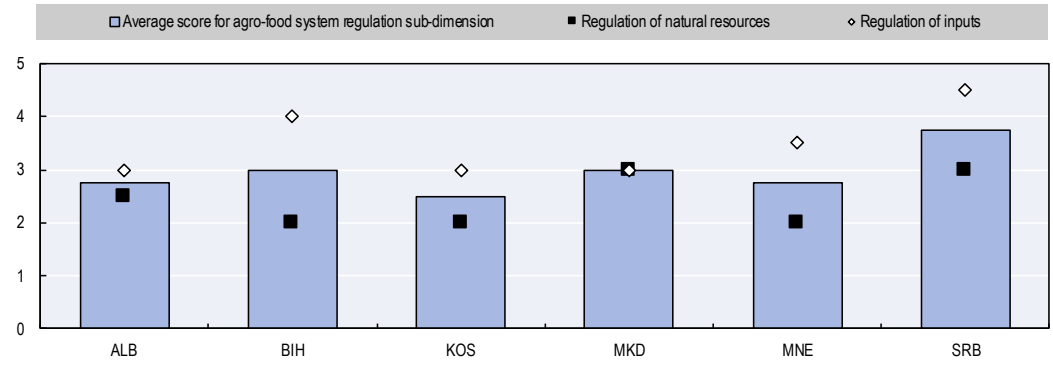
The six SEE economies mostly have operational frameworks for regulating the agro-food system, as indicated by their average score of 3 for this sub-dimension (Figure 14.17). Serbia leads its peers, followed by Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia, leaving Kosovo with the most room for improvement. Regulation of inputs is more developed than natural resource regulation in all six SEE economies.

Natural resource regulations affecting agriculture are emerging

Regulations for natural resources are central to ensuring their sustainable, long-term use. They influence access to land, water and biodiversity resources, and determine the impact of agricultural production on these resources.

All six SEE economies are making progress in developing regulations on natural resources, mostly under the impetus of the EU *acquis*, specifically the EU environmental protection directives (e.g. the Habitats and Birds Directives, Water Framework Directive, and Nitrates Directive)[3]. All six SEE economies have legislation on soil, water, and biodiversity in relation to agriculture. However, there is substantial room for improvement, particularly in transposing the Nitrates Directive (1991/676/EC), and enforcing all of them.

Figure 14.17. **Agro-food system regulation: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Recent changes in the assessed economies' regulations for land transfers, along with farmland consolidation works, are expected to help reduce farmland fragmentation and improve its use, with potential benefits for agricultural productivity and natural resource management. Albania and Kosovo have adopted land consolidation strategies. This is a positive development, but their implementation depends on effective cadastre reform and clarifying property rights. The law on agriculture in Serbia requires all agricultural land to be managed according to a code of good agricultural practice – but this is still voluntary.

All six SEE economies have made some progress with setting up cross-compliance systems – environmental requirements farmers must follow to receive public payments – similar to those in the EU Common Agriculture Policy. In the Former Yugoslav Republic of Macedonia, direct payments are conditional on adherence to environmental cross-compliance requirements. However, although the Paying Agency checks if farmers comply with these requirements, the legally regulated penalty system is not yet enforced. In Montenegro, there is a recommended code of agricultural practices, but no compulsory enforcement. Serbia supports the maintenance of genetic agricultural resources (per hectare/head payments for endangered varieties and breeds). Organic farming has also been encouraged in the economies, notably through per-hectare payments for fruit, vegetables and arable crops; payments for livestock; and payments for inspection and certification costs.

Agricultural input regulations are well defined

To be productive and competitive, farmers need access to seed, fertiliser and tractors. Regulations on inputs that seek to protect human, animal and plant health and can also affect natural resource use. Well-designed regulations can build public trust in new products, while unnecessary or disproportionate regulations can stifle technological development (OECD, 2015).

The six SEE economies have put in place well-formulated and well-enforced regulation of fertiliser and tractors. Some of them even converge towards best practice. The World Bank's *Enabling the Business of Agriculture 2017* report found the 2 assessed SEE economies that were included among its assessment of 62 economies – Bosnia and Herzegovina, and Serbia – led the way in regulating fertiliser and tractors (Box 14.1) (World Bank, 2017b). Across the assessed SEE economies, fertiliser registration, fertiliser quality control, and fertiliser importation and distribution are defined and the time and cost to register a new fertiliser product are not burdensome. Similarly, criteria

specifying tractor operation, tractor testing and standards, and tractor importing are mostly in place, and the time and cost entailed to register a tractor are reasonable. Furthermore, Serbia adheres to the OECD Tractor Codes, which include testing of tractor performance, driver safety and noise levels.

In terms of seed regulation, while national gene banks and variety release committees are established across the assessed economies, they function to varying degrees. Publicly available information on the work of these committees (e.g. composition and meeting frequency) is scarce. In Bosnia and Herzegovina, the committee does not appear to meet in practice (World Bank, 2017b). Participation in the OECD Seed Schemes is another good practice – these provide OECD certification for crop varieties that satisfy the criteria of "Distinction, Uniformity and Stability conditions, having an agronomic value, and published in official lists" (OECD, 2017c). Of the species covered by the schemes, Albania participates in the groups on cereals, and maize and sorghum, while Serbia participates in grasses and legumes; crucifers and other oil or fibre species; cereals, maize and sorghum; sugar and fodder beet; and vegetables.

Box 14.1. **Good practice: Fertiliser regulation in Bosnia and Herzegovina, and Serbia**

Bosnia and Herzegovina was found to have one of the most inexpensive and least burdensome fertiliser registration and quality control procedures in the World Bank's *Enabling the Business of Agriculture 2017*. Its fertiliser registration does not expire and is not subject to periodic fees. In addition, all registered fertiliser products are included in an online catalogue, creating further transparency for industry stakeholders. Importer registration is a one-time-only requirement and no per-shipment import permits apply. Fertiliser registration includes an application to register and lab sample analysis, and excludes field testing due to limited additional benefits. There are also good quality control measures in place: fertiliser bags must comply with comprehensive labelling requirements in at least one of the country's official languages, and mislabeled and open bags are prohibited and subject to penalties, encouraging further fertiliser quality control. Most of these good practices are applied in Serbia too. The fertiliser registration process takes about one month in both economies and costs only 0.5% (Bosnia and Herzegovina) and 5.3% (Serbia) of income per capita. In both economies there are hardly any regulatory obstacles for agri-businesses in producing, marketing and exporting fertiliser. In Bosnia and Herzegovina, only one day is required to obtain per–shipment export documents, which is among the most efficient in the world.

Source: World Bank (2017b), *Enabling the Business of Agriculture 2017: Comparing Regulatory Good Practices*, http://dx.doi.org/10.1596/978-1-4648-1021-3.

The way forward for agro-food system regulation

The six SEE economies should continue to strengthen natural resources regulations affecting agriculture, including adopting relevant EU directives such as the Nitrates Directive. They should re-double their efforts to enforce them. The SEE economies should also continue to press forward with regulations and measures to consolidate farmland, especially in Kosovo and Albania. The SEE economies can allocate water more efficiently, for example, by using water markets and appropriate regulations (Box 14.2). They should continue to put in place and enforce environmental requirements for receiving state support.

The six economies should enhance and enforce the regulation of seeds. They should improve the transparency and quality of the work of their variety release committees (especially Bosnia and Herzegovina). Seed quality control measures could be strengthened. They would benefit from making the process of registering a new variety more efficient.

Box 14.2. Good practice: Water policy reforms and property rights in Australia

Australia has embraced the idea of competition and markets as a paradigm for water management. It has established a nationally consistent water entitlement and trading system to provide security for both water users and the environment. Water trading allows scarce water resources to be transferred to their most efficient and productive uses, and is being delivered through a range of initiatives at national and state level.

This system has provided significant opportunities for sustainable and efficient water use. The development of water markets is seen as a key mechanism, along with planning and appropriate regulation, to address the over-allocation of water resources while optimising economic, social and environmental outcomes in Australia. This integrated approach will also help the country adapt to changing water availability in the face of climate change.

Underpinning the Australian experience is a suite of institutional and property right reforms that have made it easier to set up viable water markets. The general model involves developing a water entitlement regime that allows people to own the right to use water. State government legislation makes it clear that water is controlled by the state on behalf of the general public.

Water users may only acquire or hold an entitlement to use water that is available according to a statutory water plan. Moreover, it is the role of governments rather than the courts to determine how much water is available for use. The result is a property rights regime conducive to the development of efficient markets.

Source: Adapted from OECD (2010), *Sustainable Management of Water Resources in Agriculture*, http://dx.doi.org/10.1787/9789264083578-en.

Agricultural innovation system

Agricultural innovation systems are key to improving the economic, environmental and social performance of the agro-food sector. They comprise networks of actors – such as farmer representative bodies, research institutions and governments – that contribute to the development, diffusion and use of new agricultural technology and institutional innovations for productivity growth (OECD, 2016c). They are also vital for finding solutions to the ever-increasing pressures on natural resources and to society's high demands for agriculture to respond to its challenges sustainably. Two qualitative indicators measure the agricultural innovation system sub-dimension: 1) the agricultural research and development framework; and 2) the agricultural extension services framework.

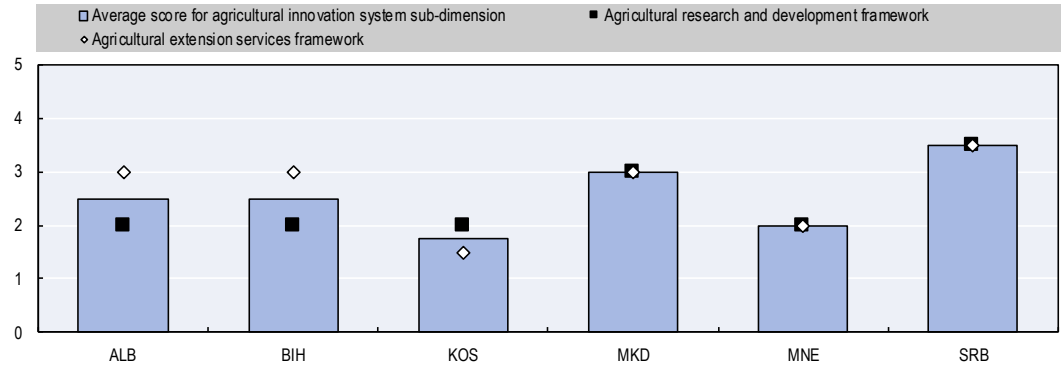
The six SEE economies' agricultural innovation systems are mostly in place but not fully implemented, leading to an overall average score of 2.5 for this sub-dimension (Figure 14.18). The Former Yugoslav Republic of Macedonia and Serbia lead the way in implementation, while Kosovo and Montenegro have the most room to improve. In all the assessed economies except Kosovo, the scores for the agricultural extension services framework indicator are equal to or higher than the scores for the agricultural research and development framework.

Agricultural research occurs despite the absence of agricultural research strategies

The agricultural research and development framework spans public, private and higher education institutions in fostering the underlying knowledge to create innovations in products, processes, marketing and organisation. Agricultural research priorities can range from crops, livestock and fisheries to sustainable resource use and climate change.

International co-operation can have many benefits – including allowing countries with limited research capacity to focus scarce resources on adapting knowledge to local specificities (OECD, 2015).

Figure 14.18. **Agricultural innovation system: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706715

Agricultural research is taking place in all six SEE economies. However, none of the economies has a strategy specifically targeting such research. The majority of agricultural research and development activities are funded by the ministries of science, while the economies' overall research strategies do not include agriculture as a thematic priority. Co-ordination between the ministries of science and agriculture is rather weak in all the economies.

Almost the entire agricultural research system is based on the prevailing public research institutes and public funding; the private sector hardly takes part. However, a couple of private companies (mainly in Serbia) are involved in agricultural research that could lead to patents and commercial products, such as new varieties or pesticides. Public research funding is modest, and insufficient for multi-year and inter-disciplinary research involving larger research teams.

Exact figures on public expenditures on agricultural research are largely lacking in all six SEE economies. Serbia's annual agricultural research budget of EUR 20 million appears to be the biggest. However, given Serbia's size and number of agricultural researchers, this budget seems modest.

Most laboratory and other research equipment is outdated; new apparatus is mainly acquired through internationally funded research projects. Most research projects are focused on applied rather than fundamental science.

Although all six SEE economies have a sufficient number of institutes involved in agricultural research, the quality of their research programmes is modest. Most agricultural research is still organised around strictly separated specialisations with little attention being paid to inter- and trans-disciplinary approaches. There are also too few research programmes focusing on the environment, such as adaptation to climate change and agro-biodiversity improvement. Links are weak between research conducted at university level, and farmers' and businesses' needs. Collaboration between research and agri-business, which facilitates innovation, is not widely practised. Farmers and the agri-business sector are rarely involved in setting the agricultural research agenda and rarely take part in

research projects. Where co-operation exists, farmers' participation is mainly limited to providing agricultural land and machinery for field trials.

The six SEE economies' agricultural research institutes and universities take part in EU and other international research projects. However, there are no exact data on the number of international projects that the agricultural research institutes are leading or taking part in, the amount of funding received or matched funding provided. The general impression given by the officials and experts contacted during this assessment is that while participation in international research projects is growing, it is not yet at the level it should be. This is also partly due to the fact that it is difficult to keep good, and especially young, researchers in the SEE region. Many of those who have been educated abroad tend to leave the region in search of better career opportunities, research facilities and higher salaries.

There is no comprehensive monitoring and evaluation of the agricultural research system, indeed any such practices are scarce. Self-evaluation of individual research projects sometimes occurs – as a chapter in the final project report. However, this is not common practice and mainly a formality.

Agricultural extension services are widely used

Agricultural extension services facilitate farmers' access to vital knowledge and technology to increase the productivity and sustainability of their activities. They also help to connect farmers to networks that allow them to adopt innovations, and contribute to shaping research networks (OECD, 2015).

All six SEE economies have functioning agricultural extension services that are widely used by farmers. But exact figures on the number of farmers regularly using these extension services are scarce. This assessment found that, in the Former Yugoslav Republic of Macedonia, out of 100 000 registered farmers, 80% receive agriculture extension services. The work of the extension service in Serbia encompasses 41 500 households which are intensively monitored four times a year. Other households are included in the extension system in other ways; mainly through participation in group classes and occasional on-farm visits and consultations.

Usually, the extension work is publicly funded and organised at central, regional and local levels. It is provided free of charge to farmers. In all six SEE economies, extension services are modestly funded with a limited number of extension specialists – for example, in Kosovo there is one extension specialist for every 1 700 farmers. Often, agriculture advisors are engaged in a number of tasks outside their primary technical specialisation. They tend to have limited knowledge, notably in farm management, marketing and business planning; their average age is high; and they have limited IT skills.

Limited private extension services are available in some of the economies, mainly provided by input dealers and food processing companies who are interested in improving the yields and quality of primary products. In Serbia, international donors have developed a small private extension network. Its long-term funding is still unclear and so far it has only reached a small number of farmers. Similarly, some donor organisations such as the US Agency for International Development in Kosovo are active in providing advice to farmers and food processors.

The way forward for the agricultural innovation system

The six SEE economies would benefit from ensuring better inter-sectoral co-ordination in formulating and implementing agricultural innovation, notably between the agriculture and science ministries and other organisations. They could develop multi- and inter-disciplinary approaches and research topics, such as the agri-environment and agro-processing, to improve the quality of their agricultural research and extension services.

The economies could strengthen agricultural research tailored to stakeholder needs and the environment, including the impact of agriculture on natural resources and the environment, and adaptation to climate change. Furthermore, the six economies could focus on making the agricultural innovation system more responsive to the needs of diverse stakeholders – such as farmers, producer groups, agri-business and policy makers. All six economies could benefit from increasing the budgets for their agricultural knowledge and innovation systems.

The economies could prepare long-term strategies and action plans for the work of agricultural extension services and revise them regularly in order to be more responsive to the needs of farmers, agri-business and other stakeholders. They could include building the capacity of extension officers and developing new models leveraging ICT to disseminate information such as the decentralised and participatory model described in Box 14.3. They could explore opportunities provided by public-private partnerships in the area of knowledge and technology transfer.

Box 14.3. **Good practice: Social networks for agricultural extension in India**

Traditional "training and visit" approaches for agricultural extension provides scientific and technical support to farmers, but the centralised system can only reach a limited number of farmers. Digital Green is a non-government organisation founded in 2008 to reach under-served smallholder producers with an innovative, decentralised and participatory model of information sharing. It combines agriculture extension workers with community engagement and participation to create multi-media content showcasing agricultural practices on social network sites.

The online community shares best practices and technical expertise through a series of independent tutorials posted online. These "agri-videos" are made in local languages, in consultation with civil society experts and other stakeholders. According to the Food and Agricultural Organization of the United Nations, "digital greening" has produced nearly 3 000 videos in more than 20 languages, and has reached more than 300 000 farmers since the practice began in 2006 (Sylvester, 2015).

Through the video-based approach, farmers communicate directly with stakeholders, eliminating logistical middlemen and ultimately saving costs. A controlled evaluation found Digital Green's model to be ten times more efficient than traditional training and visiting schemes, with best practices streamed directly to farmers' mobile devices.

Unlike centrally co-ordinated and often inaccessible expertise, the model offers an exciting platform for horizontal learning. Its community-orientated solutions are both responsive to local challenges and easily accessible online, making it the perfect space for information sharing and knowledge diffusion.

Source: Sylvester (2015), *Success Stories on Information and Communication Technologies for Agriculture and Rural Development*, www.fao.org/3/a-i4622e.pdf.

The six SEE economies' research institutions could play a more proactive role in becoming partners in collaborative international research projects, in particular at the EU level, but also in regional networks and initiatives. The six SEE economies would benefit from strengthening cross-country co-operation, which would enable a targeted focus on cross-border problems, issues and shared costs. This type of regional co-operation would enhance knowledge flow as well as exchanges of research staff and students. In addition, acquiring more internationally funded projects would diversify funding sources and reduce research institutes' dependence on public funding for agricultural research, which has been shrinking and becoming more uncertain. Examples of EU research programmes include Horizon 2020 and Hercule III.

The six SEE economies are advised to address the limitations of agricultural extension and advisory services whose outreach is frequently hampered by a lack of resources – human, financial and institutional. In particular, the economies could focus on finding solutions for the limited number of extension specialists, their high average age, limited IT skills and limited capacities in farm management, marketing and business planning. More focus could be put on developing skills that advisors are missing, including farm socio-economic assessments, calculating investment profitability, risk assessments and managing farm development projects.

Conclusions

The six SEE economies have agricultural policies and legislation in place and are taking steps to develop them further. In particular, they are setting up the requirements to implement IPARD II to invest in agricultural production and continuing to adopt environmental directives critical to agriculture, such as the Nitrates Directive. Basic rural infrastructure connects farmers to markets and to information, though existing infrastructure could be better leveraged to support agricultural activities. Land consolidation plans are in place but require significant efforts to implement.

For agriculture across the six economies to reach its full economic potential, however, agricultural productivity growth is key. As such, re-allocating labour to more productive uses within and outside the agriculture sector is vital – a process that depends on the economies' overall economic and human development. The six SEE economies should redouble their efforts to reorient their agricultural policies and producer support towards long-term productivity gains and sustainability objectives. Specifically, producer support should focus on bolstering general services, such as agricultural research and extension, which promote the creation and adoption of innovations. Policies and regulation should provide more incentives for producers to safeguard their natural resources. The economies should build and publish necessary databases including those on agricultural economic accounts, employment and nutrient balances. Monitoring and evaluation activities should be strengthened and used to inform new policies more consistently.

Notes

1. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
2. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
3. Habitats and Birds Directives Council Directive 92/43/EEC; Water Framework Directive 2000/60/EC; Nitrates Directive 1991/676/EC.

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Annex 14.A1.
Agriculture: Indicator scores

Table 14.A1.1. **Agriculture: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Agricultural policy						
Agricultural policy framework	3.0	2.0	2.5	3.5	3.0	3.0
Domestic producer support instruments	3.5	2.5	3.0	3.0	3.0	3.0
Agricultural trade policy	3.5	3.5	3.5	4.0	3.5	4.0
Agricultural tax regime	2.5	2.5	2.5	2.5	2.5	2.5
Agro-food system capacity						
Rural infrastructure policy framework	3.5	1.5	1.5	2.5	2.0	2.5
Irrigation policy framework	3.0	1.5	3.0	2.5	1.5	3.0
Agricultural education system	2.0	2.5	2.5	2.5	2.0	3.5
Agro-food system regulation						
Regulation of natural resources	2.5	2.0	2.0	3.0	2.0	3.0
Regulation of inputs	3.0	4.0	3.0	3.0	3.5	4.5
Agricultural innovation system						
Agricultural research and development framework	2.0	2.0	2.0	3.0	2.0	3.5
Agricultural extension services framework	3.0	3.0	1.5	3.0	2.0	3.5

StatLink http://dx.doi.org/10.1787/888933706772

Chapter 15.

Tourism in South East Europe

This chapter on tourism assesses the policy settings, strategies, processes, and institutions in six South East European economies. After a brief overview of trends and performance in developing tourism in South East Europe, including visitor numbers and growth, the chapter then focuses on five essential sub-dimensions. The first sub-dimension, cultural and natural resources, explores the existence of tourism strategies that draw upon the rich and varied natural assets and cultural characteristics of the area. The second, destination accessibility and tourism infrastructure, looks at efforts made to improve visa regimes, promote connectivity and infrastructure, provide relevant information, and improve the capacity and quality of visitor accommodation. The third sub-dimension, availability of a suitably qualified workforce, asks whether the economies have the capacity to balance tourism development with labour supply and demand. The fourth sub-dimension – safety and health – assesses visitors' security and healthcare provision. Finally, the tourism prioritisation and promotion sub-dimension asks whether government action in these fields is guided by a strategy backed up by adequate data collection. The chapter includes suggestions for enhancing the policies in each of these sub-dimensions in order to allow tourism to become a vibrant and sustainable sector, which in turn would foster the competitiveness of these economies.

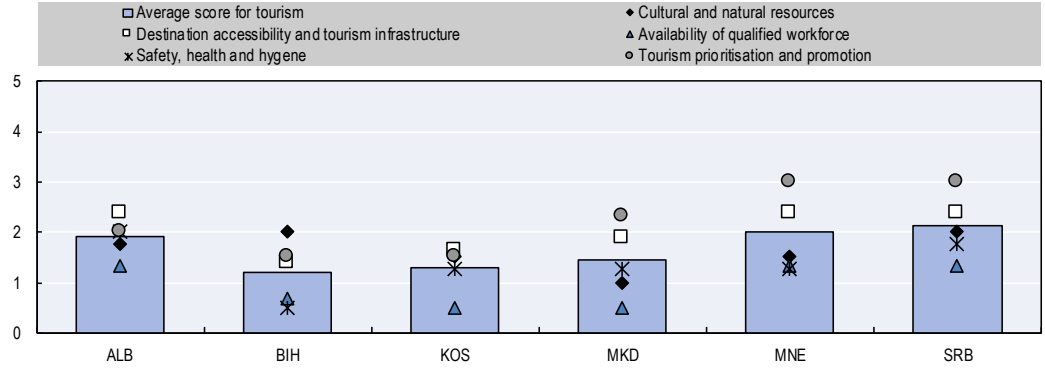
Main findings

Tourism is an important economic sector for South East Europe (SEE). Industries that deal directly with tourists (e.g. hotels, travel agents and airlines) in the region generated over 5% of regional gross domestic product (GDP) and 4% of total regional employment in 2016 (WTTC, 2017).[1] As travel and tourism continue to expand globally, the region can position itself to benefit further from tourists' increased interest in the new experiences and authentic history and culture it offers.

The six assessed SEE economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – all have tourism frameworks and institutions in place. The qualitative assessment of tourism policies in the region (Figure 15.1) found that tourism prioritisation and promotion is the strongest area for many of the economies, while providing a qualified workforce is the area with the most scope for improvement.

The scores also suggest that there is significant room to strengthen policies across all the tourism sub-dimensions. More broadly, the analysis reveals the need for measures to improve monitoring, implementation and capacity to apply a whole-of-government approach to tourism. To ensure greater competitiveness and sustainable tourism growth, the six SEE economies would benefit from more effective institutions and mechanisms to foster partnerships with the private sector, and stronger horizontal and vertical co-ordination of relevant bodies at different levels of government.

Figure 15.1. **Tourism: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706791

Comparison with the 2016 assessment

While the *2016 Competitiveness Outlook* covered 15 policy dimensions encompassing a wide range of areas that are critical to economic growth, it did not include tourism. As tourism is one of the fastest-growing sectors in most economies of the region, it has been added to this current assessment. This review draws on the OECD policy handbook, *Fostering Tourism Competitiveness in South East Europe* (OECD, 2016b) and provides a baseline against which to assess and compare future progress in developing tourism.

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Achievements

All six SEE economies have adopted strategies for tourism development and promotion and have taken initial steps to support a more sustainable tourism industry. Strategic documents on the natural and cultural heritage do occasionally focus on tourism, as well as environmental protection. Some of the economies also aim to ensure that their new tourism strategies build on previous lessons, recent market research and capacity-building plans.

Destination branding and product development have improved the tourist offer, targeting specific tourism market segments, including mountain and adventure tourism. The six economies have also taken specific measures to strengthen their offer in culture and adventure tourism. This reflects their aspiration to realise the full potential of the sector for job creation, growth and enhanced well-being of SEE citizens.

Private-sector involvement in policy design and implementation is slowly increasing through dialogue on relevant legislative changes and strategy development. The six SEE economies are beginning to introduce targeted incentives to encourage investment and higher-quality standards for tourism-related services.

The economies have taken steps to attract more international visitors from emerging markets and neighbouring countries by improving accessibility, branding and perceptions. This reflects a growing appreciation of the importance of marketing tourism in a highly competitive global environment with over 200 countries as destinations. Each economy has taken steps to liberalise visa arrangements with many countries, including those in the European Union (EU), the People's Republic of China (hereafter "China") and India. They are also establishing regional hub airports attracting low-cost as well as some domestic carriers.

Remaining challenges and key recommendations

- **Systematically implement a whole-of-government approach to tourism.** The six SEE economies' tourism strategies, and their related promotion strategies, are not sufficiently comprehensive or well informed. The relatively high scores in Figure 15.1 reflect their efforts to put such strategies in place, but their objectives are not sufficiently well defined and/or fully implemented. The sector needs a whole-of-government approach engaging relevant public-sector institutions across departments and levels of government, with support from the industry. Most of the economies also need to increase the financial and human resources allocated to tourism development.
- **Forge stronger links between natural and cultural resource strategies and tourism.** Governments would benefit from more systematic consultations among relevant public institutions and civil society stakeholders and should be more transparent about the respective budget allocations. This would help with the implementation of strategies and, ultimately, the sustainable development of natural and cultural resources. It would also help to manage the environmental impact of tourism.
- **Bring tourism infrastructure into line with internationally recognised standards**. The six economies should improve their spatial policies and support for tourism clusters, as well as the oversight of private-sector development at a local level. Local tourism development also needs to be linked more closely to

domestic economic priorities. Importantly, the accessibility of the region by air, land and sea needs significant improvement to attract greater numbers of international and domestic tourists.

- **Further professionalise the tourism workforce and address the significant skills gaps in the sector**. All six economies need to review their existing frameworks for vocational education and training (VET), higher education, and lifelong learning to strengthen their links to tourism in order to match labour supply with demand. They also need to make tourism a more attractive career choice and strengthen the links between businesses and academia to address employment and skills development issues more effectively.
- **Develop tourism data and statistics in line with international standards and good practice**. Existing data need to be more robust and comprehensive to inform forward-looking strategic planning and decision making, and to facilitate monitoring of implementation. In the future, it will be important to address the gaps in the evidence base (e.g. on inbound tourism) and the lack of satellite accounts which measure the value-added effects of tourism.
- **Improve co-ordination among institutions promoting tourism at central, regional and local levels**. The six SEE economies need to foster regular interaction among bodies and services at all levels in order to increase the effectiveness of policy making and implementation. This interaction should also focus on tracking the progress of reforms.
- **Put in place independent monitoring and evaluation of tourism-related action plans and strategies**. The economies need effective systems to track the implementation of policy measures, to learn from experience and to support policy adjustments. They need to place particular emphasis on finding synergies between sectors such as transport, the environment, investment promotion, skills and education.

Context

Tourism policy underpins a government's ability to compete in one of the fastest-growing economic sectors. Over the past six decades, tourism has seen continued expansion and diversification globally, with the total value of exports of tourism services reaching USD 1.5 trillion in 2015 (UNWTO, 2016b). Moreover, international tourist arrivals worldwide are expected to increase by 3.3% a year between 2010 and 2030, to reach 1.8 billion by 2030. In Europe, international tourist arrivals grew by 5% in 2015 to reach a total of 608 million, just over half the world's total (51%). In addition to being the world's most visited region, Europe was also the fastest growing in absolute terms and is forecast to record further growth to 2030.

As emerging tourist destinations, the six South East Europe (SEE) economies have all reported double-digit increases in recent years, making them one of the fastest-growing regions. South East Europe has the potential to capture an even more significant share of the growth in tourism thanks to its diverse and rich regional heritage. Its mountainous landscapes (such as the Albanian Alps, the Dinaric Alps and the Balkan Mountains), natural sites (such as the Durmitor Park in Montenegro, the Shar Mountain Park in Kosovo and the natural and cultural heritage of the Ohrid region in the Former Yugoslav Republic of Macedonia), as well as its beaches provide international tourists with a

wealth of possibilities. Medieval castles, Orthodox monasteries and Ottoman mosques also make it an attractive cultural destination.

Successful tourism policies need to link to well-functioning strategies in other policy areas which can play a key role in increasing accessibility and facilitating tourism development. For example, competitiveness in tourism depends strongly on efforts to increase productivity and quality, and to encourage innovation (OECD, 2012). Policy makers can also promote competitiveness by better defining the roles and competencies of relevant government and industry organisations, and by fostering skills development across the sector. In turn, a more competitive tourism sector contributes to international export earnings, providing much-needed sources of finance to build more competitive industries overall. It also increases capital stocks, thus boosting labour productivity (OECD, 2014). Beyond the strict economic benefits, increased tourism competitiveness can also help improve environmental conditions and boost job creation in the host countries (at shown, for example, by the Danube Regional Development Project; see SIPA, 2016).

This chapter aims to consider the links between tourism and other policies – the potential trade-offs and complementarities. The following chapters of the *Competitiveness Outlook* are also particularly relevant for tourism:

- **Chapter 1. Investment policy and promotion** are key for investments in tourism infrastructure, such as to transport visitors to and around a destination, and to provide adequate accommodation, entertainment and other facilities. Public and private investments play an important role in promoting the attractiveness and competitiveness of a destination and in supporting small and medium-sized enterprises (SMEs) and local development. Closer co-operation between the government bodies responsible for tourism and for investment policies and promotion could allow them to better target opportunities and boost the level and quality of investment in the sector.
- **Chapter 7. Education and competencies** are relevant as the competitiveness of tourism requires policies to anticipate and meet the labour market's demand for skilled workers in the sector. The disparity between the jobs available in tourism and workers' qualifications is of increasing concern to the public and private sector in the six economies. To fully address labour and skills shortages, the government bodies in charge of tourism and education could co-operate to revise VET and higher education curricula, build in mandatory practical training, and involve the private sector and academia in a structured way to address skills needs.
- **Chapter 11. Transport –** its capacity, efficiency and connectivity – plays an important role in tourism development. Conversely, tourism demand for transport – which has grown significantly in recent years – affects transport development. This calls for closer co-operation among the relevant ministries and agencies in policy design, especially in the areas of infrastructure planning, financing and management. At a sub-national level, co-ordination is required with the local authorities and municipalities responsible for transport provision to a destination. It will be particularly important to develop intermodal connectivity across a network of airports, seaports, roads, railways and public transport systems to improve visitor mobility and satisfaction.

- **Chapter 13. Environmental policies** are key to protect natural assets, control and manage the environmental impacts of tourism, and protect the region's competitive advantage. Nature tourism and ecotourism help promote the conservation of wildlife and natural resources, which are considered key tourism assets. At the same time, tourism development needs to respect the environment and manage the negative effects stemming from increased traffic, littering, sewage and noise. The economies need appropriate policy frameworks for these functions. Environmental and tourism policies also need to be aligned to promote sustainable growth and support domestic efforts to reconcile resource use and waste targets with tourism growth objectives.

Tourism assessment framework

The tourism dimension in the *2018 Competitiveness Outlook* examines the extent to which governments have established a competitive tourism framework. Without seeking to be exhaustive, it considers five broad sub-dimensions which are critical to a sustainable tourism sector which can favour economic growth and well-being across the population:

1. Cultural and natural resources: are there strategies in place with clear measures for the management or protection of the cultural and natural heritage? Are they linked to economic development and tourism strategies with clearly resourced plans to improve competitiveness?
2. Destination accessibility and tourism infrastructure: are there strategies and frameworks to improve land, sea and air connectivity? How do the range and quality of accommodation measure up against international standards and can visitors find reliable information about potential destinations, accommodation and experiences?
3. Availability of a qualified workforce: do the economies have the capacity to bridge skills gaps in the rapidly evolving tourism sector through frameworks for VET, higher education and lifelong learning?
4. Safety and health: are there frameworks for tourists' safety and health care, and are international visitors offered a secure and seamless travel experience?
5. Tourism prioritisation and promotion: how good are the economies' tourism and complementary promotion strategies, and do they have measurement frameworks that can produce the data needed for policy design, implementation and monitoring?

Figure 15.2 shows how the sub-dimensions and their constituent indicators make up the tourism dimension assessment framework. Each sub-dimension is assessed through quantitative and/or qualitative information. The assessment draws on template surveys, fact-finding meetings in the six economies and the insights of the OECD's tourism policy handbook (OECD, 2016b). The OECD collected the qualitative and quantitative data for this dimension with the support of the SEE governments and their statistical offices. Quantitative indicators are based on domestic or international statistics. Qualitative indicators have been scored in ascending order on a scale of 0 to 5, and are summarised in Annex 15.A1.[2] For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 15.2. **Tourism assessment framework**

Tourism dimension

Outcome indicators
- Tourism's contribution to gross domestic product
- Tourism exports
- Tourism employment
- Number of nights spent in tourism accommodation
- Total international arrivals
- Total receipts and expenditure in balance of payments
- Visitor satisfaction rating and intention to visit again

Sub-dimension 1 Cultural and natural resources	**Sub-dimension 2** Destination accessibility and tourism infrastructure	**Sub-dimension 3** Availability of a qualified workforce	**Sub-dimension 4** Safety and health	**Sub-dimension 5** Tourism prioritisation and promotion
Qualitative indicators 1. Natural heritage strategy 2. Cultural heritage strategy	**Qualitative indicators** 3. Travel facilitation strategy 4. Framework for air, land and sea connectivity 5. Accommodation capacity and quality 6. Information availability	**Qualitative indicators** 7. VET framework for tourism 8. Higher education 9. Lifelong learning	**Qualitative indicators** 10. Security framework 11. Healthcare framework	**Qualitative indicators** 12. National tourism strategy 13. National promotion strategy 14. Tourism data collection and sharing
Quantitative indicators 1. Budget for maintaining sites 2. Budget for natural heritage strategy 3. No. of recognised natural heritage sites and natural preserved areas 4. No. of plant species 5. No. of animal species 6. No. of excursions on Lonely Planet website 7. UNESCO world heritage sites	**Quantitative indicators** 8. No. of economies on visa-required list 9. Costs of obtaining visa 10. No. of economies with existing travel facilitation agreements 11. No. of beds in hotels 12. No. of beds in private accommodation	**Quantitative indicators** 13. Quality of the tourism labour force 14. Growth in labour productivity in tourism services, or if not available, in services in general 15. Budget for VET framework for tourism 16. Budget for higher education framework for tourism 17. Budget for lifelong learning for tourism	**Quantitative indicators** 18. No. of crime and violent incidents /1 000 pop. 19. No. of terrorism-related causalities 20. Access to improved sanitation 21. No. of police officers/1 000 pop. 22. No. of physicians/ 1 000 pop. 23. Hospital beds/ 10 000 pop.	**Quantitative indicators** 24. Average staff per tourism office 25. Effectiveness of marketing and branding to attract tourists 26. Country brand strategy rating 27. Budget allocated for tourism 28. Budget of national tourism agency 29. No. of international promotional events attended

Tourism performance in SEE economies

The tourism sector has substantial weight in most of the six SEE economies and performance has been strong across the region, as shown by increasing visitor arrivals and additional income generation. Table 15.1 summarises some key statistics for the SEE economies.

Visitor inflows have grown significantly in recent years across SEE, driven partly by the expansion of low-cost air carriers and the development of air route networks which increase connectivity. The double-digit growth rates of visitors to the region have regularly exceeded the EU average since 2007, thanks to the economies' cost competitiveness, improved accessibility and marketing. Visitors from more developed economies, such as those of the EU, can take advantage of lower costs and enjoy attractions in a neighbouring region that offers them a new tourist experience.

Table 15.1. **Key tourism statistics by economy**

Economy	Tourism contribution to GDP, 2016	Tourism employment contribution, 2016	Tourism receipts as % of total exports, 2016
Albania	8.4% direct 26.0% total	7.7% direct 23.9% total	56.1%
Bosnia and Herzegovina	2.5% direct 9.2% total	3.0% direct 10.6% total	12.3%
Former Yugoslav Republic of Macedonia	1.8% direct 6.7% total	1.6% direct 6.1% total	5.4%
Montenegro	11.0% direct 22.1% total	6.5% direct 14.6% total	49.3%
Serbia	2.3% direct 6.7% total	1.9% direct 5.0% total	7.7%

Note: No information available for Kosovo.

Source: Estimates of the WTTC (2017), *Travel & Tourism: Economic Impact Country Reports*, www.wttc.org/-/media/files/reports/economic-impact-research/regions-2017/world2017.pdf.

StatLink http://dx.doi.org/10.1787/888933706924

Tourism income is an important driver of both economic and employment growth, and the sector accounts for a significant share of regional income. Tourism continues to make a greater contribution to growth and exports in the six SEE economies than on average for the EU. Several of them have strong potential for further growth in the sector.

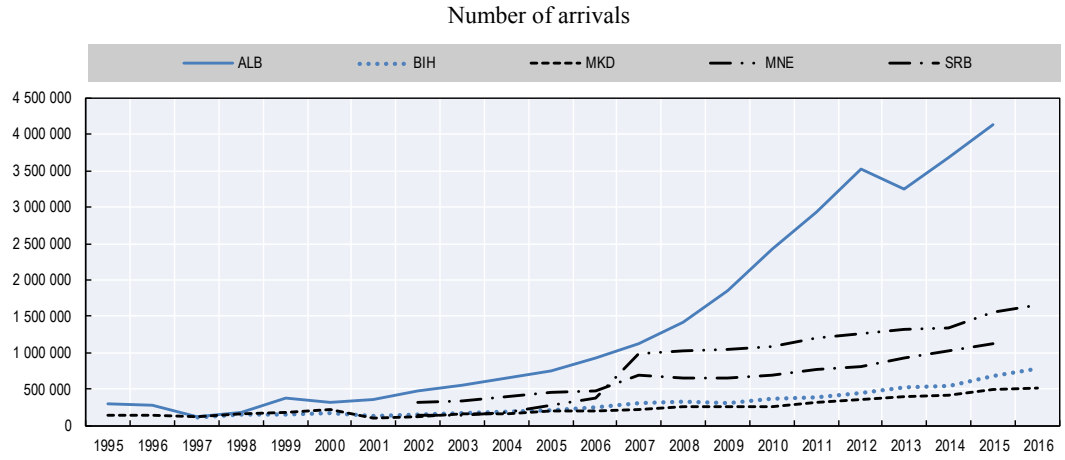
Although tourism is a key sector for the whole region, its significance varies from economy to economy. The direct contribution of tourism to GDP in 2016 ranged from an estimated 1.8% and 2.3% respectively in the Former Yugoslav Republic of Macedonia and Serbia, to an estimated 8.4% and 11% respectively in Albania and Montenegro (Table 15.1).

Montenegro exhibits the highest annual tourist inflows per capita and tourism income as a percentage of GDP, thanks in large part to continued investment in infrastructure. This can be complemented in the future by more significant efforts to improve job quality in related services and to increase average salary levels, which remain rather low.

Albania has the second highest ratio of tourism income to GDP and the largest number of international arrivals in absolute terms (Figure 15.3). Visitor growth rates have also been high in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia,

and Serbia. Each economy has achieved this growth from different baselines and has prioritised different types of tourism. For example, Serbia continues to attract congress tourism, predominantly to Belgrade, which occupies a prominent position as a regional centre and as a recognised European city-break destination.

Figure 15.3. **The growth in international tourism (1995-2016)**



Note: No information available for Kosovo.

Source: World Bank (2017), *World Development Indicators* (database), https://data.worldbank.org/products/wdi.

StatLink http://dx.doi.org/10.1787/888933706810

Despite these trends, the economies are not realising their full tourism development potential. In time, their short-term advantages based on price competitiveness and novelty are likely to become less significant. It will take effective, whole-of-government policies, as discussed below, across all five tourism sub-dimensions, to bring lasting progress in improving competitiveness and supporting sustainable and inclusive tourism growth in the region.

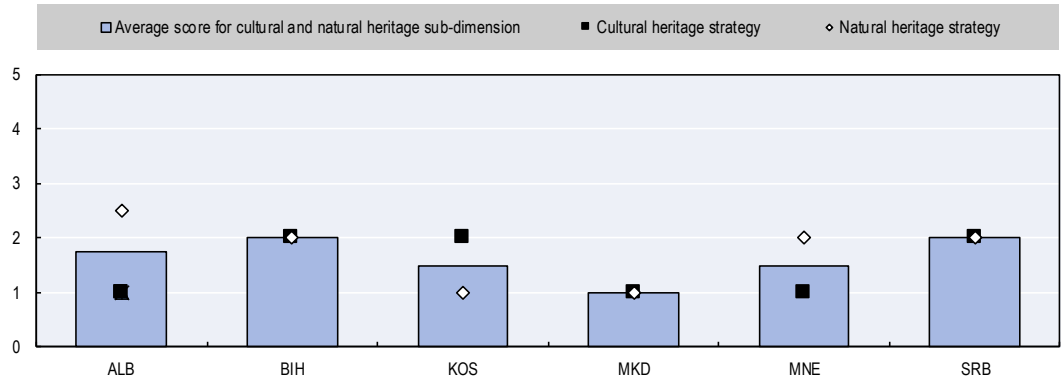
Cultural and natural resources

Natural, cultural, historical and creative resources are important elements of the tourism offer. They improve the attractiveness of a destination by promising unique experiences and creating a positive perception of a country as a place of choice for tourists.

The cultural and natural resources sub-dimension comprises two qualitative indicators that assess: 1) the natural heritage strategy; and 2) the cultural heritage strategy in each economy (Figure 15.4).

Creating a tourism offer that draws upon the rich and varied natural assets and cultural characteristics of the area is an important priority across the six economies. Yet on average, SEE economies overall score only 1.6 out of 5 for this sub-dimension. This indicates that although they are making policy advances in the area of natural and cultural resources, they have yet to develop a formal, detailed and integrated strategic approach to link their cultural and historical heritage to tourism. They also still need to establish and implement more comprehensive frameworks, and carry out monitoring. Bosnia and Herzegovina and Serbia score highest, with an average score of 2 for this sub-dimension, indicating that they have fully adopted their frameworks and entered the initial stages of implementation.

Figure 15.4. **Cultural and natural resources: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706829

However, the scores do not fully reflect the policy dynamics in this field. All the SEE economies are making important efforts to extend the type and range of tourism linked to their natural and cultural resources. In spite of these encouraging signs, however, the modest commitment of financial resources to implement any plans fully is a serious challenge.

SEE economies are focusing attention on natural and cultural resource sustainability

Natural and cultural heritage can create a competitive advantage, attracting particular segments of the tourist market – often high-value ones – and potentially generating significant receipts. Natural assets include registered sites and monuments, parks, protected areas, and activities such as hunting, forestry and extractive industries. Religious and cultural sites and specific places of interest, such as monasteries and temples, are another important part of the natural heritage. Of particular importance are internationally recognised sites such as those registered with the United Nations Educational, Scientific and Cultural Organization (UNESCO).

The six SEE economies have shown strong commitment to registering and protecting natural and cultural assets within their respective laws. For instance, they have all signed protection agreements and seek to safeguard significant proportions of their natural assets and cultural characteristics. However, across the region, the key documents for the protection and development of natural and cultural heritage have limited focus on how they relate to tourism.

There has been a general trend towards more strategic approaches to protecting natural resources, although none of the economies have specific **natural heritage strategies**. Natural heritage considerations are included in other strategic documents, such as on biodiversity, environmental and landscape protection (see Chapter 13, Environmental policy). These documents have long-term action plans, including timelines for implementing specific measures. They also draw on evidence (studies) to identify sites for designation and monitoring during the strategy period. The economies are developing other good practices, including defining key deliverables and identifying the organisations responsible for implementation. The process for stakeholder engagement and consultation includes experts from public agencies and the civil society. The biodiversity and landscape strategies identify potential sources of finance and their implementation is in progress.

The Former Yugoslav Republic of Macedonia has developed a Draft Strategy for Environmental Protection (2017-27) to complement the Draft Strategic Environmental Assessment 2017-27. However, the draft strategy does not contain a timetable for reviewing and monitoring the implementation of the strategy and there is no evidence of direct linkages to tourism.

Bosnia and Herzegovina has a Biodiversity Strategy and Action Plan for the period 2015-20. The entities of Bosnia and Herzegovina[3] have various documents that relate to some extent to natural heritage – such as the Republika Srpska's Environmental Protection Strategy – but no specifically dedicated strategies (Bosnia and Herzegovina Ministry of Foreign Trade and Economic Relations, 2015). Montenegro has a Strategy for Sustainable Development 2030, but it has only limited focus on tourism (Montenegro Ministry of Sustainable Development and Tourism, 2007).

These strategies do represent important steps forward and aim to comply with international strategies and standards, such as the Convention on Biodiversity and the Mediterranean Strategy for Sustainable Development. However, they lack information on dedicated budgets, which may mean that the implementation of at least certain aspects of their action plans may depend on the financial support of donors and international organisations. This presents potential risks for their implementation and raises concerns about the sustainability of the targeted impacts. It reinforces the need for the future monitoring and evaluation of measures to protect natural heritage in the region.

In terms of **cultural heritage strategies**, all six SEE economies recognise the importance of cultural resources as valuable assets for developing tourism. Cultural heritage sites in the region are registered according to the individual criteria for acceptance and retention on domestic registers. For example, Serbia lists 2 306 cultural heritage sites in its domestic registry. It also has 10 World Heritage Sites overseen by UNESCO, which is an important driver of policy obligations in Serbia.

Currently, all of the domestic cultural heritage documents mention tourism, and are increasingly being developed in a more co-ordinated and strategic manner. Kosovo has adopted a Strategy for Cultural Heritage for the years 2017-27, as well as an action plan (Kosovo Ministry of Culture, Youth and Sport, 2017). This strategy lists five objectives, including an integrated approach to the protection of cultural heritage and sustainable development. However, the strategy needs to provide further detail on implementation, evaluation, division of tasks and responsibilities, human resource needs, organisational structure, and financial requirements. The lack of a tourism strategy to link with this cultural heritage strategy appears to be a missed opportunity for the more effective development of cultural tourism.

Other SEE economies, such as Albania, the Former Yugoslav Republic of Macedonia and Montenegro, are drafting cultural heritage strategies for adoption in 2017/18. Bosnia and Herzegovina has implemented UNESCO Culture for Development Indicators since 2011, which highlight how culture contributes to development fostering economic growth and prosperity at domestic level. These UNESCO indicators demonstrate how culture can have an enabling and driving role in sustainable development.

The way forward for cultural and natural resources

As the six SEE economies look to strengthen their tourism sector, they need to address the role of natural and cultural resources in its development in a more structured fashion.

Emphasising the strong links among cultural heritage strategies, tourism and wider economic development will be important. An integrated approach such as this can be expected to boost cultural and adventure tourism, for example by developing new routes and product offers, with potential wider benefits in the form of increased sustainability and inclusiveness, and broader economic impacts. Serbia's new Tourism Development Strategy 2016-25 could lead the way in this area, as it contains direct references to cultural heritage and economic impacts.

It will also be important for Serbia to emphasise the relationship between tourism and its cultural development strategy, currently under preparation. This could lead to sophisticated and targeted tourism offers that balance economic impacts with the protection of natural and cultural resources.

Kosovo could consider examining the relationship between the objectives of its cultural heritage strategy and its sustainable tourism development goals. This would ideally help to design a specific tourism strategy with a long-term perspective and a whole-of-government approach across ministries and relevant public agencies.

Albania, the Former Yugoslav Republic of Macedonia and Montenegro could consider raising awareness and organising broader consultations about their current draft cultural heritage strategies and their expected outcomes. They should also include the formal monitoring and evaluation of impacts and a clear process to show how lessons from monitoring will be used to adjust strategies as necessary. This will help to develop an evidence-based policy making and learning culture.

The SEE economies could make clearer commitments to implementation. This includes identifying how tasks, roles and responsibilities will be divided among partners, as well as budget details to underpin the framework for implementation. The economies need to review their specific human resource needs, organisational structures and capacity-building approaches to improve efficiency and allow scope for future innovation.

All six SEE economies could consider doing more to promote and raise awareness about their cultural and natural heritage. Involving private-sector stakeholders and representatives of academia more widely could also lead to more relevant policy outcomes to help natural and cultural resources play a greater role in developing the region's tourism.

Destination accessibility and tourism infrastructure

There are several policy measures available that can attract more visitors. These include increasing accessibility by improving visa regimes, promoting connectivity and infrastructure, ensuring tourists have access to relevant information, and increasing the capacity and quality of visitor accommodation. The sub-dimension on destination accessibility and tourism infrastructure assesses these measures through four qualitative indicators (Figure 15.5):

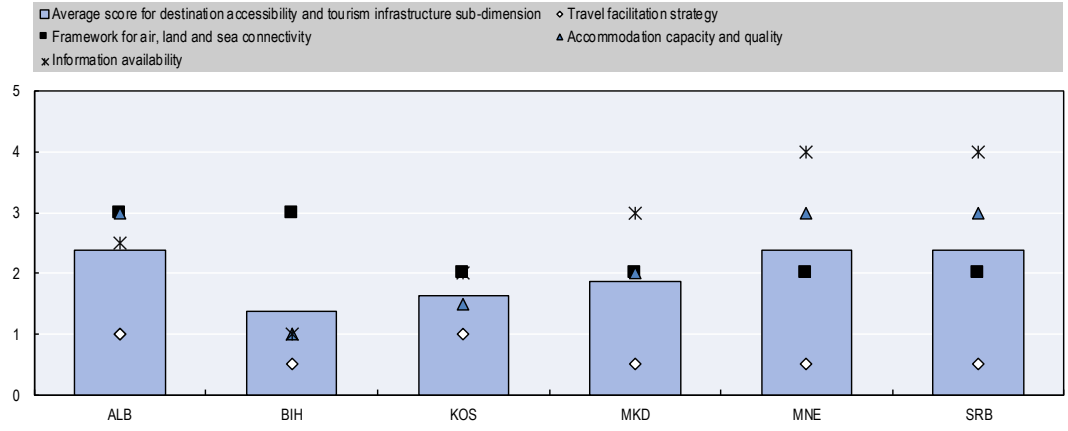
1. The **travel facilitation strategy** indicator aims to gauge whether governments apply a strategic approach to promoting travel through visa policies and fees, travel regulations, and immigration processes and services.
2. The **framework for air, land and sea connectivity** indicator looks at the steps taken to facilitate mobility between tourism locations and access points.

3. The **accommodation capacity and quality** indicator assesses the frameworks and actions in this area, the resources allocated and the steps taken to regularly monitor and evaluate existing and proposed accommodation developments.

4. The **information availability** indicator ascertains whether governments have enabled the provision of information for visitors, including entry visa requirements.

All six SEE economies have overall scores of around 2 out of 5 for this sub-dimension (Figure 15.5). These relatively low scores reflect, again, the need for more joined-up policies and specific efforts to reconcile multi-agency priorities and actions to improve tourism accessibility and infrastructure in the region.

Figure 15.5. **Destination accessibility and tourism infrastructure: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706848

The frameworks relevant to the areas assessed by each indicator are still emerging. For example, Albania, Montenegro and Serbia achieve an average score of over 2, indicating that they have fully adopted their frameworks related to this sub-dimension, but have only just started to implement them. Across the region, the two indicators with the best performance across the economies are the provision of information and connectivity measures which increase the wider accessibility and promotion of the region. Destination accessibility and tourism infrastructure frameworks, strategies and related actions have yet to be defined and implemented formally.

Travel facilitation strategies do not yet exist but visa arrangements are becoming simpler

Arrangements that facilitate travel help to make an economy attractive as a destination. These arrangements include visa policies and fees, travel regulations, and optimal taxes, as well as the relevant immigration processes and services.

Visa requirements may vary according to factors such as the length of stay, purpose of visit, economy of origin and existence of a reciprocal visa policy. The additional time, effort and cost associated with visa formalities can influence tourists' travel behaviour and global patterns of travel flows. By reducing or removing impediments and establishing bilateral travel facilitation agreements, economies can position themselves as more tourist friendly and welcoming than their competitors.

None of the six SEE economies have formal travel facilitation strategies which explains their low scores for this indicator in Figure 15.5. However, they all have visa liberalisation agreements with a number of countries and these are continuing to develop as new markets emerge in Asia, the Middle East and the Far East. Stakeholders, international tourist organisations and guide books concur that the procedures for obtaining visas are clear and relatively simple. The evidence from personal experiences and anecdotal feedback vary, but visa regimes do not feature prominently as a constraint on tourism development.

For example, Kosovo has visa exemption agreements with 115 countries. Citizens of EU Member States, the Schengen Area and neighbouring countries can enter Kosovo with a biometric ID and can stay up to 90 days over a six-month period. Bosnia and Herzegovina has had agreements with the Schengen Area since 2011 and developed visa agreements with more than 90 other countries. Citizens of China; Hong Kong, China; Macao, China and Chinese Taipei do not need visas to enter, and neither do holders of diplomatic passports from 13 other economies.

The Former Yugoslav Republic of Macedonia, Montenegro and Serbia also have similar visa agreements in place. For example, from 2017 citizens of China, the Islamic Republic of Iran and India can travel to Serbia without a visa and can stay up to 90 days within a period of 180 days from the date of first entry. Albania has removed visa requirements for citizens of states that are part of the Schengen Area and has signed agreements with a range of other countries. Albania has also developed a digital platform for consular affairs, an e-visa online platform and an e-consulate, all of which further facilitate travel to and economic interactions in the economy.

Long-term frameworks are needed to improve air, land and sea accessibility

Transport policies with well-managed synergies with tourism can improve visitor mobility to and within destinations, enhance visitor satisfaction, and help to secure the economic viability of transport systems by servicing both residents and tourists (OECD, 2015). Specific frameworks for air, land and sea accessibility facilitate mobility between tourism locations and access points and provide the basis for tourism growth and development across policy areas.

The six SEE economies have a range of transport strategies and action plans either in place or under development; hence their average score of 2 for this indicator in Figure 15.5 (see also Chapter 11, Transport). Although these documents do not make specific links to tourism, they promote reforms which will have a positive impact on connectivity in the region and thereby improve tourist travel. They also have programmes which aim to upgrade their capacity to align with the EU's long-term goals and strategic documents in the area of transport. There are no specific tourism-related travel facilitation strategies or dedicated guidelines to balance complex transport, infrastructure development and tourism policies, however (Figure 15.5).

Albania's Sector Strategy of Transport & Action Plan 2016-20 does take tourism and connectivity into consideration by including measures to improve connectivity, safety and security at border crossing points. Infrastructure upgrades have also been delivered, including improvements to intermodal connectivity, such as the strategic Durres Port-Tirana International Airport-Tirana railway link. The action plan makes specific reference to sustainable tourism as a key pillar of the strategy.

Montenegro has plans to develop a new transport development strategy with increased emphasis on monitoring and evaluation. Bosnia and Herzegovina's Framework Transport Strategy 2016-30 was adopted in July 2016. Serbia has a draft transport strategy 2016-25 and a Plan for the Development of Rail, Road, Inland Waterway, Air and Intermodal Transport for the period 2015-20. They recognise the development of multimodal transport as a key consideration that should be supported by complementary policies and strategies including the new tourism strategy.

The Former Yugoslav Republic of Macedonia and Kosovo have general frameworks for air, land and water connectivity. These provide the basis for specific development plans within their multimodal transport sector strategies and action plans, and future tourism strategies. However, the current frameworks lack budget allocations to implement the action plans and any future monitoring and evaluation of outcomes linked to tourism.

Tourism growth can increase pressure on existing transport services and infrastructure, especially during certain seasons. Other challenges include the coverage and capacity of transport networks, border crossings and inter-modality. The six SEE economies increasingly recognise the importance of hub locations, such as international airports and ports. However, they need to make stronger efforts to promote regional investment to further develop cost-effective air travel.

Recent air-transport liberalisation across the region has improved accessibility and brought in more international visitors. Government subsidies to low-cost air carriers have helped to raise the profile and marketing of the region. However, they are reportedly failing to attract high-value international tourists and are adding to the negative environmental impacts of transport. The subsidies to low-cost carriers appear to mainly benefit expatriates and the diaspora – people who would be likely to return without these incentives and who also have little in the way of additional economic impact, spending relatively little compared to other international visitors.

Accommodation capacity and quality need an upgrade

Accommodation is one of the most important elements of the tourism offer and of tourists' overall experience. Accommodation is provided by both businesses and individuals, and is increasingly marketed by digital platforms for renting private accommodation (such as Airbnb). In local tourist areas, accommodation can be one of the key economic drivers.

The six economies benefit from the presence and interest of international hotel chains and are characterised by a diversity of accommodation. However, more detailed analysis of visitor accommodation depends on the availability and accuracy of data, which could be improved. Informal and unlicensed construction of accommodation poses a variety of problems, not least environmental ones. Some economies, like Albania, the Former Yugoslav Republic of Macedonia and Montenegro, are taking steps to put in place and enforce strict licensing and environmental rules and policies, including specific regularisation procedures on accommodation buildings constructed without proper licenses.

The laws on tourism, government policies, fiscal measures and incentives encourage unrestrained private accommodation in the six SEE economies. Serbia offers low-interest loans to improve the quality of the tourism offer and has reduced value-added tax (VAT) on accommodation services to 10% instead of 20% (the rate for other services). In May 2017 Albania reduced VAT on accommodation services to 6%. Montenegro introduced measures to attract investment in high-quality accommodation facilities (four- and

five-star hotels) in priority locations identified in the Tourism Development Strategy. These include exemptions from communal tax, customs tax and VAT (Montenegro Ministry of Tourism and Environment, 2008). However, reduced VAT rates are considered an inefficient means of revenue collection because of their small impact on demand (see discussion in OECD 2017c).

Interviewees for this assessment noted that the categorisation of accommodation in the SEE economies suffers from a lack of consistency and insufficient compliance with internationally recognised quality standards. However, economies are starting to take action to improve the assessment of accommodation capacity and quality and to set consistent standards. These should be monitored regularly in the future. Municipalities across the region are also making efforts to support quality assessments of different types of private accommodation, rooms, apartments and guest houses. However, there is little evidence that there are enough resources in the region to implement quality assessments effectively.

Albania has developed an electronic application – E-Albania – to allow accommodation facilities to upload self-assessment documents before evaluation by independent assessors. The Council of Ministers approved a decision at the end of 2016 aiming to improve the quality, safety and sustainability of tourism facilities and to harmonise their classification with European standards. Albania has also developed a special "Quality Mark" awards programme, with the support of the United States Agency for International Development (USAID), to improve accommodation standards.

The tourism strategy of the Former Yugoslav Republic of Macedonia also foresees measures to improve accommodation capacity and quality. However, there is no published action plan or detailed budget allocations for the strategy implementation. Conversely, the Kosovo tourism law of 2013 relaxed procedures for the accommodation sector by agreeing to develop a voluntary system for categorising accommodation.

Montenegro and Serbia have tourism strategies that aim to complete the modernisation of older hotels and to apply a market-based approach to developing and constructing accommodation in the future. Serbia emphasises higher-quality congress tourism facilities in Belgrade, which is promoted as a regional hub and internationally competitive location. This role is facilitated by the Serbia Convention Bureau, established as a special department of the Tourism Organisation in 2007. Montenegro's congress business sector and coastal developments will require more five-star hotels and could attract international investment. Montenegro could also develop new high-value tourism segments such as spa tourism, which could be developed in many of the economies by privatising and bringing existing facilities up to international standards. An example would be Serbia's major spa centres (including their medical facilities).

Bosnia and Herzegovina has registered much less accommodation than the other SEE economies. Most of the private accommodation is in three major cities, serving specific architectural, historic and religious sites. Joint projects are underway involving domestic and international organisations to develop rural tourism. This includes improved criteria for private accommodation.

Visitor information is becoming more available

Information – online and on site – makes tourist areas more convenient to visit and is thus an important element of tourists' experience. Lack of information may affect tourists' satisfaction, what they tell others about their experience and their intention to return again.

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. Well-presented and clear information provides visitors with the details they need to compare competing offers and choose the locations and facilities that meet their needs and expectations. Information can also be essential for clarifying legal requirements, such as visas, insurance and terms of occupancy for accommodation. Digitalisation, social media, online marketplaces and other trends have also helped to make tourism information more user friendly.

In the six SEE economies, the availability of information has improved in recent years, with a greater range of sources, more regularly updated and in a variety of languages. International sources, such as Trip Advisor, the *Lonely Planet* and other travel guides, are also important references for travellers to the region. However, the many uncoordinated domestic information sources – with different municipalities producing local variations – can mean overlaps in material promoting specific areas and products in each economy.

Each of the economies has a website – often run by the tourism agency – which is the main official source of information for visitors. However, Kosovo lacks an economy-level tourism organisation or agency. Municipalities in Kosovo also provide information on cultural and religious sites, as does the private sector for resorts and attractions. This approach has resulted in fragmented information about tourist areas in Kosovo, however, confusing potential customers and making them less likely to visit or stay in the area.

In Montenegro, the tourism organisation has played a key facilitation and alignment role in co-ordinating the production of tourist information from the local to central level. The information has been tested by the tourism organisation and found to be user friendly in the local language, and also in English, Italian and German. It is updated regularly following tourist satisfaction surveys about the accessibility of the information and the quality of services provided.

The Tourism Organisation of Serbia makes information available in a greater number of foreign languages, including German, French, Italian, Russian, Spanish, Japanese and Chinese. Information from other sources is also comprehensive and user friendly, but usually only available in Serbian and English.

The way forward for accessibility and tourism infrastructure

Accessible tourism destinations depend on effective government strategies that harness synergies in all relevant sectors – such as transport, the environment and construction. Inter-agency co-operation, partnerships with the private sector, and policies and incentives that promote quality investment also play a key role. Future work in this area will require greater collaboration among domestic (local and central) authorities across SEE economies to provide adequate infrastructure, services and information at a regional level, allowing for the economic benefits of tourism to be spread more broadly.

Comprehensive travel facilitation strategies would make travel to the region more efficient, more secure and less stressful. Each economy would benefit from improvements across the full range of travel facilitation measures. These include simpler visa requirements and agreements, improved passenger security screening at departure, more thorough immigration and customs processing on arrival, the development of relevant online systems, increased inter-agency co-operation, and partnerships with airports and other private sector actors. Regional co-operation in travel facilitation is

another ingredient of success, as shown by the multi-year, comprehensive Asia-Pacific Economic Cooperation (APEC) Travel Facilitation Initiative launched in 2011.[4]

It is important that tourism information is presented in a user-friendly format and in a professional manner. Policy makers need to also consider the impact of digitalisation, social media, online marketplaces and other trends in improving the quality of information. Although English remains the dominant foreign language for travellers, a special effort needs to be made to translate information into other languages as well. Independent studies or consumer tests are needed to assess the quality, accuracy and effectiveness of the information, and to enable monitoring and evaluation. In the future, the economies could consider an integrated approach to improving information availability within their tourism and tourism promotion strategies. This could lead to the harmonisation of efforts and the emergence of good practices and standards across the economies.

The location, capacity, efficiency and connectivity of transport play an important role in how a destination develops (OECD, 2016a). To bring public transport systems in SEE up to international standards, the economies will need to attract further investment. They also need to implement specific measures, especially to modernise airport terminals, expand airport capacity and improve support services and information. Developing low-cost carrier access is not enough – there also need to be more fast and efficient connections between airports and cities or attractions. The economies also need to address movement between modes of transport and the accessibility of major attractions by bus or rail.

A structured effort to attract foreign direct investment would develop the capacity and quality of accommodation. This would require stronger links between tourism and investment promotion strategies and underlying institutions (UNCTAD, 2010). This co-ordinated effort could focus on priorities and measures for developing the accommodation sector, including the potential of offering incentives.[5] This approach could encompass higher value-added market segments, such as spa, sport and adventure, rural, agri-food, and business tourism. Increasing commitment from major accommodation providers to sustainable tourism and environmental protection would bring additional benefits, and could also be used for promotion and as a tool for quality control (UNCTAD, 2010).

The Former Yugoslav Republic of Macedonia, Montenegro and Serbia could speed up the implementation of their plans to improve accommodation capacity and quality as an integral part of delivering their tourism strategies. They could also increase their focus on modernising and prioritising new developments that promote growth in higher value-added, sustainable tourism projects. Montenegro – and the other economies which use tourist-related taxes and incentives – could consider monitoring, evaluating and analysing their impact to ensure they are meeting their objectives without adversely affecting tourism competitiveness (see Chapter 3 of OECD, 2014, 2017c). In particular, they need to focus on optimising their tax systems for tourism, reconciling competitiveness with objectives such as revenue mobilisation for tourism infrastructure and sustainability.

Kosovo could build on its improvements to the current voluntary accommodation rating system to provide clearer internationally recognised quality standards. It could undertake further market research into the accommodation profile of different regions and their capacity to serve distinct customer segments and expectations. These studies could also examine the expected economic impact of landmark projects and tourism clusters with appropriate accommodation capacity and quality.

Albania could step up the implementation of its 2016 accommodation framework, defining the criteria for design and construction, as well as the classification of tourism accommodation. This could include efforts to attract international hotel brands, identify potential investors and tailor investment incentive schemes for accommodation developments of appropriate quality. Such instruments would align with its tourism strategy priorities and principles of sustainable economic development.

All six economies could establish clear frameworks for consistent quality standards that meet internationally recognised criteria for accommodation. They also need to consider moving to mandatory categorisation, demonstration of attainment and maintenance of standards. This, together with regular inspection, formal monitoring and evaluation reporting, would facilitate a culture change among accommodation providers. Such measures need adequate financial and human resources. All of the economies could work more closely with the private sector to develop action plans and identify future funding sources for capacity improvements, training and the marketing of accommodation and standards. All these measures could form part of a comprehensive framework that fosters the availability and quality of all types of accommodation in the SEE economies.

Availability of a qualified workforce

Tourism is able to deliver job-rich growth, providing employment opportunities to all ages and skill levels (OECD, 2016a). Tourism also faces specific challenges particularly related to seasonal jobs, which often rely on informal migrant workers, paying no taxes or social contributions. In light of the potential negative fiscal effects, policy makers need to ensure that they deal with barriers to formal work – in the social protection system, labour and tax legislation, and the activation and facilitation services for the unemployed – in a comprehensive fashion. At the same time, many economies face the challenge of bridging the gap between the skills available and the labour market's evolving needs and opportunities. Balancing tourism development with labour supply and demand requires an up-to-date, comprehensive knowledge infrastructure and strong links among the public sector, the industry and academia (Stacey, 2015).

This sub-dimension assesses the availability of a qualified workforce using three qualitative indicators (Figure 15.6):

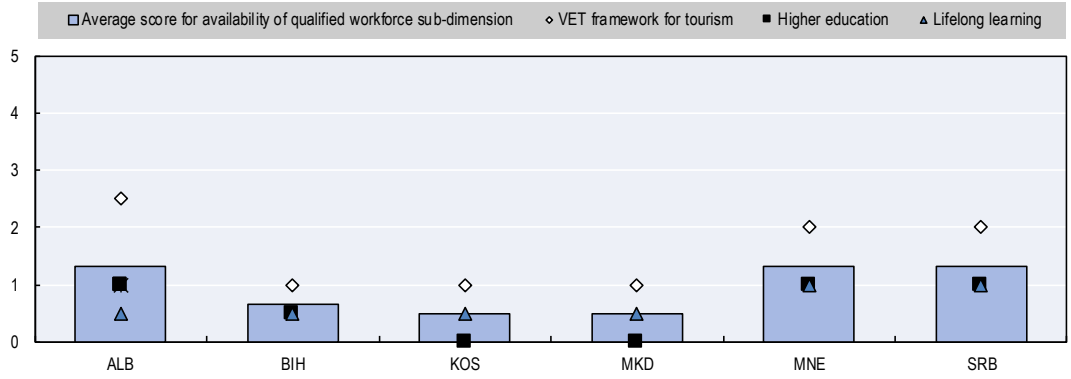
1. The **VET framework for tourism** indicator gauges whether the six SEE economies have developed industry-specific initiatives with vocational schools to bridge gaps in the labour market.
2. The **higher education** indicator aims to assess underlying policy making, quality assurance and accreditation of higher education programmes for tourism.
3. The **lifelong learning** indicator assesses to what extent frameworks for continuous education and training in tourism are in place.

The six SEE economies perform comparatively poorly on the three indicators overall. Only Albania, Montenegro and Serbia have an average score higher than 1. The low average scores point to significant workforce challenges in increasing tourism competitiveness (Figure 15.6).

The economies all have general frameworks for VET, higher education and lifelong learning which include tourism. However, none have dedicated, industry-specific frameworks for education or skills development. Nevertheless, a number of encouraging practices are in place for this sub-dimension, and there is positive recognition of the

potential for improving lifelong learning and linking education programmes to employment and career progression in tourism.

Figure 15.6. **Availability of a qualified workforce: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706867

Vocational education and training frameworks need to be better tailored to tourism

Sound tourist-focused VET frameworks play a key role in preparing individuals for a career in tourism. Drawing on partnerships with business-sector representatives can develop sustainable solutions for the industry and the economy at a central, regional and local level.

Although Albania has a Strategy for Employment and Skills 2014-20, it lacks a tourism-specific skills strategy. Vocational schools have a relatively poor reputation and find it difficult to attract motivated staff with recent industry experience and knowledge. This is blocking the pipeline of graduates ready and able to respond immediately to the needs of the industry. Donor projects could help to spread good practices across the industry and the economy through more examples of successful reforms implemented by more advanced countries. Additional efforts would be welcome to monitor and evaluate evidence on follow-up processes and programmes.

Bosnia and Herzegovina has a complex education system, with competences split at the level of each of the two entities, the Federation of Bosnia and Herzegovina and Republika Srpska. In the case of the Federation, this is the case even at cantonal level. Bosnia and Herzegovina has seen some progress in the reform and recognition of VET. New activities have also been identified to comply with the Europe 2020 Strategy and the South East Europe 2020 Strategy, as well as in the context of the European Qualifications Framework for Lifelong Learning and the Baseline of the Qualifications Framework in Bosnia and Herzegovina. A new VET strategy, which will run until 2020, is currently under preparation.

The Republika Srpska has developed VET curricula for tourism and hospitality which are taught in 20 high school centres. They include four-year courses for technicians and three-year courses for waiters and cooks, and are reported to be among the most widely attended vocational programmes. The Tourism Strategy of the Republika Srpska for the period 2011-20 identified human resource development as one of its operational

objectives. This strategy outlines a number of actions aiming to increase the quality of qualification service providers and optimise personnel potential. Ultimately, the aim is to move closer to a strategic and regulatory framework for the development of human resources in tourism.

Kosovo has increased its focus on VET in recent years but is doing little specifically on tourism. Vocational education and training programmes are poorly co-ordinated, lack appropriate strategies and priorities, and do not reinforce Kosovo's economic development strategies.

The Former Yugoslav Republic of Macedonia has started to reform its VET system in order to address weaknesses in existing structures and the lack of co-ordination between initiatives and implementation mechanisms. It has also taken steps to reduce bureaucracy in VET processes and increase flexibly to meet the fast-changing market dynamics and needs of the tourism sector.

The Montenegro Strategy for Vocational Education Development 2015-20 mentions tourism, along with specific reforms to be considered in the future. This is in part a response to pressure from the private sector, which is investing significantly in staff training in the hotel and restaurant segments. The government might wish to consider providing various forms of financial incentives for employee training, such as vouchers and tax incentives (OECD, 2016d).

The Strategy for Education Development in Serbia 2020 includes plans for promoting stronger links between education and the labour market. These include establishing Sector Skill Councils and a Qualifications Framework Agency responsible for accreditation and quality assurance. These activities have also been prioritised in other strategic documents (such as the Economic Reform Programmes of the EU Semester) and are to be supported with EU pre-accession funds.

Serbia is taking steps to improve VET, including in tourism. For example, a donor-funded programme implemented over several years, which ended in 2009, included tourism as a priority sector. Study curricula were reviewed in 22 pilot school centres for tourism and the catering sector, which also benefitted from new equipment.

None of the six economies monitors and evaluates their VET activities effectively, or in ways that can inform the development of VET frameworks for industries such as tourism.

Higher education tourism courses could be more widespread, practical and attractive

Competitive economies require effective higher education frameworks to meet the needs of fast-growing sectors such as tourism. All six economies face persistent challenges in higher education provision for tourism. These include a lack of appropriate quality frameworks and fully functioning accreditation systems. There is also limited focus on higher education content and forging links between academic study and practical experience to produce industry-ready graduates. However, in Kosovo, specific initiatives in tourism-cluster locations such as Peje, Gjakove and Prizren complement higher education curricula with practical content.

Some of the economies reportedly lack tourism experts with higher education degrees in management. This seems to be the case in the Republika Srpska, even though the University of Travnik offers a degree in economics which includes a tourism programme.

Awareness of the existence of such programmes needs to be increased and links to the industry strengthened, as university degrees do not seem to readily lead to jobs in tourism or other sectors (SIPA, 2016).

In many economies, tourism programmes in higher education have also suffered from a poor reputation. This can result in many students choosing tourism degrees as a last resort rather than as a positive career choice. This suggests the need to evaluate and modernise curricula, some of which have not changed much over the last decade. A gradual increase in the share of practical learning and the investment in educational opportunities for lecturers could also be considered.

Lifelong learning in tourism needs to be developed further

Economies need to continuously upgrade skills, especially among labour-market entrants, career changers, middle-aged cohorts and people belonging to groups at social risk (see also Chapter 8, Employment). Skills also depreciate if they are not actively maintained. For these reasons, lifelong learning is essential, and is clearly of great relevance to the six SEE economies as they face continued low educational attainment, high levels of unemployment and inactivity, and are in the process of industrial restructuring.

All the economies aim to consider lifelong learning in more detail as part of new tourism and education strategies. A number of donor projects and initiatives by non-government organisations (NGOs), such as training for mountain rescuers in Bosnia and Herzegovina, are a response to the pressing needs of the tourism sector. These have provided positive examples of the value of training. The respective programmes have also been organised in accordance with international standards and in co-operation with international organisations.

However, there is no explicit focus on lifelong learning in the SEE economies. This is a relatively new concept and has yet to receive the recognition it needs as part of creating a dynamic labour market. Further development will be essential to enhance tourism competitiveness and enable the population to realise their full potential. Surveying companies across the sector as part of training needs analyses would be an important step for identifying current and emerging skill requirements. The insights from these analyses could then form the basis for developing more relevant training programmes and curricula (OECD, 2016d).

The way forward to improve the availability of a qualified workforce

Effective frameworks for skills education, training and learning can drive improvements in productivity and competitiveness. The six SEE economies recognise the factors that contribute to an effective framework, and they now need to tailor their general frameworks to the specific requirements of the tourism sector.

More structured co-operation between government bodies in charge of tourism and education could significantly improve the availability of a qualified workforce. Such co-operation should also include representatives from industry and academia, and could focus on boosting quality jobs.

Bosnia and Herzegovina may need to put in place a specific co-ordination mechanism to address the challenges stemming from its fragmented education system (EC, 2017b). This will be critical for ensuring more effective and co-ordinated use of public resources and to define common standards for tourism-related education at all levels.

All six SEE economies could consider establishing separate, tourism-specific frameworks for VET, higher education and lifelong learning (Box 15.1). Such initiatives need to be based on independent analysis of labour market requirements and the impact of industry trends, and should include practical reform measures with adequate resource allocations.

Policy makers need to consider the impact of digitalisation, social media, online marketplaces and other trends on jobs and skills requirements. They need to put in place adequate measures to deal with such developments and also respond to challenges linked to language and culture. At the same time, the relevant authorities need to encourage the industry to do more workforce planning and development to help increase the availability of suitably qualified people.

Training in the skills needed for new tourist roles such as destination management, and new sectors – such as sustainable, cultural, adventure, accessible or green tourism – will be important. The economies will also need closer co-operation and co-ordinated policy measures to ensure decent working environments and adequate pay to address skills gaps and reduce the seasonal migration of qualified workers from the region to more advanced European countries.

The economies could do more to improve the supply of high-quality jobs in tourism to reverse the generally negative perceptions of a career in tourism among young adults. Actions could include fostering flexible local initiatives, raising awareness of education and training opportunities, creating career pathways in the sector, and developing financing mechanisms for skills development (Stacey, 2015).

Strengthening education accreditation bodies so as to work more proactively with the market would also be welcome. Independent accreditation agencies for education institutions with effective links to both the public and the private sector are important for the development of the full range of skills required by the sector. This could help develop a pipeline of qualified labour, meet individual career aspirations, service the needs of the market and support economic growth.

Box 15.1. Good practice: Boosting skilled labour for the tourism industry in Germany

Germany's dual system of vocational training provides a solid basis for increasing skills in the tourism sector, which covers 12 different occupations. Vocational training is supported through Centres of Excellence (key points of contact) and an alliance between government, business, trade unions and *Länder* that provides support for young people.

The training regulations used in the dual system are regularly modernised with the help of experts from the business sector, trade unions, and vocational schools in order to integrate new content and requirements. Employers and employees in the hospitality industry are also discussing the current need to modernise training regulations.

In 2014, the Federal Ministry published a report, "Skilled Labour for the Tourism Industry – Fit for the Future", which offers good practice examples and practical recommendations. One important recommendation is that employers need to offer more vocational training to further boost skilled labour in tourism.

Source: OECD (2016a), *Tourism Trends and Policies 2016*, http://dx.doi.org/10.1787/tour-2016-en.

Stronger relationships among public authorities, academia and industry would better bridge skills gaps in tourism. Sector-specific skills councils could provide proper platforms for collaboration between education institutions and the industry. By working more closely together, academics and other stakeholders can update their understanding of employers' requirements and visitors' expectations and develop new curricula or update existing ones accordingly (OECD, 2016d).

A regional tourism skills initiative could help to complement existing domestic efforts. The European Commission has launched a tourism skills initiative which highlights the need to bring together different industry stakeholders. This involves businesses, education and training providers, professional associations, chambers of commerce, social partners and trade unions. Together they have developed a targeted strategy and concrete action plan to close the skills gap in the tourism sector: *The Blueprint for Sectoral Cooperation on Skills in Tourism*, (EC, 2017a).

Safety and health

In spite of the tourism industry's resilience and strong growth, the sector faces regular natural and human-influenced risks which affect tourist perceptions and influence their decisions. International competition for tourism revenue is increasingly dependent on the quality of the offer and the assurance of a safe, secure and seamless travel experience.

Tourists expect all destinations to be safe. The safety and welfare of tourists should be a priority for policy makers. Safety and security issues have gained importance in recent years due to terrorist acts, local wars, natural disasters, epidemics and pandemics. Some of these events have exposed the vulnerability of tourism at both global and regional levels, with the industry unable to avoid their negative consequences. Therefore, each economy needs a security framework to cope with those challenges.

The two indicators in this sub-dimension cover visitors' security and healthcare provision (Figure 15.7):

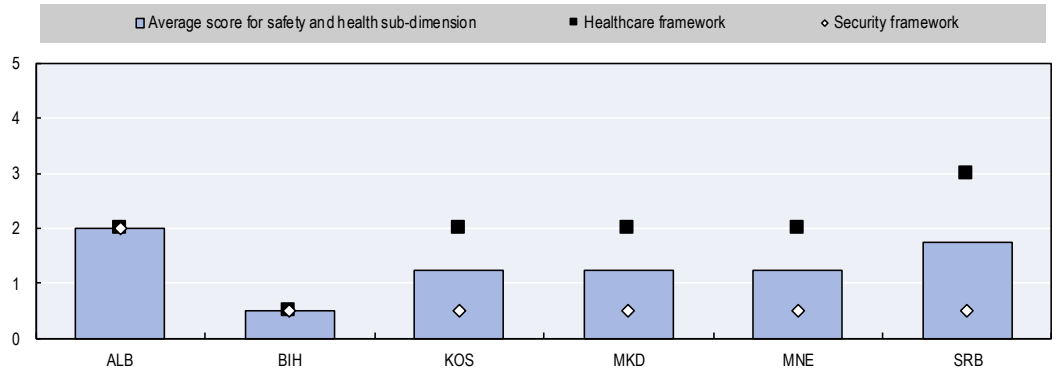
1. The **healthcare framework** indicator assesses whether and to what extent there are institutions and processes to provide health care for tourists and how effective they are. Existing institutions and processes should also allow for systematic consultations on a bilateral and regional level, involving a review of existing legislation, standards and procedures and the development of relevant roadmap and action plans.
2. The **security framework for tourism** indicator focuses on the institutions responsible for security and welfare of travellers, the related interactions at central and municipal level, the co-ordination between law enforcement agencies, and the regulatory provisions affecting the safety of tourists.

Assessing both indicators produces a variety of scores across the six SEE economies (Figure 15.7). Albania and Serbia score around 2 out of 5 on average, indicating that they have adopted their frameworks and taken specific actions towards implementation.

The six SEE economies are safe tourist destinations

The six economies all have measures in place to ensure public order and safety in all areas, including tourism. However, there is no evidence of specific tourist security frameworks or strategies with a programme of tailored actions, budgets, monitoring and evaluation. This is what their relatively low scores on safety reflect; they should not be interpreted as suggesting that the region is not a safe destination.

Figure 15.7. **Safety and health: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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In recent years, practical measures have improved road safety and there has been a move towards softer and less visible heavy security in line with other tourist areas in Europe. A number of the economies have implemented measures such as cross-border co-operation agreements, training of security personnel and co-ordinated action to improve the management and efficiency of processing at border crossings. Specific initiatives and training in Albania and Kosovo have been effective in facilitating tourist flows across the region in the peak summer season. A series of softer changes and measures have also been implemented to boost visitor confidence and perceptions.

Bosnia and Herzegovina has made efforts to increase the efficiency of its institutional framework through greater co-ordination and co-operation between law enforcement agencies. The State, the cantons and the entities have signed a number of agreements on mutual assistance and operational co-operation. The entities have also implemented specific initiatives, such as a memorandum of understanding to improve police co-operation between the Federation and five cantons, as well as a protocol on co-operation signed by the Republika Srpska's Ministry of the Interior and the Chief Prosecutor (EC, 2017b).

Kosovo has established a Security Council to draft a new security strategy with a section on linkages with broader economic development objectives. This will examine how a security platform can facilitate growth in sectors such as tourism which require attention to specific issues.

Serbia has no security framework for tourism. However, it offers good examples of tourism organisations and the government working together with other partners at municipal level to ensure the safety of tourists. This includes agreements and training on the use of police helicopters for mountain rescue and airlift of injured skiers. All major events, including festivals, international gatherings and conferences in Belgrade are subject to security planning and co-operation agreements between the organisers and the Ministry of Interior Affairs. This will be strengthened further with implementation of the new tourism strategy in Serbia.

Healthcare services are improving throughout the region

None of the six economies have specific healthcare frameworks for tourism. All tourists and visitors can access health care as in other European countries, with essential emergency services provided for citizens and visitors alike. In all of the economies, private healthcare providers are also available and offer modern facilities and services.

A number of the economies are actively participating in regional and international co-operation initiatives for health. This includes regional collaboration through the South-Eastern Europe Health Network (SEEHN), the signing and implementation of bilateral and multilateral agreements, and co-operation with the World Health Organization and the United Nations. They are also implementing EU programmes to align domestic health standards with European standards and legislation. These developments will require specific tourism links and measures such as the appraisal of outcomes, monitoring and evaluation, budgetary analysis, and forecasting additional demands related to future tourism growth.

In Albania, tourists have access to healthcare centres and qualified medical staff 24 hours a day. The Ministry of Health has established 21 centres in major tourist areas focusing on arrangements for the peak tourist season. There are aspirations to extend this across the whole year in a formal tourism healthcare strategy and action plan. Discussions on a healthcare framework have been initiated with relevant stakeholders. Further resources will be required to define the approach and process, implement the initial proposals, and train additional staff.

The Federation of Bosnia and Herzegovina has defined the Plan for Healthcare Development 2008-18. It has developed a network of healthcare centres based on previous healthcare strategies. These strategies have encompassed existing legal entitlements to healthcare which are accessible to tourists. The Federation has signed bilateral agreements with a number of economies in order to provide access to healthcare to their citizens through social insurance arrangements.

The Former Yugoslav Republic of Macedonia has the Strategic Plan for Health 2011-18, aiming to modernise the healthcare system and improve the infrastructure within a sustainable finance model. While it has no formal tourism healthcare framework, it has signed a series of agreements with various countries to facilitate tourism, for example to use the European Health Insurance Card. The general framework is well developed and health care can be provided to foreign citizens.

Montenegro has adopted a Master Plan for Development of Health Care 2015-20. Funding and capacity challenges have affected its implementation, however. Serbia has a Law on Healthcare and agreements recognising mutually public health insurance (and social insurance) with 29 countries.

The way forward for safety and health

All of the economies have frameworks for security and health that provide for visitors. **In the absence of tourism-specific frameworks, they need to strengthen the link between the sector and safety and health frameworks**. Some economies are partly addressing this but it will require further attention to facilitate tourism growth. Special efforts should be made to integrate tourism into national, regional and global emergency systems and design effective co-ordination mechanisms among all stakeholders in anticipation of a crisis. Future reforms should also include stronger public-private sector co-operation and improved communication and media partnerships for effective risk management in case of emergency situations (UNWTO, 2016a). Beyond such measures, SEE governments and stakeholders need to review current arrangements and, where necessary, take steps to ensure that tourism facilities are safe, with all protective measures in place to prevent harm (UNWTO, 2016c).

Safety and security committees could be one way to help develop domestic policies on tourism safety and ensure the necessary co-ordination across government bodies (the interior ministry, tourism, civil defence, etc.), industry representatives and the media. A tourism policy in the field, either separate or as part of broader tourism strategies, could formulate safety and security goals and objectives, and clear guidelines on stakeholder co-operation with specific responsibilities and resource allocation. An action plan could usefully complement the policy (UNWTO, 1996) and encompass measures to boost the capacity to mitigate risks and respond to crises and disasters affecting the industry. These documents could also place specific emphasis on issues arising in the context of key tourism segments including winter sports and adventure tourism.

Health and safety policies and frameworks could link more closely with the promotion and marketing of SEE economies as tourism destinations. Tourism agencies and organisations could work with industry representatives to develop guidelines for safety and health practices, and manuals for local officials with information on the relevant regulations and practical procedures. In the area of health in particular, tourism agencies could provide on their websites lists of medical services, hospitals and clinics with relevant maps. The establishment of a hotline could also be considered, especially for emergency situations.

A stronger focus on security and health care for tourism will require further training and skills development. This includes language skills to meet the needs of increasingly diverse foreign visitors. For example, hotlines could have staff speaking English and other frequently used languages to better explain the healthcare system to callers[6] and provide introductions to medical facilities.

The six SEE economies need to explore new opportunities linked to healthcare and spa tourism, including developing and refurbishing existing facilities. Significant synergies are also possible across sectors that could unlock new economic opportunities through more comprehensive tourism offerings. These could be facilitated through the formal safety and healthcare frameworks.

Finally, there is a need for independent analysis and evaluation of the contribution from security and healthcare frameworks to tourism development and competitiveness. This could build on emerging plans for monitoring and reporting to provide an evidence base for future decision making. This evidence could strengthen the case for investment and leverage additional resources from external sources.

Tourism prioritisation and promotion

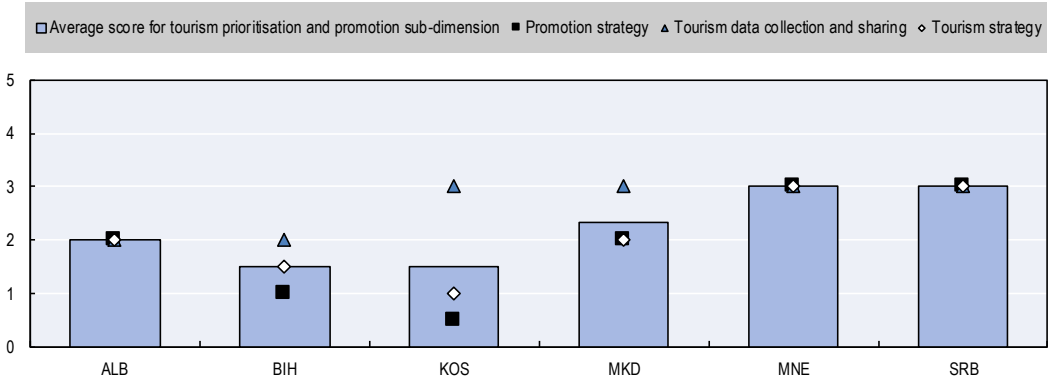
Strategic approaches to tourism development ensure a long-term perspective with clear goals and objectives. Effective tourism strategies span a range of areas, such as planning, institutional capacity building, legal and regulatory changes, product development, tourism infrastructure, the impact of tourism (economic, socio-cultural and environmental), tourism investment, and human resource development. Tourism promotion is an important tool for increasing awareness of the destination among potential tourists and influencing their travel choices. Countries conducting effective promotion policies have a competitive advantage over those that do not. Tourism prioritisation and promotion that are guided by a strategy enables policy makers to assess the areas of greatest potential for fostering long-term tourism growth and broader economic benefits. Providing comprehensive, accurate and regularly updated data will ensure that policy making is evidence-driven and adequately supports the development of tourism to its full potential.

This sub-dimension assesses the economies' efforts and experiences in these areas through three indicators (Figure 15.8):

1. The **tourism strategy** indicator measures implementation progress with dedicated sector-wide national tourism strategies.
2. The **promotion strategy** indicator is linked to the breadth of appeal of the economy as a tourist destination. It also assesses the effectiveness of the promotion strategies for achieving greater market diversification and increasing the resilience of the tourism sector.
3. The **tourism data collection and sharing** indicator assesses progress in creating sound statistics on tourism in each economy of the region. More specifically, the indicator assesses the legislative basis for systematic data collection, allocated funds, collection mechanism, and the diffusion and publication of data.

Tourism prioritisation and promotion in SEE has a considerable scope for improvement, as suggested by the overall average score of 1.7. Even Montenegro and Serbia with average score of 3 out of 5 (indicating the existence of sound frameworks and implementation) need to devote more efforts to ensure effective review, monitoring and outcomes evaluated by an independent body.

Figure 15.8. **Tourism prioritisation and promotion: Sub-dimension average scores and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933706905

Tourism strategies require improved resource allocation and implementation monitoring

The economies all recognise the value of a domestic tourism strategy but implementation has often been partial and had to compete for limited resources with other policy areas and priority sectors.

Albania adopted a new law on tourism in 2015. A strategy for tourism development 2017-22 is yet to be approved and adopted, and has an action plan linking tourism investments to other complementary policy areas such as infrastructure, training and SME development. The implementation of this strategy will be supported by an Inter-Ministerial Committee for the Implementation of Tourism Development.

In Bosnia and Herzegovina, tourism falls under the jurisdiction of the two entities. A Tourism Strategy 2008-18 for the Federation of Bosnia and Herzegovina has been drafted but not yet adopted. The Republika Srpska has developed and adopted a tourism strategy (2011-20). It has implemented several projects (for example to boost accommodation capacity, improve information for visitors and attract tourists through promotional activities), but there have been no efforts to monitor and evaluate their effectiveness and impact.

Kosovo does not have a stand-alone tourism strategy but is preparing a sector strategy as part of a larger Private Sector Development Strategy. The Kosovo Ministry of Trade and Industry has set a goal for the tourism industry to contribute to 10-12% of GDP. Specific objectives include the development of sustainable tourism along with a range of competitive products to increase the economic value of tourism, as well as human resource development. The ministry also aims to boost the hospitality sector and improve the quality of accommodation. Achieving these goals will require considerable additional resources and the realignment of institutions, roles and responsibilities for tourism.

The Former Yugoslav Republic of Macedonia implemented a tourism strategy over the period 2009-13, followed by a new draft tourism strategy for 2016-21. However, this is no evidence that the previous strategy has been evaluated, or of whether relevant insights informed the current draft.

Montenegro adopted a master plan for tourism in 2001, a strategy for the development of tourism for the period 2008-20 and an action plan in 2008 (Montenegro Ministry of Tourism and Environment, 2008). The new strategy aims to create a tourism offer based on an integrated approach focusing on coastal areas and the hinterland in order to extend the season and foster the development of its northern and central regions. Given the large number of arrivals in the peak months of the year, Montenegro needs to lengthen its tourist season, introduce new experiences and products, and develop its tourist accommodation. The government also recognises the need to boost the capacity of its infrastructure, strengthen institution building and mobilise additional funding for the implementation of reforms. The Ministry of Sustainable Development and Tourism is planning to revise the existing strategy in order to address these challenges.

The Serbian Tourism Strategy 2016-25 was adopted in November 2016. This strategy is a good example of collaborative preparation, with input from tourism experts, relevant associations and organisations, local authorities, individuals from academia, and business and NGO representatives. An action plan outlines priority measures aligned with the strategy's objectives. These objectives include the economically, environmentally and socially sustainable development of tourism; strengthening the competitiveness of the industry; increasing tourism's contribution to GDP and employment; and improving Serbia's overall image in the region, Europe and globally.

Promotion strategies are rare, but awareness raising does occur

The range and quality of assets across all of the economies present tremendous opportunities and themes for promotion that can boost growth in tourism and economic development. Promotion strategies generate multiple impacts – tangible and intangible. They range from influencing perceptions about an economy and region to directly informing individual decisions to visit a destination, location, facility or attraction.

Only Montenegro and Serbia have adopted and are implementing promotion strategies focusing on activities for publicising their offers, such as international tourism and promotion events and fairs. Other economies either lack stand-alone promotion strategies

or are working on their development. However, they are carrying out specific promotional initiatives often supported by a range of materials in different formats including online information, films and videos. Promotion efforts sometimes emphasise a specific tourism theme, such as culture and history, nature, and adventure. The budget allocation for promotion activities in the region is most often based on the previous year's expenditure rather than any evaluation of effectiveness or forecasts of future impact.

Albania does not have a stand-alone tourism promotion strategy but is currently preparing a dedicated section in its action plan for tourism development, as part of the draft tourism strategy. The Albanian Tourism Agency is responsible for tourism promotion and has been particularly active over the last years, participating in a range of international fairs, organising events, holding familiarisation tours for journalists of EU countries and preparing a range of information and promotional materials.

In spite of the absence of a tourism promotion strategy as such, Kosovo engages in a range of promotion activities including attending international events and fairs. When it does prepare a tourism strategy, promotion needs to become an integral part of it.

The Former Yugoslav Republic of Macedonia has an annual calendar of promotional activities with co-ordinated partner involvement. It has no separate strategy for tourism promotion but did formulate specific measures as part of the Draft Strategy for Tourism 2016-21.

Montenegro has a Tourism Organisation with an annual promotion work plan and a budget based on previous years. The organisation is conducting awareness-raising and promotional activities including producing information, films and multimedia output. The new domestic tourism strategy – to be adopted in 2018 – will also incorporate promotional activities.

The Serbia Tourism Strategy and law on tourism anticipate the adoption of a Strategic and Operational Marketing Plan in 2017 which will align and clarify the roles and responsibilities of all stakeholders in charge of tourism promotion. The Tourism Organisation of Serbia (NTOS) manages the promotion of the destination to major tourism markets, as well as domestic promotion. Its annual promotional plans are approved by the government. Regional tourist organisations, which are made up of several units of local government, also promote tourism. They often lack the resources to promote their destinations internationally and thus focus mainly on domestic and regional markets.

Tourism data collection and sharing need to be better aligned with international standards

It is vital to be able to produce regular, reliable and robust statistics with accompanying interpretation to tell the story of the effectiveness and efficiency of reforms in tourism. Tourism data help to prioritise tourism development and provide explicit evidence of its contribution to the economy. Data collection and analysis also inform policy design, including actions to improve the reputation of a tourism destination and measures to attract and retain investment and talent.

The tourism data collection and sharing indicator focuses on the availability of robust statistics and evidence and how they are prepared and disseminated. The value of sound tourism data is increasing as tourism is a high-growth sector with rapidly evolving trends influencing its development.

All of the economies have official statistics offices that produce an assortment of data across different economic sectors and social demographics. Many of them struggle to produce comprehensive tourism-specific data, however. There are also methodological issues around sampling, establishing baselines and regular monitoring and analysis. In many cases data collection is insufficient, in particular for inbound tourism, accommodation stock, country exit surveys and follow-up on customer feedback. There is also a significant scope to make greater use of electronic systems, such as Croatia's eVisitor initiative (Box 15.2) to increase the effectiveness of data collection and analysis, and improve its accessibility to the relevant authorities and private sector actors.

Box 15.2. **Croatia's eVisitor initiative**

The Croatian National Tourist Board, together with local tourist boards and other stakeholders, have developed the so called *eVisitor* check-in and check-out initiative as a unique information system functionally connecting all tourist 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 tourist 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 sorted 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 the 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: Rovinj-Rovigno Tourist Board (n.d.), "eVisitor – general informations", www.tzgrovinj.hr/page/e-visitor-en/evisitor-general-informations.

One major issue is the lack of tourism satellite accounts, which are the agreed international standard for measuring the economic impact or value-added effects of tourism. The preparation of fully functional tourism satellite accounts depends on the availability of a range of statistical data and would require a significant effort from all of the economies, even those with more advanced statistical systems. Therefore, this is likely to be more of a long-term goal. A more immediate focus could be placed on collecting sound data on a core set of tourism indicators to prepare the ground for the development of satellite accounts.

Overcoming challenges in tourism data collection and sharing will require sufficient budgets and increased capacity building within statistical offices, ministries and tourism organisations (see Box 15.3 for a good practice example). This will be key to achieving EU standards of monitoring, measurement and evaluation of evidence.

Albania has established a specialist unit within the Ministry of Economic Development, Tourism, Trade and Entrepreneurship dedicated to collecting and analysing tourism data. This unit could develop mechanisms to cascade practices and build capacity locally. There are plans for awareness-raising activities in various municipalities to inform stakeholders about the new systems, including the E-Albania portal for data collection.

Box 15.3. Good practice: Improving tourism data in New Zealand

The New Zealand government spends over NZD 3 million (New Zealand dollars, equivalent to USD 2.1 million) per year on collecting and analysing its tourism data. In 2011 it approved a five-year change programme to enhance the quality and usefulness of its data to help the tourism sector identify, understand and respond to emerging trends. The programme involved the development of an international visitor survey to help estimate international visitor spending. It has also launched world-first regional tourism indicators and estimates based on electronic card transactions. These indicators provide valuable information about changes in expenditure by international and domestic travellers as well as by region and industry.

The focus has now moved to improving measures of regional tourism expenditure and expenditure by international cruise-ship visitors. It continues to improve the dissemination of data, supporting the Tourism Industry Association of New Zealand's Tourism 2025 strategic plan which identifies market insight as a key theme.

Source: OECD (2016a), *Tourism Trends and Policies 2016*, http://dx.doi.org/10.1787/tour-2016-en.

The laws on statistics at state and entity level in Bosnia and Herzegovina define the responsibilities of the respective statistical institutions within their entities. This fragmented arrangement stretches the limited resources available for developing statistics and data collection. As a consequence, the official statistics are likely to underestimate the actual levels of activity and the contribution of tourism to the economy. Donor agency projects on data collection, such as those carried out with the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, have provided useful examples of the way forward. Such projects need to be consolidated with greater investment in a co-ordinated approach to gathering data.

The Agency of Statistics of Kosovo (ASK) publishes data on tourism and links to other information sources including those of NGOs, cultural institutions, and donor agencies. It engages widely in capacity building and is working to align its methodology with the EU *acquis*. However, the lack of data on key tourism statistics is hampering international and regional benchmarking and the analysis of tourism development in general.

The MakStat database of the Former Yugoslav Republic of Macedonia is seen as the main channel for data dissemination. User-friendly portal systems provide access to a wide range of statistical data in different formats and alert data users about new information. Data users from ministries, chambers of commerce, universities and VET schools are also being trained. In the future, more emphasis could be placed on greater co-operation among relevant institutions and greater consistency of the definitions they use. Future work could also focus on updating and expanding survey evidence (e.g. visitor perceptions, spending, room occupancy, revenue per room and details by statistical region) and shifting to more frequent data collection, rather than the current system of every five years (Oxford Economics, 2016).

The Statistical Office of Montenegro collects, processes and disseminates tourism-related statistics. The emphasis is on baseline data, monitoring statistics and awareness raising about how to use statistics when making decisions. The Ministry of Sustainable Development and Tourism keeps a public central tourism registry of tourism and hospitality activities in an electronic form. The Central Bank of Montenegro publishes quarterly data on revenue and expenditure in the travel and tourism sector, as part Montenegro's balance of payments.

Serbia's official statistics are produced by the Statistical Office of the Republic of Serbia alongside other sources including the central bank, local authorities and other organisations. Links with the new tourism strategy and the measurement of its impact are expected to improve the coherence of data collection and a stronger alignment with international standards.

The way forward for tourism prioritisation and promotion

The six SEE economies need to accelerate the preparation of draft tourism strategies and ensure that they are adopted quickly. These strategies need to include links to promotion strategies and data-collection frameworks. They should also explore synergies with investment policies and promotion, for example developing tourism investment strategies and/or joint campaigns organised by investment and tourism promotion agencies (OECD, 2017a).

More broadly, tourism prioritisation and promotion strategies need to consider relationships and foster co-ordination with other relevant strategies and the institutions responsible for their implementation, in order to align reforms for greater effectiveness and efficiency. Relevant strategies include those on education, employment, transport, the environment and sustainability, and culture. Policy makers also need to ensure that the links go in both directions and that these strategies also take into account interconnected issues and priorities derived from tourism strategies.

As the economies prepare their tourism strategies they should gather more evidence about their experiences implementing previous strategies. Earlier strategies often lacked the financial commitment and resources needed for effective implementation and for co-ordination of key reforms generating sector-specific and broader economic and social impacts. New strategies and action plans need to mobilise additional funding (Box 15.4). This could include EU accession funds and additional donor support. Such funds could support tourism infrastructure, education and training programmes, as well as the development of new tourism offerings.

Promotion strategies and activities are challenged by competing demands on state budgets. **There should be greater emphasis on performance evaluation and accountability, and on target markets or niches, and new funding mechanisms to support tourism marketing and development** should be identified (OECD, 2017b). Policy makers also need to explore opportunities for greater vertical integration of tourism policies and promotion strategies at central and local levels. Adjustments to promotion activities need to reflect a stronger focus on new challenges and trends in tourism related to safety, the shared economy and technological developments, to take advantage of new opportunities and address new risks.

Positive regional characteristics such as hospitality and friendliness could also be promoted jointly, to sell the idea of South East Europe as a hidden gem among tourism destinations. Regional co-operation initiatives could help develop a regional tourism offer (Box 15.5) highlighting regional thematic programmes and projects aligned with the tourism strategies of individual economies. The approach could also consolidate infrastructure initiatives, promote efficient tourism investment and stimulate a culture of fostering synergies to improve competitiveness in the six SEE economies.

The economies will need to pay closer attention to institutional structures and capacity building as part of their overall approach to strategic tourism development. They need to improve public consultations and apply a more structured approach to co-operation with the private sector, academia and other stakeholders.

Box 15.4. Good practice in funding the development of tourism: Approaches from around the world

Austria: there is a strong public-private partnership between the ministry in charge of tourism and the Austrian Bank for Tourism Development, which handles programmes funding SMEs to support innovation, grow the size of tourism enterprises, and to encourage start-ups. The initiative includes an agreement between the European Investment Bank and the Austrian Bank for Tourism Development for up to EUR 250 million to provide tourism SMEs with loans at reduced interest rates.

Costa Rica: the Costa Rica Tourist Board's budget is independent from the national budget, with two primary sources of funding: a USD 15 charge on air fares into Costa Rica and a 5% fee on flights departing from Costa Rica. In 2015 its budget was close to USD 55 million.

Morocco: the budget for the Ministry of Tourism for 2015 was MAD 723.6 million (Moroccan dirhams equivalent to USD 76.8 million), 63% of which is earmarked for the following areas: central administration (23%), training schools under the ministry's responsibility (11%), the National Tourism Office of Morocco (55%) and the Moroccan Society for Tourism Engineering (11%). The other primary source of funding for the ministry is the tourism promotion tax of MAD 1-15 per night, levied on overnight stays of tourists in classified accommodation.

New Zealand: in addition to the 2015/16 government budget appropriation related to tourism of NZD 139.8 million, a passenger security charge is levied on departing international and domestic airline passengers to fund the Aviation Security Service, which undertakes aviation screening activities. Furthermore, the government announced a border clearance levy for arriving and departing passengers which is intended to meet the costs of border clearance activities conducted by the customs and biosecurity authorities.

Slovak Republic: the government facilitates the creation and operation of local and regional tourism organisations responsible for the development of tourism within their defined territories. These voluntary public-private partnerships are funded by membership fees and matching subsidies from the national budget. In 2014, the ministry provided EUR 3.7 million to 33 tourism organisations, of which 29 were local and 4 regional, for product development, media campaigns, building and maintaining tourist infrastructure.

Source: OECD (2016a), *Tourism Trends and Policies 2016*, http://dx.doi.org/10.1787/tour-2016-en.

Box 15.5. SEE Tourism Expert Group

The SEE Tourism Expert Group, established in 2013 jointly by the OECD and the SEE Regional Cooperation Council (RCC), has agreed on a set of activities to develop and promote regional tourism products, to implement policy initiatives to address key barriers to sector development, and to steer the implementation of small-scale pilot projects for the development of regional tourist products.

The overarching goal of this work, carried out under the auspices of the RCC, is to contribute to increased revenues, exports and job creation in tourism and ultimately boost competitiveness and growth across SEE.

The expert group has agreed to focus its future work on creating a joint offer/brand to foster regional integration in tourism and supporting its promotion at a global level, diversifying the tourism offer of the region (e.g. combining adventure routes with historical/cultural routes in the region), addressing skills gaps and skills mismatches in the tourism industry, easing administrative procedures, and improving the level of services related to tourism (local administrations, health, search and rescue, insurance, etc.). This work will also aim to support policy development and address issues cutting across related policy areas.

Source: OECD (2016a), *Tourism Trends and Policies 2016*, http://dx.doi.org/10.1787/tour-2016-en.

All of the economies would benefit from investing in producing regular and comprehensive tourism statistics, in line with international standards. Special emphasis needs to be placed on the development of satellite accounts, which would ideally take place after improvements have been made to survey evidence and other data, with a proper assessment of the soundness of the information collected over a number of years. This is of critical importance for informing policies, better understanding and harnessing horizontal synergies, evaluating progress with the implementation of reforms, and increasing capacity to achieve greater impact. Improvements in data gathering should also focus on evidence from monitoring and evaluation of tourism strategies and action plans to improve decision making and resource allocation.

Improvements in these areas could lead to closer integration among policy areas and agencies (tourism, economy, environment, transport, regional development and others) and foster a whole-of-government approach to tourism. Such developments at domestic level and in the framework of regional co-operation efforts can also have greater economic impact. Strong leadership with clear roles and responsibilities for institutions at all levels could generate greater synergies in the areas of tourism investment, policy design and implementation.

Conclusions

The six SEE economies are making headway in developing their tourism sectors and increasing their contribution to the economy. Policy makers have recognised the importance of the industry as a growth sector, defined strategies for its development, considered linkages with natural assets, and improved branding and marketing.

However, they will need to do more to address a range of challenges and improve competitiveness. Tourism and promotion strategies are not sufficiently comprehensive and well informed, and in some cases, not formally adopted or given enough resources to allow them to be implemented. Tourism infrastructure, accommodation and skills are significant challenges for all of the economies. Stronger links between the public sector, industry and academic institutions along with better curricula for higher education, VET and lifelong learning are also needed to ensure enough skilled labour in tourism. Improving institutional capacity and co-ordination, the provision of data and statistics, and the monitoring and evaluation of policy actions, also require attention in order to increase tourism competitiveness.

Long-term political commitment across the region will be needed to deliver a long-term vision and adequate support for competitiveness in tourism. This would send a strong positive signal to the market, boost investor confidence and foster greater international integration of the SEE economies, in line with their EU membership aspirations. Common tourism strategies and actions could support the momentum for regional co-operation emerging from recent initiatives, such as the Multi-annual Action Plan for a Regional Economic Area and the 2017 Trieste Summit of the Berlin Process linked to the future enlargement of the European Union.

Notes

1. The figures include five of the economies under discussion; data for Kosovo are lacking.
2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.
3. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
4. See the Lima Declaration of the APEC Tourism Ministerial Meeting on Connecting Asia-Pacific Tourism through Travel Facilitation (APEC, 2016).
5. For example, Turkey has included tourism accommodation investments in cultural tourism preservation and development regions eligible for incentive instruments (Invest in Turkey, n.d.).
6. This is the case in Japan, for example (JNTO, n.d.).

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Annex 15.A1.
Tourism: Indicator scores

Table 15.A1.1. **Tourism: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Cultural and natural resources						
Natural heritage strategy	2.5	2.0	1.0	1.0	2.0	2.0
Cultural heritage strategy	1.0	2.0	2.0	1.0	1.0	2.0
Destination accessibility and tourism infrastructure						
Travel facilitation strategy	1.0	0.5	1.0	0.5	0.5	0.5
Framework for air, land and sea connectivity	3.0	3.0	2.0	2.0	2.0	2.0
Accommodation capacity and quality	3.0	1.0	1.5	2.0	3.0	3.0
Information availability	2.5	1.0	2.0	3.0	4.0	4.0
Availability of a qualified workforce						
VET framework for tourism	2.5	1.0	1.0	1.0	2.0	2.0
Higher education	1.0	0.5	0.0	0.0	1.0	1.0
Lifelong learning	0.5	0.5	0.5	0.5	1.0	1.0
Safety and health						
Security framework for tourism	2.0	0.5	0.5	0.5	0.5	0.5
Healthcare framework	2.0	0.5	2.0	2.0	2.0	3.0
Tourism prioritisation and promotion						
Tourism strategy	2.0	1.5	1.0	2.0	3.0	3.0
Promotion strategy	2.0	1.0	0.5	2.0	3.0	3.0
Tourism data collection and sharing	2.0	2.0	3.0	3.0	3.0	3.0

StatLink http://dx.doi.org/10.1787/888933706943

Chapter 16.

Public services in South East Europe

This chapter on public services assesses the policy settings, strategies, processes and institutions in six South East European (SEE) economies. Drawing on the SIGMA (Support for Improvement in Governance and Management) Principles of Public Administration, this chapter uses five sub-dimensions to assess progress in public administration reform in the six SEE economies. The first sub-dimension, policy development and co-ordination, examines the policy-making system, policy planning, and transparency of government decisions and legislation. The second, human resources, assesses the merit-based recruitment and integrity of civil servants. The third, accountability, considers administrative judicial dispute mechanisms and public liability regimes, including the appropriate legislative frameworks. The fourth, service delivery, examines citizens' and businesses' experience of public services. Finally, the public procurement sub-dimension examines the legal and institutional public procurement framework and operations as well as the system for handling complaints. The chapter includes suggestions for enhancing key elements of public administration from across these areas which are critical to economic competitiveness.

Main findings

Effective public governance is characterised by accountability, transparency and responsiveness to the rule of law, and lays the foundation for economic growth and competitiveness. Well-functioning public institutions and services create incentives for businesses to invest. Additionally, a transparent, predictable and coherent regulatory approach strengthens the business environment. These characteristics rest on effective policy-making processes and a competent civil service.

The six South East Europe (SEE) economies assessed in the chapter – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – have established the critical elements of public administration. However, their progress is uneven across different areas and from economy to economy. Generally, the six SEE economies have made the most progress in the areas of accountability and public procurement, although shortcomings persist. While they have established the key principles and functions for policy development and co-ordination, the SEE economies have the most room to improve in this area. In particular, their use of evidence-based approaches and public consultations in policy making are less well developed.

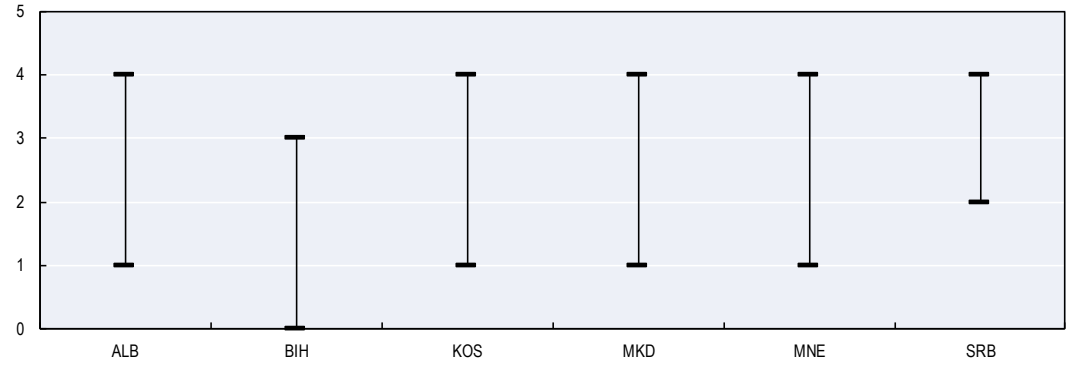
Across the 13 indicators assessed in this chapter, most of the SEE economies score a minimum of 1 and a maximum 4 – out of a possible top score of 5 – while Serbia ranges from 2 to 4 and Bosnia and Herzegovina from 0 to 3 (Figure 16.1). Montenegro leads its regional peers in the public availability of government reports, transparency and legal compliance of government decision making, and the functioning of its public liability regime. Serbia has basic elements in place across all areas and leads in public procurement. Bosnia and Herzegovina lags behind its SEE peers due to its complex constitutional arrangements and organisational structure.[1] The public service system in Bosnia and Herzegovina remains seriously fragmented.

Comparison with the 2016 assessment

Over the past two years, despite several positive steps, there has been no major improvement in incorporating evidence and public participation into policy development in the six SEE economies overall, and there has even been some deterioration in Kosovo and the Former Yugoslav Republic of Macedonia. Although the economies have adopted new laws and regulations on regulatory impact assessments (RIAs) and public consultation, they have yet to fully implement them in a consistent way. In Kosovo and the Former Yugoslav Republic of Macedonia, the consistency with which public consultation procedures are enforced has deteriorated. Some progress has been achieved in the legal frameworks for public procurement in four of the SEE economies, while in Albania and the Former Yugoslav Republic of Macedonia no major developments have been observed. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro have continued to improve their e-procurement platforms (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Figure 16.1. **Public services: Indicator score range**



Note: The score range is for the 13 indicators included in this chapter as listed in Figure 16.2.

Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: the Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

StatLink http://dx.doi.org/10.1787/888933706962

Achievements

The six SEE economies show increasing commitment to improving their standards of economic governance. In recent years, the SEE economies have strengthened their efforts to improve their economic governance, supported by initiatives such as the Economic Reform Programmes (ERPs) and the *Competitiveness Outlook* assessment.

The SEE economies have well-developed legislative frameworks for public procurement, including systems to handle complaints. The frameworks are largely aligned with the European Union *acquis*, though some inconsistencies remain. The scope of their review and remedy systems are also to a large extent in line with the requirements of the *acquis*. However, one challenge to their implementation is the focus on procedural compliance rather than good outcomes.

Most of the SEE economies have established legislative frameworks for merit-based recruitment of civil servants. Key elements in place include the principle of merit, defined professional categories for civil service staff and legislated competition for positions. However, they are not fully reflected in practice.

The six SEE economies have legal frameworks to guide procedures for government sessions – i.e. formal, regular meetings of ministers. The legal frameworks set out procedures to prepare for, follow-up and communicate on government sessions. They also define the roles and responsibilities of the centre-of-government institutions which ensure legal compliance and conformity with procedures, and policy coherence.

Remaining challenges and key recommendations

- **Strengthen the use of evidence in policy making.** Regulatory impact assessments (RIAs) should be conducted for all draft legislation and policies which require them, and should include basic elements such as a problem analysis and a comparison of the options, grounded in evidence. Furthermore, the RIA process and the financial impact assessment should be linked. Additional capacity building for line ministries should support this.
- **Further develop the public consultation legal framework and its implementation.** Requirements for public consultation should be more systematically enforced. Central portals for public consultation should be used more consistently.
- **Strengthen recruitment procedures for the civil service**. Objective selection methods should be reinforced by developing and using common standards to design written exams and structured interviews. The SEE economies should also enhance the capacity and professionalism of selection panels.
- **Reduce the backlogs in administrative courts of appeals.** Albania, Bosnia and Herzegovina, Kosovo and Serbia should develop and implement a corresponding action plan, including measures to increase the number of judges and legal assistants in the administrative courts and to establish a mechanism to regularly monitor the courts' workload. Albania and Kosovo should establish case-management systems, and Serbia should enhance its existing one.
- **Continue to modernise and digitalise public services**. The SEE economies should continue to implement their strategies and build political support for these reforms. They should provide digital skills training and awareness raising for the general public.
- **Further develop laws and implementing regulations on public procurement** by harmonising them with recent EU procurement directives. This includes abolishing preferences for domestic bidders and goods of domestic origin, and reducing the use of the lowest price as the only criterion for awarding contracts. Secondary legislation should be reoriented away from formal procedures and focus on transparency and value for money.
- **Enhance e-procurement systems and expand their use.** Montenegro should start implementing e-procurement, while the remaining economies should increase its use. Their e-procurement systems should be expanded to include monitoring functions and modern purchasing tools such as e-auctions, e-catalogues and dynamic purchasing systems.
- **Improve the procedures of public procurement review bodies.** Review procedures should be clarified and simplified to improve the quality of complaint processing. Electronic case-management systems should be made fully operational and mechanisms put in place to ensure the consistency of review bodies' decisions, especially by making past decisions fully searchable.

Context

Effective public governance – which covers all aspects of the design and delivery of policy measures – is critical to creating a competitive business environment. Furthermore, it plays an important role in implementing crucial reforms, including those related to

accession to the European Union. All six of the SEE economies have committed to improving economic governance practices.

This chapter draws directly from the SIGMA (Support for Improvement in Governance and Management) *Principles of Public Administration* and its corresponding *Methodological Framework* to assess the public administration of economies seeking EU accession. SIGMA is a joint initiative of the OECD and the EU whose key objective is to support socio-economic development by strengthening the foundations for improved public governance. SIGMA has been providing tools and methodologies to countries in transition to bring them closer to the European Union for 25 years. Its Principles are based on universal good governance criteria tailored to the EU *acquis*, guidelines and instructions. As such, its monitoring framework defines a coherent set of requirements for successful EU accession (OECD, 2017g, 2017h).

This chapter considers a subset of the SIGMA public administration reform areas and indicators which are most directly related to competitiveness. Each of this chapter's sub-dimensions directly corresponds to a SIGMA area. The exceptions are the human resource management sub-dimension, which corresponds to the SIGMA public service and human resource management area, and the public procurement sub-dimension, which corresponds to the SIGMA public financial management area.

As the quality of public services determines a government's ability to deliver services and implement reforms, it cuts across government institutions and policy areas. This chapter is therefore inter-related with all chapters in the *Competitiveness Outlook*, and more particularly to the following chapters:

- **Chapter 1. Investment policy and promotion** benefit from effective public administration. Lighter administrative burdens on businesses and a more transparent, predictable and coherent regulatory environment can help attract more foreign investment (OECD, 2015).
- **Chapter 10. Digital society** aims to develop an economy's use of information and communications technology (ICT). Digitalisation has great potential for making public administration more inclusive, transparent and innovative. For example, ICT can make government data more accessible and usable as well as offer new ways to engage citizens in the reform process.
- **Chapter 17. Anti-corruption policy** is instrumental in building a public administration system with public officials who promote integrity and fight corruption – especially in public procurement and public service delivery. In corrupt environments, the competitiveness of markets is hampered by preferential treatment which may be given to those who pay bribes or have a personal connection.

Public services assessment framework

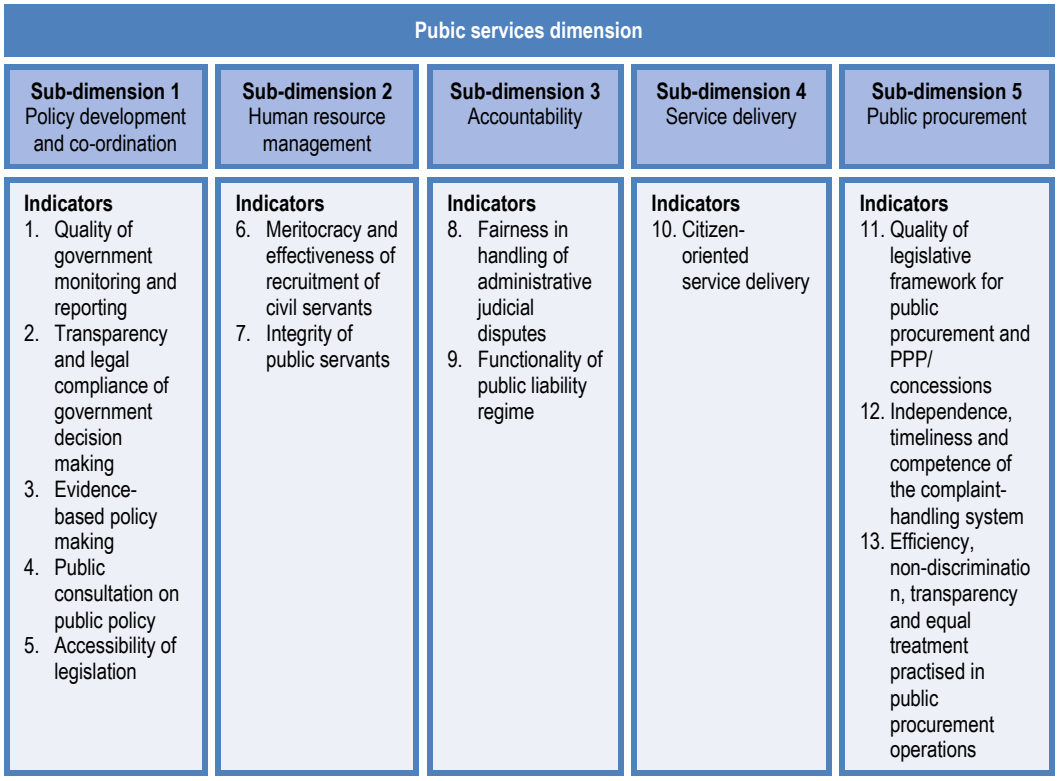
The public services dimension in the 2018 *Competitiveness Outlook* examines the extent to which governments have established policies to support effective public governance. Without seeking to be exhaustive, it considers five broad sub-dimensions:

1. Policy development and co-ordination: do government policy monitoring and reporting systems feed strategic information into the decision-making process? Are government decisions prepared in a transparent manner? Is the policy process evidence-based? Does public participation inform policy design? Is legislation accessible?

2. Human resource management: do governments ensure a competitive merit-based recruitment process for civil servants? Are candidates anonymously assessed? Do governments abstain from intervening in independent selection committees? Are legislative frameworks established to ensure the integrity of public servants?
3. Accountability: do governments ensure that state institutions are held accountable for their actions? Does a public liability regime exist? Does it hold individuals who wield public authority accountable for their behaviour? Do administrative courts offer the right of appeal to an independent authority? Are payments made to entitled plaintiffs in a timely manner?
4. Service delivery: do governments deliver public services in an accessible, competent and expedient manner? Are undue burdens to services removed? Do governments streamline processes whenever possible? Do governments offer performance feedback and monitoring of services? Are they responsive to citizen feedback?
5. Public procurement: how effective is the legal and institutional public procurement framework? Is the complaints handling system independent, transparent and efficient? Do public procurement operations make efficient use of public funds? Are modern procurement techniques and methods used?

The indicator scoring model and data collection methodology in this chapter are different from the standard *Competitiveness Outlook* approach. The five sub-dimensions listed above and the 13 indicators included in this assessment are a subset of the SIGMA public administration reform areas and indicators most related to economic competitiveness (Figure 16.2).

Figure 16.2. **Public services assessment framework**

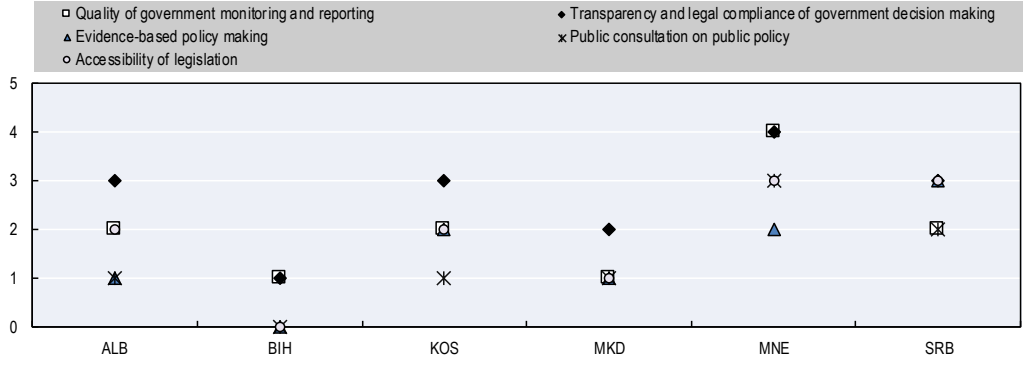


Each of the 13 indicators comprises several sub-indicators which can either be qualitative, based on information such as legal reviews or expert interviews, or quantitative, based on administrative data and surveys. The quantitative sub-indicators encompass both output and outcome measures. This mixed method approach, combining information and data from a variety of sources and multiple methods, strengthens the findings. Each sub-indicator is scored according to the number of criteria that are met. For each indicator, the total number of criteria met from across the sub-indicators is converted into a value on a scale of 0 to 5; 0 being the lowest and 5 being the highest (see Annex 16.A1 for a summary of the scores).[2] For detailed information on the SIGMA assessment framework and indicators, see SIGMA's *Methodological Framework for the Principles of Public Administration* (OECD, 2017g). Based on this *Methodological Framework*, SIGMA assessed each indicator according to the information and data it collected. For the full analysis of the 13 indicators summarised in this chapter, as well as the full suite of indicators analysed, see SIGMA's individual economy reports (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Policy development and co-ordination

Transparent and effective democratic governance depends on a well-functioning policy-making system. Efficiently designed policies and services better enable governments to improve their citizens' well-being and their economy's competitiveness. Furthermore, policy development and co-ordination are critical to managing the reforms needed to prepare for EU accession. The policy development and co-ordination sub-dimension concentrates on the centre-of-government institutions that directly support the head of the government and the council of ministers, such as the head of the prime minister's office, cabinet secretaries and secretaries-general of the government. It also covers policy proposals such as draft laws and regulations or tax and spending measures. Five indicators assess the development and implementation of: 1) quality of government monitoring and reporting; 2) transparency and legal compliance of government decision making; 3) evidence-based policy making; 4) public consultation on public policy; and 5) accessibility of legislation.

Figure 16.3. **Policy development and co-ordination: Sub-dimension indicator scores**



Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: the Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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The six SEE economies have made the most progress in setting up and implementing key features of transparency and legal compliance of government decision making. Accordingly, each economy scores the highest for this indicator (Figure 16.3). In contrast, although the SEE economies have largely put in place requirements for public consultation on public policy, they are not consistently enforced – as reflected by the generally low scores for that indicator. Montenegro leads the SEE economies in almost all indicators, especially the quality of government monitoring and reporting. Bosnia and Herzegovina has the most room for improvement across all indicators.

Government monitoring and reporting frameworks are in place, but quality could be improved

Monitoring and reporting systems feed strategic information on the performance of public interventions into the decision-making process, which helps governments to adjust policy measures to meet their goals. Sound monitoring and reporting also fosters transparency and accountability by providing stakeholders with information on the government's performance. As SIGMA Principle 5 in the policy development and co-ordination area states: "Regular monitoring of the government's performance enables public scrutiny and supports the government in achieving its objectives" (OECD, 2017h).

The legal framework in the Former Yugoslav Republic of Macedonia stipulates regular monitoring and reporting of the implementation of key horizontal central planning documents, but not of sector strategies. Furthermore, the regulations do not require any of these reports to be made public except for the annual financial report on the budget. Consequently, except for the budget report, none of the monitoring reports are publicly available. Government reporting focuses on outputs and does not discuss outcomes (OECD, 2017e).

In Albania, a fragmented regulatory framework consisting of several legal instruments foresees the monitoring of central planning documents, as well as sectoral ones. However, the regulations do not require all of the reports on central planning documents to be published. Several institutions are involved in monitoring and reporting activities, using various reporting tools, templates and standards, but their roles are not clearly established. The reports prepared for planning documents vary significantly in quality (OECD, 2017a).

Kosovo has a legal framework for monitoring government annual work plans and budgets but no established legislative framework or procedures for monitoring and reporting sectoral strategies or the European integration programme. As a result, these strategies are not consistently reported on or reports are not published. Furthermore, most reports lack clear information about the achievement of the majority of outputs and outcomes (OECD, 2017c).

In Serbia, the legal framework for monitoring government annual work plans, budgets, the multi-annual action plan and the plan to adopt the EU *acquis* are in place. It has not established any legislative framework or procedures for monitoring and reporting on sectoral strategies. Serbia's reports on strategy implementation are not comprehensively available for 2015 and 2016 because of regulatory gaps and inconsistencies in following the existing rules (OECD, 2017f). Serbia leads the region by having defined specific performance indicators in its annual mid-term strategy, the Economic Reform Programme (ERP), to monitor implementation progress. These indicators assess both outputs and outcomes, and are reported on, but could be more strategic in some cases (OECD, 2017i).

Montenegro's legal framework stipulates regular monitoring and reporting of the implementation of key horizontal central planning documents, while individual sector strategies establish their own monitoring and reporting mechanisms and frequencies. There is a general requirement to publish materials which have been considered in government meetings, and in practice all reports are publicly available. The reports track implementation and outputs, but as the strategies themselves generally lack outcomes, these are also missing from the reports (OECD, 2017e). However, Montenegro is beginning to design and report on performance indicators which include outcomes in its ERP (OECD, 2017i).

In Bosnia and Herzegovina, the relevant legal frameworks at the state and entity levels define the requirements for annual reporting on the implementation of government annual work programmes, legislative plans and budget plans. However, there are no requirements or procedures to report on the implementation of sectoral strategies or the EU Action Plan, or to publish regular reports on the government annual work programmes at any administrative level. Although the State administration publishes reports on its work programme and legislative plan, the entities do not publish the reports on their work programmes, EU Action Plans or sectoral strategies. Overall, the quality of reporting documents in Bosnia and Herzegovina is weak (OECD, 2017b).

The findings from across the policy areas in this *Competitiveness Outlook* and the *SME Policy Index* (OECD et al., 2016) support this assessment. In general, monitoring and reporting activities are basic but are growing stronger. In some cases, donors' project monitoring activities have provided a model for governments to follow.

Regulations enforce the transparency and legal compliance of government decision making, but gaps remain

A strong government decision-making system underpins effective policy development and implementation. Formal rules and common guidelines about how decisions are made, including how they will be co-ordinated across institutions, smooth the decision-making process. This supports the efficient and transparent use of public resources. To that end, SIGMA Principle 6 in the policy development and co-ordination area states: "Government decisions are prepared in a transparent manner and based on the administration's professional judgement; the legal conformity of the decisions is ensured" (OECD, 2017h).

The legal frameworks in all six of the SEE economies set out procedures for the preparation, follow-up and communication of government sessions – formal, regular meetings of centre-of-government institutions to discuss and adopt various draft policy proposals. All assessed economies except Bosnia and Herzegovina have defined the roles and responsibilities of the centre-of-government institutions for ensuring legal compliance and conformity, and the policy coherence of policy proposals including draft laws and spending measures. In Bosnia and Herzegovina, no government institution has been designated to review the quality or policy coherence of policy proposals. In the Former Yugoslav Republic of Macedonia, the rules of procedure do not clearly state how to ensure the policy coherence of policy proposals and the institutions responsible for developing policy proposals, such as ministries, only partially fulfil their role – leaving gaps in the required documentation and sometimes formal legal scrutiny and financial-affordability checks are even missing. In Albania, consistency and coherency checks of policy proposals are not yet systematically carried out; instead, the focus is on legal compliance and the quality of legal drafting. Similarly, in Kosovo, the checks focus on compliance with procedural requirements. In contrast, draft laws in Serbia undergo legal and financial scrutiny, and RIAs are checked for coherence with existing policies but not

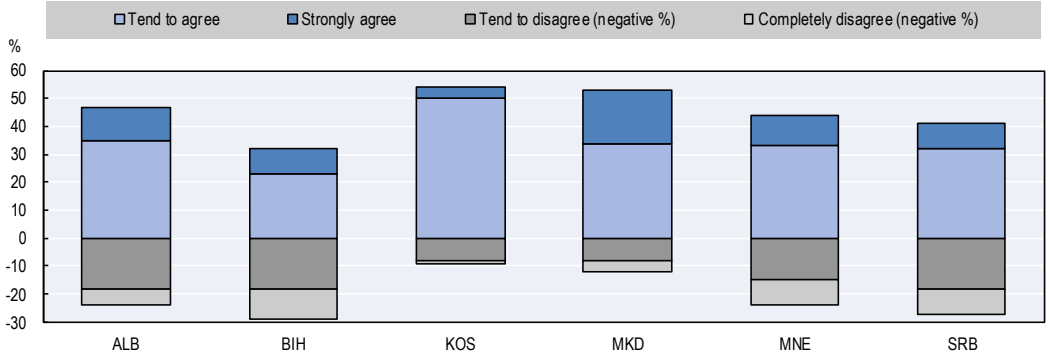
government priorities. In Montenegro, the content and coherence of policy proposals are checked, legal and financial scrutiny is carried out, and the quality of RIAs is checked, although negative opinions are rarely given (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In Albania, the Former Yugoslav Republic of Macedonia and Kosovo, centre-of-government institutions have the authority to return a policy proposal to the lead ministry if it has flaws in its substance or form. However, in Bosnia and Herzegovina, and Serbia, centre-of-government institutions are not authorised to return proposals on the basis of flawed content. In Montenegro, items can only be returned to ministries in cases where the procedures have not been followed (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In Montenegro, 96% of regular agenda items for government sessions were submitted on time (in the last quarter of 2016), 70% in Kosovo (in 2016), and 28% in Albania (in the last quarter of 2016) and in the Former Yugoslav Republic of Macedonia (in 2015). Serbia's legal framework does not set clear deadlines for the preparation and submission of draft proposals to government sessions. In Montenegro, the agenda must be published after it is approved and before the meeting is held, but this requirement is not consistently fulfilled. Decisions are made available online. In Albania, all administrative levels of Bosnia and Herzegovina, Kosovo and Serbia, government decisions are published, but agendas are not made public prior to the sessions, except in the Federation of Bosnia and Herzegovina, where agendas are published a few hours before the session. However, ensuring all decisions are publicly available in practice is a challenge for all levels of administration in Bosnia and Herzegovina. In the Former Yugoslav Republic of Macedonia, neither the agendas nor the decisions were publicly available until May 2017 (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Of the six SEE economies assessed, the Former Yugoslav Republic of Macedonia and Kosovo were the only two in which more than half the businesses polled by the 2017 *Balkan Barometer* survey found laws and regulations affecting their companies to be clearly written, free of contradictions and not changed too often (Figure 16.4).

Figure 16.4. **Degree to which businesses agree relevant laws are written clearly (2017)**



Note: Full question: To what extent do you agree with the following statement - Laws and regulations affecting my company are clearly written, not contradictory and do not change too frequently?

Source: Regional Cooperation Council (2017a), *Balkan Barometer 2017: Business Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

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Evidence-based policy making is still a challenge

Basing policy making on high-quality evidence is critical if public interventions are to be effective. To ensure evidence is consistently and appropriately used in the policy-making process, key requirements and standards for analytical processes and budgetary impact analysis are needed. This reflects SIGMA Principle 10 in the policy development and co-ordination area, which states: "The policy-making and legal-drafting process is evidence-based, and impact assessment is consistently used across ministries" (OECD, 2017h).

All the SEE economies still face challenges in basing their policies on evidence. For example, although the SEE economies have made substantial improvements to their annual mid-term ERPs in the assessment of their economic environments, and in defining and prioritising measures to meet their policy objectives, their impact assessments and costing estimations are basic, if they exist at all (OECD, 2017i). Assessments in other policy areas of this *Competitiveness Outlook* are consistent with this finding.

Legal frameworks define requirements and procedures for submitting policy proposals to the government for approval in all six SEE economies. These include requirements to accompany policy proposals with basic analytical tools to assess its potential impacts and fiscal effects.

In Bosnia and Herzegovina, despite RIA requirements in the policy-making system and guidelines at the entity level, the overall quality of the analyses supporting policy proposals is very poor at all administrative levels. Institutions at the entity level – the General Secretariat in the Federation of Bosnia and Herzegovina, and the Ministry of Economic Relations and Regional Co-operation in the Republika Srpska – are responsible for quality control at the entity level, but they do not have the power to return low-quality RIAs to the originating ministry. At the state level, an amendment requiring RIAs has been drafted, but preparation to implement it is inadequate. At all levels, the financial implications of policy proposals are required to be assessed but they are not consistently conducted (OECD, 2017b).

In Albania and the Former Yugoslav Republic of Macedonia, even though it is required, the financial impacts of policy proposals are not consistently assessed, and when they are they are not conducted properly. The overall quality of RIAs supporting new policy proposals in these two economies is low as they often lack basic information: they do not properly define problems, fully consider or compare options, identify the impact on the budget, describe implementation aspects, or present any monitoring activities. In the Former Yugoslav Republic of Macedonia, the Ministry for Information Society and Administration, which conducts quality controls of RIAs, lacks the mandate to perform the task effectively as it does not necessarily receive other relevant documents and does not have the formal right to return RIAs to line ministries (OECD, 2017a, 2017d).

Policy-making systems in Kosovo, Montenegro and Serbia include elements of broad RIAs accompanied by guidance documents and quality control of impact assessments. Despite this, in Kosovo, only a minority of draft laws are accompanied by the mandated background analytical document. Therefore, the resulting analysis accompanying draft laws is poor – often not including any problem analysis or justification for government intervention. On the other hand, in Serbia, nearly all relevant draft laws were supported by at least a partial RIA. While these do define problems and compare options, their overall quality is poor and not sufficiently evidence based. Quality assessments of the RIAs are limited to the analysis of the opinions given by the Public Policy Secretariat

which are listed in a specific chapter but are not compared using any systematic approach. In Montenegro, RIA reports are prepared and analysed consistently by two departments of the Ministry of Finance: the Directorate for Budget and the Directorate for Financial System and Improvement of Business Environment. However, the quality of analysis is basic, budget impact assessments are very formal as they only refer to the cost provided for in the budget and there is no comprehensive training programme on RIAs (OECD, 2017c, 2017e, 2017f).

Legal frameworks for public consultation on public policy are in place, but not consistently followed

Meaningful public consultation results in better public policy, as citizens' input can improve policy design and implementation. The resulting public engagement and awareness also create greater acceptance of government programmes. Greater transparency in the policy-design process increases trust in government institutions. Finally, more active citizenship strengthens democracies (OECD, 2001). To that end, SIGMA Principle 11 under the policy development and co-ordination area states: "Policies and legislation are designed in an inclusive manner that enables the active participation of society and allows for co-ordinating perspectives within the government" (OECD, 2017h).

All six SEE economies have legal and regulatory frameworks that define the general principles and procedures for public consultation. Nearly all of them require ministries to report the outcomes of public consultation and to publish reports – with the exception of the state level and the Republika Srpska in Bosnia and Herzegovina. All the SEE economies except Albania require public consultation for all draft primary and secondary legislation and define minimum durations for public consultation activities. Only Kosovo, the Former Yugoslav Republic of Macedonia and Serbia require other relevant policy documents, such as the RIA report, to be published for public consultation. All the economies mandate all public consultation to be organised through a central portal and each economy has a functioning portal, although Bosnia and Herzegovina only has a state-level central portal. No economy uses its portal consistently, however. For example, Albania's electronic platform only became functional in 2017, and not all ministries are using it yet (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Kosovo is the only economy with an institution responsible for checking the execution and outcomes of the public consultation process – the Office on Good Governance of the Office of the Prime Minister. It took on this role in 2017 and is required to prepare an annual report on the functioning of the public consultation process (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Many of the mandated requirements for public consultation have not yet been implemented. This is particularly the case in Bosnia and Herzegovina, where implementation of existing practices at both the state and entity levels is poor and inconsistent, and there is little evidence that public consultation is being used. In the Former Yugoslav Republic of Macedonia, draft laws are not regularly published online and RIAs do not include basic references to public consultation processes (OECD, 2017b, 2017d). Furthermore, the European Commission Joint Conclusion highlighted an unpredictable regulatory environment without due stakeholder consultations (EC, 2017). The 2016 ERP consultation process only received two written comments, perhaps because of the limited time available for the process (OECD, 2017i). In Albania, the quality of public consultations varies significantly from ministry to ministry and activities are fragmented. In Kosovo, draft proposals for public consultation are not consistently published. In

Serbia, public debates are organised, but not for all laws, and consultation reports focus on procedural aspects and do not systematically record stakeholder suggestions or how they are addressed (OECD, 2017a, 2017c, 2017f). However, Serbia held two rounds of public consultations on the 2016 ERP and prepared a detailed table of all comments received and how they were addressed (OECD, 2017i). In Montenegro, the sample of draft laws analysed showed that the way key steps in the public consultation process are followed varies from ministry to ministry. For example, only just over half of the reports on the consultation process included any of the comments received (OECD, 2017e).

The assessments across the policy areas in this *Competitiveness Outlook* and the *SME Policy Index* (OECD et al., 2016) are consistent with the finding that despite the existence of legal frameworks for public consultation, consultations are not conducted consistently and lack the required follow-up documentation of the comments received and how they were addressed. For example, Chapter 1, on investment policy and promotion, finds that dialogue and online consultations were not conducted systematically and Chapter 2, on trade policy and facilitation, shows that formal consultation mechanisms are in place but consultation summaries are rarely published.

Legislation is largely made accessible online

Readily accessible legislation is fundamental to the rule of law. If citizens and business can easily access and understand legislation and regulation, it may be more difficult for government officials to impose arbitrary requirements. Accordingly, SIGMA Principle 12 in the policy development and co-ordination area states: "Legislation is consistent in structure, style and language; legal drafting requirements are applied consistently across ministries; legislation is made publicly available" (OECD, 2017h).

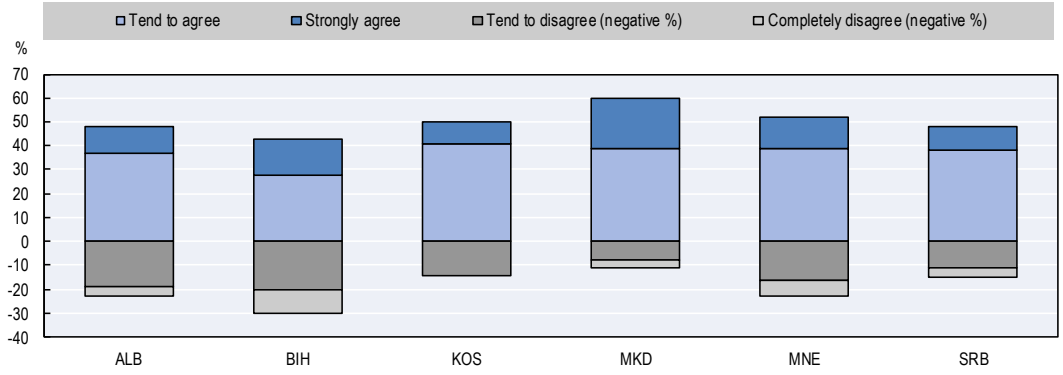
Legal frameworks for the accessibility of legislation are well established in all six SEE economies. In most of the economies these cover key elements such as procedures to make legislation accessible to the public, a competent body to publish legislation, deadlines for publishing legislation, and clarity on what types of legislation must be published and the responsibilities of bodies to submit adopted legislation and consolidated versions of legal texts. The exceptions are Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia where many fewer elements are in place. In the Former Yugoslav Republic of Macedonia, the rules do not define procedures and deadlines for publication, or the responsibilities of bodies submitting the adopted legislation for publication. In Albania and the Former Yugoslav Republic of Macedonia, consolidated versions of laws – bringing together the original act and all subsequent amendments – have no official status. In Bosnia and Herzegovina, at both the state and entity levels, the regulations do not outline the process for publication in the Official Gazette, they only identify the bodies responsible for publication. Basic requirements such as which documents need to be published, deadlines for publication after submission and the responsibilities of the bodies submitting legislation to the Official Gazette are yet to be defined (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

All six SEE economies have legally mandated central registries for legislation and they are all available online. Despite this, the extent to which legislation is available through these portals varies from economy to economy. In Montenegro and Serbia, primary and secondary legislation is widely available. However, in Montenegro there is no obligation to publish consolidated versions of legal texts, while in Serbia official consolidation can only be done if a law explicitly requires it. In Kosovo, all primary legislation is available online, but secondary legislation is only available online when

specifically requested by the Prime Minister and there is no obligation to publish consolidated versions of legal text. In Albania, significant efforts to make legislation available are underway, but not all laws are available online. In the Former Yugoslav Republic of Macedonia, all primary and secondary legislation is available electronically in the Official Gazette, but legislation adopted during the current year is only available for a fee; older legislation is available without charge. Finally, in Bosnia and Herzegovina, primary and secondary legislation is available in central registries at the state and entity levels, but at the state level and the Federation of Bosnia and Herzegovina, only legislation adopted after 2009 is available in electronic form and legislation adopted before 2009 is only available for a fee. There are no procedures for consolidating legislation at the state or entity levels, so consolidated versions are not comprehensively available (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In most of the SEE economies, about half of the businesses polled by the 2017 *Balkan Barometer* survey found it is easy to obtain information about laws and regulations affecting their companies (Figure 16.5).

Figure 16.5. **Degree to which businesses agree relevant laws are easy to obtain (2017)**



Note: Full question: To what extent do you agree with the following statement - Information on the laws and regulations affecting my company is easy to obtain from the authorities?

Source: Regional Cooperation Council (2017a), *Balkan Barometer 2017: Business Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

StatLink http://dx.doi.org/10.1787/888933707019

The way forward for policy development and co-ordination

Half of the SEE economies should amend their legal frameworks for policy implementation reports. In Bosnia and Herzegovina, the entities should formally require the preparation and publication of regular implementation reports for government annual work plans and sectoral strategies. Albania should adopt a new methodology for monitoring and reporting cross-cutting and sectoral strategies, and provide guidance to ministries on using it. Ministries should also be required to report annually on the implementation of the analytical programme, supported by guidance. Kosovo should launch a system to report on sector strategy implementation (OECD, 2017a, 2017b, 2017c).

Four of the SEE economies should strengthen policy monitoring and reporting activities. The Former Yugoslav Republic of Macedonia should prepare and publish an annual report on the government annual work plan. Serbia should develop and publish monitoring reports on its cross-cutting strategies. The Kosovo government annual work

plan should contain concise and precise information on the implementation of planned activities by ministry. Albania should review its existing monitoring and evaluation practices to streamline procedures and integrate its monitoring systems into a single central system (OECD, 2017a, 2017c, 2017d, 2017f).

Four of the SEE economies should include information about the outcomes of policies in their monitoring reports. At the state and entity levels in Bosnia and Herzegovina, monitoring and reporting requirements should include information on progress towards policy objectives. Implementation reports in Kosovo and Montenegro should include an assessment of the impact of policies, not just outputs such as activities that took place. Serbia should include information on achievements of agreed policy objectives in its monitoring of central planning documents (OECD, 2017b, 2017c, 2017e, 2017f).

The Former Yugoslav Republic of Macedonia and Kosovo should make all policy monitoring reports publicly available immediately after they are approved. The Former Yugoslav Republic of Macedonia should also include sector strategies. Kosovo should publish its implementation reports for the National Programme for the Implementation of the Stabilisation and Association Agreement (OECD, 2017c, 2017d).

Serbia should strengthen its legal framework for government session procedures. The rules and procedures should define the timeframe for submitting proposals for government deliberation. Relevant regulations should be amended to allow material submitted for government sessions to be returned to the ministries if it doesn't meet quality standards. An institution should be appointed to review the content of all policy proposals (OECD, 2017f).

Five of the SEE economies should strengthen quality controls of policy proposals submitted to government sessions, covering their affordability and coherence with government priorities and European integration commitments. In Albania, Bosnia and Herzegovina, Kosovo and Montenegro, proposals which do not meet mandated criteria or contain flaws should be returned to originating ministries. In the Former Yugoslav Republic of Macedonia, the Secretariat for Legislation should only scrutinise legislative proposals for deliberation in a government session, while the legal departments of the General Secretariat should handle other non-regulatory and non-priority items (OECD, 2017a, 2017b, 2017c, 2017d, 2017e).

Four of the SEE economies should make the government decision-making process more transparent. In the Former Yugoslav Republic of Macedonia, all government session agendas and decisions, except those containing confidential information, should be made publicly available and in Kosovo and Serbia, government session agendas should be published in advance. Serbia should also review its approach to publishing all types of government decisions, including government conclusions, and widen publication to include all government decisions unless they are purely administrative or would jeopardise the national interest. In Bosnia and Herzegovina, the entities should make all decisions publicly available and should review their regulatory frameworks and procedures governing decision-making systems (i.e. making government decisions and government session agendas publicly available) and make them more transparent (OECD, 2017b, 2017c, 2017d, 2017f).

All six SEE economies should improve the quality of their impact assessments in the policy-making process. Albania should develop a clear plan for RIA implementation within its policy-making system, including costing policy proposals, after the pilots are

complete. In Albania and Serbia, RIAs should be submitted alongside draft proposals to parliament. Serbia and the Former Yugoslav Republic of Macedonia should align the processes for developing financial impact assessments and RIAs. The Former Yugoslav Republic of Macedonia should also develop detailed guidance for costing draft laws and strategies. All administrative levels in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro should rigorously enforce requirements to conduct RIAs, and enable those of insufficient quality to be returned to the originating ministry. Kosovo should improve the analytical quality of budgetary impact assessments so the reasons for selecting preferred options are clear. Montenegro should evaluate its RIA system, including which proposals need an RIA and how the RIA relates to the overall draft proposal explanation (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Four of the SEE economies should strengthen the legal framework for and the implementation of public consultation activities. In Bosnia and Herzegovina at all administrative levels, the legal framework for public consultation and its implementation should be enhanced and public consultation reports in policy proposals should be checked against the consultation requirements. Montenegro should amend its legislation to provide supporting documents alongside draft laws under consultation. The Former Yugoslav Republic of Macedonia should enforce requirements for public consultations. Albania should develop its public consultation guidelines to help ministries meet all the requirements, and ensure all ministries consistently use the electronic portal for public consultations (OECD, 2017a, 2017b, 2017d, 2017e).

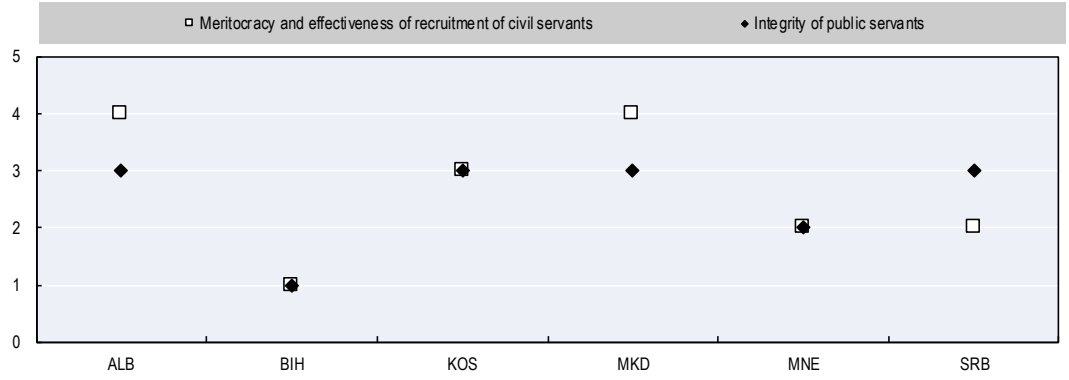
All six SEE economies should make all primary and secondary legislation available online. Bosnia and Herzegovina, and Montenegro should make all legislation, including consolidated versions, available for free while the Former Yugoslav Republic of Macedonia should ensure recent legislation is freely accessible. Bosnia and Herzegovina should also establish rules and procedures for preparing the consolidated texts of major laws. Kosovo should establish a mechanism to publish all secondary legislation in the Official Gazette, as well as consolidated versions of normative acts. Serbia should move towards routinely compiling consolidated texts of legislation, as should the Former Yugoslav Republic of Macedonia once it has implemented a legal solution to do so. Albania should make all primary and secondary legislation available in an officially consolidated form in an online database (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Human resource management

Effective human resource management ensures the right people are in position to achieve public policy objectives. Merit-based recruitment entails the competitive, fair and non-discriminatory selection of people to public-sector jobs. The recruitment of competent officials helps ensure outcomes can be efficiently delivered by skilled professionals and, crucially, establishes a degree of reliability in public services. What is more, selecting and retaining a professional civil service improves the perception of the public sector, and inspires qualified individuals to join their ranks. Likewise, high levels of integrity among civil servants ensure that state employees act in the best interests of the citizen, forgoing opportunities for personal gain and upholding high professional standards. Public-sector integrity is linked to a more honest service delivery culture and as a direct consequence, a better-managed and well-functioning state administration. Two indicators assess the legal frameworks and practice of: 1) meritocracy and effectiveness of recruitment of civil servants; and 2) integrity of public servants.

All six assessed SEE economies have frameworks in place for the merit-based recruitment of public servants and guidelines on integrity for civil servants, although gaps remain in both areas (Figure 16.6). The Former Yugoslav Republic of Macedonia and Albania lead overall, particularly in merit-based recruitment, where they both score 4. However, the Former Yugoslav Republic of Macedonia held a very limited number of recruitment procedures during the assessment period, which means its score on this indicator should be interpreted with caution. Bosnia and Herzegovina has the most room for improvement for both indicators.

Figure 16.6. **Human resource management: Sub-dimension indicator scores**



Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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Merit-based recruitment procedures are in place, but gaps remain

A merit-based recruitment process means that the best candidate is hired through an open, fair and competitive selection process. Appointing the most eligible candidate enhances the performance of the public sector by increasing staff competence and thus boosting the overall attractiveness of public-sector work. A merit-based selection process represents the first step in establishing a more responsive civil service and ultimately leads to public-sector savings and greater economic gains. Accordingly, SIGMA Principle 3 in the public service and human resource management area states: "The recruitment of public servants is based on merit and equal treatment in all its phases; the criteria for demotion and termination of public servants are explicit" (OECD, 2017h).

Although all six SEE economies have legal frameworks for recruitment procedures for civil servants based on the principle of merit, there are shortcomings in the regulations and practices which challenge this principle. Albania, the Former Yugoslav Republic of Macedonia and Kosovo all prepare annual staffing plans, which facilitate more timely procedures. Albania has improved its selection method for external recruitment by introducing anonymous and electronically graded multiple-choice questionnaires for the written test. However, limited capacity for staff planning and shortcomings in job

descriptions contribute to delays in the organisation of pooled recruitment. In the Former Yugoslav Republic of Macedonia, the Agency of Administration provides effective management of the selection processes. In Kosovo, selection panels have wide discretion to formulate written and oral test questions, which compromises the objectivity of the selection process. In Bosnia and Herzegovina (at all administrative levels), Kosovo and Montenegro, ad hoc selection committees formally provide impartiality during recruitment, but in practice the majority of committee members come from the recruiting institution and are not sufficiently trained, which reduces the level of professionalism. In Bosnia and Herzegovina, especially at the state level and in the Federation of Bosnia and Herzegovina, application procedures continue to be quite bureaucratic and time consuming, with no evidence to show how they support merit-based selection. The entrance examinations differ between the state and entity levels and they are not systematically recognised across administrative levels, creating obstacles for candidates. In Montenegro, a legal provision allows candidates to be assessed with alternative methods without needing to specify a reason for such an exception, and the lack of uniform standards for designing written tests challenges the principle of equal opportunity for all candidates. In Serbia, institution heads have discretionary power to select candidates from a closed list, and temporary personnel are exempted from the standard recruitment process, challenging the principle of merit (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The recruitment process took less than three months in at least four of the five institutions assessed in Albania and Kosovo, as well as in the very limited number of recruitment procedures in the Former Yugoslav Republic of Macedonia. Data were unavailable in the remaining three SEE economies (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

A lack of eligible candidates is a challenge in Bosnia and Herzegovina, Montenegro and the Former Yugoslav Republic of Macedonia. In the latter, new language and computer skill certification requirements that may not be relevant to the work may pose barriers to otherwise suitable candidates. In Albania, the number of eligible candidates per vacancy fell significantly from 10.9 in 2015 to 7.4 in 2016. The retention rate of newly hired civil servants is an indicator of the effectiveness of recruitment procedures. Over 90% of civil servants appointed in the year before the assessment had stayed in the civil service for at least one year in Albania, the Former Yugoslav Republic of Macedonia and Kosovo. Data were unavailable for the other three SEE economies (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Policies and frameworks to promote the integrity of public servants are in place but enforcement could be strengthened

The integrity of public servants entails their respect for legal codes of conduct and personal ethics to act in the best interest of citizens, and forgo opportunities for personal gain. The degree to which institutions and their representatives act in good faith is a measure of civic culture, and informs how individuals perceive and trust their government. For example, instances of bribery not only undermine the rule of law – they corrode the moral authority of the state and its public institutions. The integrity of public servants is an important pillar of human resource management as it facilitates a more reliable civil administration and helps fight corruption by holding public servants to account. This is reflected in SIGMA Principle 7 in the area of public service and human resource management, which states: “Measures for promoting integrity, preventing corruption and ensuring discipline in the public service are in place” (OECD, 2017h).

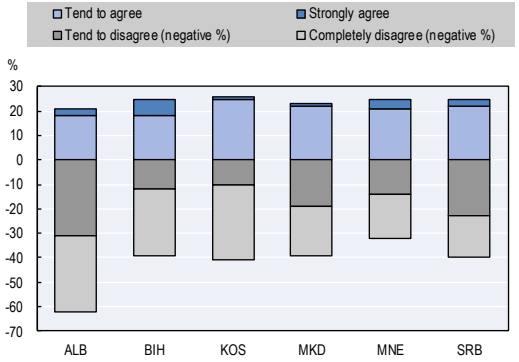
Apart from Bosnia and Herzegovina, all of the SEE economies have legal frameworks that contain the key elements for public-sector integrity. Albania's, however, is complex and highly fragmented, while Kosovo's framework has shortcomings in the areas of conflicts of interest and whistleblower protection. Bosnia and Herzegovina does have some relevant laws and institutions. The Agency for the Prevention of Corruption and the Co-ordination of the Fight against Corruption has powers to promote integrity, but only among state-level institutions, and it has no investigative powers. It has a law on whistleblower protection at the state level and in the Republika Srpska, although the latter has yet to be implemented (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f). For more information see Chapter 17 on anti-corruption policy.

Apart from Bosnia and Herzegovina, and Montenegro, the remaining SEE economies also have comprehensive public-sector integrity policies accompanied by action plans. In Montenegro, in the absence of a multi-year anti-corruption policy, the Agency for the Prevention of Corruption works on the basis of annual operational plans. In Bosnia and Herzegovina, the State and each entity have a strategy in place, and those of the State and the Federation of Bosnia and Herzegovina are accompanied by action plans. In the Former Yugoslav Republic of Macedonia, the programme's narrative section is quite complete and based on international reports, and its action plan outlines measures and timelines, though it lacks cost estimates. In Kosovo, instead of a diagnosis of the current situation, its strategy generally references the previous one and does not specify how implementation is to be funded. Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Serbia all have resources to monitor public-sector integrity policy implementation (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Montenegro's anti-corruption agency seems well established, and its decisions and opinions have led to the resignation and dismissal of public officials. In Albania on the other hand, a high proportion of investigative cases against public servants that were referred to the prosecutor remain unanswered. In Kosovo, the number of cases referred to the prosecutor fell by about 70% between 2015 and 2016 for unknown reasons. In Bosnia and Herzegovina, legislated sanctions and procedures are rarely used in practice. Data on the use of integrity investigations were unavailable in the Former Yugoslav Republic of Macedonia and Serbia (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

According to the 2017 *Balkan Barometer* survey, citizens and businesses perceive corruption in the public sector to be rather high across the six SEE economies. About one-quarter of them agree that it is common for firms to have to pay some irregular "additional payments" or "gifts" to "get things done" (Figure 16.7). However, less than one-tenth of citizens reported paying a bribe in the past 12 months for any government service (Figure 16.8).

Figure 16.7. **Degree to which businesses agree paying bribes to public officials is common (2017)**

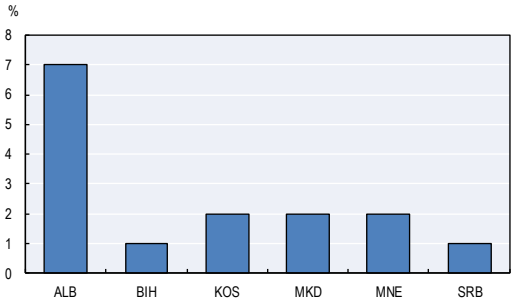


Note: Full question: Thinking about officials, to what extent would you agree with the following statements - It is common for companies in my line of business to have to pay some irregular "additional payments/gifts" to "get things done"?

Source: Regional Cooperation Council (2017a), *Balkan Barometer 2017: Business Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

StatLink http://dx.doi.org/10.1787/888933707057

Figure 16.8. **Share of citizens reporting to have paid a bribe for any government service (2017)**



Note: Full question: In your contact or contacts with the institutions, have you or anyone living in your household paid a bribe in any form in the past 12 months - Any government services?

Source: Regional Cooperation Council (2017b), *Balkan Barometer 2017: Public Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_PublicOpinion_2017.pdf.

StatLink http://dx.doi.org/10.1787/888933707076

The way forward for human resource management

Half of the SEE economies should improve the civil service recruitment process. Albania should enhance the quality of job descriptions and speed up the organisation of recruitment from the date of publication to reduce delays in filling vacancies, while Serbia should simplify its application process. Bosnia and Herzegovina, at the state and entity levels, should amend recruitment regulations to reduce the cost and formalities involved for candidates in applying for civil service positions (OECD, 2017a, 2017b, 2017f).

Four of the SEE economies should strengthen their merit-based recruitment procedures for the civil service. Serbia should fill temporary positions on the basis of competition. In Bosnia and Herzegovina, all responsible institutions should propose unified rules to recognise entrance exams across all levels of administration. Montenegro should change the underlying principles of selection panels to increase the stability of their composition, develop common standards for the design and administration of the practical part of the written test across the civil service, and apply unified candidate assessment methods. For both internal and external competitions Kosovo should enhance the capacity of selection panels to use objective selection methods and standards, ensure the anonymity of written tests, and support the use of structured selection interviews (OECD, 2017b, 2017c, 2017e, 2017f).

Albania and the Former Yugoslav Republic of Macedonia should aim to increase the number of candidates in public competitions. The Former Yugoslav Republic of Macedonia should conduct communication campaigns to promote employment opportunities and Albania should investigate why the number of applicants is falling, and seek an effective solution (OECD, 2017a, 2017d).

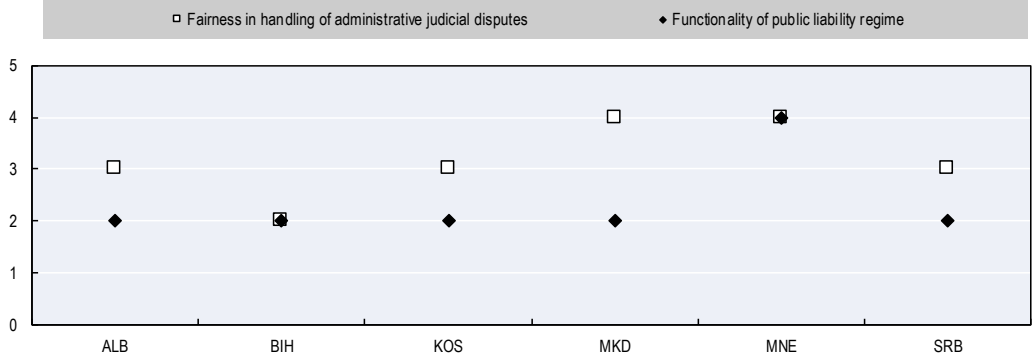
Bosnia and Herzegovina, and Montenegro should take further steps to promote integrity across the public services. At the state and entity levels, Bosnia and Herzegovina should ensure adequate political support and resources for promoting integrity and preventing corruption. Montenegro should prepare a multi-annual plan for the prevention of corruption and for promoting integrity in public service (OECD, 2017b, 2017e).

Accountability

For a government to function effectively it should be answerable to the public it serves. Without mechanisms for redress, states are free to act unlawfully. Among the elements supporting public accountability, administrative judicial dispute mechanisms and public liability regimes provide important checks on government power, including those affecting economic activities, and are therefore particularly relevant for a strong business environment. Administrative judicial dispute mechanisms ensure that state institutions are held accountable for their actions, including personal transgressions or the omission of services. Similarly, a public liability regime holds individuals who wield public authority accountable for their behaviour towards the public. Two indicators assess the development and implementation of: 1) fairness in handling administrative judicial disputes; and 2) the functionality of the public liability regime.

All six of the SEE economies have frameworks to govern administrative judicial disputes and public liability, but the consistency of their application varies (Figure 16.9). None of the economies could provide data on payments made in public liability court cases, which limits the analysis. With a score of 4, Montenegro is the highest performer of the SEE economies for the functionality of its public liability regime, in part because it is the only the economy to provide data on the application of its public liability mechanism by the courts. Montenegro also scores 4 for administrative judicial disputes, as does the Former Yugoslav Republic of Macedonia – in these two economies cases are handled reasonably quickly and backlogs are not a problem. Bosnia and Herzegovina has the most room for improvement across both areas.

Figure 16.9. **Accountability: Sub-dimension indicator scores**



Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

StatLink http://dx.doi.org/10.1787/888933707095

Legal mechanisms support the right to fair treatment in administrative courts, but long delays can be a barrier to justice

The accessible and uniform application of justice ensures plaintiffs have equal opportunity for redress – including administrative disputes which involve the exercise of public power as classified by the country's legal regime. Fair and accessible administrative justice reduces the risk of arbitrary power over economic matters and levels the playing field for individual actors. For example, if an application for a building permit is denied, the decision can be appealed in an administrative court, which is a generally faster and cheaper process than in the general courts. This is reflected in SIGMA Principle 4 in the area of accountability: "Fair treatment in administrative disputes is guaranteed by internal administrative appeals and judicial reviews" (OECD, 2017h).

The six SEE economies all have legislative frameworks for administrative justice, giving individuals the right to challenge the lawfulness of administrative acts, including those related to the regulation of economic activity. In Bosnia and Herzegovina, the legal regime for judicial review of administrative acts is decentralised, with separate laws on administrative disputes at the state and entity levels (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In Albania, Montenegro and Serbia, accessibility to administrative justice is strengthened through legal assistance programmes and fee waivers to those in need. In the Former Yugoslav Republic of Macedonia court fees are not so high as to restrict access, and a number of exemptions from fees are also available. In Kosovo, court fees in administrative cases are fairly low and low-income applicants may be exempt from paying them. However, in Bosnia and Herzegovina, the basic fee for filing an administrative case is significant, amounting to 8% of the average monthly salary. In the SEE economies, parties are generally responsible for their own expenses and successful plaintiffs do not receive compensation for costs, which may discourage parties from using the courts. In Montenegro, the court costs incurred by successful plaintiffs may only be covered by the other party when there has been an oral hearing, which may encourage unnecessary oral hearings (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

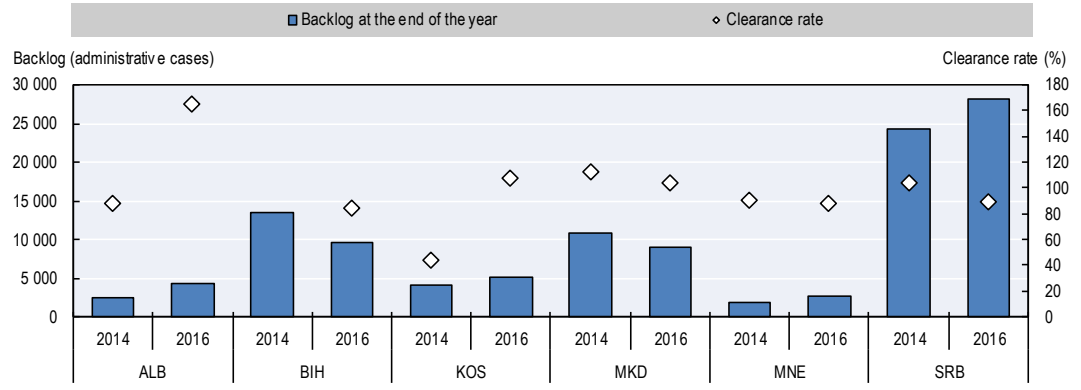
Drawn-out proceedings are a powerful disincentive for seeking redress, and ultimately undermine the integrity of the process by eroding public trust in judicial institutions. Legislation provides remedies against excessively long proceedings in administrative cases – such as the right to compensation for delays in access to justice – in the Former Yugoslav Republic of Macedonia, Montenegro and Serbia, but have only been implemented in the latter two economies. However, they do not exist in Albania, Bosnia and Herzegovina, or Kosovo (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Effective electronic case-management systems can accelerate case adjudication and better manage case information. Albania and Kosovo are the only assessed economies without an electronic case-management system which can register documents and record events and results. In Albania, Bosnia and Herzegovina, Montenegro and Serbia court rulings are accessible online. For example, in Bosnia and Herzegovina real-time monitoring using an advanced case-management system makes it possible to electronically register cases, digitalise documents, search files and decisions, and generate statistical reports about judicial performance (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Case flow, or the rate at which cases make their way through the court system, can be described by the clearance rate (number of resolved cases divided by number of incoming cases) and backlog. In Montenegro, the clearance rate in 2016 dropped to 88%, indicating

a growing backlog, but the court has no cases which have been pending in proceedings for more than two years (Figure 16.10). The Former Yugoslav Republic of Macedonia has had a clearance rate of over 100% since 2012 and its backlog of cases is falling (OECD, 2017d, 2017e).

Figure 16.10. **Backlog of administrative cases and clearance rates of administrative courts (2014 and 2016)**



Note: Data for Bosnia and Herzegovina are for the court at the state level. The 2014 clearance rate for Bosnia and Herzegovina is unavailable.

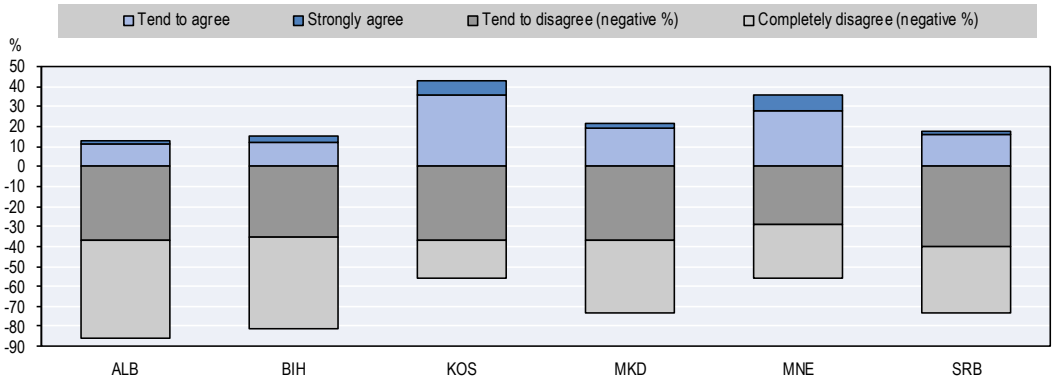
Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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On the other hand, clearing the backlogs in Albania, Bosnia and Herzegovina, Kosovo, and Serbia is unlikely in the foreseeable future unless extraordinary measures are taken. Despite the clearance rate in Albania improving to 165%, the number of unresolved cases at the beginning of 2017 was more than twice the total number of cases resolved in 2016 (Figure 16.11). Kosovo's clearance rate in 2016 was 108%, but the number of new cases is greater, increasing the backlog. In Bosnia and Herzegovina, the efficiency of courts dealing with administrative cases varies across the economy. Compared to 2014, all first instance courts in Bosnia and Herzegovina have managed to reduce the calculated disposition time by more than 100 days. Nevertheless, obtaining a ruling in the courts of the Federation of Bosnia and Herzegovina takes over 16 months, with the average case pending for over 2 years. Despite having mechanisms to submit a complaint against excessive lengths of proceedings, Serbia has a significant backlog of unresolved cases. In 2016, the clearance rate dropped below 90% (OECD, 2017a, 2017b, 2017c, 2017f).

Across all six of the SEE economies, public perception of the independence of courts from political influence is low, with less than half the individuals polled agreeing that they are independent (Figure 16.11).

Figure 16.11. **Degree to which the public agrees the judicial system is independent (2017)**



Note: Full question: Do you agree that judicial system is independent of political influence?

Source: Regional Cooperation Council (2017b), *Balkan Barometer 2017: Public Opinion Survey,* www.rcc.int/seeds/files/RCC_BalkanBarometer_PublicOpinion_2017.pdf.

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Public liability is enshrined in legal frameworks, but information on their application is lacking

A public liability regime ensures that individuals or legal entities have the right to seek remedial compensation against any unlawful and/or improper act by the state administration. An unlawful act is defined in this context as a personal transgression or administrative omission by a state body affecting an individual's rights, properties and privileges. An effective public liability regime depends on a clear legal framework of transparent procedures to check the power of state institutions and associated bodies. Accordingly, SIGMA Principle 5 in the area of accountability states: "The public authorities assume liability in cases of wrongdoing and guarantee redress and/or adequate compensation" (OECD, 2017h).

Legal frameworks enshrine the principle of public liability in all the SEE economies except Kosovo, where there is no conceptually clear legal regulation on public liability. All six of the SEE economies have laws which cover damage caused by the activities and omissions of state administration bodies and private bodies performing public functions. The scope of compensation is broad, as it covers both direct losses and profits forgone. The right to compensation is guaranteed to everyone. The time limit for submitting a public liability request is reasonable – not less than a year in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Montenegro, and three years in the remaining SEE economies (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

There are no data on the practical implementation of the right to seek compensation, making it impossible to assess how the current systems are functioning in practice. Montenegro is the only SEE economy to provide statistical data on the practical application of the public liability mechanism in the form of court rulings. These data show that the procedural framework for public liability is used – in 2016, first instance courts resolved 201 public liability cases, awarding a total of nearly EUR 300 000 in compensation. However, there are no data on actual payments made in Montenegro nor in any of the other economies. In Serbia, according to the State Attorney's Office, the public liability mechanism is also widely applied in practice. However, it is rarely used in the

Former Yugoslav Republic of Macedonia, according to the Ministry of Information Society and Administration. Its draft strategy on public administration does contain a plan to develop new legislation on public liability, however (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The way forward for accountability

Four of the SEE economies should reduce the backlogs in their administrative court of appeals. In Albania, Bosnia and Herzegovina, Kosovo and Serbia, authorities should develop and implement an action plan to address backlogs by increasing the number of judges and legal assistants in the court, and by establishing a mechanism to regularly monitor court workloads. Albania should establish a new case-management system. Kosovo should also modernise its courts by introducing a digital court information system (OECD, 2017a, 2017b, 2017c, 2017f).

The Former Yugoslav Republic of Macedonia and Montenegro should improve their administrative case flow and enforcement of court rulings. Montenegro should analyse the reasons for the considerable increase in administrative cases and implement measures to address them. The Former Yugoslav Republic of Macedonia should review its current system of administrative appeals to find out why they take so long. The Former Yugoslav Republic of Macedonia and Montenegro should both strengthen the enforcement of court rulings (OECD, 2017d, 2017e).

Half of the SEE economies should improve the accessibility of administrative justice. New laws on legal aid are needed in the Former Yugoslav Republic of Macedonia and Serbia. Kosovo should amend its legislation so that successful plaintiffs in administrative cases have their expenses compensated (OECD, 2017c, 2017d, 2017f).

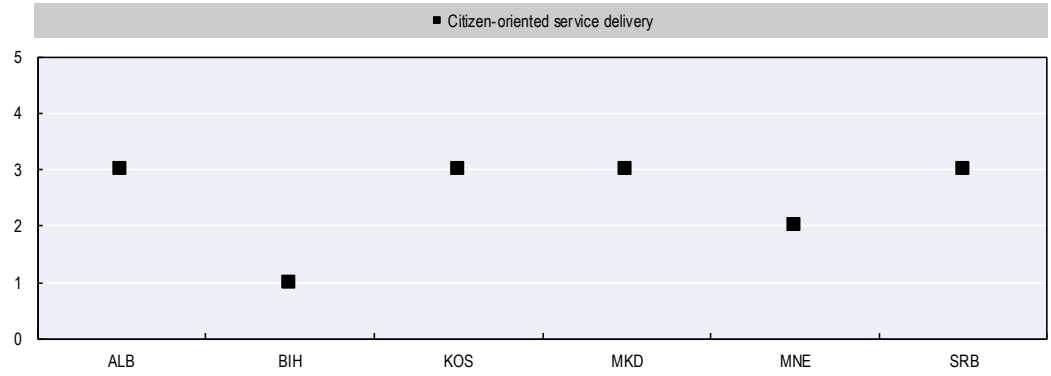
All six SEE economies should improve their public liability administrative procedures and decisions. To improve policies and administrative practices to reduce public liability cases in the long run, they should introduce a mechanism to monitor court cases that result in the liability of public bodies. Kosovo should prepare and implement legislation on non-contractual liability (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Service delivery

Representatives of the state provide individuals and businesses with services ranging from routine tasks – such as renewing a driver's licence – to more complex bureaucratic interactions, such as applying for a construction permit or opening a small business. Public services are often the first point of contact between the state and citizens. Inefficient and unreliable public services diminish trust in government institutions and, crucially, encourage informality in private citizens' affairs, such as personal income tax, and in wider economic activity, including registering a business. Effective service delivery requires a high degree of professionalism, predictability and customer service orientation. The advent of digitalisation and new electronic management tools offers the potential to organise service management better. A single indicator assesses citizen-oriented service delivery.

Four of the SEE economies score 3 on this indicator, while Montenegro, with a score of 2, and Bosnia and Herzegovina, with a score of 1, have the most ground to make up in this area (Figure 16.12). Apart from the Former Yugoslav Republic of Macedonia, the SEE economies all have policy frameworks for citizen-oriented services in place.

Figure 16.12. **Service delivery: Sub-dimension indicator scores**



Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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However, the quality of service delivery is inconsistent in all the economies, resulting in the perception of public services being inefficient and unreliable. All the SEE economies except Bosnia and Herzegovina have established policies to simplify administration, but full implementation remains a challenge. Bosnia and Herzegovina has a common service delivery strategy at all administrative levels, but its implementation is behind schedule and service delivery arrangements are incoherent.

Efforts to digitalise public services and to reduce administrative burdens for businesses should continue

Citizen-oriented service delivery is an approach that puts the citizen at the centre of administrative procedures. Service delivery that prioritises users' experience is characterised by customer-friendly and expedient transactions. This is accomplished by identifying and removing undue burdens when using services, often by streamlining processes whenever possible and linking administrative databases across government institutions. When services are efficient, less time is spent on basic bureaucratic tasks and can be dedicated to more productive uses. Services which are not easily accessible or inefficient give greater licence to non-compliance and can facilitate the growth of the informal sector. SIGMA Principle 1 in the service delivery area states: "Policy for citizen-oriented state administration is in place and applied" (OECD, 2017h).

All of the SEE economies except the Former Yugoslav Republic of Macedonia have a strategic service-delivery framework, including digital service delivery. Albania's and Kosovo's strategic frameworks for public service delivery and digital service delivery include government-wide objectives, explicit actions to achieve those objectives, clearly assigned responsibilities to specific institutions and a monitoring mechanism. However, the two strategies in Kosovo are poorly synchronised. In Bosnia and Herzegovina, the overarching Public Administration Reform Strategy has formally expired but continues to be implemented at the state and entity levels. Serbia has multiple strategies, which pose

challenges for co-ordination and efficient resource allocation. In Montenegro, service delivery and digital service delivery activities are well aligned across two strategies. In the Former Yugoslav Republic of Macedonia, the public administration reform strategy encompassing service delivery is outdated and the new draft strategy is yet to be finalised. A strategic plan includes some digital service delivery activities but there is no government-wide strategy (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f). For more information on digital strategies see Chapter 10 on the digital society.

In Albania, central co-ordination of service delivery reform is split between two bodies for the delivery of physical and digital services; this does not always result in the optimal selection of service delivery method. Central co-ordination for service delivery reform in Kosovo is insufficient, leaving other public institutions waiting for guidance or implementing their own solutions. Montenegro's Ministry of Public Administration has the responsibility to assist service delivery improvements and monitor their implementation, but monitoring is hindered in practice by the lack of mechanisms to measure performance. In the Former Yugoslav Republic of Macedonia, the central co-ordination of service delivery reform is hampered by limited resources and power. Serbia provides central assistance for digital government but there is no central authority to review or monitor information technology (IT) projects, creating a high risk of overlapping or duplicated digital investments. Central co-ordination of digital government projects in Bosnia and Herzegovina is at an early stage (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

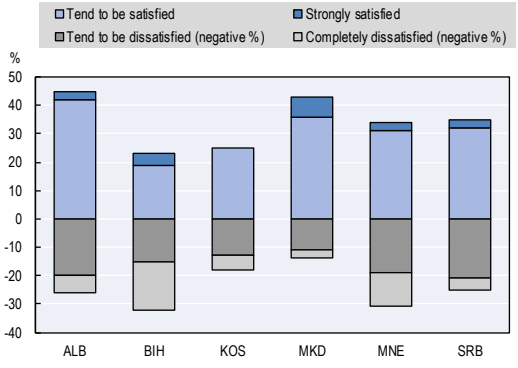
All the SEE economies have put key elements in place to simplify administration procedures, increase their cost efficiency and reduce the burden they pose on citizens and business, albeit to a lesser extent in Bosnia and Herzegovina. Key measures to achieve these objectives include *ex ante* and *ex post* assessments of regulations (for example, regulatory impact assessments and regulatory guillotine procedures[3]). Montenegro launched a regulatory guillotine programme in 2012 with most activities implemented by 2015, but in the absence of monitoring it is difficult to assess the results. A positive development in the Former Yugoslav Republic of Macedonia is the Law on General Administrative Procedures which came into effect in 2016. This unifies administrative procedures across government structures. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have had guidelines for mandatory RIAs in place for some time, but they have not been applied effectively. Kosovo's Better Regulation Strategy 2017-2021 is in place, but RIAs are at an early stage of development and implementation has been problematic. Albania aims to reduce administrative burdens – particularly the time spent complying with administrative procedures – but does not use RIAs or other tools to systematically evaluate these burdens. Bosnia and Herzegovina recently introduced RIAs but they are still too inconsistently applied and uneven in quality to detect administrative burdens in all new legislation effectively. In Bosnia and Herzegovina, the Republika Srpska conducted a regulatory guillotine from 2005 to 2006 and it did reduce some bureaucracy, but has not conducted a follow-up since. The Federation of Bosnia and Herzegovina implemented a strategy for regulatory reform between 2013 and 2016, but it did not significantly reduce administrative burdens (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In general, it is not burdensome to start a business in any of the SEE economies except the Federation of Bosnia and Herzegovina, where business registration has become more burdensome and complex: 65 days to complete 12 procedures in 2017, compared to 35 days in 2015 (World Bank, 2017). The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have taken some steps to digitalise land registrations

and construction permits. In fact, the Former Yugoslav Republic of Macedonia has fully digitalised the whole application process for construction permits and no longer accepts paper-based applications. However, closing companies remains burdensome and time-consuming in the Former Yugoslav Republic of Macedonia, usually taking more than 600 days (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Across all six SEE economies, less than half the businesses polled by the 2017 *Balkan Barometer* survey were satisfied with public services for businesses (Figure 16.13). However, more than half of the citizens polled in three SEE economies indicated that public administrative procedures were efficient (Figure 16.14).

Figure 16.13. **Business satisfaction with public services for businesses (2017)**

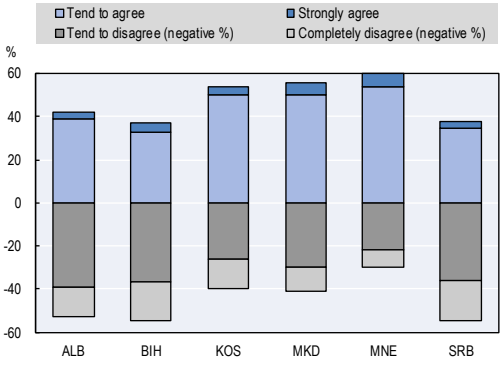


Note: Full question: Could you please tell me how satisfied you are with public services for businesses?

Source: Regional Cooperation Council (2017a), *Balkan Barometer 2017: Business Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

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Figure 16.14. **Degree to which citizens agree that public administrative procedures are efficient (2017)**



Note: Full question: Do you agree that the administrative procedures in public institutions are efficient?

Source: Regional Cooperation Council (2017b), *Balkan Barometer 2017: Public Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_PublicOpinion_2017.pdf.

StatLink http://dx.doi.org/10.1787/888933707190

The way forward for service delivery

Four of the SEE economies should continue to modernise and digitalise their public services. Bosnia and Herzegovina should continue to implement its Strategy for Public Service Delivery and Digitalisation (part of the Public Administration Reform Strategy) and should pursue ways to depoliticise and defragment reforms at all administrative levels. In the Former Yugoslav Republic of Macedonia, the Ministry of Information Society and Administration should assign a specialised unit to improve administrative service delivery. Kosovo should prioritise and support the digitalisation of services. It should use its public services inventory to provide standardised information about public services to inform decisions on future digitalisation. Albania should reinforce its "digital first" principle through a holistic approach to digitalisation, including digital skills training and awareness raising among the general population (OECD, 2017a, 2017b, 2017c, 2017d).

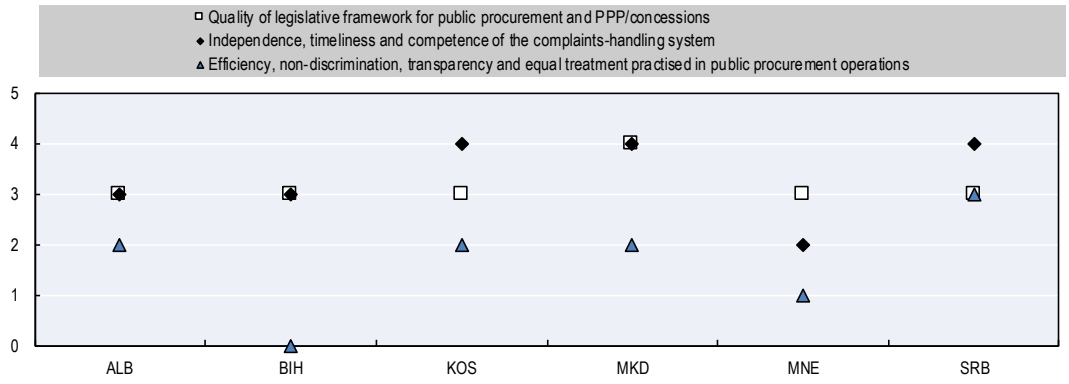
The Former Yugoslav Republic of Macedonia and Montenegro should further strengthen centralised approaches to reduce administrative burdens facing businesses and citizens. The Former Yugoslav Republic of Macedonia should develop a comprehensive service delivery strategy, linked to a government-wide ICT strategy, within an overarching framework for administrative simplification. Montenegro should continue to systematically collect feedback from businesses and citizens for creating and implementing a government-wide road map for simplification. It should scrutinise its RIAs to ensure that proposed legislation does not impose additional administrative burdens (OECD, 2017d, 2017e).

Public procurement

Public procurement is the way governments purchase goods, services and works; as such, it is a critical element of public financial management. A substantial proportion of taxpayers' money is spent through public procurement, including public-private partnerships (PPPs) and concessions. It significantly affects the delivery of public services, such as the provision of infrastructure and educational facilities, and also creates business opportunities for the private sector. It also has the potential to advance socio-economic and environmental objectives. To ensure high-quality service delivery, governments must design an effective public procurement framework and implement public procurement efficiently, employing high standards of conduct. Three indicators assess public procurement performance: 1) the quality of the legislative framework for public procurement and PPP/concessions; 2) the independence, timeliness and competence of the complaint-handling system; and 3) the efficiency, non-discrimination, transparency and equal treatment practised in public procurement operations.

In 2016, public procurement amounted to a significant share of gross domestic product (GDP) in the SEE economies: 7.4% in Albania, 13.7% in Kosovo and 8.0% in Serbia (OECD, 2017a, 2017c, 2017f). The six economies largely have legislative frameworks for public procurement and systems for handling complaints and correspondingly score the highest in these indicators (Figure 16.15). Practising their public procurement operations efficiently and transparently is more of a challenge as reflected in the indicator's lower scores. Across all areas, the Former Yugoslav Republic of Macedonia and Serbia perform best: Serbia is the strongest of the six economies for its public procurement operations, while the Former Yugoslav Republic of Macedonia performs particularly well in its legal framework for public procurement. Bosnia and Herzegovina has the most room for improvement, especially in public procurement operations.

Figure 16.15. **Public procurement: Sub-dimension indicator scores**



Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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Legislative frameworks for public procurement are becoming more aligned with EU directives, but gaps remain

Sound legislative frameworks for public procurement lay the foundations for efficient and transparent public procurement operations and high-quality public service delivery. Given the six SEE economies' objective of European integration, the EU *acquis* is a good guide for legislation. SIGMA Principle 10 in the area of public financial management is as follows: "Public procurement regulations including public-private partnerships and concessions are aligned with the European Union *acquis*, include additional areas not covered by the *acquis*, are harmonised with corresponding regulations in other fields and are duly enforced" (OECD, 2017h).

In all six of the SEE economies, legal frameworks for public procurement are largely aligned with the EU *acquis*. However, no SEE economy has fully aligned the scope of their public procurement legislation with the *acquis* – encompassing the procurement directives on classic (2014/24/EU), utilities (2014/25/EU) and defence (2009/81/EC) fields. Legislation for procurement in the classic and utilities sectors in Albania, the Former Yugoslav Republic of Macedonia, Kosovo and Serbia is largely harmonised with the 2004 EU public procurement directives. In Bosnia and Herzegovina, and Serbia the application of domestic preferences is incompatible with the *acquis*. Serbia's national rules largely cover the provisions of the Defence Directive, while Albania has not implemented the Defence Directive. In Montenegro, defence procurement is no longer regulated by the law on public procurement and does not follow the basic principles set out in the Treaty on the Functioning of the European Union. Kosovo and the Former Yugoslav Republic of Macedonia have not transposed the Defence Directive into national law. None of the six assessed economies has fully transposed all the provisions of the 2014 EU public procurement directives on classic and utility fields, although Serbia has set up a working group to develop new legislation to address this. The personal and

material scope of public procurement legislation in the SEE economies is also not fully aligned with the EU *acquis*. While Bosnia and Herzegovina leads its SEE neighbours in this area, it has exemptions for natural and legal monopolies, which are not in line with the *acquis*. In Montenegro, because the definitions of public works contracts and public services contracts do not fully reflect the terms in the *acquis* it lags behind its peers in this area (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The SEE economies, particularly Albania, Kosovo and Serbia, have not fully aligned key criteria for public procurement procedures – including open, restricted, competitive and negotiated – with EU directives. For example, the regulatory framework in Albania deviates over thresholds, time limits, selection criteria and award methodologies. Most of the main elements on publication and transparency, such as publication of contract notices and awards, are in place in the SEE economies, but Kosovo lacks clear and detailed guidance on how to avoid conflicts of interest in public procurement operations (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The SEE economies are beginning to put key elements in place over the choice of participants and awarding of contracts, with Montenegro and Serbia leading the way. The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have the most developed choice of procedural options for contracting authorities although some of the procedures provided in the EU directives are not yet available (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The SEE economies mostly meet the key criteria for advertising public procurement procedures: contract notices with essential details are published in the national official journal or public procurement portal, and exceptions are only allowed in specifically defined situations. Their procedures for awarding contracts are largely aligned with the EU *acquis*, although some points still do not comply with EU law (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

All six SEE economies have legislative frameworks which facilitate the participation of small and medium-sized enterprises (SMEs) in public procurement to some degree, though less so in the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro. For greater detail on the factors which facilitate SME participation in public procurement in the SEE economies, see the *SME Policy Index* (OECD et al., 2016).

Albania, Kosovo and Serbia have mostly aligned their legal frameworks for the procurement of concessions and PPPs with the EU *acquis* although gaps remain with the new Concessions Directive (2014/23/EU). Notably, the PPP law in Kosovo includes a procedure to allow the initial request for proposals to be changed, which may lead to violations of the principle of equal treatment. The legal framework for concessions and PPPs in the Former Yugoslav Republic of Macedonia covers works and services in accordance with the principles of transparency, non-discrimination, proportionality, efficiency, equal treatment and mutual recognition. However, provisions on the award of PPPs are not aligned with the Concessions Directive. The current legal framework for concessions and PPPs in Bosnia and Herzegovina is highly fragmented and not in line with the *acquis*. Montenegro has developed a draft PPP law but has not adopted it yet (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Complaint-handling systems are in place, but implementation remains weak

Access to justice through an independent, transparent and efficient remedies system allows aggrieved parties to address alleged breaches in public procurement processes. Legislated mechanisms for handling complaints in line with EU directives and the

institutional set up are fundamental for the performance of the review system. SIGMA Principle 12 in the area of public financial management is as follows: "The remedies system is aligned with the European Union *acquis* standards of independence, probity and transparency and provides for rapid and competent handling of complaints and sanctions" (OECD, 2017h).

The SEE economies' review and remedies systems for public procurement are largely in line with the requirements of the *acquis* but a few provisions have not been transposed. Time limits for challenging procurement decisions are in line with the *acquis* requirements in four of the SEE economies, but in Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia they are too short. Mechanisms to avoid ineffectiveness of contracts are also mostly in place, although only Bosnia and Herzegovina has provisions for alternative penalties that are fully aligned with the *acquis*. Only Albania and Kosovo lack legal provisions to ensure effective and timely implementation of the review body's resolutions. In all the SEE economies except Serbia, the decisions of the review body can be challenged in court (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Review bodies – institutions that resolve public procurement procedure disputes in the first instance – in the six SEE economies are largely independent and only accountable to the assembly and parliament. The laws and amendments on public procurement which define their responsibilities and composition have elements which facilitate their independence. In Albania, this is a recent change, as the review body was previously responsible to the prime minister. The SEE economies also have mechanisms in place to ensure the independence of members of the review body. In Kosovo however, members of the review body board may be removed if they act in a way that is contrary to professional ethics. Such a vague provision risks being used inappropriately (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The SEE economies largely have the review bodies' organisational structure and procedures in place, though less so in Montenegro. However, Bosnia and Herzegovina has no formal co-ordination mechanisms to ensure coherent decision making across its three review body offices. In Serbia, the review body uses specialised software to automate case-file management. In the second half of 2016, Kosovo created an internal document management system, which aids the preparation of annual reports and improves the tracking of active cases (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Apart from Bosnia and Herzegovina, all of the SEE economies publish the decisions of their review bodies and information about formal requirements for lodging a complaint without delay. In Bosnia and Herzegovina only decisions are published, and then months after they are adopted. In all the SEE economies except Montenegro the databases of review body decisions on procurement cases have some search functions. However, they mostly lack a free text search option. This hinders their effective use by limiting the type of analysis possible (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

An economic operator with a legal interest in the public procurement award procedure, who has or may suffer damage as a consequence of a possible violation of the public procurement law, may initiate a case appealing against the procedure. However, the associated fees are set at levels which do not facilitate access to justice in the assessed economies but to a lesser extent in the Former Yugoslav Republic of Macedonia. In Kosovo and Serbia, recent fee increases were followed by a reduction in the number of complaints submitted. Despite the higher fee level, the number of complaints filed in Albania has been increasing steadily – which is a serious issue. Albania has issued a

guidance note to attempt to address about 60% of complaints which concern tenders for security (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The median length of time to resolve a complaint in all but two of the SEE economies falls between one and three months. In Bosnia and Herzegovina, the median length was under a month, but the shortage of staff and technical resources combined with an increased number of complaints is likely to reduce the quality and efficiency of the review bodies' decisions. In the Former Yugoslav Republic of Macedonia, in most cases, a decision needs to be made within 15 days of the receipt of the dossier – in practice, the average time taken is 10 days (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

A SIGMA analysis of a sample of decisions by the review bodies found that they were based on the applicable law(s) and reflected the principles of transparency, competition and equal treatment in all the SEE economies except Bosnia and Herzegovina. However, in Kosovo the decisions do not always contain a clear rationale, as they tend to concentrate on the arguments expressed by the parties rather than explaining the reasoning behind the decision. In Albania, the sample of decisions varied more widely in quality (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Tenders and awards for concessions and PPPs are subject to the same review and remedies systems as public procurement in most of the SEE economies. The exceptions are Bosnia and Herzegovina – where there are laws addressing concessions at the state and entity levels – and Montenegro – where there is no system for concessions or PPPs. The laws at all administrative levels in Bosnia and Herzegovina do not include certain provisions, such as the deadlines for lodging complaints, the time limits for deciding disputes and whether the procedure allows for or obliges the decision-making body to take "rapid and effective" decisions (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Public procurement operations require strengthening

To deliver high-quality services from a competitive supply market, contracting authorities need to be adequately staffed and resourced, and work according to regulations and good practice. Key elements of public procurement procedure performance include planning, transparency, modern methods, contract management and integrity. Accordingly, SIGMA Principle 13 in the area of public financial management states: "Public procurement operations comply with basic principles of equal treatment, non-discrimination, proportionality and transparency, while ensuring the most efficient use of public funds and making best use of modern procurement techniques and methods" (OECD, 2017h).

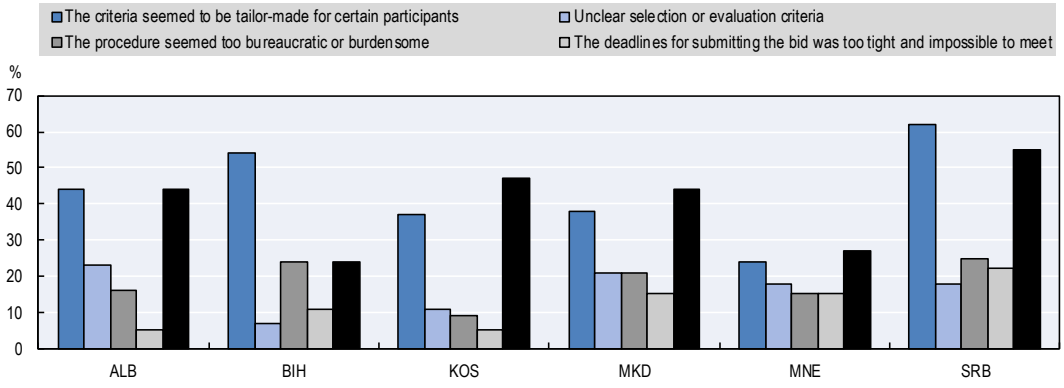
The SEE economies lack the key elements in the planning process for public procurement described above, especially Bosnia and Herzegovina, and Serbia. In Bosnia and Herzegovina, the public procurement law requires procurement plans to be published on the contracting authorities' websites, but in practice not all contracting authorities have a website. In the Former Yugoslav Republic of Macedonia and Kosovo, the contracting authorities are obliged to draft an annual procurement plan, but because these plans do not have to be published, they are not. As a result, economic operators do not have access to these plans and cannot benefit from them. In Albania, Montenegro and Serbia contracting authorities are required to adopt an annual procurement plan and to publish it, and this is usually done. However, in Bosnia and Herzegovina, Montenegro and Serbia, the provisions of the 2014 EU Public Contracts Directive (2014/24/EU) and Utilities Directive (2014/25/EU) concerning preliminary market consultations are not provided in

the legislation nor are they reflected in practice (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The contracting authorities in the SEE economies generally use the cost estimation methods set out in their legislation and they launch procedures after ensuring that funding can reasonably be expected, albeit to a lesser degree in Bosnia and Herzegovina, and Serbia. However, their use could be improved across the assessed economies. For example, Kosovo has comprehensive public procurement rules on determining estimated values which comply with the *acquis*. Even so, Kosovo still has significant problems with budgeting in practice; for example, budget allocations and the estimated values of a contract are often determined by using outdated budgetary forecasts instead of realistic market prices (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Across all six SEE economies, businesses polled by the 2017 *Balkan Barometer* survey reported that their reasons for not taking part in public procurement related to the quality of the tender and fairness of the procedure (Figure 16.16). The most popular reasons given were "the criteria seemed to be tailor-made for certain participants" and "the deal seemed to have been sealed before the tender was published".

Figure 16.16. **Reasons businesses did not take part in public procurement (2017)**



Note: Full question: In the past three years, has your company decided not to take part in a public tender or a public procurement procedure? If yes, why?

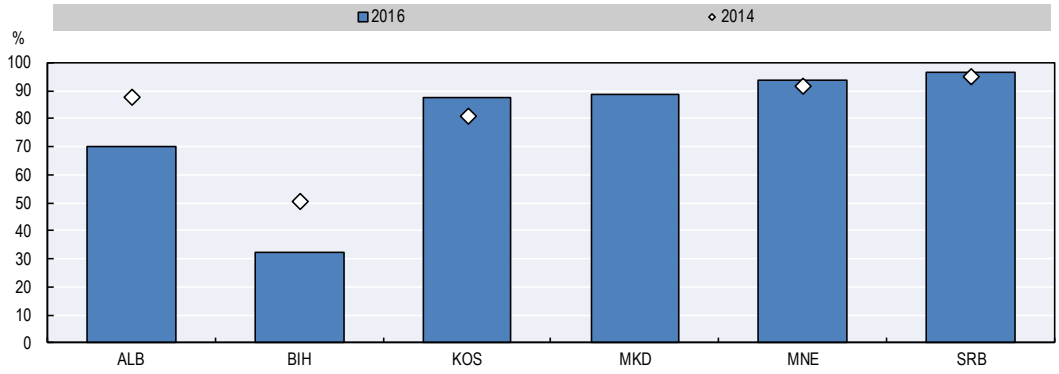
Source: Regional Cooperation Council (2017a), *Balkan Barometer 2017: Business Opinion Survey*, www.rcc.int/seeds/files/RCC_BalkanBarometer_BusinessOpinion_2017.pdf.

StatLink http://dx.doi.org/10.1787/888933707228

Five of the assessed SEE economies, with the exception being Bosnia and Herzegovina, awarded most of their public procurement contracts through competitive procedures in 2016 (Figure 16.17). All six economies use open procedures, and these make up the largest proportion of competitive procedures in Kosovo, Montenegro and Serbia. In Albania, proposal requests are the most common competitive procedure. The number of participants in competitive procurement procedures remained fairly high in Kosovo and Albania, averaging 5.4 and 4 per procedure respectively in 2016. Meanwhile, in Serbia only 2.9 tenders were submitted for each competitive procedure on average, and just 2.2 in Montenegro. A large share of procedures only received a single tender: more than 35% in Bosnia and Herzegovina, Kosovo, Montenegro and Serbia (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

In all six SEE economies the contracting authorities overwhelmingly awarded contracts based solely on the "lowest-price" criterion: 98% in Albania, 99% in Kosovo, over 90% in Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia, 87% in Serbia and over 60% in Montenegro. The "most economically advantageous" tender criterion is hardly ever used, even though the laws on public procurement in the SEE economies contain no limitations or restrictions on its use (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Figure 16.17. **Share of contracts awarded by competitive procedures (2014 and 2016)**



Note: Data for the Former Yugoslav Republic of Macedonia in 2014 are unavailable.

Source: OECD (2017a), *Monitoring Report: Albania*, www.sigmaweb.org/publications/Monitoring-Report-2017-Albania.pdf; OECD (2017b), *Monitoring Report: Bosnia and Herzegovina*, www.sigmaweb.org/publications/Monitoring-Report-2017-Bosnia-and-Herzegovina.pdf; OECD (2017c), *Monitoring Report: Kosovo*, www.sigmaweb.org/publications/Monitoring-Report-2017-Kosovo.pdf; OECD (2017d), *Monitoring Report: The Former Yugoslav Republic of Macedonia*, www.sigmaweb.org/publications/Monitoring-Report-2017-the-former-Yugoslav-Republic-of-Macedonia.pdf; OECD (2017e), *Monitoring Report: Montenegro*, www.sigmaweb.org/publications/Monitoring-Report-2017-Montenegro.pdf; OECD (2017f), *Monitoring Report: Serbia*, www.sigmaweb.org/publications/Monitoring-Report-2017-Serbia.pdf.

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Among the SEE economies Serbia has the most advanced regulatory framework and makes the most use of framework agreements – agreements between one or more contracting authorities and one or more economic operators to establish the terms governing contracts to be awarded during a given period. In 2016, it concluded a total of 2 199 framework agreements to a total value of RSD 42.7 billion (Serbian dinars, approximately EUR 340 million). While the Former Yugoslav Republic of Macedonia's law on public procurement provides for the use of framework agreements, their use has fallen following a new requirement to obtain prior approval for agreements involving fewer than seven economic operators. Albania and Serbia have regulations in place for centralised purchasing, which is in use. The remaining four economies have legislation for centralised purchasing, but rarely use it (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The Former Yugoslav Republic of Macedonia has a comprehensive e-procurement system to facilitate the use of modern procurement techniques. In 2016, almost half of all procedures were conducted through e-procurement. In Albania, the e-procurement system is a web-based platform in Albanian and English that enables the electronic processing of public procurement and concession procedures, including the publication of contract notices, downloading and uploading of tender documentation and tender submissions, and

e-archiving. The platform has benefitted the public procurement system in many ways, most visibly through increased transparency, easier access, simplification, lower transactions costs, and improved data collection and monitoring. All contracting authorities are mandated to use the system for all transactions above ALL 100 000 (Albanian lek, EUR 740). The development of e-procurement systems is less advanced in the other SEE economies. In Serbia, e-noticing and e-tender documentation are in place but contracting authorities rarely accept the e-submission of tenders. Kosovo has introduced an e-procurement platform and its mandatory use is being phased in over several years. However, it has faced significant challenges, including the need to train staff at government institutions and economic operators in its use, to adopt supporting secondary decrees, and to prevent sudden technical defects (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Contract management is a weak part of the procurement process in all six SEE economies. The contracting authorities generally do not use contract management systems and do not review the results of previous contract executions when preparing the next procurement procedures (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Montenegro and Serbia conduct integrity training programmes for procurement staff in the public sector and have adapted general public-sector integrity tools to the specific risks of the procurement cycle. The other four SEE economies have less well-developed integrity training and tools tailored to public procurement (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

The way forward for public procurement

All six of the SEE economies should further develop laws and implementing regulations on public procurement by harmonising them with recent EU procurement directives. Bosnia and Herzegovina, and Serbia should abolish any preference system for domestic bidders and goods of domestic origin. Several economies should reorient their legislation and practices towards value for money: Bosnia and Herzegovina should amend the public procurement law and secondary legislation to remove provisions on using the lowest price as the only criterion when awarding public contracts, Albania should reorient secondary legislation from focusing on procedures, and the Former Yugoslav Republic of Macedonia should also amend the law on public procurement to remove or reduce the penalties for procurement officials for non-compliance with procedural and other requirements. When appropriate, grant contracting entities in Albania should be given more flexibility and discretion to manage procurement operations. Albania, the Former Yugoslav Republic of Macedonia and Kosovo should transpose and implement the provisions of the Defence Procurement Directive (2009/81/EC; OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Five of the SEE economies should further develop their concession and PPP procurement laws by harmonising them with the EU Concessions Directive (2014/23/EU). Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo, Montenegro and Serbia should adopt a PPP law aligned with the Concessions Directive. Bosnia and Herzegovina should harmonise and eliminate overlaps and inconsistencies in the legal framework for public procurement across all administrative levels. Montenegro should establish a review and remedies system for concessions and PPPs (OECD, 2017b, 2017c, 2017d, 2017e, 2017f).

Half of the SEE economies should strengthen their legislation on remedies for public procurement by fully aligning it with the EU Remedies Directive (2007/66/EC). Serbia and the Former Yugoslav Republic of Macedonia should amend their public

procurement laws. Albania should align its review mechanism and explicit standstill period (time between the award and signature of a public contract) (OECD, 2017a, 2017d, 2017f).

Four of the SEE economies should build the capacity of their review bodies and, in two economies, their administrative courts. Albania and Montenegro should ensure that their review bodies have the necessary resources including staff, premises and equipment. Albania, Bosnia and Herzegovina, Kosovo, and Montenegro should build the capacity of their review body staff. The Former Yugoslav Republic of Macedonia and Montenegro should increase specific public procurement trainings for administrative court staff. Montenegro should also build the capacity of its review body and administrative court to implement EU practices for concessions and PPPs (OECD, 2017a, 2017b, 2017c, 2017d, 2017e).

All six SEE economies should improve their review bodies' procedures. In the Former Yugoslav Republic of Macedonia, the review body should improve its IT system to permit the electronic submission and handling of complaints. Bosnia and Herzegovina should introduce a formal co-ordination mechanism to facilitate uniform and coherent decision making across the three review bodies and the competent decision-making bodies should establish a review system for decisions on the award of concessions and PPPs. In Albania, review procedures should be clarified and simplified, particularly around the time limits and stages in the process. Serbia's review body should finalise and implement measures in its action plan to speed up complaint processing. Kosovo's review body should make its electronic case-management system fully operational and establish a mechanism to ensure the consistency of its decisions. It should also fully integrate its website into the e-procurement system, making it possible to make changes in normative acts or in the needs of system users. The review body of Montenegro should analyse the types of errors made by contracting authorities and give feedback to them and policy makers. It should also look at why its decisions are being reversed by the administrative court and update its approach accordingly (OECD, 2017a, 2017b, 2017c, 2017d, 2017e, 2017f).

Bosnia and Herzegovina, and Serbia should make the procurement decisions of their review bodies and administrative courts available. Bosnia and Herzegovina should publish decisions taken by the review body before 2015. Serbia should make administrative court decisions on procurement more accessible, initially giving contracting authorities access to judicial reviews of procurement decisions and ultimately publishing the administrative court's decisions (OECD, 2017b, 2017f).

Four of the SEE economies should strengthen their web-supported search engines of review-body procurement decisions. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo and Montenegro should enable users to browse by the type of problem and to run free text searches (OECD, 2017b, 2017c, 2017d, 2017e).

Half of the SEE economies should make their procurement plans available. In the Former Yugoslav Republic of Macedonia and Kosovo, contracting authorities should be required to publish annual procurement plans on their websites. In Bosnia and Herzegovina, procurement plans and contract modifications should be published in the central public procurement portal (OECD, 2017b, 2017c, 2017d).

Albania and Montenegro should improve the efficiency of various components of public procurement operations. Albania should review its procurement system operations to improve their efficiency and revise or abolish the system for low-value

purchases. Montenegro should reduce the number of contracting authorities to improve procurement management in the remaining authorities (OECD, 2017a, 2017e).

Albania and Serbia should clarify their legislation related to the budget for procurement contracts. Albania should revise its limited fund rules and the approval procedures under the Budget Law for the control and authorisation of procurement transactions. In Serbia, secondary legislation should be clarified to allow participation requests to be issued before the corresponding contract budget has been adopted, without affecting the stipulation that contacts can only be concluded if the budget provides enough funds (OECD, 2017a, 2017f).

Four of the SEE economies should strengthen and expand the use of their e-procurement systems. Albania should continue to develop its e-procurement system to prepare it for e-auctions and a dynamic purchasing system. Montenegro should start implementing e-procurement. Kosovo should assess the legal framework and operations of e-procurement to identify areas of improvement and introduce monitoring functionality in its e-procurement system. Over time it should use e-procurement more widely and further develop the system to include modern purchasing tools such as e-auctions and dynamic purchasing. Serbia should also expand its e-procurement system to include more e-tools such as e-auctions, e-catalogues and dynamic purchasing systems (OECD, 2017a, 2017c, 2017e, 2017f).

Half of the SEE economies should improve procurement procedures and promote the greater use of modern procurement methods such as centralised purchasing and framework agreements. Serbia should analyse why so few economic operators are taking part in public procurement procedures, and develop sector-specific operational tools including model tender documents, standard technical specifications and methods for evaluating tenders. Albania should review its centralised purchasing to consider options outside the Ministry of Interior and should strengthen support for the wider use of framework agreements. Montenegro should promote and introduce joint procurement and centralised purchasing (OECD, 2017a, 2017e, 2017f).

Conclusions

All six SEE economies have made progress in establishing the legal public governance frameworks which are key to laying the foundation for economic growth. They have largely aligned their legal frameworks for public procurement, including the remedies system, with the EU *acquis*. The basic elements for merit-based recruitment of civil servants are in place and procedures to prepare, follow up and communicate government sessions have been set out. However, legislative gaps remain and the full, consistent implementation of existing legal frameworks is a challenge.

All six SEE economies have room to improve important elements of public governance. They still do not consistently base policy making on evidence, which is of a sufficiently high level of quality. As impact assessments and costing estimations are key to designing effective public interventions, the six SEE economies should redouble their efforts in this area. They need to make their public consultations more systematic and rigorous to improve policy design and implementation, as well as to build trust among citizens and businesses. They should reinforce objective recruitment procedures for the civil service with common standards for exams and improve the capacity of selection panels. Most of the SEE economies need an action plan to reduce backlogs in the administrative court of appeals, including an increase in the number of judges and/or legal assistants. All six SEE

economies should continue their efforts to modernise and digitalise public services. As public procurement directly affects service delivery and creates business opportunities, they should continue their plans to improve it and harmonise their corresponding legal frameworks with new EU directives. E-procurement should be further enhanced and the remedies system for public procurement should be strengthened.

Notes

1. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
2. For indicators which have corresponding competences at more than one level of administration in Bosnia and Herzegovina, the assessment assigns the lowest score earned by the relevant level of administration. While the SIGMA assessment for Bosnia and Herzegovina includes Brčko District and levels of administration below the entity level, these levels are not described in this chapter.
3. This involves a systematic cataloguing of all existing regulation in which only those that are justified are retained.

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Annex 16.A1.
Public services: Indicator scores

Table 16.A1.1. **Public services: Indicator scores**

	ALB	BIH	KOS	MKD	MNE	SRB
Policy development and co-ordination						
Quality of government monitoring and reporting	2	1	2	1	4	2
Transparency and legal compliance of government decision making	3	1	3	2	4	3
Evidence-based policy making	1	0	2	1	2	3
Public consultation on public policy	1	0	1	1	3	2
Accessibility of legislation	2	0	2	1	3	3
Human resource management						
Meritocracy and effectiveness of recruitment of civil servants	4	1	3	4	2	2
Integrity of public servants	3	1	3	3	2	3
Accountability						
Fairness in handling of administrative judicial disputes	3	2	3	4	4	3
Functionality of public liability regime	2	2	2	2	4	2
Service delivery						
Citizen-oriented service delivery	3	1	3	3	2	3
Public procurement						
Quality of legislative framework for public procurement and PPP/concessions	3	3	3	4	3	3
Independence, timeliness and competence of the complaints-handling system	3	3	4	4	2	4
Efficiency, non-discrimination, transparency and equal treatment practised in public procurement operations	2	0	2	2	1	3

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Chapter 17.

Anti-corruption policy in South East Europe

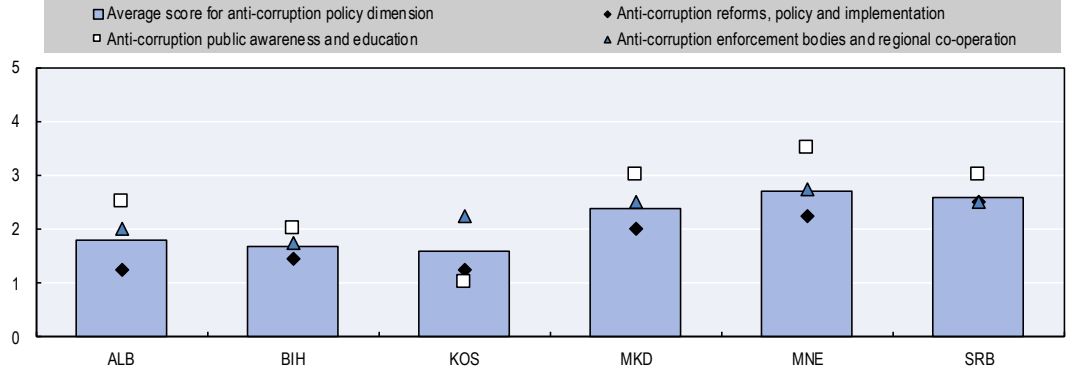
This chapter on anti-corruption policy assesses the policy settings, strategies, processes and institutions in six South East European economies. After a brief overview of trends and performance in the fight against corruption in South East Europe, including the economies' performance against international anti-corruption indicators, the chapter then focuses on five essential sub-dimensions. The first sub-dimension, anti-corruption reforms, policy and implementation, examines anti-corruption policies: how they were developed, including civil society involvement, and how their implementation is monitored. The second, anti-corruption public awareness and education, assesses the extent of government activities in this area. The third, corruption prevention and co-ordination institutions, covers how anti-corruption bodies are organised and their powers and independence guaranteed. The fourth, preventing and managing conflicts of interest and whistleblower protection, considers the frameworks in use and the challenges faced in this area. Finally, the anti-corruption enforcement bodies and regional co-ordination sub-dimension considers whether there are independent and effective enforcement bodies and the frameworks for cross-border action. The chapter includes policy suggestions for enhancing policies in each of these sub-dimensions in order to tackle corruption, which in turn would help to foster greater competitiveness.

Main findings

Corruption imposes a variety of costs on society and can diminish the competitiveness of an economy. It wastes public resources, widens economic and social inequalities, breeds discontent and political polarisation, and reduces trust in institutions. Corruption perpetuates inequality and poverty, affecting well-being and the distribution of income. Moreover, it undermines opportunities to participate equally in social, economic and political life. Corruption can hamper growth, lower the productivity of capital, reduce incentives for innovation and productive labour, and discourage foreign direct investment.

All six assessed SEE economies – Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Kosovo,* Montenegro and Serbia – score an average of around 2.1 for the anti-corruption policy dimension (Figure 17.1). This signifies that in the areas covered by the qualitative indicators they generally have their anti-corruption policy frameworks in place. Montenegro has the highest average score of 2.7, thus nearing the level of active policy implementation. Serbia, with an average score of 2.6, and the Former Yugoslav Republic of Macedonia with 2.4 are also relatively advanced. Nevertheless, the implementation of some elements of the frameworks is more advanced than others. Generally, anti-corruption public awareness and education are more advanced than anti-corruption reforms, policy and implementation; anti-corruption enforcement bodies; and regional co-operation.

Figure 17.1. **Anti-corruption policy: Dimension and sub-dimension average scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Comparison with the 2016 assessment

The six SEE economies continue to face challenges in fully implementing their anti-corruption frameworks. However, compared to the previous assessment, consistent monitoring of the implementation of anti-corruption activities has become almost universal. All of the SEE economies have begun to effectively collect detailed information on the implementation progress of their anti-corruption strategies and action

* This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

plans. They have adopted new laws and established anti-corruption institutions (in Montenegro and the Republika Srpska entity of Bosnia and Herzegovina[1]) or are currently in the process of establishing them (in Albania, the Federation of Bosnia and Herzegovina entity of Bosnia and Herzegovina, and Serbia). Moreover, several of the economies have undertaken crucial first steps to protect whistleblowers. Although their perceived levels of corruption have only modestly improved, their anti-corruption policies demonstrate a certain degree of innovation and learning from international good practice.

Achievements

Most economies have adopted comprehensive anti-corruption policy documents and taken steps to involve civil society in their preparation and monitoring. These documents typically contain clear objectives, concrete tasks and deadlines. They assign responsibilities to implementing bodies and define follow-up mechanisms.

All six SEE economies have made efforts to raise public awareness of anti-corruption issues and to train public officials. Several economies have run extensive campaigns targeting the general public.

All of the economies have assigned clear responsibilities for co-ordinating the implementation of anti-corruption policy documents. They often have sophisticated procedures for appointing the leadership of their corruption prevention and co-ordination institutions in order to ensure transparency and limit the risk of undue political interference.

The economies generally have comprehensive legal frameworks for managing conflicts of interest. All relevant public officials and civil servants are generally covered by conflict-of-interest rules.

Remaining challenges and key recommendations

- **Improve the involvement of civil society in policy development** and preparing draft legislation by outlining the terms of co-operation more clearly, for example for how participating organisations will be selected and for providing feedback on their responses.
- **Ensure more systematic and comprehensive corruption proofing of legislation**. The six SEE economies are still not widely corruption proofing new legislative proposals.
- **Make public awareness-raising activities more sustainable** in those economies where there is insufficient funding from government budgets.
- **Some multi-stakeholder co-ordination institutions should do more to demonstrate their effectiveness**. In several of the economies, stakeholders have indicated that the relevant councils or similar bodies are not proactive and stakeholders generally feel insufficiently involved.
- **Implement the whistleblower protection laws** enacted by all of the SEE economies. The particular challenges vary from economy to economy, but include a lack of public awareness about the options for protection, as well as the need to improve the effectiveness of protective measures.
- **Provide better safeguards to protect anti-corruption investigation units** from undue interference. For instance, they are usually not separated from the regular police hierarchy and several of the anti-corruption investigation or prosecution bodies suffer from staff shortages.

Context

Anti-corruption policy refers to the formal framework as well as the concrete activities for containing and eventually reducing corruption. Anti-corruption strategies are a key driver of sustainable growth and good governance (OECD, 2015). States that are parties to the United Nations Convention against Corruption (UNCAC) are obliged to develop and implement, or maintain, effective co-ordinated anti-corruption policies (UN, 2004).

In recent decades, the negative impact of corruption on growth has been extensively examined (see for example Mauro, 1995). Corruption has been shown to lower productivity of capital (Lambsdorff, 2003), reduce incentives for innovation and productive labour, damage government services, and lower trust in public institutions (OECD, 2015).

Considering the adverse effects of corruption, anti-corruption policy benefits most of the policy areas covered in this publication. However, the topic is particularly relevant to the following chapters:

- **Chapter 1. Investment policy and promotion** can benefit from anti-corruption efforts. Countries with less corruption generally provide a better investment climate and therefore attract more foreign direct investment.
- **Chapter 7. Education and competencies** are 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 bear the cost of corruption. Corruption in education particularly affects the values formed by young people (Transparency International, 2013).
- **Chapter 16. Effective public services** suffer from corruption. Corruption impairs effective tax collection, distorts public procurement and thus reduces the resources available for public services and welfare programmes (Gupta, Davoodi and Alonso-Terme, 2002). In heavily corrupt environments, the government usually only serves those people who pay bribes or have personal connections.

Anti-corruption policy assessment framework

This chapter analyses anti-corruption policy in the six SEE economies. The analysis is not exhaustive but focuses on anti-corruption efforts across five broad sub-dimensions:

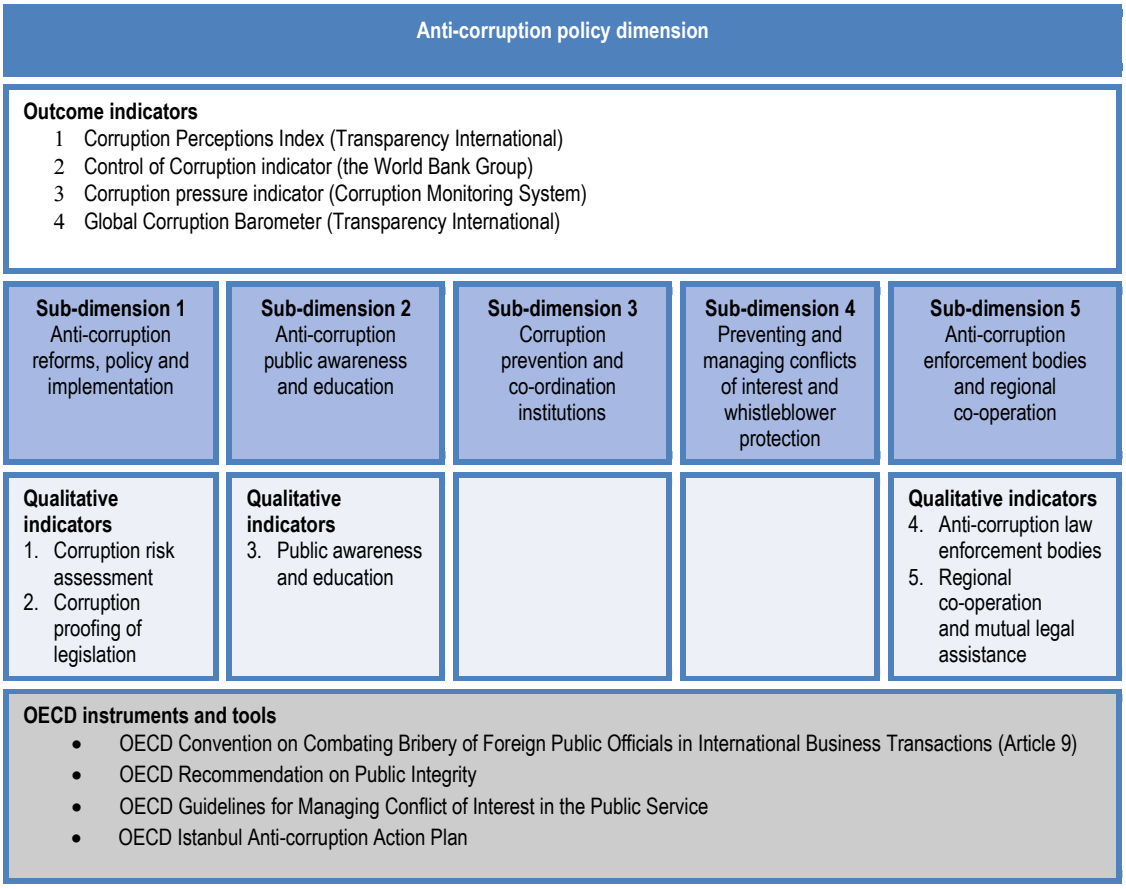
1. Anti-corruption reforms, policy and implementation: what anti-corruption policy documents exist? How were they developed and adopted? How is their implementation monitored and evaluated?
2. Anti-corruption public awareness and education: what public-awareness activities have the government and other stakeholders carried out? Do public officials and other target groups have education and training opportunities on corruption-related issues? Are these activities sustainable and how are they funded?
3. Corruption prevention and co-ordination institutions: how is the co-ordination of anti-corruption policies organised? What powers do prevention and co-ordination institutions have? How are their independence and capacity ensured?
4. Preventing and managing conflicts of interest and whistleblower protection: what is the framework for managing conflicts of interest? What measures are used when conflicts of interest occur? What protection is available for whistleblowers? What are the main challenges in providing protection?

5. Anti-corruption enforcement bodies and regional co-operation: are there specialised anti-corruption enforcement bodies? How are their independence and capacity ensured? What is the framework for international co-operation in anti-corruption matters? What evidence is there for the effectiveness of the framework?

Figure 17.2 shows how the sub-dimensions and their constituent indicators make up the anti-corruption policy assessment framework.

The assessment used qualitative indicators for three of the sub-dimensions (anti-corruption reforms, policy and implementation; anti-corruption public awareness and education; and anti-corruption enforcement bodies and regional co-operation). The other two were assessed through questionnaires based on the OECD instruments and tools for anti-corruption and public integrity listed in Figure 17.2. For the qualitative indicators, public authorities and independent consultants in each of the six SEE economies were invited to score their performance on a scale from 0 to 5, with the results summarised in Annex 17.A1.[2] The results were reconciled and processed by the OECD. For more details on the methodology underpinning this assessment please refer to the methodology chapter.

Figure 17.2. **Anti-corruption policy assessment framework**



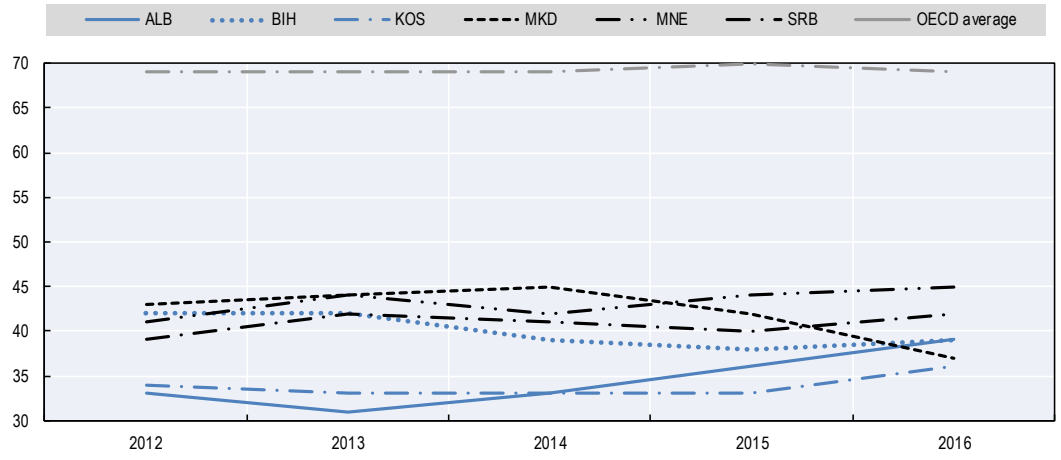
Anti-corruption policy performance in SEE economies

Over recent years, the six SEE economies have reportedly made only minor progress in reducing corruption. The widely cited Corruption Perceptions Index ranks them between 64th (Montenegro) and 95th (Kosovo) out of 176 countries and territories

(Transparency International, 2017). On a scale from 0 (highly corrupt) to 100 (very clean) the six SEE economies scored an average of 40 in 2016, a slight improvement from 39 in 2012. This compares to an average score of 69 for OECD countries in 2016 (Figure 17.3). Albania, Kosovo, Montenegro and Serbia improved their scores over the period 2012-16, while the scores for Bosnia and Herzegovina and the Former Yugoslav Republic of Macedonia got worse.

Figure 17.3. **Corruption Perceptions Index (2012-16)**

Scale from 1 to 100



Note: 1 – highly corrupt; 100 – very clean.

Source: Transparency International (2017), Corruption Perceptions Index 2016, www.transparency.org/news/feature/corruption_perceptions_index_2016.

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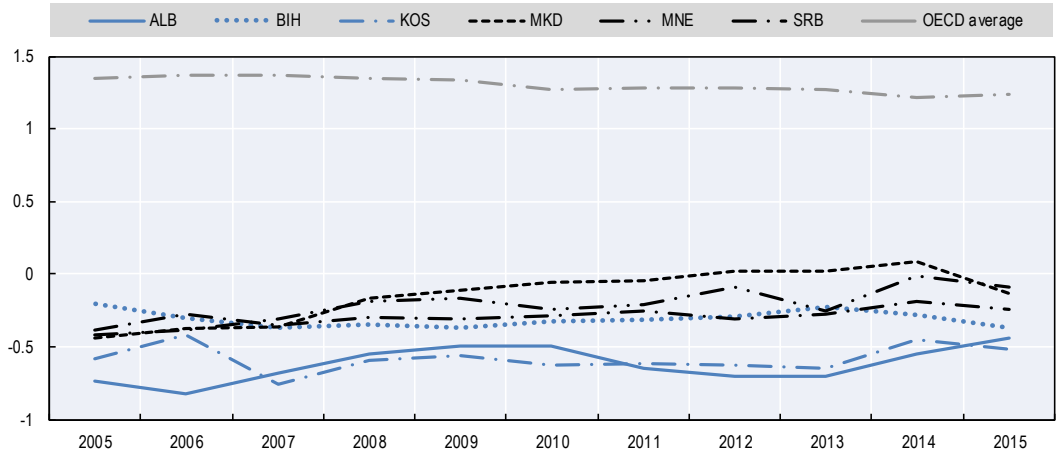
The World Bank's Control of Corruption indicator reveals a similar dynamic (Figure 17.4). On a scale from -2.5 (worst) to +2.5 (best), the six economies improved their average score marginally (from -0.33 to -0.30) between 2012 and 2015. For comparison, the OECD average in 2015 was 1.24. They have made a more substantial improvement on their scores in 2005, however, when they averaged -0.46. Between 2005 and 2015, all of the economies except Bosnia and Herzegovina improved. Both the Corruption Perception Index and Control of Corruption scores suggest that Albania, Montenegro and Serbia have made the most progress.

The regional Corruption Monitoring System of the Southeast Europe Leadership for Development and Integrity (SELDI) coalition has registered a general improvement in corruption since the early 2000s. However, the position remains quite unstable. Between 2014 and 2016, the corruption pressure indicator (the share of citizens reporting having been asked for bribes by public officials) of the Corruption Monitoring System improved in Montenegro and Serbia but worsened in the other four economies. Increasing public demand for good governance has faced continued rent seeking by corrupt officials (Shentov, Stefanov and Todorov, 2016).

The overall regional trend in the experience of bribery is also improving, according to the Global Corruption Barometer of Transparency International, most notably in Albania, the Former Yugoslav Republic of Macedonia and Kosovo (Figure 17.5).

Figure 17.4. **Control of Corruption score (2005-15)**

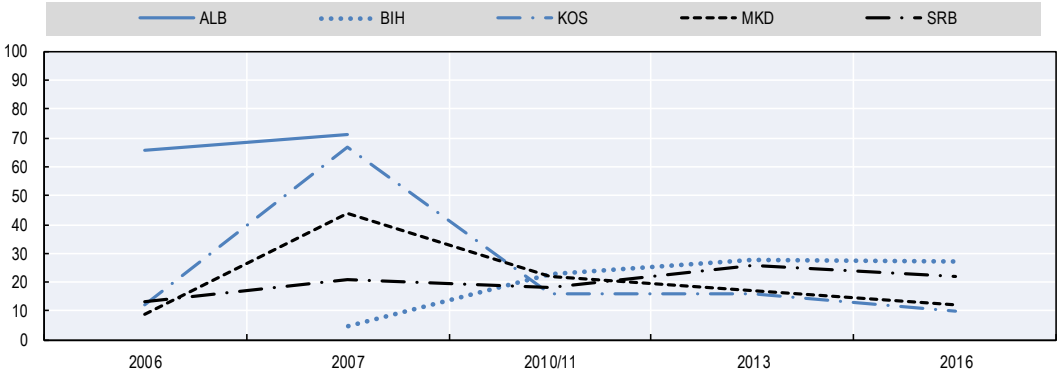
Scale from -2.5 to 2.5



Source: World Bank (2017), *Worldwide Governance Indicators* (database), http://info.worldbank.org/governance/wgi/index.aspx.

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Figure 17.5. **Percentage of households who paid a bribe in the past year (2005-16)**



Note: In Albania, the share was 34% in 2016 (no data in 2010/2011 and 2013). No data for Bosnia and Herzegovina in 2006. No pre-2016 data for Montenegro (16% in 2016).

The exact list of services covered in the surveys varied from year to year. In 2016, the question was: "Did you or any member of your household make an unofficial payment or gift when using these services over the past 12 months? The road police, public agencies issuing official documents, the civil courts, public education (primary or secondary), public education (vocation), public medical care, public agencies in charge of unemployment benefits or any other public agencies in charge of other social security benefits?"

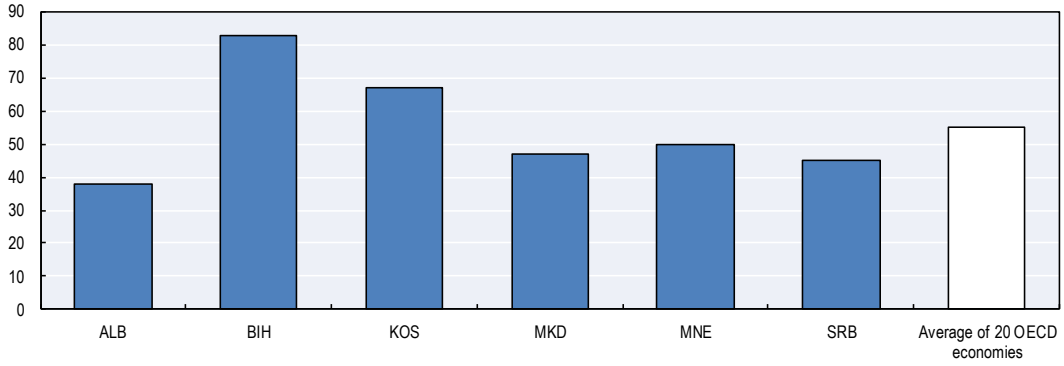
Source: Transparency International (n.d.), "Global Corruption Barometer", www.transparency.org/research/gcb.

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Moreover, there is a contrast between public opinion about the government's fight against corruption and perceived levels of corruption. Although perceived corruption is much worse in the six SEE economies than the OECD average (Transparency International, 2017), in the SEE economies on average 55% of respondents thought that the current government was handling the fight against corruption poorly – the same

average as for 20 OECD countries (Figure 17.6). The public are most sceptical about the government's fight against corruption in Bosnia and Herzegovina and Kosovo – economies which also have relatively high perceived levels of corruption in the region.

Figure 17.6. **Share of respondents who believe their government is poor at fighting public corruption (2016)**



Note: The *Global Corruption Barometer* covered the following OECD countries: Australia, Belgium, the Czech Republic, Estonia, France, Greece, Hungary, Italy, Japan, Korea (South), Latvia, the Netherlands, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom.

Source: Pring, (2016), *People and Corruption: Europe and Central Asia: Global Corruption Barometer,* www.transparency.org/whatwedo/publication/people_and_corruption_europe_and_central_asia_2016; Pring (2017), *People and Corruption: Asia Pacific: Global Corruption Barometer*, www.transparency.org/whatwedo/publication/people_and_corruption_asia_pacific_global_corruption_barometer.

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Anti-corruption reforms, policy and implementation

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 set strategic objectives and immediate goals, and allocate responsibilities for particular tasks, are widely recognised to be the optimal way to frame anti-corruption policies.

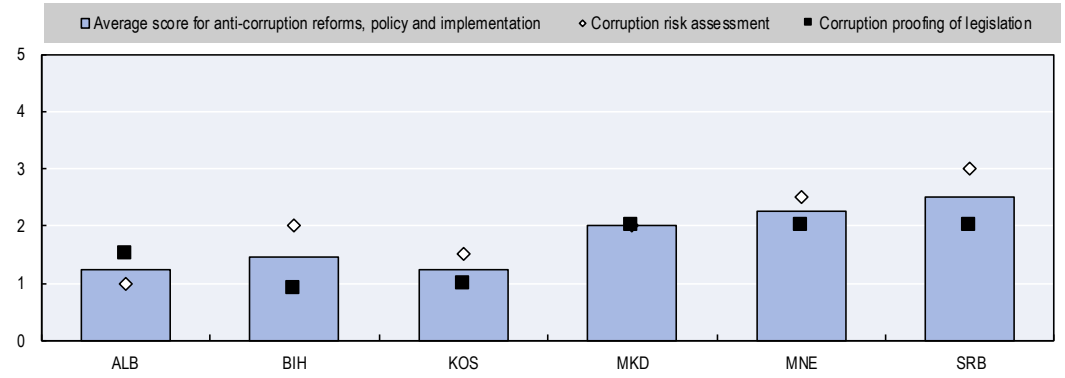
The anti-corruption reforms, policy and implementation sub-dimension comprises two qualitative indicators: 1) the framework and practice of corruption risk assessment; and 2) the corruption proofing of legislation (Figure 17.7).

The results of the assessment of these two indicators are presented in the next section. Two further sections assess two other important issues for anti-corruption policy: civil society involvement and monitoring.

The six SEE economies score 1.8 on average in this sub-dimension, indicating there is scope for further progress, especially on implementation.

These scores indicate that the economies generally have corruption risk assessment procedures in place. Several have introduced them as standard practice in all public institutions. Overall, the Former Yugoslav Republic of Macedonia, Montenegro and Serbia obtain the highest average scores for this sub-dimension. These three economies all have relevant procedures and methodologies to corruption proof laws, with Serbia having accumulated the most extensive practical experience in this area.

Figure 17.7. **Anti-corruption reforms, policy and implementation: Sub-dimension average score and indicator scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

StatLink http://dx.doi.org/10.1787/888933707380

Analysis nevertheless indicates that all the economies should strengthen their efforts to ensure that they systematically follow up their corruption risk assessments with activities to reduce those risks.

Corruption risk assessments are common but there is no routine corruption proofing of legislation

In order to ensure effectiveness and to enable informed adjustments, anti-corruption policies need to contain objective and measurable criteria for measuring progress. A viable policy will also need to be evidence-based in order to ensure that it meets the real needs of the economy and achieves its goals.

The **corruption risk assessment** indicator explores whether the legal and methodological framework for corruption risk assessments has been adopted and implemented in public institutions. The indicator takes into account how systematic the practice is, whether it has become an integral part of organisational activities, and whether it is sufficiently funded and regularly carried out.

All six economies have introduced corruption risk assessments in public institutions or in particular sectors. However, their level of use varies. In some economies, corruption risk assessments represent a crucial stage in the process of developing institutional integrity plans. Such plans are mandatory in Bosnia and Herzegovina, Montenegro and Serbia. As a result, these economies demonstrate the most systematic activity in this area.

Serbia has most experience with institutional integrity plans. By 2014 around 47% of all institutions had adopted an integrity plan (Anti-corruption Agency, 2014). In addition, the Anti-corruption Agency assesses the quality and implementation of a selection of the integrity plans. In Montenegro, according to the Corruption Prevention Agency's 2016 annual report, 674 out of 697 public institutions had fulfilled their obligation to develop an integrity plan as of 31 December 2016 (Corruption Prevention Agency, 2017).

In Bosnia and Herzegovina, as of 31 December 2016, all the state-level institutions had fulfilled or were in the final stage of fulfilling their obligation to develop integrity plans. By May 2017, a considerable proportion of institutions in the Federation of Bosnia and Herzegovina had developed such plans. In the Republika Srpska, the anti-corruption strategy requires all public institutions to develop integrity plans. The entire public sector

should have adopted integrity plans by December 2017. The Ministry of Justice organises training for officials on the development of integrity plans.

While corruption risk assessments are fairly well-established in the SEE region, the **corruption proofing of legislation** is not yet a universal practice, although the trend is improving (see Figure 17.7 above). This indicator evaluates whether the government has established a formal process to corruption proof legislation. In order to ensure it has the desired impact, any recommendations from the corruption-proofing process should lead to effective changes in draft legislation. Ideally, corruption proofing should cover the majority of laws and normative acts, even local regulations. Several of the economies have adopted national corruption-proofing methodologies based on a regional methodology (Hoppe, 2014) and are building their capacities through training and amendments to their strategic documents and legal frameworks.

The Former Yugoslav Republic of Macedonia, Montenegro and Serbia have made most progress in corruption proofing. In the Former Yugoslav Republic of Macedonia, the State Commission for the Prevention of Corruption is authorised to give opinions on proposed draft laws of significance for combating corruption. Accordingly, it has published a methodology for assessing legislation. However, the commission had published only four assessments on its website as of September 2017. In Montenegro, the Corruption Prevention Agency has the power to conduct corruption proofing. It started preparing corruption-proofing opinions based on a methodology developed by an international expert in 2017. It had published seven opinions as of September 2017. In Serbia, the Anti-corruption Agency has carried out more than 100 assessments since 2013, although its conclusions do not need to be considered, and corruption proofing is not generally mandatory for all relevant legislation.

In July 2017, Bosnia and Herzegovina introduced corruption proofing of legislation at the state level through amendments to the Unified Rules for Drafting Legal Acts in the Institutions of Bosnia and Herzegovina. The amendments include the concept of impact assessment in the field of corruption and put the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption in charge of doing so.

Albania has no legislative basis or formal process for corruption proofing legislation. However, it has signed a memorandum of understanding with a non-government think tank to conduct corruption proofing. According to information provided by the National Co-ordinator against Corruption, approximately 55 legal acts had been screened as of early 2017. To date, Kosovo has made significantly less progress towards corruption proofing legislation.

Civil society is generally involved in developing anti-corruption strategies

All six economies have anti-corruption strategies and corresponding action plans. Montenegro differs from the rest in that it has integrated its anti-corruption policy planning into the framework of its accession process with the European Union (EU) and has action plans for the relevant negotiation chapters. The Operational Document for Prevention of Corruption in Areas of Particular Risk accompanies the action plan for Chapter 23 (Judiciary and Fundamental Rights) of its negotiations.

Most of the economies' anti-corruption strategies and action plans set out objectives and specific measures for each objective, designate institutions responsible for implementing each measure, and define timeframes for their implementation and criteria for assessing implementation. However, not all of the economies specify the budget allocation.

All of the economies organised special rounds of consultations, debates or workshops with civil society during the preparation of their strategies and action plans. Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia included civil society representatives in the working groups which actually drafted the plans. Drafters in all of the economies set up channels for receiving input from civil society and provided opportunities for civil society actors to voice their views.

Despite this, stakeholders raised two areas of grievance. First, in some of the economies, Albania, Kosovo and Montenegro, stakeholders openly regretted that they got no feedback as to whether their comments and proposals were incorporated into the final policy documents. In the case of Montenegro, some non-government organisations (NGOs) formally complained that they were not consulted. Discussions with stakeholders in the Former Yugoslav Republic of Macedonia led to the conclusion that a clearer outline of the role of the various stakeholders (including state agencies) in all stages of preparing the policy planning documents would ensure more comprehensive participation.

Overall, where civil society stakeholders were involved in the actual drafting of policies rather than just in debates, the number and intensity of grievances were reduced. Permanent institutional arrangements (such as the Thematic Group on Anti-corruption Policies in Albania) can generally be considered good practice for both developing anti-corruption policies and monitoring their implementation.

Monitoring of anti-corruption policies is mostly limited to outputs rather than outcomes

The six SEE economies have set up systems to monitor the implementation of the actions envisaged in the relevant anti-corruption plans. Typically the implementing bodies report to a co-ordinating body. In most of the economies (except Albania and Montenegro) their specialised anti-corruption agencies gather the information from all the implementing institutions. The latter, which may be numerous, typically have designated individuals who are responsible for reporting. The co-ordinating body compiles the information, and prepares and publishes regular progress reports.

In the Former Yugoslav Republic of Macedonia, the methodology for monitoring and evaluating the anti-corruption action plan is described in the State Anti-corruption Programme. The competent institutions – those directly implementing the activities – have fixed deadlines for reporting to the State Commission for Prevention of Corruption. The institutions appoint individual representatives who submit implementation information on their behalf.

In Montenegro monitoring is organised differently – it is carried out directly by working groups within the framework of its EU accession negotiations. In March 2014, the government of Montenegro established the Council for the Rule of Law as the high-level body to oversee all relevant activities and address potential challenges.

Overall, monitoring is efficient in most of the SEE economies. The exception is Bosnia and Herzegovina, where the state-level Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption has not yet been able to enforce the requirement for institutions to report on progress in implementing the Anti-corruption Strategy. Out of around 75 state-level institutions, some 25 had not submitted their implementation reports at the time of this assessment. Hence the status of implementation remains unclear.

In substance, monitoring is mostly limited to measuring outputs – the assessment of outcomes and impact is rare. For instance, Albania's monitoring matrix includes eight reporting sections for each activity, including implementation status, descriptions of key achievements per output indicator, planned steps for implementing the measure, and disbursed funds for specific activities and their source. In Kosovo the reporting matrices include quantitative and qualitative indicators, where the quantitative data reflect the number of measures implemented in each sector. Montenegro uses both result and impact indicators, but its impact indicators are generally basic and are missing for some activities. Many of the indicators lack baseline and target values, which makes them hard to monitor since there are no clear benchmarks against which to assess the results and impact (Government of Montenegro, 2015). Serbia has introduced additional monitoring reports commissioned from civil society actors selected by competition.

The way forward for anti-corruption reforms, policy and implementation

The six economies, but particularly Albania, Kosovo and Montenegro, should **ensure that non-government stakeholders participating in developing anti-corruption policies receive comprehensive feedback** on which of their proposals were taken into account and why. This could be done by publishing all proposals online with remarks about whether and why they were adopted or rejected.

Bosnia and Herzegovina should **consider options to strengthen institutions' compliance with their obligation to report on progress in implementing the Anti-corruption Strategy.** Creating and disseminating attractive infographics summarising the current status of compliance could be an effective approach for informing the general public.

Albania, the entities of Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Kosovo should **ensure more systematic assessments of corruption risks in public institutions**, for example by obliging anti-corruption bodies to review a sample of institutions annually to determine whether they have assessed their corruption risks. Moreover, they should explicitly define corruption as one of the main risk areas in general risk-management systems.

Albania, Bosnia and Herzegovina and Kosovo should **systematically corruption proof their legislation** by adopting a corruption-proofing methodology and making its use mandatory for the most relevant legislation. The other economies should strengthen their existing corruption proofing of legislation by ensuring that all relevant legislation is assessed against criteria set in the proofing methodology and making it mandatory to consider the findings.

Anti-corruption public awareness and education

Tackling corruption effectively fundamentally relies on intolerance of corruption amongst the general public and public officials. Key practices, such as reporting corruption to competent bodies or punishing corrupt candidates at the ballot box, depend on people being hostile to corruption. The objective of anti-corruption public awareness and education is to create a culture in which corruption is not perceived to be the norm in public service provision. Anti-corruption public awareness and education are also essential to provide practical knowledge on how to act in order to avoid corruption.

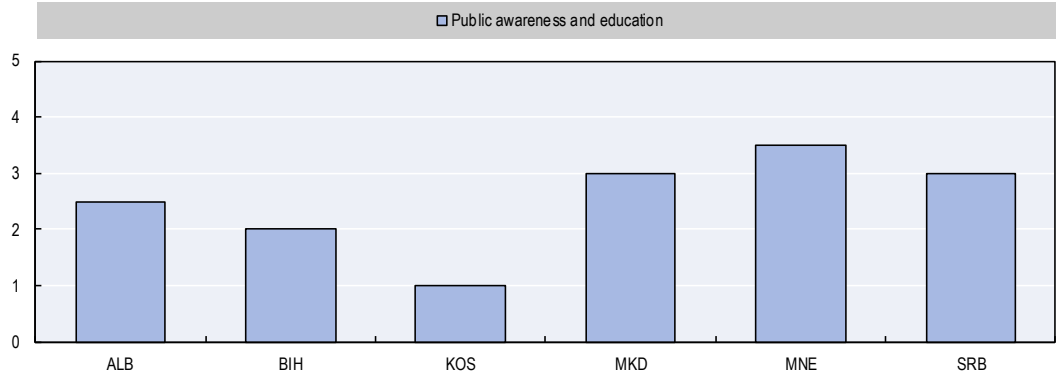
The OECD Recommendation on Public Integrity highlights the need to foster public awareness of and education about anti-corruption and overall integrity. It emphasises the importance of "a whole-of-society culture of public integrity" and the provision of

"sufficient information, training, guidance and timely advice for public officials to apply public integrity standards in the workplace" (OECD, 2017).

The anti-corruption public awareness and education sub-dimension has one qualitative indicator, public awareness and education, which assesses the extent of government engagement in awareness raising and education activities. In particular, it considers whether the government produces easily accessible materials, allocates specific funding, monitors the effectiveness of awareness-raising campaigns and adjusts them accordingly, and develops and supports anti-corruption education programmes (Figure 17.8).

As shown in Figure 17.8, all six SEE economies have engaged in awareness-raising activities. The level of activity and available resources vary across the economies, however, with the Former Yugoslav Republic of Macedonia, Montenegro and Serbia achieving a score of 3 or higher.

Figure 17.8. **Anti-corruption public awareness and education: Sub-dimension scores**



Note: See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Awareness raising continues to rely predominantly on international funding

In recent years, all six of the economies have engaged in public awareness-raising campaigns, including "Show the Real Face of Corruption – Denounce the Invisible so Visible" in Albania and "Not a Cent for a Bribe" in Montenegro. Kosovo has broadcast TV clips of the President, Chief State Prosecutor, the Head of Kosovo Police, the Director of the Anti-corruption Agency, and the Chairman of the Kosovo Judicial Council asking citizens to report corruption and be part of the anti-corruption effort. Serbia has also carried out a similar campaign, using print and electronic media, as well as social networks. The Regional Anti-corruption Initiative recently commissioned a regional documentary promoting whistleblowing, *The Medal of the Loud*, featuring stories from Albania, Bosnia and Herzegovina, Croatia, and Serbia.

The effectiveness of these activities has been limited, however, notably by a lack of continuity and national funding, with most of them currently funded by international donors. Some of the campaigns mentioned above were completed several years before this assessment (for example, Kosovo's in 2014 and Serbia's in 2013). They were not part of a broader government communication strategy, instead reflecting momentum and opportunities at that particular moment.

Bosnia and Herzegovina report that the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption has no specific budget for awareness raising. Kosovo has no budget for raising awareness and public education, and there is no clear evidence of state funding for such activities in Albania. Montenegro and Serbia have funded some awareness-raising activities from state budgets. The Former Yugoslav Republic of Macedonia has introduced anti-corruption education in schools supported by joint contributions (funding and other resources) from the State Commission for the Prevention of Corruption, an international donor and an NGO.

Moreover, monitoring and evaluation of the effectiveness of such activities remain rare. Montenegro has the highest score on the public awareness and education indicator, in part because of its good practice in measuring the impact of the Not a Cent for a Bribe campaign. It used a survey question to measure how many citizens were familiar with the campaign and how many believed that these campaigns encouraged citizens to counter corruption.

Training in anti-corruption needs to become a permanent feature throughout the region

Several of the economies provide anti-corruption training for certain categories of public officials and civil servants in general. The Former Yugoslav Republic of Macedonia reports that the Academy for Judges and Public Prosecutors runs training programmes; the Ministry of Information Society and Administration has annual generic training programmes for civil servants that include courses on anti-corruption topics; the Ministry of Finance offers training on risk assessment and management; and the Instrument for Pre-Accession Assistance 2010 twinning project, Support to Efficient Prevention and Fight against Corruption, in 2014-16 provided extensive training activities. In 2014-16 there were also a series of specialised training courses for law enforcement agencies on inter-institutional co-operation; legal changes concerning proceedings against legal persons; international co-operation in processing cases of corruption; and new methods to protect whistleblowers, informants, collaborators and undercover agents. The State Commission for the Prevention of Corruption also provides institutions with training on request.

However, continuity demands that national authorities engage permanently in training as part of their regular functions. Across the SEE economies, there is evidence of such continued effort, although the amount of training varies. In Albania, tailored anti-corruption training programmes for public officials have been designed in co-operation with the Albanian School of Public Administration. Six training curricula were developed and adopted, and a total of 80 public employees were recently trained.

Bosnia and Herzegovina has a standardised training curriculum on preventing corruption and co-ordinating the fight against corruption in public institutions (APIK, 2017). In the Federation of Bosnia and Herzegovina, the Civil Service Agency provides training programmes on corruption-related matters (e.g. the integrity plan and guidelines for its design, prevention of conflict of interest, and ethics and integrity). For example, in 2016 it provided 4 days of training of trainers to 11 participants on the fight against corruption. In 2015 it organised 6 training days for 106 participants on the development and implementation of integrity plans (ADS, n.d.). This explains the score of 1 for the Federation of Bosnia and Herzegovina, where more government activity in awareness raising and education is needed. According to the Ministry of Interior of the Republika Srpska, since 2014 around 100 secondary school students, 300 tertiary students and

350 employees of government institutions have attended training on a variety of subjects related to corruption. In addition, around 1 500 public-sector employees participated in training on integrity plans. In Montenegro, the Corruption Prevention Agency organised 11 training courses in 2016 on the agency's competences and authorities' obligations for implementing anti-corruption legislation. These courses were attended by 340 participants. Seminars and training were also provided on developing integrity plans and designing anti-corruption campaigns. In Serbia, a total of 1 588 public-sector employees have attended the Anti-corruption Agency's ethics and integrity training programme.

E-training on anti-corruption exists or is in development in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia. For example, according to information provided by the government, the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption of Bosnia and Herzegovina has developed an online course on public-sector ethics that has been taken by more than 2 600 officials.

Furthermore, the Regional Anti-corruption Initiative has implemented a number of training courses in corruption proofing legislation and corruption risk assessment.

The way forward for anti-corruption public awareness and education

The six SEE economies, but particularly the Federation of Bosnia and Herzegovina and Kosovo, should **endeavour to step up awareness-raising activities** in print, public television and other media. They should ensure that the general public are regularly made aware of the negative consequences of corruption and given information about practical means to counter it.

All of the economies should **define objectives for raising public awareness and ensure these activities become permanent**. Objectives might include such measures as a minimum share of the population who are aware of how to report corruption. Governments should make use of the international donor support on offer to do this, but should also fund awareness-raising efforts from their own budgets. This would signal that they give these activities adequate priority. In particular, Albania, Bosnia and Herzegovina, and Kosovo should **introduce government funding for awareness raising, preferably as a separate budget item**.

The economies, particularly Bosnia and Herzegovina (at the state and entity level), the Former Yugoslav Republic of Macedonia and Kosovo should **consider measuring the effectiveness of their awareness-raising activities**, for example by using public opinion surveys to measure the extent to which members of the public remember the information provided. All of the economies should use the results of such monitoring to adjust their future activities, for example by using media channels that reach groups with lower awareness.

The six economies should also **increase the reach of anti-corruption training**, for example by developing and introducing cost-effective online courses. This is particularly important for economies with tighter budget constraints such as Kosovo, and those economies where falling donor funding may reduce the level of training. For instance, online courses could be made available to all public officials relatively cost effectively.

Corruption prevention and co-ordination institutions

Prevention and co-ordination are crucial functions of governments' overall anti-corruption efforts. There is a firmly established consensus that preventing corrupt acts before they occur is equally important, if not even more important, than repressing corruption. Moreover, the overall success of anti-corruption efforts requires concerted actions by a range of stakeholders. It is therefore crucial to ensure that they undertake these efforts across the public sector in a mutually reinforcing way. Institutions to implement, oversee and co-ordinate corruption-prevention policies are therefore one of the cornerstones of an effective anti-corruption framework. This is reflected in Article 6 of the United Nations Convention against Corruption (UN, 2004).

This sub-dimension was not assessed using qualitative indicators. Instead it was assessed through questionnaires based on the OECD instruments and tools for anti-corruption and public integrity listed in Figure 17.2 in the Context section above. All six SEE economies have established specialised institutions with corruption-prevention functions and designated entities responsible for co-ordinating anti-corruption policies. They have all adopted procedures to safeguard the autonomy of these institutions, especially in selecting and appointing their leadership.

Some SEE economies use multi-stakeholder bodies to co-ordinate anti-corruption efforts

One way to approach the task of co-ordination is to set up multi-stakeholder councils, teams or other similar arrangements, comprising representatives from various relevant government and non-government institutions. Some of the economies only include the representatives of public authorities in such bodies, however. In Kosovo, the Anti-corruption Council consists of heads of 15 public institutions and is presided over by the President of Kosovo. Multi-stakeholder co-ordinating institutions consisting only of representatives of state institutions have also been set up in the Federation of Bosnia and Herzegovina (Anti-corruption Team), and the Republika Srpska (Commission for the Implementation of the Strategy on the Fight against Corruption, with non-government representatives participating as observers; RTRS, 2015).

In Serbia, the Advisory Council for the Fight against Corruption has six members who have been selected based on their scholarship and expertise rather than to represent institutions. In 2014, the government also set up a co-ordination body to implement the Anti-corruption Strategy, consisting of the Prime Minister, the Minister of Justice, the Minister of Finance and a representative of the Council for the Fight against Corruption (Mera Vlade, 2014). The multi-stakeholder bodies have been reported to lack decisive influence on some occasions. Along with multi-stakeholder bodies, all of the economies have also designated single co-ordinating bodies.

Functions and powers of the corruption prevention and co-ordination institutions vary

Five of the six SEE economies have specialised institutions to prevent corruption and to co-ordinate anti-corruption policies, while in Albania, the Minister of State for Local Issues is designated as the National Co-ordinator against Corruption. The scope of the institutions' functions varies from economy to economy (Table 17.1). Albania's High Inspectorate of Declaration and Audit of Assets and Conflict of Interest fulfils several of the responsibilities reflected in Table 17.1.

Table 17.1. **Areas of primary responsibility of specialised prevention and co-ordination institutions**

	BIH	KOS	MKD	MNE	SRB
Strategic planning and monitoring implementation	X	X	X		X
Managing conflicts of interest	X	X	X	X	X
Overseeing assets	X	X	X	X	X
Preliminary investigation of other corruption offences		X	X	X	
Overseeing political finance				X	X
Protecting whistleblowers	X			X	
Raising awareness	X	X	X	X	X
Lobbying			X	X	

Note: Primary responsibility means that the institution has some central responsibility for this area. For example, it will not count as primary responsibility if the institution is only one of several channels where whistleblowers may report or if it is responsible for the oversight of only some narrow aspects of campaign financing.

The bodies vary not just in their general functions but also in their particular powers. For example, with regard to strategic planning, the State Commission for the Prevention of Corruption of the Former Yugoslav Republic of Macedonia stands out as it has the power to adopt state anti-corruption programmes and action plans. Elsewhere this power rests with the government or parliament.

All of the bodies have responsibility for overseeing and managing conflicts of interest, but again their powers differ. Typically, these agencies issue recommendations on how to manage conflicts of interest. However, in the Former Yugoslav Republic of Macedonia, Kosovo and Serbia they can also request or recommend the dismissal of the official in question. In particular, the Serbian agency can publish decisions concerning violations of the law and make recommendations to dismiss officials. Notably, the Corruption Prevention Agency of Montenegro has the strongest repressive powers as it can issue misdemeanour reports and initiate misdemeanour and other proceedings.

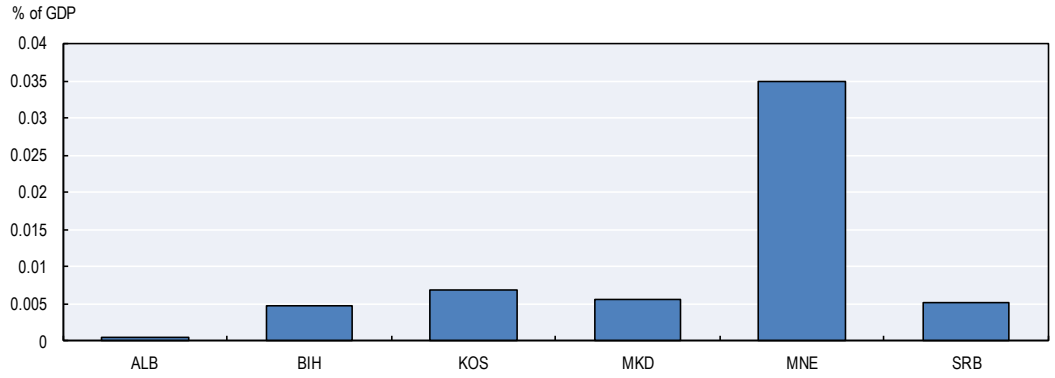
The Anti-corruption Agency of Kosovo and the State Commission for the Prevention of Corruption of the Former Yugoslav Republic of Macedonia have the power to carry out preliminary investigations of corruption before forwarding the cases to the competent prosecutorial or judicial bodies. In Kosovo, however, civil society organisations have argued that the Anti-corruption Agency should not have responsibility for carrying out investigations because it does not have the necessary legal powers. For example, it cannot request the use of covert and technical surveillance and investigation measures (Sutaj, 2016).

Institutional capacity varies across economies

The resources allocated to corruption prevention and policy co-ordination institutions vary from economy to economy (Figure 17.9). The available data do not allow direct funding comparisons to be made because the mandates of these bodies differ. For example, the funding of the Albanian body (the Ministry of State on Local Issues) may appear relatively low, but it lacks several important responsibilities held by institutions in the other economies. At the most general level of comparison, however, Montenegro and Serbia have the most well-resourced prevention and policy co-ordination bodies.

Staffing levels are another measure of these agencies' resources (Figure 17.10), and mostly correlate with their budget.

Figure 17.9. **Budgets of the corruption prevention and policy co-ordination institutions (2016)**



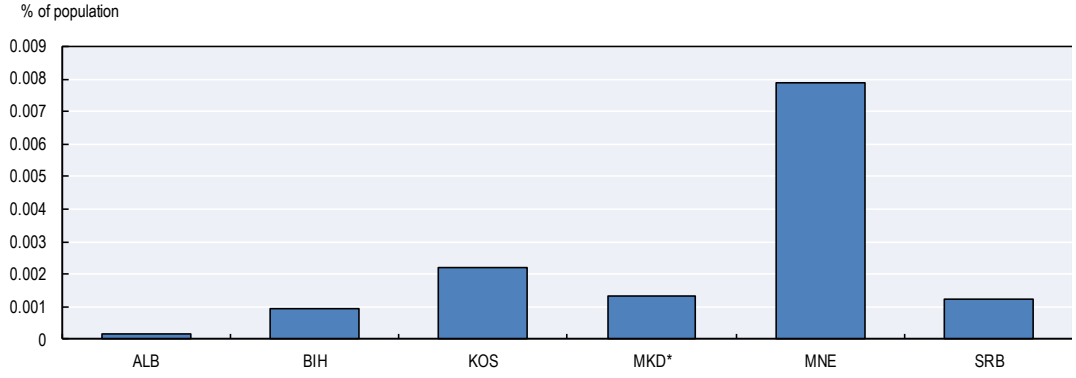
Note: Including all operational costs of the staff of the Minister of State on Local Issues in Albania.

Source: Data provided by the governments. Bosnia and Herzegovina: APIK (2017), "Izvještaj o radu: Agencije za Prevenciju Korupcije i Koordinaciju Borbe Protiv Korupcije: Za period 01.01. - 31.12". 2016. Godine" [APIK work report: For the period 01.01 - 31.12.2016] http://apik.ba/izvjestaji/izvjestaji-agencije/default.aspx?id=1325&langTag=bs-BA. Kosovo: ACA (2017), *Annual Report January – December 2016*, http://akk-ks.org/repository/docs/ANG-9._Raporti_Vjetor_2016_versioni_final_shqip_477475.pdf; Montenegro: Corruption Prevention Agency (2017); Serbia: Anti-corruption Agency (2017) "Izveštaj o radu za 2016. Godinu", [Work report 2016], www.acas.rs/wp-content/uploads/2017/03/Izvestaj-o-radu-2016-za-net.pdf?pismo=lat. The World Bank Group.

StatLink http://dx.doi.org/10.1787/888933707418

Figure 17.10. **Staffing levels of corruption prevention and policy co-ordination institutions (2016)**

% of population



Note: * For the Former Yugoslav Republic of Macedonia, staff numbers do not include the seven Commission members.

Source: Data provided by the governments. Bosnia and Herzegovina: APIK (2017), "Izvještaj o radu: Agencije za Prevenciju Korupcije i Koordinaciju Borbe Protiv Korupcije: Za period 01.01 - 31.12". 2016. Godine" [APIK work report: For the period 01.01 - 31.12.2016], http://apik.ba/izvjestaji/izvjestaji-agencije/default.aspx?id=1325&langTag=bs-BA; Montenegro: Corruption Prevention Agency (2017), "Izvještaj o radu Agencije za Sprjecavanje Korupcije u 2016. Godini" [Annual report on the work of the Corruption Prevention Agency: 2016], www.skupstina.me/zakoni/web/dokumenta/zakoni-i-drugi-akti/114/1392-8913-00-72-17-12.pdf; Serbia: Anti-corruption Agency (2017), "Izveštaj o Radu za 2016. Godinu" [Work report 2016], www.acas.rs/wp-content/uploads/2017/03/Izvestaj-o-radu-2016-za-net.pdf?pismo=lat.

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Limited resources mean unfilled positions remain an issue and several of the agencies have large numbers of vacancies. For example, in the Former Yugoslav Republic of Macedonia, the anti-corruption institution has just 28 employees out of 51 planned positions. The Anti-corruption Agency of Serbia has both the largest budget and most staff of the six SEE economies, but as of May 2017 it still had unfilled vacancies.

Despite open mechanisms to recruit their leadership, trust in anti-corruption agencies is often lacking

The six SEE economies use sophisticated procedures to appoint the leadership of their co-ordination and prevention institutions. For example, in Montenegro the Committee for Anti-corruption, which is appointed by parliament, selects the candidates to sit as members of the council of the Corruption Prevention Agency. The committee consists of two members of parliament (one from the parliamentary majority, one from the opposition), a representative of the Judicial Council, a representative of the Prosecutorial Council and an NGO representative, who is selected through an open call. The committee interviews the applicants, reviews their written visions for the future work of the agency and proposes suitable candidates to parliament for appointment. The process for appointing the agency's director is similar except that the council selects the candidates and makes the final appointment.

The procedure is similar in Serbia, where the National Assembly appoints members of the board of the Anti-corruption Agency and the board appoints the agency's director. However, Serbia is the only economy where the director is not appointed through an open competition.

In some cases, these procedures have provoked complaints about an alleged lack of transparency or merit-based approach. In Montenegro, the interviews for the director's post took place in a closed meeting in 2015, which caused controversy (MANS, 2015). In the Former Yugoslav Republic of Macedonia some stakeholders felt that consideration should be given to changing the procedure for assessing candidates for the State Commission for Prevention of Corruption in order to ensure they were appointed on merit (Taseva et al., 2016).

However, often it is not particular deficiencies in procedures or abuses of power that raise doubts about the appointment decisions, but rather an underlying general lack of trust in such public agencies in the region (Shentov, Stefanov and Todorov, 2014).

The way forward for corruption prevention and co-ordination institutions

To **strengthen the capacity of its co-ordinating institution, Albania should consider increasing staffing levels of the National Co-ordinator against Corruption**. Alternatively, it could consider allocating the co-ordination function to a new specialised anti-corruption body.

The Former Yugoslav Republic of Macedonia and Serbia should **attempt to reduce the number of vacancies in their specialised corruption prevention and co-ordination institutions** by actively advertising the vacancies, inviting qualified individuals to apply and, if necessary, increasing salaries.

In Kosovo, responsible officials could consider demonstrating greater political will to **improve co-ordination of anti-corruption reforms through the Anti-corruption Council**. One way to do this would be to propose concrete anti-corruption activities, such as common information campaigns, for joint implementation by the institutions represented

in the council. The council could also review implementation progress regularly, e.g. every six months, and report on it publicly.

Serbia could **consider streamlining its anti-corruption co-ordination function** by allocating responsibilities to a single multi-stakeholder body instead of the current two entities. The responsible body should include both trained officials and experts.

The Former Yugoslav Republic of Macedonia should **consider amending the procedures for selecting key personnel for the State Commission for Prevention of Corruption in order to safeguard the merit-based assessment of candidates**. Montenegro could also consider further clarifying the criteria for the selection of candidates to the post of the Director of the Agency since the current provisions of the Corruption Prevention Law (Sections 83 and 91) are very brief. The criteria should define all the key competencies required, such as proven leadership skills, a track record in effective communication and strong ethics. The professional experience requirements should also be published in detail, such as a minimum number of years worked in managerial positions and a certain amount of experience with international anti-corruption mechanisms.

Preventing and managing conflicts of interest and whistleblower protection

According to the OECD Guidelines for Managing Conflict of Interest in the Public Service "a 'conflict of interest' involves a conflict between the public duty and private interests of a public official, in which the public official has private-capacity interests which could improperly influence the performance of their official duties and responsibilities" (OECD, 2003). If they are not managed properly, conflicts of interest can lead to corruption. On the other hand, effective control of conflicts of interest is an effective preventive tool because all corrupt acts involve some form of conflict of interest. Protecting whistleblowers is essential because sometimes receiving a report may be the only way to detect corruption.

The sub-dimension on preventing and managing conflicts of interest and whistleblower protection draws on two key OECD tools: the OECD Guidelines for Managing Conflict of Interest in the Public Service (OECD, 2003) and the OECD Recommendation on Public Integrity (OECD, 2017).

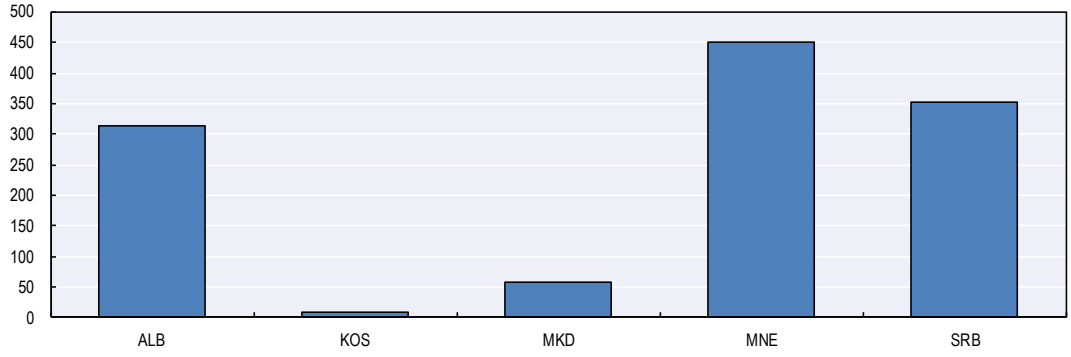
Overall, the six SEE economies have comprehensive frameworks for limiting how public officials behave in conflict-of-interest situations and envisage elaborate incompatibilities, i.e. activities that are not compatible with the official position. In this regard, all relevant public officials and civil servants are generally covered by dedicated conflict-of-interest, civil service and other laws. All of the economies also provide channels for reporting conflicts of interest and corruption. However, whistleblowers need greater protection if this channel is to be effective.

Economies vary in the severity of their sanctions for conflicts of interest

All six SEE economies are making efforts to tackle conflicts of interest and have adopted laws to regulate them. However, the public officials that are covered by dedicated conflict-of-interest laws vary. In several of the economies (for example, Bosnia and Herzegovina at the state and entity level, Kosovo, Montenegro, and Serbia), civil service laws govern the conflicts of interest of civil servants. Generally, the conflict-of-interest frameworks cover public-sector office holders comprehensively.

The aggregate data shown in Figure 17.11 include a variety of sanctions applied for conflict-of-interest related violations. These overall numbers are not directly comparable because the type of sanctions largely depends on the approach of the particular economy. For example, in Kosovo, the seemingly low number of sanctions (just 9) is mostly explained by the large number of cases where no sanctions were applied: of 210 cases of reported conflicts of interest, in 90 of them the conflict of interest was averted and in 54 opinions (advice) were issued (ACA, 2017). Serbia records a large number of sanctions, but in 234 of the total of 353 cases, the sanctions were warnings to public officials. In the Former Yugoslav Republic of Macedonia, 39 out of the 58 sanctions were reprimands. In contrast, 337 out of the 450 cases in Montenegro resulted in fines, as did all of the cases in Albania, suggesting that Albania and Montenegro have the most repression-based systems.

Figure 17.11. **Number of sanctions (including warnings) applied for conflict-of-interest related violations (2016)**



Note: Data for the Former Yugoslav Republic of Macedonia from 2015. Data for Bosnia and Herzegovina were not available.

Source: Data provided by the governments. Kosovo: ACA (2017), *Annual Report January – December 2016*, http://akk-ks.org/repository/docs/ANG-9._Raporti_Vjetor_2016_versioni_final_shqip_477475.pdf; Serbia: Anti-corruption Agency (2017), "Izveštaj o Radu za 2016. Godinu" [Work report 2016], www.acas.rs/wp-content/uploads/2017/03/Izvestaj-o-radu-2016-za-net.pdf?pismo=lat.

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The SEE economies all provide guidance to officials on how to manage conflicts of interest. This guidance includes publications and/or opportunities to ask questions. For example, Albania has published the *Explanatory and Training Manual for Preventing Conflict of Interest*; the *Guideline on the Declaration of Assets and Prevention of Conflict of Interest*, which covers all public servants; as well as guides on preventing conflict of interest in particular sectors such as tax administration, customs administration, public procurement and local governments.

The Former Yugoslav Republic of Macedonia has also published a variety of guidance notes on managing conflicts of interest. Serbia has published guidance notes which look more broadly at integrity, and Montenegro has published rulebooks. Kosovo and Bosnia and Herzegovina (at the state level) have limited or no guidelines. The Commission for the Prevention of the Conflict of Interest in Government Institutions of the Republika Srpska has published guidelines on the application of particular provisions of the relevant law.

Whistleblower protection is at an early stage of development

All of the SEE economies have adopted whistleblower protection laws: Kosovo in 2011, Bosnia and Herzegovina at the state level in 2013, Montenegro in 2014, Serbia in 2015, the Former Yugoslav Republic of Macedonia in 2015, and Albania in 2016. The Republika Srpska also adopted a law in 2017. As these dates show, this is a recent trend. Civil society is also becoming increasingly active in the field of whistleblowing; for example, the Southeast Europe Coalition on Whistleblower Protection was established in 2015.

The degree to which these laws are being implemented varies. In Kosovo, for instance, there is significant scope to increase public knowledge about the existence of a whistleblower law. Both government and non-government representatives contacted for this assessment also admitted that the Law on Protection of Informants was ineffective due to a lack of adequate implementation and oversight mechanisms.

Some OECD countries have implemented proven good practice mechanisms to protect whistleblowers' anonymity as much as possible (such as Austria's reporting hotline, Box 17.1); these may serve as an inspiration to the SEE economies.

Box 17.1. **Good practice: Reporting hotline in Austria**

In 2013, the Federal Ministry of Justice in Austria launched a portal to enable individuals to report wrongdoing. After reviewing the measures of anonymity provided by this virtual disclosure system, the user is directed to select the type of wrongdoing that best fits the information they would like to disclose, according to the following options: corruption, white-collar crime, welfare fraud, financial crime, fraudulent accounting, capital-market offences and money laundering.

Upon selecting the most suitable option, the user is invited to submit their information. The technical setup of the portal ensures that investigators from the Public Prosecutor's Office against Corruption and White-Collar Crime are not able to trace submissions or identify the discloser, rendering the system an anonymous method of communication. To ensure that anonymity is guaranteed, disclosers are required to choose pseudonymous user names when setting up their secured mailbox. The anonymity of the information disclosed is maintained using encryption and other security procedures. Disclosers are also asked not to enter any data that might give any clues to their identity and to refrain from submitting their report on a device that was provided by their employer. Following submission, the Office of Prosecution for Economic Crime and Corruption provides the discloser with feedback and the status of their disclosure via a secure mailbox. If there are issues left to be clarified regarding the case, the questions are directed to the discloser through anonymous dialogue.

Source: Adapted from OECD (2016a), *Committing to Effective Whistleblower Protection*, http://dx.doi.org/10.1787/9789264252639-en.

Albania and the Former Yugoslav Republic of Macedonia have taken steps to implement their whistleblower laws. For example, Albania has appointed responsible units in every institution which has more than 80 employees. However, there is little information in any of the economies about the actual practice of whistleblower protection and the effects of the laws, perhaps because the laws have only been adopted recently.

Three economies provide quantitative evidence on whistleblower activity. In Montenegro in 2016 the Corruption Prevention Agency received nine requests for whistleblower protection. Of these, seven cases have been resolved. The agency granted three people

whistleblower status, while in the other four cases, it issued negative opinions on the people reporting suspicions of corruption (Corruption Prevention Agency, 2017). In Bosnia and Herzegovina, the Agency for the Prevention of Corruption and Co-ordination of the Fight against Corruption reported it had received 16 requests for whistleblower protection. It granted this status to 3 of the requesters, 12 cases did not meet the conditions for granting the status and 1 case was still under review as of 31 December 2016 (APIK, 2017). In Serbia, in September 2016 the court of first instance made 1 judgement in favour of a whistleblower, along with 12 temporary measures for return to previous workplaces (Government of the Republic of Serbia, 2016).

Some of the economies' laws have specific limitations. For example, the Law on Protection of Whistleblowers of Bosnia and Herzegovina does not cover whistleblowers from entity-level institutions or the private sector. Excluded individuals occasionally report corruption and then find out that they are not protected. Montenegro is an example of the sensitivity surrounding decisions to grant or deny whistleblower status. Here there is confusion about how protection for whistleblowers is applied. In addition, as protection has been refused in a number of cases, this may strain public trust in the mechanism of whistleblower protection. Deeper analysis would be required to determine whether the main deficiencies rest with overly restrictive legal provisions in Montenegro, implementation practice within the agency, or merely the communication about the process.

Among OECD countries, Korea's clear sanctions for retaliation against whistleblowers in its Protection of Public Interest Whistleblowers Act is a good example to follow (Box 17.2).

The way forward for preventing and managing conflicts of interest and whistleblower protection

To ensure further progress in preventing and managing conflicts of interest, the SEE economies could **evaluate the effectiveness of the available sanctions for conflicts of interest** in order to determine whether the less repressive approaches, such as those used by the Former Yugoslav Republic of Macedonia, Kosovo and Serbia, lead to the best results. One option would be to gather information on comparable conflicts of interest over several years and assess whether the occurrence of conflicts of interest declined and whether certain types of cases decreased more than others. If the number of cases remained consistently high, further steps to make the policy more effective could be needed.

Bosnia and Herzegovina should **develop guidelines for the public sector on how to recognise and evaluate conflict-of-interest situations** and to manage them. These guidelines could include a checklist to help public officials or civil servants assess whether they are in a conflict-of-interest situation.

Bosnia and Herzegovina, Kosovo and Montenegro should **do more to raise awareness of whistleblower protection** to ensure that the public knows what measures are available to protect them, and under what circumstances. They should disseminate as widely as possible (e.g. online) an easily understood list of the situations in which people are entitled to protection.

Bosnia and Herzegovina should **consider extending whistleblower protection to include the private sector**. More generally, the Federation of Bosnia and Herzegovina should introduce a legal framework for whistleblower protection, which could define whistleblowing, specify the conditions under which individuals would be considered to be whistleblowers, provide measures to protect them and outline how they can access effective remedy if their whistleblowers' rights are violated.

Box 17.2. Good practice: Sanctions for retaliation against whistleblowers in Korea

According to Korea's Protection of Public Interest Whistleblowers Act, any person who falls under any of the following categories shall be punished by imprisonment for not more than two years or by a fine not exceeding KRW 20 million (Korean won, approximately USD 19 000): 1) a person who implemented disadvantageous measures described in Article 2, subparagraph 6, item (a) [Removal from office, release from office, dismissal or any other unfavourable personnel action equivalent to the loss of status at work] against a public interest whistleblower; and 2) a person who did not carry out the decision to take protective measures that had been confirmed by the Commission or by an administrative proceeding.

In addition, any person who falls under any of the following points shall be punished by imprisonment for not more than one year or a fine not exceeding KRW 10 million:

1. A person who implemented disadvantageous measures that fall under any of Items (b) through (g) in Article 2, Subparagraph 6 against the public interest whistleblower [(b) disciplinary action, suspension from office, reduction in pay, demotion, restriction on promotion and any other unfair personnel actions; (c) work reassignment, transfer, denial of duties, rearrangement of duties or any other personnel actions that are against the whistleblower's will; (d) discrimination in the performance evaluation, peer review, etc. and subsequent discrimination in the payment of wages, bonuses, etc.; (e) the cancellation of education, training or other self-development opportunities; the restriction or removal of budget, work force or other available resources, the suspension of access to security information or classified information; the cancellation of authorisation to handle security information or classified information; or any other discrimination or measure detrimental to the working conditions of the whistleblower; (f) putting the whistleblower's name on a blacklist as well as the release of such a blacklist, bullying, the use of violence and abusive language toward the whistleblower, or any other action that causes psychological or physical harm to the whistleblower; (g) unfair audit or inspection of the whistleblower's work as well as the disclosure of the results of such an audit or inspection; (h) the cancellation of a license or permit, or any other action that causes administrative disadvantages to the whistleblower].
2. A person who obstructed the public interest whistleblowing, etc. or forced the public interest whistleblower to rescind his/her case, etc. in violation of Article 15, Paragraph 2.

Source: Republic of Korea (2011), *Act on the Protection of Public Interest Whistleblowers*, No. 10472, Chapter V, Article 30 (2) and (3), www.acrc.go.kr/en/data/2.0.Act%20on%20the%20Protection%20of%20Public%20Interest%20Whistleblowers.pdf.

Montenegro should **clarify the uncertainties among the public about whistleblower protection** in order to remove any doubt over whether whistleblowers will be protected and to rebuild trust. Analysis may be needed in order to determine if this would mean improving legal provisions, implementation practice at the Agency for Prevention of Corruption, or communication.

Anti-corruption enforcement bodies and regional co-operation

Investigation and prosecution are two of the main anti-corruption functions. Implementing an effective anti-corruption policy requires a complex combination of expertise, knowledge and skills. Therefore, a degree of specialisation is needed within law enforcement in the anti-corruption field (OECD, 2013). Corruption also often

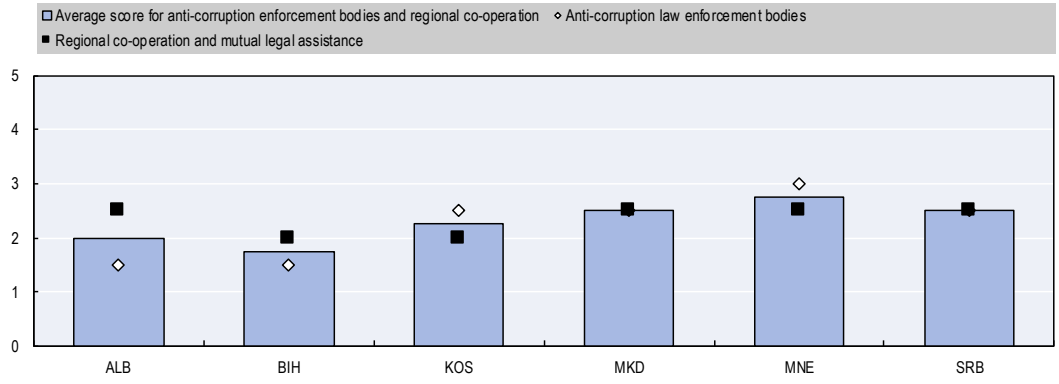
involves transactions between several economies. An effective fight against such practices can therefore depend on co-operation between several jurisdictions in the form of mutual legal assistance, joint investigations, and so on.

The anti-corruption enforcement bodies and regional co-operation sub-dimension comprises two qualitative indicators (Figure 17.12):

1. The **anti-corruption law enforcement bodies** indicator assesses the existence and operation of specialised law enforcement bodies. It considers whether they were established through consultations with key public and private stakeholders; whether they are adequately staffed and funded; whether staff receive training on handling complex corruption cases; and whether their financial and operational independence is ensured.
2. The **regional co-operation and mutual legal assistance** indicator focuses on the legal framework and practice of data exchange and mutual legal assistance (MLA) in corruption cases, the role of the central authority in receiving and providing MLA, as well as the monitoring and evaluation of regional co-operation in curbing corruption.

On average, across both indicators, the six SEE economies score 2.3 in this sub-dimension. Performance against the specific indicators is discussed in the sections which follow.

Figure 17.12. **Anti-corruption enforcement bodies and regional co-operation: Sub-dimension average score and indicator scores**



Note: The entities of the Republika Srpska and the Federation of Bosnia and Herzegovina were not assessed for the regional co-operation and mutual legal assistance indicator because several of the criteria are not applicable at the sub-national level. See the methodology chapter for information on the *Competitiveness Outlook* assessment and scoring process.

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Anti-corruption enforcement bodies exist but independence, resources and enforcement powers could be improved

According to Article 36 of the United Nations Convention against Corruption, governments shall "ensure the existence of a body or bodies or persons specialised in combating corruption through law enforcement. Such body, bodies or persons shall be granted the necessary independence to be able to carry out their functions effectively and without any undue influence. Such persons or staff of such body or bodies should have the appropriate training and resources to carry out their tasks" (UN, 2004).

As the scores indicate, the six economies have generally designated anti-corruption law enforcement bodies that specialise in corruption investigation and prosecution (Figure 17.12). Several of the economies are taking steps to establish new bodies.

Currently none of the SEE economies have criminal investigation bodies which are dedicated to the fight against corruption. However, all of them have some specialised law enforcement and often have several units within their police forces responsible for investigating corruption.

For the most part, other than the general police safeguards, police investigative units do not have special safeguards against undue interference. A recent comparative study found that "These units are, however, typically embedded in the larger police force or the ministries of interior which deprive them of the institutional autonomy that is required for a specialised anticorruption institution" (Shentov, Stefanov and Todorov, 2014).

Montenegro and Bosnia and Herzegovina have established bodies that are partially outside the ordinary police hierarchy and lines of accountability. In Montenegro, the Special Police Department deals with those crimes which fall under the competence of the Special Prosecutor's office (organised crime, money laundering, terrorism, war crimes and high-level corruption). At the state level, Bosnia and Herzegovina has the institutionally separate State Investigation and Protection Agency, which operates on the basis of a separate law and contains the Section for Prevention and Detection of Financial Crime and Corruption. In most of the SEE economies, the public prosecutor contains departments or special prosecutor's offices with mandates that include corruption.

Several of the economies are continuing to develop their institutions. In Albania, a law adopted in 2016 envisages the establishment of the National Bureau of Investigation, the Special Prosecutor's Office, and the Anti-Corruption and Organised Crime Courts. These bodies were in the process of being set up at the time of assessment. In the Federation of Bosnia and Herzegovina, the Law on Suppression of Corruption and Organised Crime was adopted in 2014 and envisages specialised units in the Federal Prosecutor's Office and the Supreme Court. At the time of assessment, these institutions were also being set up. The Republika Srpska adopted the Law on Suppressing Corruption, Organised Crime and the Most Serious Forms of Economic Crime in 2016 and has established a special department in the Public Prosecutor's Office for these crimes. In Serbia, according to the Law on Organisation and Jurisdiction of State Bodies in Combating Organised Crime, Terrorism and Corruption, adopted on 23 November 2016, a new specialised anti-corruption unit will be formed in the Ministry of Interior Affairs.

The State Investigation and Protection Agency of Bosnia and Herzegovina is the only specialised criminal investigation agency that is based on a separate law and has a special legally prescribed open procedure for selecting its leadership. The Director, Deputy Director, Assistant Director for the Criminal Investigative Department and Assistant Director for the Internal Control Department are all appointed by the Council of Ministers based on the proposals of the Selection Commission.

Various studies have expressed doubts about the independence of law enforcement bodies in fighting corruption in the region. For example, the National Integrity Assessment of Albania states that "in practice, the Police is highly politicised. Massive staff turnover follows government changes and continues, though to a lesser degree, during the same administration" (Transparency International, 2016). Public prosecutors in Albania have made public claims about political pressure in high-profile cases (Halo and Llubani, 2016). A report about the Former Yugoslav Republic of Macedonia states that

"the independence of the police is jeopardized by close relationships between police officers and the ruling political parties" and "there are concerns regarding the independence of the [public prosecutor] in practice, especially in terms of its independence from political influence" (Taseva et al., 2016). Doubts about proper adherence to the rules can give rise to suspicions about these bodies' independence. For example, in Kosovo an NGO published claims about a member of the Kosovo Prosecutorial Council who reportedly stayed in post beyond the legally prescribed time (KLI, 2016), and about public prosecutors being transferred to the Special Prosecutor's office in circumvention of existing procedures (KLI, 2017).

No precise evaluation is possible on whether law enforcement outputs such as the number and type of investigations, prosecutions and sentences are adequate in the fight against corruption. There is no benchmark for the number of prosecutions and convictions that are "needed". However, the general assessments that have been made are rather critical of enforcement results across the six SEE economies, especially against high-level corruption.

The European Commission describes the achievements using words such as "low overall [track record], especially regarding corruption cases involving high-level officials" (Albania), "no final convictions in high-profile cases in the reporting period" (Bosnia and Herzegovina), and "still very few final convictions for high-level corruption" (Serbia) (EC, 2016a).

Even the more positive assessments are worded with caution. For example, according to the European Commission, although in the Former Yugoslav Republic of Macedonia "the track record of investigations, prosecutions and convictions is strong on corruption offences committed by lower-level officials, it remains very weak on high-level corruption". It noted that the number of investigated and prosecuted high-level cases had increased in Kosovo. Montenegro received the seemingly most favourable assessment regarding its fight against high-level corruption: "As regards the development of track records in investigation, prosecution and final conviction in corruption cases some results have been reached also in high-level corruption cases" (EC, 2016a). However, even in Montenegro observers note a large number of acquittals, cases being dismissed due to statutes of limitation and a mild sentencing policy (Calovic Markovic et al., 2017).

Limited and sometimes insufficient resources are common challenges for the law enforcement bodies of the six SEE economies. The Former Yugoslav Republic of Macedonia has identified the need to improve law enforcement agencies' technical resources to increase their operational efficiency, and has initiated projects to address this need. According to government information, only 143 of the 194 job positions in the regional internal affairs departments of the Public Security Bureau have been filled and 5 posts remain to be filled in the Anti-corruption Unit of the Public Security Bureau.

In Kosovo, a low budget and insufficient resources have been blamed for the alleged inefficiency of the Special Prosecutor's office (Serhati et al., 2016). At the beginning of 2017, allegedly only half of the 18 prosecutor posts in the Special Prosecutor's Office were filled (KLI, 2017).

A regional co-operation framework is in place but monitoring is weak

The international character of many corruption transactions and the opportunities to hide the proceeds of corruption outside the jurisdiction where a particular corrupt act took place mean that economies need to be able to co-operate to help counter large-scale corruption.

The legal framework and the institutional arrangements for regional co-operation are generally well established across the region (Figure 17.12), but monitoring and evaluation of co-operation in corruption cases is yet to be introduced. All of the economies assessed, except Kosovo, are parties to a number of international conventions that allow data exchange and mutual legal assistance (MLA) in corruption cases. These include the United Nations' conventions against corruption and transnational organised crime; European conventions on extradition, mutual assistance in criminal matters and the transfer of proceedings in criminal matters; and the Criminal Law Convention on Corruption. Although Kosovo is not party to most international conventions, it unilaterally applies international treaty standards (EC, 2016b). The six SEE economies have also entered bilateral agreements to facilitate co-operation.

All of the economies have designated their ministries of justice as the central authority for sending and receiving MLA requests. However, evidence on activity in this area is fragmentary. Since January 2016, Montenegro has had a fully operational information technology system, LURIS, to monitor judicial co-operation cases (EC, 2016c). Serbia has also introduced the same system. Albania and the Former Yugoslav Republic of Macedonia have no case/data management system for MLA requests, however (OECD, 2017). None of the economies have yet provided evidence that they are monitoring and evaluating regional co-operation in curbing corruption.

Data on the percentage of granted MLA requests remain scarce. As part of the assessment process, the Former Yugoslav Republic of Macedonia provided the number of judicial co-operation requests in criminal matters (1 418 incoming requests and 1 137 outgoing requests in 2015, down from 2 252 and 2 856 respectively in 2014). Data provided by the Ministry of Justice of Kosovo show 12 715 requests and 8 989 responses in the period January 2014 to March 2017, but do not state how many of these cases relate to corruption.

Serbia reported that MLA requests in corruption cases are always marked as urgent and most of them are successfully satisfied. However, in 2016, the European Commission wrote that:

> Serbia needs to step up measures to allow direct co-operation between Serbian and foreign courts and centralise receipt of requests to courts for international judicial cooperation. The necessary infrastructure and database should be put in place for replying promptly to requests for mutual legal assistance and ensuring better statistics on their monitoring, as well as applying the mutual recognition principle. In order to improve efficiency, greater capacity and expertise are needed, including language skills. (EC, 2016d)

However, this assessment does not warrant comparison between Serbia's situation and the other economies, some of which could have similar problems.

According to the European Commission in Bosnia and Herzegovina, "The international judicial cooperation legislative framework is in place and functional, yet not always efficient. The relevant department within the Bosnia and Herzegovina Ministry of Justice, which is responsible for implementation of the legislation and adherence to the conventions, is understaffed" (EC, 2016d). It also cites problems including the lack of harmonised case law, and therefore inconsistent implementation of international standards by judges throughout the country. In the period covered by the European Commission report, the court in Bosnia and Herzegovina reportedly "received seven new requests to

provide international legal aid in criminal matters … and completed 10 cases in total" (EC, 2016e).

The dual criminality requirement for corruption cases means that the criminal offence under investigation in the state that requests assistance or extradition must be similar in substance to an offence in the law of the state receiving the request. Albania (for extradition), the Former Yugoslav Republic of Macedonia (for extradition), Montenegro and Serbia apply the dual criminality requirement (OECD, 2016b and information provided by the governments). However, this would not be an obstacle to international co-operation if the definitions of corruption offences were harmonised with international standards.

Efforts have also been made to strengthen regional co-operation on data exchange, which will be consolidated through the anticipated signing of the International Treaty on Data Exchange on Asset Disclosure and Conflict of Interest. Integrity bodies in South East Europe have completed technical negotiations on the treaty, which would enable them to communicate formally with each other in a more effective and efficient manner than currently. At the Trieste Western Balkan Summit in July 2017, the treaty received strong political support among the six SEE economies for commencing the political negotiation process (MFAIC, 2017).

The way forward for anti-corruption enforcement bodies and regional co-operation

The six SEE economies should **view institutional autonomy to be a key success factor in strengthening anti-corruption enforcement and regional co-operation**. In particular, where corruption investigation bodies are located within the regular hierarchies of the police or the ministry of interior, the economies should consider ways to strengthen their institutional autonomy.

More specifically, the Former Yugoslav Republic of Macedonia and Kosovo should **explore the possibility of introducing additional safeguards for the independence of the criminal investigation units** that specialise in corruption cases, for example considering exempting them from ordinary disciplinary liability mechanisms. Serbia also should ensure that the planned specialised anti-corruption unit in the Ministry of Interior Affairs is afforded adequate institutional autonomy.

The Former Yugoslav Republic of Macedonia, Kosovo and Serbia **should consider options to further increase the openness and competitiveness of the process for selecting the heads of anti-corruption enforcement bodies**, in line with the principles of their respective state systems. They should consider introducing open competitions and assessments of candidates by committees which include representatives from several public institutions.

In addition to greater institutional autonomy, all six economies should **make further efforts to ensure due independence in the processes of investigating and prosecuting corruption**.

The Former Yugoslav Republic of Macedonia and Kosovo should **make particular efforts to fully staff their anti-corruption enforcement bodies** with qualified personnel by actively posting vacancies, inviting qualified individuals to apply and, if necessary, increasing salaries.

Finally, all six SEE economies should **develop better practices to monitor and evaluate international co-operation in corruption cases**. Their ministries of justice should gather statistics on international co-operation proceedings and their results by type of case, including corruption cases as a category.

Conclusions

The six SEE economies have demonstrated tangible progress in the area of anti-corruption. In recent years, they have developed comprehensive anti-corruption policy documents and involved civil society in their preparation and monitoring as standard. Most of the economies have set up dedicated prevention and co-ordination bodies with clear responsibility for co-ordinating the implementation of anti-corruption policy documents. Moreover, there is shared recognition of the need to raise public awareness of anti-corruption issues and train public officials. It is worth highlighting that all of the economies have made practical progress towards this end.

Nevertheless, the six economies continue to face serious corruption challenges, and these merit further action. In order to strengthen their capabilities to counter corruption, the economies should continue to strengthen whistleblower protection with sustained awareness-raising activities and, where necessary, widen the scope of individuals eligible for protection. They should also consider ways to strengthen the institutional autonomy of their corruption investigation units, which currently are placed within regular law enforcement institutions. All of the economies should better monitor and evaluate international co-operation in corruption cases.

Notes

1. There are four main administrative levels in Bosnia and Herzegovina: the State, the Federation of Bosnia and Herzegovina, the Republika Srpska and the Brčko District. The administrative levels of the State, the Federation of Bosnia and Herzegovina and the Republika Srpska are taken into account in the *Competitiveness Outlook 2018* assessment, when relevant. The Brčko District is not assessed separately.
2. A score of 0 denotes absence or minimal policy development while a 5 indicates alignment with what is considered best practices. Each level of scoring is updated for the individual indicator under consideration, but they all follow the same score scale: a score of 1 denotes a weak pilot framework, 2 means the framework has been adopted as is standard, 3 that is operational and effective, 4 that some monitoring and adjustment has been carried out, and 5 that monitoring and improvement practices are systematic.

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Annex 17.A1.
Anti-corruption policy: Indicator scores

Table17.A1.1. **Anti-corruption policy: Indicator scores**

	ALB	BIH*	BIH FBIH	BIH RS	KOS	MKD	MNE	SRB
Anti-corruption reforms, policy and implementation								
Corruption risk assessment	1.0	2.0	1.5	1.5	1.5	2.0	2.5	3.0
Corruption proofing of legislation	1.5	0.9	0.5	0.0	1.0	2.0	2.0	2.0
Anti-corruption public awareness and education								
Public awareness and education	2.5	2.0	1.0	2.0	1.0	3.0	3.5	3.0
Anti-corruption enforcement bodies and regional co-operation								
Anti-corruption law enforcement bodies	1.5	1.5	1.0	0.0	2.5	2.5	3.0	2.5
Regional co-operation and mutual legal assistance	2.5	2.0	n/a	n/a	2.0	2.5	2.5	2.5

Note: * Scores for Bosnia and Herzegovina reflect the result of calculation based on the original BIH state-level scores and the scores of the entities. The state- and entity-level scores have been assigned the weights 50%-50%. FBIH – the Federation of Bosnia and Herzegovina; RS – the Republika Srpska; n/a – not applicable.

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